HUMPTY DUMPTY AND THE FORECLOSURE CRISIS: LESSONS FROM THE LACKLUSTER FIRST YEAR OF THE HOME AFFORDABLE MODIFICATION PROGRAM (HAMP)

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This Article examines in detail the disappointing first year of the Obama Administration's foreclosure mitigation effort, the Home Affordable Modification Program (HAMP), including its premises, mechanics, slow start, and ultimately modest results. The Administration committed $75 billion to try to help three to four million struggling homeowners avoid foreclosure and reduce the spillover effects of the foreclosure crisis on the economy as a whole. After a year of operations, ending in March 2010, only about 230,000 borrowers had entered into permanent HAMP modifications, and even these were not necessarily truly permanent. Government agencies predicted a redefault rate of 40% or more because HAMP borrowers were typically left owing more on their homes than their value and with high and difficult-to-sustain debt burdens overall. HAMP is a compelling illustration that prevention is easier than cure; the challenges of getting relief to millions in a short period of time proved daunting. A partial front-end regulatory fix was adopted, applicable to future subprime home loans, but if policymakers and regulators are ever tempted again to ease up constraints on high-risk financial products such as subprime mortgages, they should remember the cautionary tale of HAMP.

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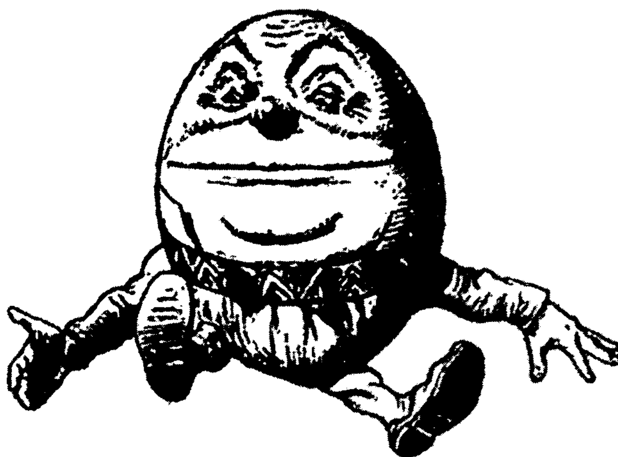
> "Don't you think you'd be safer down on the ground?" Alice went on, not with any idea of making another riddle, but simply in her good-natured anxiety for the queer creature. "That wall is so very narrow!"



> "What tremendously easy riddles you ask!" Humpty Dumpty growled out. "Of course I don't think so! Why, if ever I did fall off—which there's no chance of—but if I did—" Here he pursed up his lips, and looked so solemn and grand that Alice could hardly help laughing. "If I did fall," he went on, "the King has promised me—ah, you may turn pale, if you like!"[1]

INTRODUCTION

Let us imagine a time, say in 2020 or 2030, when the economy has recovered, the mortgage foreclosure crisis is behind us, and happy days are here again. What should policymakers and regulators who oversee the consumer financial product marketplace remember from the troubled years 2009–2010? By then they might have forgotten the story of a new administration's attempt to act boldly to prop up the housing market and bring relief to homeowners who could no longer afford their mortgage payments. But they would be well advised to take to heart the lessons of the disappointing first year of the Obama Administration's Home Affordable Modification Program (HAMP).[2] HAMP provides a compelling

1. LEWIS CARROLL, THROUGH THE LOOKING-GLASS 88 (Random House, spec. ed. 1946) (1869).

2. *See* generally U.S. DEP'T OF THE TREASURY, MAKING HOME AFFORDABLE UPDATED DETAILED PROGRAM DESCRIPTION (Mar. 4, 2009) [hereinafter, MARCH 4, 2009, HAMP PROGRAM DESCRIPTION], *available at* http://www.treas.gov/press/releases/reports/housing_fact_sheet.pdf (first outline of HAMP program); *see also* HOME AFFORDABLE MODIFICATION PROGRAM, SUPPLEMENTAL DIRECTIVE 09-01, INTRODUCTION OF THE HOME AFFORDABLE MODIFICATION PROGRAM (Apr. 6, 2009) [hereinafter HAMP, SUPPLEMENTAL

case study of the complex challenge of mitigating the effects of an economic crisis brought on by high-risk financial products. After a fall, economic stability is excruciatingly difficult to put together again.

HAMP committed $75 billion in incentives to loan investors, servicers, and homeowners to try to get them to enter into more mortgage modifications, with a goal of reaching three to four million struggling borrowers, thus mitigating the foreclosure crisis and its spillover effects.[3] Cumulatively, the program produced 230,801 permanent modifications in the first year of operations, through March 2010.[4] While even this number was unimpressive compared to the millions of borrowers at risk of foreclosure, it in fact overstated how many participants would truly get permanent relief; although HAMP modifications reduced monthly mortgage payments to 31% of gross monthly income, they left borrowers with high overall debt-to-income ratios, did not require reduction of loan principal even for those owing much more than the value of their homes, and used primarily temporary interest rate breaks, resulting in a high risk of redefault.[5] Indeed, the

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DIRECTIVE 09-01], *available at* https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0901.pdf (more detailed description of HAMP, noting that President Obama announced the HAMP program on February 18, 2009, and that initial program guidance was issued by the U.S. Department of the Treasury (Treasury) on March 4, 2009).

3. MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2 (stating the $75 billion commitment and goal of helping three to four million at-risk homeowners); *see also* HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 1 (noting goal of helping three to four million at-risk homeowners in default or in imminent risk of default and also that President Obama announced the program on February 18, 2009); CONG. OVERSIGHT PANEL, OCTOBER OVERSIGHT REPORT: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS 43 (Oct. 9, 2009) [hereinafter COP OCTOBER 2009 REPORT], *available at* http://cop.senate.gov/documents/cop-100909-report.pdf (stating government commitment of $75 billion comprised $50 billion of Troubled Asset Relief Program funds, "directed toward modifying private-label mortgages," and $25 billion from the Housing and Economic Recovery Act, "dedicated to the modification of Fannie Mae and Freddie Mac mortgages"). Of course, lower numbers of modifications realized meant that much less would be spent subsidizing them than the original $75 billion figure. *See infra* note 117 and accompanying text.

4. MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH MARCH 2010 at 4 [hereinafter MHA, MARCH 2010 SERVICER PERFORMANCE REPORT], *available at* http://www.makinghomeaffordable.gov/docs/Mar%20MHA%20Public%20041410%20TO%20CLEAR.PDF. Although the HAMP program was announced by President Obama on February 18, 2009, it did not become operational until April 2009. *See* HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2 (setting out program details on April 6, 2009); MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH SEPTEMBER 2009 [hereinafter MHA, SEPTEMBER 2009 SERVICER PERFORMANCE REPORT], *available at* http://www.financialstability.gov/docs/HAMP/MHA%20Public%20100809%20Final.pdf (graphically representing "HAMP Trial Modifications (Cumulative, by Month)" and showing 50,130 trial modifications for the first period reported, for "May and Prior"). Thus, this Article will treat the first year of the program as running from April 2009 through March 2010. *See also* Figure 1 *infra* Part II.B.4.c.

5. *See infra* notes 100–10 and accompanying text (discussing reduction of first lien monthly payments to 31% of gross income, with only those in default or imminent default and suffering a hardship eligible); notes 168–70 and accompanying text (concerning

redefault problem began to materialize even before the first year was over, with 2842 permanent modifications already cancelled as failures by the end of March 2010 and with government estimates that 40% or more would redefault within five years.[6] Compounding the problem, the slow progress of HAMP played out against a rising tide of unemployment and foreclosures. Joblessness rose steeply in 2009, reaching 10% nationally at the end of the year and remaining close to that in early 2010.[7] The rate of residential mortgages in foreclosure rose to 4.63% at the end of March 2010, with another 9.38% of mortgages delinquent.[8] The private alliance of mortgage market participants, HOPE NOW, reported that its servicers started about 2.2 million foreclosures and completed 746,629 foreclosure sales in 2009, and Standard & Poor's estimated in March 2010 that five to seven million more

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high overall debt burdens of HAMP borrowers); notes 172–79 and accompanying text (concerning primary use of interest rate reduction to modify loans under HAMP and optional nature of principal reduction, used rarely); notes 180–81 and accompanying text (noting that 76% of permanent modifications under HAMP involved negative equity, with the loan balance exceeding the value of the home, and that 51% had a loan to value ratio greater than 125%).

6. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (reporting 2879 permanent modifications cancelled and stating that thirty-seven of the cancellations represented paid-off loans, meaning that 2842 represented unsuccessful permanent modifications); *infra* note 162 and accompanying text (detailing a concern of the Congressional Oversight Panel that redefault rate on permanent modifications could be significantly higher than Treasury estimate of 40%); *see also infra* note 8 (detailing industry data on the size of the foreclosure crisis).

7. U.S. Bureau of Labor Statistics, *Labor Force Statistics from the Current Population Survey*, http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id=LNS14000000 (last visited Mar. 26, 2010).

8. *See* Press Release, Mortgage Bankers Ass'n, Delinquencies, Foreclosure Starts Increase in Latest MBA National Delinquency Survey (May 19, 2010) [hereinafter MBA, Delinquencies, Foreclosure Starts Increase], *available at* http://www.mbaa.org/NewsandMedia/PressCenter/72906.htm (reporting 4.63% of residential mortgages were in the foreclosure process at the end of the first quarter of 2010, up from 4.58% at the end of 2009, with an additional 9.38% delinquent, for a total of 14.01% delinquent or in foreclosure); *Recently Announced Revisions to the Home Affordable Mortgage Program (HAMP): Hearing Before the Subcomm. on Hous. and Cmty. Opportunity of the H. Comm. on Fin. Serv.*, 111th Cong. 1, n.1 (Apr. 14, 2010) (statement of Alan M. White, Associate Professor, Valparaiso University School of Law) [hereinafter White Testimony], *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/testimony_-_white_4.14.10.pdf (noting that the percentage figures in foreclosure and additionally delinquent were roughly 1% and 4% in 2005); Press Release, Mortgage Bankers Ass'n, Delinquencies, Foreclosure Starts Fall in Latest MBA National Delinquency Survey (Feb. 19, 2010), *available at* http://www.mortgagebankers.org/NewsandMedia/PressCenter/71891.htm (reporting rise to 4.58% of residential mortgages in foreclosure at the end of the fourth quarter of 2009, an increase of eleven basis points from the third quarter and 128 basis points from a year earlier and additional delinquency rate of 10.44%, although the seasonally adjusted delinquency rate and foreclosure starts in the fourth quarter of 2009 declined slightly from the previous quarter); COP OCTOBER 2009 REPORT, *supra* note 3, at 6, 119 (reporting industry statistics that new foreclosures were started at a rate of three million per year in May–July 2009, or about quadruple their pre-crisis levels); *see also id.* at 35–36, 136 (noting that the government was forced to rely on "imperfect private data" in the foreclosure crisis and that government foreclosure data were needed).

homes could go into foreclosure over the next three years.[9] On March 26, 2010, the Obama Administration admitted that progress in HAMP had been slow and that challenges continued.[10] It announced new "enhancements" to the program to provide for optional principal forgiveness for underwater homeowners (including by second-lien holders) and temporary assistance for the unemployed; the enhancements also included greater definition of solicitation requirements, required foreclosure forbearance during consideration for HAMP, clarification that debtors in bankruptcy must be considered for the program upon request, and increased relocation assistance for those unable to complete a modification.[11] The initial program details indicated, "We anticipate the full set of programs to be

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9. *See* HOPE NOW, State Loss Mitigation Data, tbls. 2 & 3 (Mar. 2010), http://www.hopenow.com/industry-data/State%20Loss%20Mitigation%20Data%20 (Mar%202010)%2005-07-2010a.pdf (reporting foreclosure starts and sales by quarter, adding up to the numbers stated in the text). HOPE NOW is a private association of mortgage-market participants formed with government encouragement to address the foreclosure crisis. *See What Is HOPE NOW?*, HOPE NOW, http://www.hopenow.com/ hopenow-aboutus.php (last visited July 17, 2010); Press Release, HOPE NOW, HOPE NOW Alliance Created to Help Distressed Homeowners (Oct. 10, 2007), *available at* http://www.fsround.org/media/pdfs/AllianceRelease.pdf (announcing creation of the alliance at the urging of the Bush Administration); *see also* Renae Merle, *New Round of Foreclosures Threatens Housing Market*, WASH. POST, Mar. 12, 2010, at A01 (reporting estimate of foreclosure starts in the next three years).

10. *See* Press Release, U.S. Dep't of the Treasury, Housing Program Enhancements Offer Additional Options for Struggling Homeowners (Mar. 26, 2010), *available at* http://www.ustreas.gov/press/releases/tg614.htm (announcing adjustments in the program to better help the unemployed and those underwater and stating, "we continue to see challenges. Servicers were slow to implement HAMP, resulting in a slow start for the program").

11. *See* MAKING HOME AFFORDABLE PROGRAM, ENHANCEMENTS TO OFFER MORE HELP FOR HOMEOWNERS (Mar. 26, 2010) [hereinafter MHA MARCH 2010 PROGRAM ENHANCEMENTS], *available at* http://makinghomeaffordable.gov/docs/HAMP%20 Improvements_Fact_%20Sheet_032510%20FINAL2.pdf (listing, in an initial outline of program enhancements, all these enhancements under four headings: "Temporary assistance for unemployed homeowners while they search for re-employment," "Requirement to consider alternative principal write-down approach and increased principal write-down incentives," "Improvements to reach more borrowers with HAMP modifications," and "Helping homeowners move to more affordable housing"). This document indicated a new principal write-down option was to be developed for servicers, applicable where net present value (NPV) of the loan with principal reduction exceeded net present value of modification involving just interest rate reduction; in cases where loan-to-value ratio was at least 115%, the servicer was required to run this NPV comparison but not required to offer principal write-down even if it had a higher NPV; principal reduction remained at servicer option. *Id.*; *see also* CONG. OVERSIGHT PANEL, APRIL OVERSIGHT REPORT: EVALUATING PROGRESS ON TARP FORECLOSURE MITIGATION PROGRAMS 115 (Apr. 14, 2010) [hereinafter COP APRIL 2010 REPORT], *available at* http://cop.senate.gov/ documents/cop-041410-report.pdf (discussing estimates that nearly a quarter of homeowners were underwater on their loans at the end of 2009); *id.* at 23–24 (noting that principal write-down under the enhanced program announced in March 2010 would be voluntary and that, "[a]s with other aspects of HAMP, however, uncertainty remains as to whether the incentives will be enticing enough to encourage servicers to forgo income and actually write down principal").

available by the fall."[12] In other words, results under the enhancements would not even begin to be measurable until a year and a half into HAMP.

HAMP attempted to balance many difficult policy considerations. Above all, the program sought to avoid further depressing the financial markets; it eschewed steps that might have forced more recognition of reduced financial-asset values or might have created a moral hazard by encouraging underwater debtors to default.[13] Instead, it attempted to motivate servicers to modify mortgage payments by promising them incentives to reduce interest rates, while requiring borrowers to be in default or in "imminent default" and to show financial hardship to participate in the program.[14] Only at the end of the first year did HAMP announce plans to add incentives to reduce principal, applicable when loan-to-value ratio exceeded 115%, but participating servicers were not required to write the loan down even if net present value analysis favored this step.[15] While it was easy to think of possible fixes for the program, such as backing up the carrots offered to servicers with sticks in the form of enforcement efforts and adding bankruptcy write-down of loan principal, it was also easy to be concerned—as the administration apparently was—that these approaches might undermine the big picture goal of returning to economic normalcy as soon as possible.[16] In sum, fears about the precariousness of financial markets stood in the way of aggressive action to get help to homeowners fast.

Effective private-modification programs—if truly desired by the industry—should have been up and humming ahead of HAMP. Although there were private initiatives, the Obama Administration grew impatient with the pace and efficacy of private-sector action and embarked on the ambitious HAMP

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12. *Frequently Asked Questions*, HAMP (Mar. 26, 2010), http://makinghomeaffordable.gov/docs/Consumer%20FAQs%20032510%20FINAL.pdf.

13. *See* COP APRIL 2010 REPORT, *supra* note 11, at 23–25 (discussing lack of use of principal write-down as part of the HAMP guidelines through March 2010 and then introduction of only voluntary write-down; also discussing focus on the problem of moral hazard); *infra* notes 1843–84 and accompanying text (concerning large numbers of homeowners with negative equity in 2009–2010); *see also* Jean Braucher, *A Law-in-Action Approach to Comparative Study of Repayment Forms of Consumer Bankruptcy*, *in* CONSUMER CREDIT, DEBT AND BANKRUPTCY: COMPARATIVE AND INTERNATIONAL PERSPECTIVES 331, 333 (2009) (Johanna Niemi et al. eds., 2009) (discussing tensions among various goals of consumer–insolvency regimes, which include creditor repayment, debtor discharge, and treatment, particularly as measured by whether debt problems recur, and noting that emphasis on morality of repayment of old debt can interfere with getting debtors on a sustainable financial footing).

14. *See infra* notes 103–06 and accompanying text (concerning HAMP eligibility requirements, including hardship and default or imminent default); *see also infra* notes 164–67 and accompanying text (additional discussion of hardship requirement).

15. *See supra* notes 10–12 and accompanying text.

16. *See infra* Part III.B.1.d (concerning the need to enforce servicer obligations under the program); note 27 and accompanying text; Part III.C (concerning the need for write-down of principal, originally endorsed by the Administration). While the Administration longed for a return of normalcy, not addressing the negative equity positions of millions of homeowners left them in a state that could hardly be considered normal. *See infra* notes 180–85 and accompanying text (discussing the failure of HAMP to address negative equity problem).

program, which became operational in April 2009.[17] Unfortunately, the result was an at least temporary reduction in numbers of modifications, even though HAMP modifications were more affordable than purely private efforts that preceded them and, on that basis, a distinct improvement.[18] After six months under HAMP, the relatively puny results achieved by September 2009 led some to call it a failure.[19] Later in the fall of 2009 and into early 2010, however, HAMP finally seemed to ramp up to produce trial modifications at a significant if not high rate, results achieved not only by promised government subsidies, but probably more so by official jawboning and by embarrassing servicers into producing more modifications by issuing monthly public report cards.[20] Conversion of trials to permanent modifications nevertheless continued to be a problem through the end of HAMP's first year, with most achieved only in the first few months of 2010.[21]

As so-called permanent modifications modestly increased, another problem loomed: many appeared unsustainable,[22] replicating a key problem with many loans produced during the real estate bubble. HAMP focused on short-term affordability—reducing gross monthly mortgage payments to 31% of borrowers' gross monthly income.[23] This was achieved primarily by temporary interest rate decreases rather than by reducing principal, which was optional under the program

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17. *See supra* note 4 and accompanying text (noting HAMP became operational in April 2009); *see also infra* notes 95, 132–33 and accompanying text (discussing increases in monthly payment amounts under voluntary modifications in 2007–2008 and noting initial decline in the private HOPE NOW program as HAMP ramped up and then increased in private modifications in early 2010).

18. *See infra* note 95 and accompanying text (concerning lack of reduction in mortgage payments under private HOPE NOW modifications); notes 168–70 and accompanying text (describing reduction in first-lien mortgage payments under HAMP, although resulting debt-to-income ratios remained high when all debts were considered).

19. The criticism came from diverse perspectives. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 136 (under "Additional Views of Congressman Jeb Hensarling") (calling HAMP and other administration foreclosure mitigation efforts "a failure"); *infra* note 43 and accompanying text (discussing the laissez-faire views of Rep. Hensarling, a Republican on the COP); *see also* NATIONAL CONSUMER LAW CENTER, INC., WHY SERVICERS FORECLOSE WHEN THEY SHOULD MODIFY AND OTHER PUZZLES OF SERVICER BEHAVIOR v, viii (Oct. 2009) [hereinafter, NCLC REPORT], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1502744 (saying the Administration, along with Congress and the Securities and Exchange Commission, "failed to provide servicers with the necessary incentives" and that what was needed was not just carrots but "sticks," in the form of "certain and substantial" penalties for not making modifications where appropriate).

20. *See infra* notes 125–28, 143, 151 and accompanying text.

21. *See infra* notes 131, 144, 154 and accompanying text (concerning cumulative numbers of permanent modifications, of only 1711 through the end of August 2009, rising to 31,382 at the end of November 2009 and to 230,801 at the end of March 2010); *see also infra* Figure 2, Part II.B.4.c.

22. *See* COP APRIL 2010 REPORT, *supra* note 11, at 4, 16, 22–23, 45, 48–49, 60–62, 69–70.

23. *See infra* notes 110, 168–79 and accompanying text.

even after March 2010.[24] HAMP thus produced modifications that typically were low-interest but involved negative equity and stretched budgets, making redefault a high risk; in the event of income or expense shocks or life events prompting a move, borrowers would not be able to sell their homes and pay off their loans.[25] Only a year into the program did the Administration acknowledge that principal reduction—of both first and second mortgages—was also needed, and even then it took only weak steps toward that goal.[26]

Part I of this Article explores the premises of HAMP, particularly the desirability of taxpayer-funded foreclosure mitigation and the specific form it took under HAMP. Part II describes the program and its results in its first year. Part III turns to evaluation of possible ways HAMP could have been fixed, examines why the government resisted adopting these methods, and discusses the central lesson of HAMP, that back-end solutions after a crisis can be slow and weak, thus failing to address painful economic repercussions. While the Administration continued to try to prompt servicers to make more modifications, it stopped short of enforcement actions as a means. It also resisted creating a mandatory mechanism to reduce principal obligation on underwater mortgages. The Obama Administration originally envisioned bankruptcy modification of principal to the value of the home as a companion program to HAMP, but that would have required legislative action that Congress did not take.[27] Neither did the Administration use HAMP guidelines to mandate principal reduction by participating servicers and investors to increase long-term sustainability of its modifications. It appeared to fear further destabilizing financial markets as well as political fallout, as will be discussed in Part III.D.

Effective October 1, 2009, the Federal Reserve Board implemented a partial, weak, and breathtakingly obvious front-end solution to the foreclosure crisis. New rules required lenders making high-priced mortgage loans to assess repayment ability of borrowers, verify their income, and refrain from charging prepayment penalties if payments could change in the first four years of the loan.[28]

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24. *See infra* notes 172–79 and accompanying text; *see also supra* note 11 and accompanying text (concerning the optional nature of principal reduction under the program enhancements announced March 26, 2010).

25. *See infra* notes 172–85 and accompanying text.

26. *See supra* notes 10–12, 15 and accompanying text.

27. MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 6–8 (discussing as part of the HAMP overall plan judicial modification in bankruptcy for debtors who have attempted unsuccessfully to obtain affordable modifications); *see also infra* notes 266–67 and accompanying text (concerning failed attempts to pass legislation).

28. Regulation Z, Subpart E—Special Rules for Certain Home Mortgage Transactions, 16 C.F.R. §§ 226.31–226.39 (2010), *available at* http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=73b0ce0a31458768f5f3c112d327fd5d;rgn=div5;view=text;node=12%3A3.0.1.1.7;idno=12;cc=ecfr. This regulation amounted to requiring basic due diligence on the largest transactions that most individuals make. The rule applies to "higher-priced mortgage loans" defined in § 226.35(a) in terms of a rate floating above prime, a definition designed to capture "virtually all loans in the subprime market." Press Release, Federal Reserve, Highlights of Final Rule Amending Home Mortgage Provisions of Regulation Z (Truth in Lending) (Nov. 6, 2009), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/regz20080714.htm. Unfortunately,

The agency adopted this regulatory approach under statutory authority it had throughout the housing bubble.[29] If regulators are ever tempted to loosen up controls on subprime mortgage lending again, they should remember how difficult it is to mitigate a foreclosure crisis after the fact.

I. EXAMINING HAMP'S PREMISES: IS GOVERNMENT FORECLOSURE MITIGATION DESIRABLE AND WHAT SHOULD BE ITS NATURE?

A. The Simple Logic of Modification Rather than Foreclosure

A premise of HAMP's creation was that in a foreclosure crisis, more modifications would be a good thing for borrowers, mortgage investors, and the American economy as a whole. This assumption, however, should be explored rather than assumed. Foreclosure mitigation in general has simple economic logic in its favor. Investors in home mortgages, through their servicers,[30] should want to modify them rather than foreclose when prospects are good for repayment of an amount greater than could be realized in a foreclosure sale.[31] The foreclosure process is costly, and foreclosure sale prices are typically depressed.[32] Thus, it

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the rule does not cover nontraditional prime mortgages or home equity lines of credit. Also, its use of only an interest rate trigger leaves open evasion through a shift to fees, and the enforcement provisions could be stronger; rescission is available only for violations of the prepayment penalty rule and not other new rules. Other problems include failure to tackle the riskiness of 100% financing (nothing down) and non-amortizing or negatively amortizing loans (interest only or less than interest only). *See* White Testimony, *supra* note 8, at 5 (discussing that the regulation did not address borrower equity and amortization). Furthermore, prevention will also require addressing the ways in which mortgage securitization fueled the making of dubious loans. *See* Christopher L. Peterson, *Predatory Structured Finance*, 28 CARDOZO L. REV. 2185, 2273–80 (2007) (discussing securitization as a method of providing capital for judgment-proof brokers, originators, and servicers and advocating use of imputed liability theories to modernize consumer protection law).

29. 15 U.S.C. § 1639(l)(2) (2006) (giving the Federal Reserve power to regulate unfair, abusive, and deceptive mortgage lending practices).

30. The term "investors" will be used instead of "lenders." Investors include originating lenders who hold on to the loans that they originated, thus investing in them, and also third parties who buy interests in securitized pools of home mortgages. In either case, servicers are used to collect payments and distribute them to the investors and others such as taxing authorities and insurers. *See* Katherine Porter, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121, 126–27 (2008) (discussing functioning of servicers and the rise of the servicing industry in connection with securitization); *see also infra* notes 83–92 and accompanying text (discussing growth of the servicing industry and how its interests can conflict with those of investors).

31. Joe Nocera, *From Treasury to Banks, an Ultimatum on Mortgage Relief*, N.Y. TIMES, July 10, 2009, at B1, *available at* http://www.nytimes.com/2009/07/11/business/11nocera.html ("[I]t would seem obvious that mortgage relief makes more sense than foreclosure for everyone concerned.").

32. COP OCTOBER 2009 REPORT, *supra* note 3, at 120 (reporting losses of 50% or more on foreclosures compared to original principal obligation); *see also* Alan M. White, Columbia Collateral File Summary Statistics, September 25, 2009, http://www.valpo.edu/law/faculty/awhite/

theoretically should be a win–win proposition for loan investors and struggling borrowers to modify loans to avoid foreclosure; one would expect new terms to give investors returns somewhere between those on the original loan and on a foreclosure sale.[33]

So obvious is this logic that a puzzling question in 2009 was why private foreclosure mitigation did not burgeon during the crisis without a potentially vast government intervention such as HAMP. After the housing bubble burst in 2007, however, mortgage-loan investors and their servicers were not quick to enter into modifications. After a couple of years, a chorus began asking why. Those demanding answers and offering explanations included government entities, consumer advocates, economists, and journalists.[34] The slow pace of modifications puzzled many.

Investors in loans and their servicers should have acted faster if more modifications were in their self-interest, and thus their failure to do so indicates that they were not. Simple economic assumptions failed to account for such problems as lack of servicer capacity to handle the scale of the crisis, the bizarre incentives in the Rube Goldberg contraption called securitization, and investor desire not to recognize losses.[35] With so many debtors under water on their mortgages, there was also more than ordinary concern about moral hazard,[36] so

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data/sept09_summary.pdf (noting average of 65% of loan balance lost on foreclosure in a database of subprime and Alt A mortgages in September 2009).

33. White, *supra* note 32 (noting average modification losses in the same pool of 10% of loan balance, compared to 65% on foreclosure sales).

34. COP OCTOBER 2009 REPORT, *supra* note 3, at 70 (noting "the question of why servicers are not engaged in more modifications" and suggesting as possible answers a lack of servicer capacity as well as concern about redefault); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-837, TROUBLED ASSET RELIEF PROGRAM: TREASURY ACTIONS NEEDED TO MAKE THE HOME AFFORDABLE MODIFICATION PROGRAM MORE TRANSPARENT AND ACCOUNTABLE (2009), *available at* http://www.gao.gov/new.items/d09837.pdf; NCLC REPORT, *supra* note 19; Larry Cordell et al., *Designing Loan Modifications to Address the Mortgage Crisis and the Making Home Affordable Program* (Fed. Reserve Bd. Fin. & Econ. Discussion Series, Divisions Research & Statistics & Monetary Affairs, Working Paper No. 2009-43, 2009), *available at* http://www.federalreserve.gov/pubs/feds/2009/200943/200943pap.pdf; Manuel Adelino et al., *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* (Fed. Res. Bank of Bos. Pub. Pol'y, Discussion Papers No. 09-4, 2009), http://www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf; Nocera, *supra* note 31 (floating many explanations, including the costs of setting up a large modification program and undertaking serious underwriting, avoiding writing down assets in a practice called "extend and pretend," self-cure, and redefault as reasons not to modify).

35. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 21 (concerning interest in avoiding loss recognition); *see also infra* notes 83–95 and accompanying text (further discussing servicer and investor disincentives to modify).

36. MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 2 (setting HAMP eligibility requirements to make the program unavailable to those who could afford repayment, *inter alia*, by requiring delinquency or "reasonably foreseeable" default, documentation of financial hardship, and representation of inability to make monthly payments backed by documentation of income); *see also supra* notes 13–14 and

that investors may have preferred to resist pressure for breaks on underwater loans to hold down the volume of defaults, despite suffering greater losses on loans that did go into foreclosure. In sum, servicer and investor disincentives to enter into modifications were complex[37] and as fascinating as a train wreck. HAMP's carrots proved insufficient to overcome them, leading to calls for some sticks.[38] These could have been justified as means to hold servicers to the commitments they made when they signed up for HAMP and also to invigorate the program sufficiently to reduce the incidence of foreclosure enough to avoid a long-term drag on economic recovery. But caution prevailed, and sticks were not employed.

B. Possibilities for Doing Less or More

For the economy as a whole, there was the possibility that a cascade of foreclosures would have been the best way to "reset" the market, with investors and borrowers taking the pain fast and getting it over with. A minority staff report of the U.S. House Committee on Oversight and Government Reform issued in February 2010 called HAMP "technocratic tinkering" and said that it "distorts the housing market, delaying any recovery."[39] Remarkably, the report also seemed to view walking away as a better solution for debtors than modification, stating that those who got HAMP trial plans but failed to qualify for permanent modifications "would have been better off if they had defaulted earlier and spent the payments on more affordable housing options."[40] The argument seemed to be that distressed borrowers, and investors in loans, should have taken their lumps and then rebuilt their financial futures.[41]

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accompanying text (concerning eligibility requirements); *infra* note 103 and accompanying text (same).

37. *See infra* notes 83–95; *see also* Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 624 (arguing that the paucity of workouts during the foreclosure crisis was "multicausal").

38. *See infra* Part III (concerning possible fixes of stepped-up compliance review, enforcement, and reduction of principal obligation).

39. MINORITY STAFF OF H. COMM. ON OVERSIGHT AND GOV'T REFORM, 111TH CONG., REP. ON THE TREASURY DEPARTMENT'S MORTGAGE MODIFICATION PROGRAMS: A FAILURE PROLONGING THE ECONOMIC CRISIS 1 (Feb. 25, 2010) (discussing small number of permanent modifications and also stating, "[t]he only viable long-term solution to falling housing prices and rising foreclosures is a broad-based economic recovery," and "Treasury owes American taxpayers and homeowners an honest explanation of HAMP's ill-advised creation and ongoing mismanagement"); *see also id.* at 14–15 (discussing analysis that HAMP might be prolonging the housing crisis and delaying recovery by avoiding an honest accounting of losses, adding uncertainty to the housing market, and creating HAMP modifications that represent "a new class of misunderstood, complex mortgage products that further expose the American economy to systemic risk"). The authors of this report seemed to try to have it both ways—that the results were small but would have dire effects—but it seemed more likely the program would have little impact.

40. *Id.* at 1; *see also id.* at 2 (charging that Treasury was "trying to hide the failure of HAMP").

41. *See* Michael Corkery, *A Florida Court's 'Rocket Docket' Blasts Through Foreclosure Cases*, WALL ST. J., Feb. 19, 2009, at 1, *available at* http://online.wsj.com/article/SB123491755140004565.html (quoting a court clerk in hard-hit Lee County, Florida,

There are, of course, winners in a steep, unmitigated housing-market decline. More foreclosures mean more bargain basement prices, some of them for prudent first-time home buyers who waited out the bubble, but also for others without the same attractive moral status, such as vulture investors who were beating out many first-time buyers at foreclosure sales during the crisis.[42]

Although members of the Republican minority in Congress mounted a laissez-faire argument,[43] the government had been so deeply involved in the housing market for so long[44] that the Administration did not seriously consider abandoning the field in the middle of a crisis. The result might have been even more massive foreclosures and greater losses to large sectors of the economy in the short term, with risk of prolonging the financial crisis.[45]

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as explaining that rapid action on a high volume of foreclosures cases would allow the market to "get to the bottom faster").

42. *See* Louise Story, *Wall St. Finds Profits by Reducing Mortgages*, N.Y. TIMES, Nov. 21, 2009, at A1, *available at* http://www.nytimes.com/2009/11/22/business/22loans.html?_r=1 (concerning "vulture funds" that were buying distressed mortgages at bargain prices—this particular story did not concern a purely private sector phenomenon, however, because the loans were being insured by the Federal Housing Administration, creating additional risk for U.S. taxpayers); *see also* John Cutts, *Foreclosure Auctions in Bay Area Frustrate First Time Buyers*, REAL ESTATE PRO ARTICLES (Dec. 21, 2009), http://www.realestateproarticles.com/Art/11179/265/Foreclosure-Auctions-in-Bay-Area-Frustrate-First-Time-Buyers.html (reporting on ability of large investors to beat out individual buyers at foreclosure auctions by such strategies as paying cash and buying in bulk).

43. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 159 (views of Congressman Jen Hensarling, who took the position that government intervention in housing in general is bad because it has the effect of "crowding out private-sector participation" and stating, "[w]hile there are short-term gains to such interventions, the longer-term hurdle" was "returning to sustainable activity in the absence of such support"); *id.* at 155 (arguing that government programs might have "enticed" servicers and mortgage holders to "sit on their hands and wait for higher fees, servicing payments, and interest and principal subsidies courtesy of HAMP or some other government-sponsored foreclosure mitigation program"); *supra* notes 39–40 and accompanying text. The latter argument was also articulated by Cordell et al., *supra* note 34, at 13 (noting servicers may have been waiting for better incentives).

44. *See* GAIL RADFORD, MODERN HOUSING FOR AMERICA: POLICY STRUGGLES IN THE NEW DEAL ERA (1996) (tracing federal housing policy beginning in the 1920s); R. ALLEN HAYS, THE FEDERAL GOVERNMENT & URBAN HOUSING: IDEOLOGY AND CHANGE IN PUBLIC POLICY (2d ed. 1995) (discussing, in part, the expansion of housing programs in the 1960s and 1970s); *see also* A. Mechele Dickerson, *The Myth of Home Homeownership and Why Home Ownership Is Not Always A Good Thing*, 84 IND. L. J. 189, 193 (2009) (concerning deep level of federal involvement in promoting home-buying, justified with rhetoric extolling homeownership).

45. *See* MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 1–2 (concerning "devastating consequences" of "deep contraction in the economy and in the housing market" on communities and homeowners, including those who made their mortgage payments, risking "an intensifying spiral in which lenders foreclose, pushing area home prices still lower, reducing the value of household savings, and making it harder for all families to refinance"); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 3 (noting the foreclosure crisis created direct costs for displaced owners and tenants, indirect costs for

Strong policy considerations favored intervention to reduce foreclosures. In general, foreclosure prices are artificially and severely depressed compared to unpressured sales.[46] Huge spillover effects would have resulted from resetting values for a significant percentage of the housing market at firesale prices, with no effort at mitigation. Not just the displaced homeowners but also homeowners nearby suffer losses due to foreclosures.[47] Investors also lose, and in the crisis, they included not just pensioners but also taxpayers, through U.S. Treasury holdings of "toxic assets," Federal Reserve purchases of mortgage-backed securities to try to stabilize the financial markets, and through the government sponsored entities (GSEs), which went into federal conservatorship in 2008.[48]

Massive foreclosure losses—to distressed borrowers, other homeowners, and investors—in turn depress consumer confidence and thus consumption and ultimately all economic activity.[49] For any homeowner who needs to sell while market prices are depressed, the loss is realized. For distressed borrowers who lose their homes to foreclosure, there are both the economic and psychic costs associated with financial failure and housing displacement. In addition, rapid foreclosure results in large vacancy rates in some areas, leading to squatting and vandalism that further depress home values, and municipalities end up with bigger

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cities and towns and neighboring homeowners whose property values were driven down, and potentially an "enormous obstacle to recovery"); Ben S. Bernanke, Chariman, Bd. of Governors of the Federal Reserve, Speech at the Federal Reserve System Conference on Housing and Mortgage Markets: Housing, Mortgage Markets, and Foreclosure (Dec. 4, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm (discussing societal impact of mortgage foreclosures).

46. *See supra* notes 32–33 and accompanying text.

47. Cordell et al., *supra* note 34, at 8–9; *see also* Memorandum from the Office of the Special Inspector Gen. for the Troubled Asset Relief Program to the Honorable Timothy F. Geithner, Secretary of the Treasury, IGTARP-10-005, Factors Affecting Implementation of the Home Affordable Modification Program 1 (Mar. 25, 2010) [hereinafter, SIGTARP, March 2010 Report on HAMP], *available at* http://www.sigtarp.gov/reports/audit/2010/Factors_Affecting_Implementation_of_the_Home_Affordable_Modification_Program.pdf (discussing "devastating impact" of home foreclosures "not only on the families losing their homes, but also on the communities affected and on mortgage lenders").

48. COP OCTOBER 2009 REPORT, *supra* note 3, at 3, 119 (concluding that the benefits of foreclosure mitigation are likely to outweigh the cost to taxpayers and noting that taxpayers are mortgage investors through Treasury and Federal Reserve investments in mortgage-back securities and through Fannie Mae and Freddie Mac, government-sponsored entities that participate in the secondary mortgage market). These government-sponsored entities have been under conservatorship of the Federal Housing Finance Agency since September 2008. *See About Fannie Mae*, FANNIE MAE, http://www.fanniemae.com/about/index.html (2010); *Corporate Governance Under Conservatorship*, FREDDIE MAC, http://www.freddiemac.com/governance/ (2010); *see also* Sudeep Reddy, *Fed Officials Differed on Inflation, MBS Purchases*, WALL ST. J., Oct. 15, 2009, at A4, *available at* http://online.wsj.com/article/SB125554283878685333.html (discussing Federal Reserve's Open Market Committee decision to stick with its commitment to purchasing $1.25 trillion in mortgage-backed securities because of concern about the strength of the economic recovery).

49. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 7, 12.

policing bills and reduced real estate tax receipts.[50] Modification to keep homeowners in place can reduce all these losses, direct and indirect. The Congressional Oversight Panel estimated in 2009 that the benefits of foreclosure mitigation likely would outweigh the cost to taxpayers.[51]

An argument against the form of the HAMP bailout could have been mounted on the basis that it was too favorable to investors and not well designed to get immediate help to distressed homeowners. Such an argument, however, never gained traction. Taxpayer-paid incentives went in significant part into the pockets of servicers and investors, who were not required to write down principal and who for the most part were only giving temporary interest rate breaks, and there was no enforcement for them to do even that.[52] Under HAMP, investors got incentives to stem their own losses. Requiring principal reduction might have produced more sustainable and thus more permanent modifications, but the government instead chose to leverage its investment to prompt private sector action using incentives in an attempt to get relief to homeowners while also propping up capital markets.

After Congress failed to adopt bankruptcy modification, which would have forced principal write-down on investors, the Administration added to HAMP a weak alternative, required analysis of principal reduction for whether it would increase the net present value of the loan but only voluntary participation by HAMP servicers even if so.[53] Of course, a cynical explanation of the poor performance of HAMP in its first year is that its designers may have well understood that it was unlikely to work, but the Administration wanted to appear to do something for struggling homeowners while in fact doing little. A less harsh version of this critique might include the assumption that the Administration hoped economic recovery would increase employment and home values in time to make a more effective but also more intrusive modification program unnecessary.

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50. Cordell et al., *supra* note 34, at 7; *see also* John P. Harding et al., *The Contagion Effect of Foreclosed Properties*, 66 J. URBAN ECON. 164 (2009).

51. COP OCTOBER 2009 REPORT, *supra* note 3, at 3.

52. *See infra* notes 114–23 and accompanying text (describing incentives to investors and servicers); notes 172–79 and accompanying text (concerning temporary interest rate breaks and lack of principal reduction in HAMP); *see also infra* Part III.A (discussing lack of government enforcement of HAMP). The COP APRIL 2010 REPORT, *supra* note 11, argues that HAMP was too favorable to investors. *E.g.*, *id.* at 50 (stating that, "HAMP's original emphasis on interest rate reduction, rather than principal reduction, benefits lenders and servicers at the expense of homeowners . . . . The structure of HAMP modifications favors lenders and servicers, but it comes at the expense of a higher redefault risk for the modifications, a risk that is borne first and foremost by the homeowner but is also felt by taxpayers funding HAMP."). However, the COP also recognized systemic reasons for the approach taken. *E.g.*, *id.* at 24, ("Treasury must continue to be mindful of the matter of moral hazard. When Treasury Secretary Timothy Geithner was asked at a Panel hearing in December 2009 about the problem of underwater borrowers, he cited moral hazard for borrowers as one reason why Treasury had not prioritized principal reduction.").

53. *See supra* note 11 (discussing new requirement that HAMP servicers must evaluate HAMP-eligible borrowers for both standard HAMP modifications and new principal write-down modifications and leaving it to the "option" of servicers which to use); *see also infra* notes 266–67 (discussing failed congressional efforts to pass bankruptcy modification).

C. Leaving Out Relatively High- and Low-Risk Borrowers

The government itself did not claim that modification was for everyone who could not afford their mortgage payments. It took the position that in some instances modification could not help either borrowers or investors because redefault was either inevitable or too high risk.[54] The underlying problem in such cases is that the loan, even when reduced, is more than the homeowner can afford. Home "ownership," in transactions where there was little or no equity to begin with, grew too fast in the years before the 2007 bust.[55] HAMP provided for reducing monthly first-lien mortgage payments to 31% of gross monthly income in the interest of affordability,[56] but because its formula only focused on first mortgage expense in relation to income, it did not look at affordability in terms of the debtor's overall household budget, which could be out of whack if the debtor had other significant debt and high expenses. HAMP did not require principal reduction or taking into account the full budget, even if either step was needed to make the loan truly affordable.[57] When the Administration announced program enhancements on March 26, 2010, the plan was to add incentives to reduce principal, at the servicer's option, if that would make the loan more valuable under a net present value analysis, but there was no requirement to write down principal even if that would increase the value of the loan.[58]

Many so-called homeowners lacked much equity to begin with. After the real estate bust, many of them—as well as others whose home prices dropped precipitously—ended up with what is euphemistically called "negative equity," meaning more debt than the house is worth. Even when borrowers can afford

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54. *See Foreclosure Prevention: Is the Home Affordable Modification Program Preserving Homeownership?: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 111th Cong. 1, 5 (Mar. 25, 2010) (statement of Herbert M. Allison, Assistant Secretary for Financial Stability, U.S. Department of the Treasury) [hereinafter Allison, March 2010 Testimony], *available at* http://www.ustreas.gov/press/releases/tg608.htm (noting that some borrowers may be better suited for "a dignified transition to other housing," that "not all homeowners can be successfully reached through a HAMP modification," and that among those who get into permanent modifications "a significant number will redefault"); *see also* Cordell et al., *supra* note 34, at 26, 29 n.31 (discussing various concerns about redefault).

55. *See* Press Release, U.S. Dep't of the Treasury, *supra* note 10 (stating, "[W]e cannot and should not help everyone . . . . Some people simply will not be able to afford to stay in their homes because they bought more than they could afford."); *see also* Dickerson, *supra* note 44, at 202–07, 233 (concerning risk-layering in affordability products and problems in the rental market that lead to use of these products); Melissa B. Jacoby, *Bankruptcy Reform and Homeownership Risk*, 2007 U. ILL. L. REV. 323, 335–38 (2007) (discussing the problem of unsustainable home mortgages in Chapter 13 bankruptcy).

56. *See supra* note 52 and accompanying text (concerning emphasis on temporary interest rate breaks in HAMP); *infra* notes 172–79 and accompanying text (same).

57. *See supra* note 11 (principal reduction remained voluntary even under the program enhancements announced in March 2010); *infra* notes 168–70 (concerning high overall debt-to-income burdens of HAMP borrowers because the HAMP formula only considered first-lien mortgage payments in relation to income).

58. *See supra* note 11.

payments on underwater homes, they may not be able to move to take a better job because they cannot sell their current home and lack sufficient savings to pay the deficiency.[59] This lock-in to homes worth less than the debt puts a drag on the labor market, affecting the economy as a whole.[60] Even on the individual level, many such borrowers would be better off renting.[61] A debtor with serious negative equity may not be willing to keep up even affordable payments for many years before the loan-to-value ratio climbs back to one-to-one, and if the payments become unaffordable due to loss of income or expense shocks such as a serious illness, the debtor may have no choice but to walk when the home is still worth less than the debt.[62] With climbing unemployment in 2009–2010, borrowers were at higher risk of losing their jobs and not being able to pay even a modified loan any longer.[63] As we shall see, HAMP modifications in the first year did not reduce negative equity and actually typically increased it slightly.[64]

The other side of the redefault coin is that some mortgagors cure their defaults without modification. A modification for a borrower in default who is able to cure is unnecessary and, if government subsidized, increases taxpayer expense while also reducing investor return.[65] Cure rates dropped in 2009–2010, however, so losses from unnecessary modifications became a declining risk, much smaller than redefault.[66]

An even bigger worry was the possibility of drawing underwater borrowers into the program even if they could ride out the financial downturn without the need for a modification. It would have increased both costs of the program and losses of investors if HAMP had included borrowers who could and would continue to make their payments. The program addressed this problem with requirements that to be eligible, borrowers must be either already in default or in imminent default and, in addition, must have suffered a hardship.[67] This excluded strategic defaulters and restricted program access to the more needy but in the process excluded borrowers with the best performance prospects.

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59. *See generally* Jakob Roland Munch et al., *Are Homeowners Really More Unemployed?*, 116 ECON J. 991 (2006), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=937072 (concerning homeownership as hampering propensity to move for job reasons, even without lock-in of negative equity).

60. *See id.*

61. *See* Dickerson, *supra* note 44, at 233.

62. Cordell et al., *supra* note 34, at 10–11 (concerning "double trigger" of home-value decline and loss of income as driver of defaults).

63. COP OCTOBER 2009 REPORT, *supra* note 3, at 110 (concerning lack of programs to deal with saving homes of the unemployed and suggesting bridge loans as a mechanism); *see also supra* notes 10–11 (concerning announcement of program enhancements on March 26, 2010, that included temporary assistance for the unemployed).

64. *See infra* notes 180–82 and accompanying text.

65. *See* Adelino et al., *supra* note 34, at 7, 19 (concerning self-cure rates after mortgage default).

66. COP OCTOBER 2009 REPORT, *supra* note 3, at 12 fig.3 (quoting an industry source as reporting self-cure rates have declined dramatically, for example from a prime mortgage self-cure rate of 45% in the period 2000–2006 to 6.6% in 2009).

67. *See infra* notes 103–04 and accompanying text (describing eligibility requirements).

D. Other Foreclosure Alternatives: Promoting Short Sales and Deed-in-Lieu-of-Foreclosure Transfers

The federal government also had a program to promote short sales and transfers of a deed in lieu of foreclosure (DIL).[68] A short sale is a real sale to a willing buyer, with the deficiency forgiven, and a DIL transfer means the borrower voluntarily gives up the home to the servicer, with the debt cancelled. Typically a DIL transfer follows a failed attempt at a short sale after a set amount of time.[69] Both have the effect of forgiving principal indebtedness. HAMP provided incentives to servicers for pursuing these alternatives and to borrowers for relocation expenses.[70]

These alternatives were necessary because modifications are not always either affordable or sustainable. When a debtor gets a modification but remains seriously under water, short sales and DIL transfers may be necessary to provide an exit and avoid redefault. Sometimes a short sale or DIL transfer might even be a better first resort, because a modification is just too likely to fail.[71] Short sales and DIL transfers do not keep borrowers in their homes, but like modifications they reduce the dead-weight losses of foreclosures that create a drag on economic recovery through their spillover effects.[72] They do not reduce loss as much as sustainable modifications because they put additional inventory on the market for sale rather than keeping the debtor in the home,[73] but at least they avoid the degree of expense and delay of a foreclosure.

Toward the end of HAMP's first year, the Administration took steps to put more emphasis on its short sale and DIL program. A Treasury official explained in testimony before a U.S. House committee that,

> [T]he Administration has recognized from the start that not all homeowners can be successfully reached through a HAMP modification or another modification offered by the servicers. A

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68. *See* Press Release, Making Home Affordable, Update: Foreclosure Alternatives and Home Price Decline Protection Incentives (May 14, 2009), *available at* http://www.treas.gov/press/releases/docs/05142009FactSheet-MakingHomesAffordable.pdf (concerning short sale and DIL as alternatives to foreclosure).

69. COP OCTOBER 2009 REPORT, *supra* note 3, at 77–79.

70. *See id.* (concerning servicer incentive of $1000 for completing a short sale or DIL, with $1500 in relocation expenses for borrowers as well as up to $1000 to pay junior lien holders to release their claims; the program covered cases where borrower met eligibility requirements for a modification but did not qualify for a modification or could not maintain payments during the trial period or permanent modification). Increases in incentives for these foreclosure alternatives were announced on March 26, 2010, with servicer incentive payments going from $1000 to $1500 and relocation payments to borrowers doubling to $3000. *See* MHA MARCH 2010 PROGRAM ENHANCEMENTS, *supra* note 11, at 3–4.

71. Cordell et al., *supra note* 34, at 30 (expressing skepticism about modifications for those with significant negative equity and noting short sales and DIL transfers may be appropriate in such cases).

72. *See id.* at 27 (noting reduced losses, by 15–20%, on short sales compared to foreclosure sales).

73. COP OCTOBER 2009 REPORT, *supra* note 3, at 78.

> short sale or a deed-in-lieu . . . helps borrowers avoid foreclosure, and transition to other sustainable housing in a more dignified way . . . helping families maintain mobility in the labor force, which has broader economic benefits as well.[74]

From the point of view of the mortgage industry, short sales have several advantages over modifications involving principal reduction—they involve a market transaction in which a buyer is willing to pay the new, lower value, and they also reduce moral hazard because the seller has to give up the home to get out from under the negative equity.

In sum, not every distressed borrower should have gotten a HAMP modification, but the arguments were compelling for more of them, as well as for more short sales and DIL transfers, and fewer foreclosures. In a mortgage crisis, sustainable modifications help not only borrowers and loan investors but also much of the rest of the population by reducing spillover effects and improving prospects for economic recovery. But, as we shall see, all the President's men (and women) could not patch together a robust solution along these lines by the end of HAMP's lackluster first year.

II. FORECLOSURE MITIGATION UNDER HAMP: HISTORY, PROGRAM FEATURES, AND RESULTS IN THE FIRST YEAR

A. The Rise of Securitization and Third-Party Servicing

Modifications of home mortgage loans were nothing new when HAMP was designed. An obvious difference during the foreclosure crisis, however, was the sheer volume of mortgages in or near foreclosure.[75] The Congressional Oversight Panel noted estimates that through 2012, ten to twelve million homes would enter foreclosure during the crisis, out of about fifty-two million homes subject to mortgages.[76]

Not long before the crisis, in 1998, analysts were troubled by a rise in foreclosures on conventional mortgages to just over 1%,[77] a figure that looked low a decade later.[78] The rate of foreclosure at the close of the twentieth century seemed elevated, however, in comparison to the previous fifty years. In the 1950s,

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74. *See* Allison, March 2010 Testimony, *supra* note 54, at 8.

75. *See supra* notes 8–9 and accompanying text.

76. COP OCTOBER 2009 REPORT, *supra* note 3, at 3, 6.

77. *See* Peter J. Elmer & Steven A. Seelig, *The Rising Long-Term Trend of Single-Family Mortgage Foreclosures Rates* 1 (FDIC, Working Paper No. 98-2, 1998), *available at* http://www.fdic.gov/bank/analytical/working/98-2.pdf (noting that foreclosure rate was 1.04% in 1997).

78. *See supra* notes 8, 9, 76 and accompanying text; *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 6 (stating that there are 51.6 million homes subject to mortgages). According to the Congressional Oversight Panel, the MBNA National Delinquency Survey showed 4.58% of residential mortgages in foreclosure as of the end of 2009, an increase of 1.28% during the year, "indicat[ing] that foreclosure starts are adding to the stock of inventory faster than lenders are selling their real estate owned property." COP APRIL 2010 REPORT, *supra* note 11, at 125. COP also noted an estimate that 2.4 million foreclosures would occur in 2010. *Id.* at 131.

when mortgage lending was remarkably conservative, foreclosure rates ranged from 0.04% to 0.12%.[79] As the century ended, before the housing bubble, the increase in foreclosures was attributed to higher household risk, e.g., higher debt and lower savings, conditions that made lenders less inclined to forbear from asserting foreclosure rights.[80] In the new century, households continued to increase their leveraged condition,[81] and foreclosure rates continued to climb.[82]

Securitization helped to fuel the growth in household debt,[83] and mortgage-backed securities resulted in expansion of third-party mortgage servicing to collect and distribute payments.[84] As a result, securitization of mortgages had the unintended consequence of creating a robust new version of the old problem of agency costs due to the separation of ownership and control.[85] Trusts holding securitized mortgages had to be passively managed to get preferential tax treatment.[86] Home mortgage finance became fraught with potential for conflict among the various interests involved. Not only were servicers' interests not necessarily aligned with those of investors, but there were many potential conflicts among investors because of their different interests in securitized mortgage pools,

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79. Elmer & Seelig, *supra* note 77, at 1, 4.

80. *Id.* at 7–11.

81. *See U.S. Household Deleveraging and Future Consumption Growth*, FRBSF ECON. LETTER (Fed. Res. Bd. S.F., San Francisco, Cal.), May 15, 2009, at 1 & fig.1, *available at* http://www.frbsf.org/publications/economics/letter/2009/el2009-16.pdf (reporting that the ratio of debt to personal disposable income increased from 55% in 1960 to 133% in 2007); *see also* Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 THEORETICAL INQUIRIES L. 323, 336–41 (2006) (discussing American cultural change associated with the unleashing of consumer demand for credit).

82. MBA, Delinquencies, Foreclosure Starts Increase, *supra* note 8.

83. *See* Patricia A. McCoy et al., *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 1327, 1329–33, 1336–38, 1343, 1369–72 (2009) (describing the growth of asset-backed securitization and how it expanded consumer credit in a deregulated environment); *see also* Peterson, *supra* note 28, at 2213–21 (discussing the growth of subprime lending fueled by securitization and how this structured finance enabled predatory lending).

84. *See* Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075, 1080–1112 (2009) (examining the rigidity of pooling and servicing agreements under which servicers operate); *see also* Porter, *supra* note 30, at 127 (discussing how servicers make money—by charging a percentage of the principal in the securitized pool, by the float on collections between the time of collection and distribution, and by charging default fees).

85. *See* Porter, *supra* note 30, at 127 (discussing that rights to default fees put servicers' interests in conflict with those of investors); *see also* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983) (discussing the problem that passive shareholders are not perfectly represented by officers and directors of a corporation). In the case of securitization, passive investors in debt pools are not perfectly represented by servicers.

86. NCLC REPORT, *supra* note 19, at 5 (concerning tax requirement of passive management of a trust holding securitized mortgages).

a problem popularly referred to as the "slicing and dicing" of home mortgages and potentially involving "tranche warfare."[87]

In the boom years of the twenty-first century's first decade, roughly 2003–2006, when a housing market fall was barely contemplated, servicers were successful in getting contract rights that insulated them from investor control, thus leaving them largely free to pursue their own interests.[88] Prior to the foreclosure crisis, so-called servicers did very little servicing in the sense of dealing directly with borrowers; rather, they ran automated processing systems with as few personnel as possible and did very little loss mitigation work.

To participate in HAMP, servicers essentially had to go into a new business.[89] One disincentive to modification, under HAMP or outside it, was the servicer's administrative expense, a cost undertaken under a risk of lack of success and one not typically covered by pooling and servicing agreements (and even after HAMP added servicer incentives, nothing was paid until a trial plan was not only entered into but also kept current for three months).[90] In addition to the

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87. *Id.* at 3–4, 40 n.12 (concerning the inability of investors to even get information about the status of a loan pool and discussing the end of unity of ownership—with different bonds issued to investors for different pieces of the income stream—and the strong contractual position of servicers, making it extremely difficult for investors to replace them); *see also* Kurt Eggert, *What Prevents Loan Modifications?* 18 HOUSING POL'Y DEBATE 279, 284–87, 290–92 (2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1081479 (discussing servicer self-interest and conflicts among the tranches of investors in a securitization, i.e., "tranche warfare," tranche being the French word for slice and used by investment bankers to refer to sections, or slices, of a securitized pool with the same risk); Shahien Nasiripour & Ryan Grim, *Who Owns Your Mortgage? "Produce the Note" Movement Helps Stall Foreclosures*, HUFFINGTON POST, June 17, 2010, *available at* http://www.huffingtonpost.com/2009/09/22/whos-got-the-mortgage-pro_n_294169.html ("Modern-day home mortgages have been so sliced and diced by rapacious financiers that some homeowners are successfully delaying—or even blocking—foreclosures through the simple tactic of demanding that banks produce the original mortgage note, which amazingly enough is often not so easy for them to do.").

88. Gelpern & Levitin, *supra* note 84, at 1149–52 (arguing that pooling and servicing agreements should therefore be overridden as against public policy).

89. COP OCTOBER 2009 REPORT, *supra* note 3, at 66–67 (concerning lack of servicer capacity for loss mitigation at the start of the foreclosure crisis); *see also* Allison, March 2010 Testimony, *supra* note 54 ("HAMP is the largest mortgage modification program our nation has seen . . . [I]t has impacted the broader industry by forcing mortgage servicers to build up systems to meet unprecedented demand and streamlining and standardizing modification processes across the industry.").

90. COP OCTOBER 2009 REPORT, *supra* note 3, at 68–70 (discussing administrative cost and doubts about the sufficiency of HAMP's incentive payments); *see also* Joseph R. Mason, Mortgage Loan Modification: Promises and Pitfalls 6–7 (Oct. 3, 2007) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1027470 (discussing expense of modification and labor-intensive nature of the work as well as the fact that servicers had not done much of it through 2007 and that the work involved risk of lack of success); *infra* notes 116, 118 and accompanying text (concerning HAMP's $1000 incentive payment to servicers, due upon completion of a trial plan, and another $500 if the loan was current under the original loan, with potential for another $1000 per year for three years if the borrower remained current on the modified

administrative cost disincentive, servicers often made more money by keeping delinquent loans in the pool on which they collected a percentage fee and also by charging delinquency fees and "junk fees" for inspections, appraisals, and the like. Only when cure looked impossible, servicers pursued foreclosure as quickly as possible to avoid carrying costs. Under servicing contracts, when borrowers did not pay, servicers had to cover the payments and make advances to investors anyway, without earning interest; then servicers were reimbursed from foreclosure proceeds for their advances and the costs of foreclosure.[91] To minimize the cost of carrying advances, then, it was in servicers' interest, after a default without prospect of a quick cure, to rush to foreclosure rather than taking extra time and expense trying to arrange a modification.[92]

Because of concern about redefault, investors also were not particularly keen for modifications and did not appear to be pressuring servicers.[93] Ironically, as will be discussed below, the underwater loans produced by HAMP, which also left debtors with high overall debt-to-income ratios, made redefault a high risk, particularly in the context of high unemployment and slow recovery of home values.[94] Furthermore, avoiding or delaying loss recognition appeared to be investor goals in resisting modifications; indeed, prior to HAMP, most modifications increased principal by rolling in arrearages and also increased monthly payments, with predictably high redefault rates.[95]

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loan, but with the servicer having to forego late fees and penalties it might otherwise be able to charge).

91. *See* NCLC REPORT, *supra* note 19, at vi–vii (summarizing findings on servicer incentives); Cordell et al., *supra* note 34, at 24–27 (noting that loss mitigation including modification is more costly than foreclosure for the servicer).

92. *See* COP APRIL 2010 REPORT, *supra* note 11, at 25–27 (discussing disincentives to servicers to enter into modifications); *id.* at 73 (discussing credit rating agencies' encouragement to servicers to move loans quickly through the foreclosure process). COP also noted that servicers had a disincentive to engage in mortgage write-down because they charged their fees on the outstanding principal balance, and principal reduction decreased that balance, while interest rate reductions did not. *Id.* at 23.

93. *See id.* at 26–27 & n.82 (discussing high redefault rate in late 2009). It was possible that foreclosure losses might eventually prompt more pressure by investors on servicers to modify rather than foreclose.

94. *Id.* at. 28–30; *see supra* note 11; *infra* notes 172–85 and accompanying text (concerning lack of loan forgiveness requirement in HAMP and resulting negative equity positions of borrowers under most HAMP modifications).

95. *See infra* notes 168–69 and accompanying text (describing reductions in payments under HAMP); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 22 (noting possibility that servicers were delaying loss recognition for accounting purposes); *id.* at 120 (concerning capitalization of past-due interest in voluntary modifications done in 2007–2008 and redefault rates "as high as 50% or more"); COP APRIL 2010 REPORT, *supra* note 11, at 74–75 (discussing investors' desires to avoid loss recognition required by accounting rules where cash flows under a modified loan were less than under the original loan); Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Contract Modifications*, 41 CONN. L. REV. 1107, 1116–18 (2009) (concerning increased payments under these modifications).

B. HAMP's Features and Results in the First Year

1. Eligibility

To deal with investor and servicer disincentives to modify home mortgages, the Obama Administration announced details of the Making Home Affordable Program (MHA) on March 4, 2009, including the Home Affordable Modification Program (HAMP) with a goal "to [r]each [u]p to 3 to 4 [m]illion [a]t-[r]isk [h]omeowners."[96] HAMP, which turned out to be the largest MHA program,[97] was complex and subject to refinement over time. Its specifics became the subject of a dense website for servicers, which included "directives," "updates," and "frequently asked questions" and did not entail the process or substantive specificity typical of federal regulations, resulting in U.S. Department of the Treasury guidance that lacked the feel of law and operated more as bureaucratic procedures.[98] To summarize the key elements of this guidance (with some details omitted in the interest of making the description penetrable), HAMP provided for modification of first-lien mortgage loans originated on or before January 1, 2009, where the loan was secured by a one- to four-unit property, one unit of which was the borrower's principal residence, and with the unpaid current

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96. MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 2.

97. *See id.* at 2 (stating that the Home Affordable Refinance Program (HARP) had an initial goal of four to five million refinancings of mortgages guaranteed by government-sponsored entities despite lack of equity, making it potentially the bigger program within MHA); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 40–42 (discussing the program and its low usage, mostly by those without negative equity and therefore probably primarily because of reduced income); Allison, March 2010 Testimony, *supra* note 54 ("HAMP is the largest mortgage modification program our nation has seen, in size, scope, and impact on affordability.").

98. *See Home Affordable Modification Program: Overview*, HOME AFFORDABLE MODIFICATION PROGRAM: ADMINISTRATIVE WEBSITE FOR SERVICERS, https://www.hmpadmin.com/portal/programs/hamp.html (last visited July 11, 2010). The U.S. Department of the Treasury established the Making Home Affordable Program under the Emergency Economic Stabilization Act of 2008. Emergency Economic Stabilization Act of 2008 Pub. L. No. 110-343, §§ 101, 109 (2008) (setting up the Troubled Asset Relief Program under a new Office of Financial Stability within Treasury in section 101 and providing that "the Secretary [of the Treasury] shall implement a plan that seeks to maximize assistance for homeowners and use the authority of the Secretary to encourage the servicers of the underlying mortgages, considering net present value to the taxpayer, to take advantage of the HOPE for Homeowners Program . . . or other available programs to minimize foreclosures" in section 109), as amended by the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7002 (2009). A good contrast, for comparison purposes, to the loose statutory authorization for HAMP and to its administration under guidance is the elaborate structure and articulation of federal truth-in-lending law, which includes a detailed statute, agency regulations, and agency official staff commentary. Truth in Lending Act, 15 U.S.C. §§ 1601–1667e; *see also* Regulation Z, 12 C.F.R. § 226; Supplement I to 12 C.F.R. § 226 (providing the official staff interpretations of Regulation Z).

principal balance not more than $729,750 for a one-unit property (and up to $1,403,400 for a property with four units).[99]

As the Congressional Oversight Panel explained in its first report on HAMP, "[t]he goal of HAMP is to create a partnership between the government and private institutions in order to reduce borrowers' gross monthly payments to an affordable level. The level has been set at 31 percent of the borrower's gross monthly income."[100] HAMP also standardized modifications to create an industry paradigm, making it possible that the program would become better understood over time and also reducing servicers' risk of legal liability to investors, because they were arranging modifications made according to an industry standard.[101] Unfortunately, a perverse consequence of initially failing to include any mortgage principal write-down in the program was that this choice arguably made it more risky for servicers to do so voluntarily.[102]

To be eligible for a HAMP modification, Treasury's initial guidance set these requirements:

- The borrower had to document a financial hardship and be delinquent on the loan (or imminent default had to be "reasonably foreseeable");
- The debtor's gross monthly mortgage payment had to exceed 31% of gross income;

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99. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 2–3. A second-lien program was mentioned in the HAMP Program Description of March 4, 2009, MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 5–6, but incentive payments were not announced until later. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2 (issued Apr. 6, 2009); *see also infra* notes 119–22 and accompanying text (concerning the second-lien program and the Congressional Oversight Panel's conclusion that it had not gotten off the ground by February 2010). In late March 2010, the Administration announced plans for Federal Housing Administration refinancings with HAMP incentive payments to encourage extinguishing of second-lien loans, with the program to be effective by fall 2010, but available only to underwater borrowers current on their loans. COP APRIL 2010 REPORT, *supra* note 11, at 20–22 (expressing doubts that the new program would reach many borrowers, particularly with a requirement that they be current on their loans to be eligible, and with lenders and servicers able to decide case by case whether to participate).

100. COP OCTOBER 2009 REPORT, *supra* note 3, at 43.

101. *Id.* at 44 (concerning creation of an industry paradigm); *see also* NCLC REPORT, *supra* note 19, at 7 (concerning pooling and servicing agreement terms that permit modifications in accordance with "usual and customary industry practice"); *id.* at 8 (arguing that fears of servicer legal liability for making modifications were overblown in light of lack of lawsuits on this theory); Richard H. Neiman, Letter to the Editor, *The Mortgage Crisis: Suggestions for Some Relief*, N.Y. TIMES, Feb. 11, 2010, at A32, *available at* http://www.nytimes.com/2010/02/11/opinion/l11mortgages.html (noting that the federal mortgage modification program created an industry standard that did not include write-down of principal).

102. *See* Neiman, *supra* note 101 (noting fear of liability to investors as reason for servicers not to write down principal, given the industry standard created by the federal program, and also noting that doing so required loss recognition on investors' books).

- The debtor could not have had a prior HAMP modification of the same loan (a serious limitation on program scope given high expected redefault rates);
- The debtor had to execute a trial plan and deliver it to the servicer by December 31, 2012; and
- The debtor had to keep current on the plan and submit required paperwork.[103]

Debtors in foreclosure or bankruptcy were also eligible, the latter at the servicer's discretion through the first year of HAMP.[104]

Loans sixty or more days delinquent or deemed in "imminent default," a fuzzy concept left largely to the servicers' discretion,[105] had to be evaluated for modification using a Net Present Value (NPV) test comparing estimated NPV of modification (including risk of redefault) to NPV of no modification (including possible cure or risk of foreclosure). An offer of a modification was required if this comparison was positive, meaning the estimated value of a modified loan exceeded the value of an unmodified loan based on a risk assessment model.[106] The HAMP NPV formula was not made public, in part out of concern that doing so would have allowed borrowers to game the calculation but also in deference to servicers' preferences; as a result, it was difficult for borrowers and their mortgage counselors to know whether to apply for a modification or to assess denial of an

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103. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 2; *see infra* notes 162–63 (discussing expectations of a high rate of redefault). In October 2009, the requirement of executing a trial plan document was dropped and the borrower was deemed to have accepted by making the first trial plan payment. *See* HOME AFFORDABLE MODIFICATION PROGRAM, SUPPLEMENTAL DIRECTIVE 09-07 (Oct 8, 2009) [hereinafter HAMP, SUPPLEMENTAL DIRECTIVE 09-07], *available at* https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0907.pdf.

104. In March 2010, there was a clarification that if requested, a modification for a debtor in bankruptcy "must be considered," but even if NPV analysis was positive, there was no explicit requirement stated in the directive that a plan must be offered. *See* HOME AFFORDABLE MORTGAGE PROGRAM, SUPPLEMENTAL DIRECTIVE 10-02, at 1, 7–9 (March 24, 2010) [hereinafter HAMP, SUPPLEMENTAL DIRECTIVE 10-02], *available at* https://www.hmpadmin.com/portal/docs/hamp_servicer/sd1002.pdf. However, consumer advocates believed that it was implicit that if review showed a positive NPV from a modification for a debtor in bankruptcy, one must be offered. They also believed the Administration would issue "frequently asked questions" so stating if necessary, because that had been the intent of the change, i.e., that review for HAMP was required on request of a debtor in bankruptcy and a plan must be offered if NPV analysis was positive, just as for other borrowers.

105. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 3–4 (providing that "Reasonably Foreseeable (Imminent) Default," was to be determined "based on the servicer's standards for imminent default," using an evaluation of the circumstances of the debtor's financial condition and hardship).

106. *Id.* at 4–5 (discussing NPV analysis). Prior to September 1, 2009, servicers could create their own NPV calculator based in part on their own experience with such phenomena as redefault and cure rates, but after that date they were required to use a standard NPV model set by the Treasury. COP OCTOBER 2009 REPORT, *supra* note 3, at 47 and annex C, 130–31; *see also* HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 5.

offer.[107] When the announcement of principal write-down as a feature of the program was made at the end of the first year, an exception was made to the mandatory offer paradigm, so that even if NPV analysis made the loan more valuable with principal forgiveness, the servicer did not have to offer it.[108]

2. *Standard "Waterfall"*

For loans where modification was required after the NPV analysis,[109] HAMP then used a "Standard Modification Waterfall," with enumerated modification steps taken in a specified order to reduce the borrower's gross monthly first-lien mortgage payment to 31% of gross monthly income.[110] First, reasonable delinquency fees due to third parties during the trial period were capitalized (added to the loan) and then the interest rate was taken down to as low as 2%. This was followed by a loan term extension up to forty years, and, finally, the servicer had to provide principal forbearance (not forgiveness, which was

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107. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 111 (calling for release of the NPV model to increase transparency concerning eligibility and denials); *id.* at 47 (noting Treasury concern with gaming of the calculation and suggesting use of a web application as a solution); *id.* at 132–33 (referring to "HAMP Base NPV working paper" and analyzing sensitivity of the Treasury NPV model based on risk premiums, LTV ratio, FICO credit score, and borrower's income); *see also* COP APRIL 2010 REPORT, *supra* note 11, at 82 & n.270 (concerning continuing lack of transparency of NPV analysis); Cordell et al., *supra* note 34, at 23 (discussing "key parameters" in the NPV calculation as "the discount rate, the expected default rate for the unmodified loan and the expected default rate for the modified loan, and the expected value of the property collateral at the time of foreclosure"). On December 8, 2009, Treasury announced that it was increasing public access to a white paper concerning its NPV model, but not to the NPV model itself. *See The Private Sector and Government Response to the Mortgage Foreclosure Crisis: Hearing Before the H. Fin. Servs. Comm.*, 111th Cong. 7 (2009) (written statement of Herbert M. Allison, Assistant Secretary for Financial Stability, U.S. Department of the Treasury) [hereinafter Allison, December 2009 Testimony], *available at* http://www.ustreas.gov/press/releases/tg430.htm; Home Affordable Modification Program, Base Net Present Value (NPV) Model v3.0, Model Documentation (2009), *available at* https://www.hmpadmin.com/portal/docs/hamp_servicer/npvmodeldocumentationv3.pdf.

108. *See supra* note 11 and accompanying text (discussing optional nature of principal write-down even if NPV analysis was positive under enhancement announced at the end of the first year of HAMP).

109. *But see infra* notes 216–17, 258 and accompanying text (discussing indications that servicers frequently evaded making offers, perhaps even when NPV analysis was positive, by losing paperwork and generally giving many borrowers the runaround, including inappropriate denials).

110. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 8–9; *see also* John Eggum, Katherine Porter & Tara Twomey, *Saving Homes in Bankruptcy: Housing Affordability and Loan Modification*, 2008 UTAH L. REV. 1123, 1136 & n.52, 1137 (2008) (discussing the debate over what is housing affordability that began in the 1920s, when one week's wages was considered the appropriate amount to spend on housing (25%), whether to own or to rent, and use of a 30 or 31% figure in federal housing policy since the 1970s; also noting that in 2006, just under 30% of households exceeded the 30% standard). It is notable that the standard developed at a time when other household debt burdens were typically lower than they are today. *See supra* note 81 and accompanying text (concerning increases in the leveraged condition of American households).

optional), resulting in a balloon obligation due on transfer of the property or payoff of the loan.[111] Interest rate reductions under the program were not usually permanent; they could begin to rise in five years, at the rate of 1% per year until reaching a standard prime mortgage rate at the time of modification.[112] The program appeared to envision that a combination of increases in borrower income and in home values would make these gradual resets unproblematic for most borrowers, but of course some fraction could be expected to have trouble with the resets.

3. Costs and Incentives

HAMP made investors responsible in full for the cost of bringing the debtor's gross monthly mortgage payment down to 38% of gross monthly income.[113] HAMP also provided for the government to then share equally with investors the further cost of bringing the mortgage payment down to 31% of income.[114] Investors also received a one-time incentive payment of $1500 for entering into modifications with a borrower who was current, if monthly payments were reduced by at least 6%.[115]

For servicers, there were incentives that could add up to a total of $4500. For completing a modification, the servicer received $1000, plus an additional $500 if the borrower was current under the original loan (but the borrower would have to be in "imminent default" to be eligible), with these incentives payable when a borrower successfully completed the trial period and got a permanent modification.[116] HAMP required a three-month trial plan before a modification became permanent, but because HAMP paid nothing to servicers for trials that did not convert to permanent status, the incentive payments were weaker than they sounded on first impression and, in fact, relatively little was actually spent on servicer incentives during the first year of the program.[117] A servicer also was entitled to "pay for success" fees of $1000 per year for three years if the borrower's monthly mortgage payment was reduced by at least 6% and the borrower remained current on the loan as modified; as a tradeoff, late charges and penalties had to be waived upon completion of a trial period and servicers could not charge borrowers for administrative costs or out-of-pocket expenses associated with arranging a modification.[118] In essence, the HAMP incentive payments had to

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111. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 9–10.

112. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 9 (stating that the interest rate would rise after five years if that rate was less than the Freddie Mac Weekly Primary Mortgage Market Survey Rate for thirty-year fixed-rate conforming loans, rounded to the nearest 0.125%, as of the date that the modification agreement was prepared); *see infra* note 175 and accompanying text (discussing an example of the possible impact of increasing the interest rate after five years).

113. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 24.

114. *Id.*; *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 43.

115. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 24.

116. *Id.* at 23.

117. COP APRIL 2010 REPORT, *supra* note 11, at 32–33 (noting payment of $57.75 million to servicers, out of a cap of $36.87 billion, through February 2010).

118. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 22–23 (concerning no late fees or charges for administrative costs and outlining incentive compensation).

be taken in lieu of contract charges, so how much these incentives represented, if anything, net of what servicers might otherwise have received, was unknown; it depended on varying contract rights of servicers.

The U.S. Treasury estimated in 2009 that half of at-risk mortgages had second liens,[119] so additional incentives were promised for servicers who dealt with them as part of a HAMP modification. Servicers were entitled to an extra $500 payment for making a successful modification of a second lien plus $250 per year for three years if the modified loan stayed current.[120] This second-lien program did not become operational in the first six months of HAMP,[121] and information about its success or failure was not included in the regular monthly progress reports of the program. The Congressional Oversight Panel (COP), however, reporting on data through February 2010, stated that the program in its initial form, "did not attract much participation from second-lien holders, and consequently failed to get off the ground."[122] COP also noted a new second-lien initiative announced in March 2010, to be effective by fall, but it expressed skepticism that the new program would reach many borrowers.[123]

HAMP also included incentives to homeowners to keep making their modified loan payments, although the incentives as a practical matter were to go more immediately to investors. Like servicers, borrowers were entitled to "pay for performance" incentives of up to $1000 a year for modified loans on which they continued to make timely payments; the incentives to borrowers were for five years, applied to the principal of their loans, thus benefiting investors when paid.[124] Borrowers also benefited by having their loans amortized more quickly. If a modification included a second lien, borrowers were entitled to an additional $250 per year for five years for staying current, applied in the same way.[125]

4. Results in the First Year

a. Efforts to Overcome Servicer Reluctance to Participate in HAMP

Servicer foot-dragging became apparent by the summer of 2009. To deal with it, the Obama Administration used both jawboning and report cards on individual servicer success in getting trial modifications. On July 9, 2009, U.S. Treasury Secretary Timothy Geithner and U.S. Housing and Urban Development Secretary Shaun Donovan wrote to the CEOs of the servicers participating in HAMP and called on them to devote "substantially more resources" to the

119. Press Release, U.S. Treasury Dep't, Making Home Affordable Program Update 1–2 (Apr. 28, 2009), *available at* http://www.financialstability.gov/docs/042809SecondLienFactSheet.pdf.

120. *Id.* at 3.

121. COP OCTOBER 2009 REPORT, *supra* note 3, at 75 (stating that the program was not operational at the time of the report in October 2009).

122. COP APRIL 2010 REPORT, *supra* note 11, at 14.

123. *See supra* note 99.

124. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 24.

125. Press Release, U.S. Treasury Dep't, *supra* note 119, at 3.

program.[126] The first twenty-seven servicers to sign up for HAMP were called to Washington on July 28, 2009, and again pressed to significantly increase their staffing and performance.[127] Monthly "Servicer Performance Reports" started to come out in August, and these gave the following information: numbers of eligible borrowers sixty or more days delinquent (for those with 1000 or more borrowers in this category), numbers of trial plan offers, offers as a percentage of eligible delinquencies, numbers of trial modifications started, and trial starts as a share of eligible delinquencies; it was not until December that the report included a figure for permanent modifications.[128]

b. Initial Information on Results

In a six-month progress report on foreclosure-mitigation efforts that gave figures through September 1, 2009, the Congressional Oversight Panel reported that HAMP, with a goal of avoiding three to four million foreclosures in three

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126. Letter from Timothy Geithner, U.S. Treasury Secretary, & Shaun Donovan, U.S. Housing and Urban Development Secretary, to Servicers (July 2009), *available at* http://www.housingwire.com/wp-content/uploads/2009/07/servicer-letter.pdf; *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 64.

127. COP OCTOBER 2009 REPORT, *supra* note 3, at 64.

128. MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH OCTOBER 2009 [hereinafter MHA, OCTOBER 2009 SERVICER PERFORMANCE REPORT], *available at* http://financialstability.gov/docs/MHA%20Public%20111009%20 FINAL.PDF. This report was released on Nov. 10, 2009. Press Release, MHA, Obama Administration Releases New Data on Making Home Affordable Program, Includes State-Specific Modifications to Date (Nov. 10, 2009), *available at* http://makinghomeaffordable.gov/pr11102009.html; *see also* MHA, SEPTEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4; MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH AUGUST 2009, *available at* http://www.financialstability.gov/docs/MHA-Public_090909.pdf; MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH JULY 2009, *available at* http://www.treas.gov/press/releases/docs/MHA_public_report.pdf. The first report to add permanent-modification figures was released in December 2009, giving figures through the end of November. MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH NOVEMBER 2009 at 4 [hereinafter MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT], *available at* http://www.financialstability.gov/docs/ MHA%20Public%20121009%20Final.pdf; *see also* Press Release, Making Home Affordable Program, Obama Administration Releases New Data on Modification Program (Dec. 10, 2009), *available at* http://makinghomeaffordable.gov/pr_12102009.html; *infra* note 144 and accompanying text (concerning figure of only 31,382 permanent modifications in HAMP through the end of November 2009).

Subsequent servicer performance reports increased the numbers in various categories for past periods based on additional information received from servicers, including numbers for those eligible for the program and numbers of trial plan starts and permanent modifications. As a result, for example, the figure for permanent modifications through November increased to 31,424 by the report giving information through March 2010. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4; *see also infra* note 209 and accompanying text (noting that HAMP compliance reviews were built on self-reporting by servicers).

years,[129] had achieved only 362,348 three-month trial modifications.[130] Even more disappointing, the Congressional Oversight Panel reported that the program had achieved only 1711 permanent modifications through September 1, 2009.[131]

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129. MHA, OCTOBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 1 (stating a goal of "offering 3–4 million homeowners lower mortgage payments through a modification over three years"). The word "offering" is a bit of hedge, in that there was a significant gap between trial modifications offered and those actually entered into. *See id.* (showing 919,965 offers of trial modifications through October 2009, with 650,994 entered into). This gap continued in the November 2009 report, which showed 1,032,837 offers, 759,058 trial starts, and a total of 728,408 active trials and permanent modifications. MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 4. The figures for trial modifications started through October and November 2009 went up to 712,969 and 825,188, respectively, in information reported by servicers through March 2010. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4; *supra* note 128 (concerning increases in numbers in various categories for past periods in later servicer performance reports based on additional information received from servicers); *see also* MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 2–3 (describing the program as "A $75 Billion Home Affordable Modification Program to Prevent Foreclosures and Help Responsible Families Stay in Their Homes" and stating "Home Affordable Modification to Reach Up to 3 to 4 Million At-Risk Homeowners"); *infra* notes 135, 138–40 and accompanying text (concerning persistence of gap between trial plan offers and trial plan starts through the first year of HAMP); *infra* notes 157–60 and accompanying text (concerning criticism that the Administration was backing away from a meaningful goal as the first year of HAMP wore on).

130. COP OCTOBER 2009 REPORT, *supra* note 3, at 3. Although the program was announced in February and the program description was issued in March, Treasury has treated May as the first month with any significant activity, reporting in its monthly servicer performance reports 50,130 trial modifications for "May and Prior." *See* MHA, SEPTEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 4, at 2; MHA, OCTOBER 2009 SERVICER PERFORMANCE REPORT, supra note 128, at 1–2; *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 21 (noting that the HAMP program did not become operational until April 2009); *id.* at 94 (noting 224,262 foreclosures were started in August 2009, when only 94,312 trial modifications were begun, a shortfall of 130,000; also noting that from March through August, there were five foreclosures started and 1.5 completed for every trial modification).

131. COP OCTOBER 2009 REPORT, *supra* note 3, at 3. On October 8, 2009, Treasury Secretary Timothy F. Geithner announced that a half million homeowners had received trial modifications under the Obama MHA initiative. Peter S. Goodman, *Treasury Hails Milestone in Home Loan Modifications*, N.Y. TIMES, Oct. 9, 2009, at B1, *available at* http://www.nytimes.com/2009/10/09/business/09home.html?_r=1&scp=1&sq=Peter%20S.%20Goodman,%20Treasury%20Hails%20Milestone&st=cse; *see also* Press Release, U.S. Dep't of the Treasury, Obama Administration Releases New Data on Making Home Affordable Program, Achieves Key Milestone Weeks Ahead of Schedule (Oct. 8, 2009), *available at* http://www.treas.gov/press/releases/tg315.htm (announcing that the Making Home Affordable program had reached 500,000 trial modifications as of October 8, 2009). The next day, the COP revealed that only 1711 permanent modifications had been made under the HAMP program through September 1, 2009. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 3. The same day that Treasury announced reaching a half million trial modifications, it also issued its monthly report on servicer performance and showed a figure of 487,081 trial modifications through September. *See* MHA, SEPTEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 4, at 1. However, the half million figure through September proved justified based on servicer information received later and included in later reports. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4

Meanwhile, the private HOPE NOW program produced over a million modifications in 2009, but it declined temporarily as HAMP ramped up and at any rate its higher numbers should not necessarily be seen as greater success because the quality of HOPE NOW modifications was doubtful, given its history of lack of payment reductions and high default rates.[132] Later in the first year of HAMP, servicers started doing more HOPE NOW than HAMP modifications, but it was unclear why, whether to serve those ineligible for HAMP or to avoid HAMP requirements, and what the quality of proprietary modifications was.[133]

(reporting 554,293 trial plans through September 2009); *see also supra* notes 128–29 (concerning such upward adjustments for past periods based on later information from servicers).

In HAMP's companion Making Home Affordable program, the Home Affordable Refinance Program (HARP), only 95,729 refinancings were closed in the same period. COP OCTOBER 2009 REPORT, *supra* note 3, at 3. HARP was a program for refinancing mortgages guaranteed by government sponsored enterprises into mortgages with lower payments; it was for borrowers who are current and originally was limited to debtors with a maximum loan to value ratio of 105%, later raised to 125% to cover more of those who could not refinance because of negative equity. *Id.* at 40–41. It was originally intended to cover up to five million homeowners, before the expansion of the LTV ratios covered, but it has been used mostly by those with less than 90% LTV ratios, suggesting that curtailed income rather than negative equity has been the driver for use of HARP. *Id.* at 41–42; *see also supra* note 97 and accompanying text (noting that HAMP has turned out to be the largest MHA program).

132. *See supra* note 9 (concerning creation of HOPE NOW, a private association of mortgage market participants, in 2007 at the urging of the Bush Administration); HOPE NOW, *WORKOUT PLANS (Repayment Plans + Modifications) and FORECLOSURE SALES July 2007 – September 2009* (September 2009), https://www.hopenow.com/industry-data/HOPE%20NOW%20National%20Data%20July07%20to%20Sep09%20v2.pdf (last visited Aug. 21, 2010) (reporting 1.9 million homes had been sold at foreclosure and nearly 5.5 million had entered foreclosure in the period July 2007 to September 2009); *see also* HOPE NOW, *Workout Plans and Foreclosures, July 2007–November 2009*, at 7, http://www.hopenow.com/industry-data/HOPE%20NOW%20National%20Data%20July07%20to%20Nov09%20v2%20(2).pdf (last visited Aug. 21, 2010) (showing total of 2.1 million foreclosure sales and 5.9 million foreclosure starts from July 2007 to November 2009); *id.* (showing HOPE NOW modifications peaked in the first quarter of 2009 at 370,436, dropped to 310,556 in the second quarter, and dropped further to 236,734 in the third quarter, with the total number of modifications in the first eleven months of 2009 at 1,073,348, with the addition of 73,190 in October and 82,432 in November); *supra* note 95 and accompanying text (concerning lack of payment reductions and high default rates in private modification efforts in 2007–2008).

133. *See* HOPE NOW, Industry Extrapolations and HAMP Metrics 3–4 (April 2010), http://www.hopenow.com/industry-data/HOPE%20NOW%20Data %20Report%20(April)%2005-28-2010.pdf (showing 305,518 proprietary modifications completed in January through March, 2010, compared to 163,863 HAMP permanent modifications in the same period); White Testimony, *supra* note 8, at 2 (raising the question whether servicers were giving up government subsidies to avoid having to comply with HAMP guidelines). *But see* Press Release, HOPE NOW, HOPE NOW Reports Industry Completed Over 172,000 Loan Modifications in April (June 2, 2010), *available at* http://www.hopenow.com/press_release/files/April%20Data%20Release_06_02_10.pdf (reporting 104,265 proprietary modifications in addition to 68,291 HAMP permanent modification in April 2010 and stating, "[t]he number of HAMP modifications continues to

In September through November, HAMP did show signs of starting to take off. By the end of November 2009, seventy-eight servicers had signed servicer-participation agreements to modify loans under HAMP and about 85% of HAMP-eligible mortgage debt was covered by these servicers, who included those who serviced loans owned or guaranteed by Fannie Mae or Freddie Mac, loans held in portfolio by investors, and loans serviced for other investors.[134]

c. Results in HAMP Modifications in the First Year in Particular Categories

Number of trial offers and trial plans. HAMP reported in April 2010 that 1,436,802 trial plans were offered cumulatively through March 2010, with 1,166,925 three-month trials actually entered into by that time and 1,008,873 of them still active as trial or permanent modifications (a figure that dropped significantly early in the second year of HAMP).[135] That means trial plans were offered to 42% of the 3.4 million homeowners who were at least sixty days delinquent as of March 2010 and otherwise potentially eligible for HAMP; 19% of those offered trial plans did not enter into them, for unknown reasons.[136] The

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increase, but for homeowners who are not eligible, sustainable proprietary modifications continue to play an important role in helping homeowners in difficulty across the country"); Press Release, HOPE NOW, HOPE NOW Reports Mortgage Servicers Complete 148,000 Total Loan Modifications in February (March 31, 2010), *available at* http://www.hopeloanportal.org/press_release/files/Data%20Release_03_31_10.pdf (stating that about 78% of proprietary loan modifications completed in February 2010 "included reduction of principal and interest—a lower monthly payment for at-risk homeowners," but the use of the conjunctive raised the question whether most of those, like HAMP modifications, involved only interest reductions).

134. MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 3; *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 44 (noting that servicers of Fannie Mae or Freddie Mac mortgages were obligated to participate in HAMP for these mortgages, and otherwise the program was mostly voluntary; also that participants in Troubled Asset Relief Program initiatives begun after February 9, 2009, had to participate, but the main program for bank assistance, the Capital Purchase Program, was initiated before that and as a result most financial institutions were participating voluntarily).

135. MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (figures in HAMP data through March 2010). Through June 2010, a total of 520,814 trials were cancelled, leaving 364,077 active trials and 389,198 active permanent modifications. MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH JUNE 2010 at 2, *available at* http://www.financialstability.gov/docs/June%20 MHA%20Public%20FINAL%20072010.pdf [hereinafter MHA, JUNE 2010 SERVICER PERFORMANCE REPORT] (chart concerning "HAMP Activity: All Servicers," giving figures for cancelled trials, active trials, and active permanent modifications).

136. MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4, 7 (the 42% figure for trial offers is a computation based on HAMP data showing 3,398,612 eligible and sixty or more days delinquent through March 2010, compared to 1,436,802 trial offers; the 19% rate for nonacceptance of offers is a computation based on 1,166,925 trial starts out of the number of trial offers, meaning 81% were accepted and 19% were not, with all percentages rounded to whole numbers). A possible partial explanation of nonacceptance of offered plans was the initial requirement of execution of a trial plan, removed in October 2009 in favor of making payments as means of acceptance. *See supra* note 103 and accompanying text.

exclusion of the imminent default group from the eligible pool probably inflated the percentage of the eligible pool being served, and at any rate the group in imminent default could be minimized by servicer discretionary standards.[137]

Borrowers had thirty days to respond to offers of a trial modification.[138] Thus, falloff in distressed borrower participation occurred at two early points—not getting an offer of a modification and not accepting one that was made, problems that will be discussed further below.[139] Through the end of March 2010, those two falloff points resulted in entry into trial plans by 34% of those potentially eligible in the pools of participating servicers and at least sixty days in default (leaving out those in "imminent default" who were also eligible); on the other hand, although HAMP counted the eligible pool at 3.4 million in March 2010, at the same time it suggested that just half of those were both at least sixty days delinquent and likely to meet HAMP requirements.[140] This inconsistency was hard to understand, but the reporting of it suggested that Treasury was signaling that it had originally overstated the eligible pool, perhaps to make the trial plan results look better.

Additional falloff occurred during the conversion of trial plans to permanent status. Twenty percent of trial plans entered into cumulatively during the program had become permanent by the end of March 2010,[141] but since a three-

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137. *See supra* note 105 and accompanying text (concerning servicers' discretion to define "imminent default").

138. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 14–15. The borrower had thirty days to submit documents evidencing an intent to accept a trial plan offer, *id.*, and a servicer could consider an offer to have expired at the end of sixty days if the borrower had not submitted both an executed trial plan and complete documentation required under the plan, *id.* at 15.

139. *See infra* notes 211–45 and accompanying text (discussing compliance and enforcement efforts needed to improve participation at these stages).

140. MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4, 7 (computation of 34% participation based on eligible pool of 3,398,612 borrowers at least sixty days delinquent and 1,166,925 three-month trials started through the end of March 2010, with percentage rounded to a whole number); *id.* at 5 (indicating four ways in which borrowers were ineligible: they had jumbo loans or loans originated after January 1, 2009, a debt-to-income ratio already less than 31%, negative net present value for a modification compared to the existing loan, or property vacant or otherwise excluded; also showing net eligible at 1.7 million rather than 3.4 million and thus nearly doubling the percentage who got trial plan offers out of those eligible, to over 80%, calculating that percentage based on over 1.4 million offers of 1.7 million eligible). As of the performance report issued in May for information through April 2010, the program dropped the figure for the eligible pool of delinquent borrowers to 1.7 million. *See* MAKING HOME AFFORDABLE, APRIL 2010 SERVICER PERFORMANCE REPORT 6, *available at* http://www.financialstability.gov/docs/April%20 MHA%20Public%2005171 0%20FINAL.pdf (showing 1,702,134 as the figure for "Estimate Eligible 60+ Day Delinquent Borrowers" in a chart of HAMP Modification Activity by Servicer); *see also supra* notes 105, 137 and accompanying text (concerning eligibility of those in "imminent default" but discretion of servicers to exclude them and issue of inflation of percentage figures of modifications by excluding them).

141. MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (showing 230,801 trials converted to permanent status as of the end of March 2010, compared to 1,166,925 trials started since program inception which based on these two figures produces the 20% conversion ratio, rounded up to a whole number).

month record of making payments during a trial plan was required for conversion to permanent status, the conversion percentage was likely to rise somewhat. For example, comparing the cumulative number of trial starts in the program as of the end of December, and allowing three or more months for them to have completed a trial period by the end of March, the percentage ripe to convert to permanent status that did so as of the end of March 2010 was 25%.[142]

At the individual-servicer level, there was significant variation in performance. For example, for the three participating servicers with the largest eligible delinquent populations, the rates of active modifications (trial plus permanent) out of their pools as of the end of March 2010 were, from first to third largest, 26%, 37%, and 38%, with an overall participation rate in the program of 30%.[143]

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142. *See* MAKING HOME AFFORDABLE PROGRAM, SERVICER PERFORMANCE REPORT THROUGH DECEMBER 2009, at 3, *available at* http://www.financialstability.gov/docs/report.pdf (showing a figure of 902,620 for "All HAMP Trials Started Since Program Inception"); MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (showing a figure of 939,949 for Dec. in a graph of "HAMP Trials Started (Cumulative by Month)" and a figure of 230,801 for "Trials Converted to Permanent Modifications," which produces the 25% conversion rate from trials to permanent modification, when rounded to a whole number).

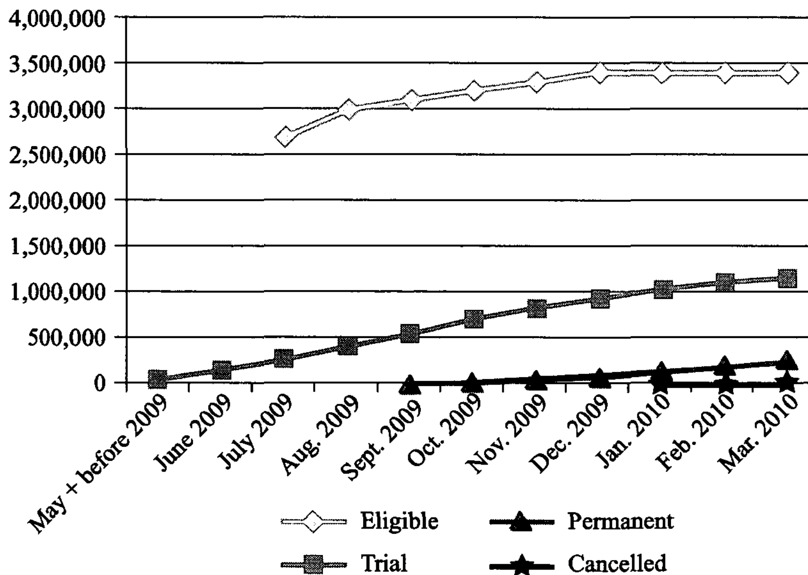
143. MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 7 (with these percentages, respectively for Bank of America, NA, J.P. Morgan Chase Bank, NA, and Wells Fargo Bank, NA; the 30% participation rate is based on 1,008,873 active modifications, 780,951 trials and 227,922 permanent modifications, out of 3,398,612 eligible and at least sixty days delinquent, with the percentage figure rounded up to a whole number).

Figure 1*

Of Eligible Borrowers 60+ Days Delinquent, Trial and Permanent Modifications and Cancellations Cumulatively Through Each Month

Month	Eligible	Trial	Permanent	Cancelled
May + Before 2009	Unreported	55,000		
June 2009	Unreported	155,000		
July 2009	2,700,000	274,000		
Aug. 2009	3,000,000	419,000	1,711**	
Sept. 2009	3,100,000	554,000	5,000	
Oct. 2009	3,200,000	713,000	16,000	
Nov. 2009	3,300,000	825,000	31,000	
Dec. 2009	3,400,000	940,000	67,000	
Jan. 2010	3,400,000	1,029,000	117,000	1,000
Feb. 2010	3,400,000	1,110,000	170,000	1,500
Mar. 2010	3,400,000	1,167,000	231,000	2,900

In the table above, figures are rounded as follows: for those eligible, to the nearest hundred-thousand; for trials and permanent modifications, to the nearest thousand; and for cancelled permanent modifications, to the nearest hundred. The graph below shows the ratios of the figures above.



* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4, 5.

** COP APRIL 2010 REPORT, *supra* note 11, at 4. Unreported by HAMP.

Slow progress initially in conversion to permanent modifications. In its first official monthly report giving the number of permanent modifications, issued on December 10, 2009, the Obama Administration announced a figure of only 31,382 permanent modifications through the end of November 2009, a figure later revised to 31,424 based on updated servicer information.[144] The only generally available figure until then had been that from the Congressional Oversight Panel, reporting that less than 2000 (actually, 1711) permanent modifications had been entered into as of September 1, 2009.[145] The Administration had signaled to the press in late November both that it was about to release permanent modification figures and that they would be disappointing,[146] as proved to be the case. Since HAMP only became operational in mid-April 2009 and trial modifications lasted three months, the first full month for permanent modifications was August, and at the end of that month, a two-month extension was granted for all pending trial plans not yet final,[147] presumably because the results would have been very low otherwise. As a result, November became the first month for a significant number of modifications to become final.[148] Even compared to the Administration's figure of 419,163 trial modifications through August,[149] with three months for them to become final by the end of November, the 31,424 figure represented a conversion ratio from trial to permanent modification of only about 7%.[150] Despite the Obama Administration's goal of acting boldly to mitigate the foreclosure crisis, in this early period HAMP did not provide permanent modifications to many struggling borrowers.

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144. MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 3 (first monthly report showing number of permanent modifications and giving the 31,382 figure); *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (with figure of 31,424 for November in graph of "Permanent Modifications Started (Cumulative, by Month)"); Press Release, Making Home Affordable Program, Obama Administration Releases New Data on Modification Program (Dec. 10, 2009), *available at* http://makinghomeaffordable.gov/pr_12102009.html.

145. *See supra* note 131 and accompanying text; *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (giving figure of 4742 for permanent modifications through September 2009, in graph of "Permanent Modifications Started (Cumulative, by Month)").

146. *See* Peter S. Goodman, *U.S. Will Push Mortgage Firms to Reduce More Loan Payments*, N.Y. TIMES, Nov. 28, 2009, at A1, *available at* http://www.nytimes.com/2009/11/29/business/economy/29modify.html?fta=y (reporting that Treasury was soon to release figures showing permanent modifications through the end of November in the tens of thousands).

147. Cordell et al., *supra* note 34, at 23–24 (concerning two-month extension granted to all those in the trial period at the end of August who had not completed their paperwork); *see also supra* note 4 (concerning HAMP becoming operational in April 2009).

148. *See supra* note 144 and accompanying text (concerning the upward revision of the number for November over time).

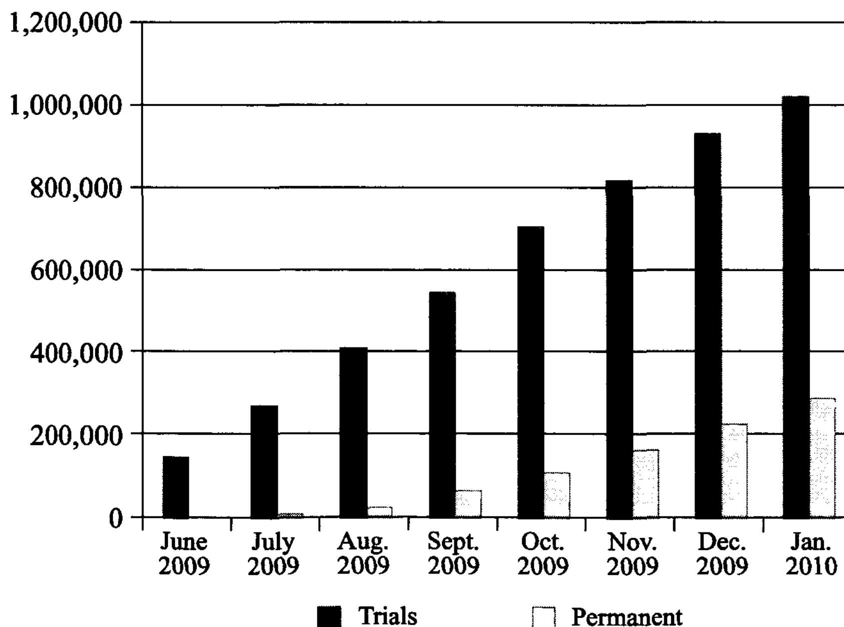
149. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (giving the 419,163 figure for trial modifications through August 2009, based on servicers reports through March 2010, in graph of "HAMP Trials Started (Cumulative, by Month)").

150. *See id.* The 7% figure is a computation, rounded to the nearest whole number, based on 419,163 trials through August 2009 and 31,434 permanent modifications through November 2009.

Figure 2*
Trial Plans Converted As of Three Months Later

Month	Trials	Permanent	Converted as of	% converted
June 2009	155,108	4,742	Sept. 2009	3%
July 2009	274,116	15,649	Oct. 2009	6%
Aug. 2009	419,163	31,424	Nov. 2009	7%
Sept. 2009	554,293	66,938	Dec. 2009	12%
Oct. 2009	712,969	117,302	Jan. 2010	16%
Nov. 2009	825,188	170,207	Feb. 2010	21%
Dec. 2009	939,949	230,801	Mar. 2010	25%
Jan. 2010	1,028,887	299,092	Apr. 2010	29%

In the table above, the months in the column on the left are for the trial plans entered into cumulatively as of that month, with the number shown in the next column, and the months in the fourth column from the left are for conversions to permanent modifications as of three months later. The bar graph below shows the ratios of trials to permanent plans three months later, with the months at the bottom for trial plans through that month, with the numbers of trials shown in the dark bars, and the lighter bars for permanent plans as of three months later.



* MHA, JUNE 2010 SERVICER PERFORMANCE REPORT, *supra* note 135, at 2.

At the end of November 2009, the Administration expressed displeasure with the HAMP permanent modification results. Michael S. Barr, Treasury's Assistant Secretary for Financial Institutions, stated to a journalist that the government would try to use shame as a corrective by publicly naming those servicers moving too slowly and, in addition, the government would not pay incentives before plans were permanent.[151] The terms of the program provided for that timing of payment at any rate, so this "threat" seemed more for media consumption. Furthermore, Herbert Allison, Treasury's Assistant Secretary for Financial Stability, announced plans to hold servicers accountable by creating "SWAT teams" of Treasury staff who would be "imbedded" at servicers as part of a "conversion drive" and also by inviting reports by borrowers and their advisers of servicer violations of program rules in an "escalation process" that could result in "additional, stricter compliance reviews and monitoring."[152] The vivid language describing a step-up in compliance review, however, was not accompanied by enforcement activity, as will be discussed in Part III. Indeed, imbedded review of compliance might even have made enforcement more difficult because servicers potentially gained the defense that the government was vetting their operations.[153]

The conversion drive significantly increased the number of permanent modifications, with 227,922 active as of the end of March 2010.[154] The total number of permanent modifications entered into was 230,801, with 2879 already cancelled as of the end of March 2010.[155] Since thirty-seven of those were cancelled because they were paid off,[156] the number of failed permanent modifications was 2842 at the end of a year of operations.

Despite progress, the total number of permanent modifications did not look good compared to the goal of reaching three to four million homeowners by the end of 2012; even using the lower goal number of three million (compared to the 230,801 permanent modifications started), less than 8% of it was reached in the first year of the program. In late March 2010, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) noted that the Administration had begun stressing the number of offers of trial plans rather than the number of permanent modifications achieved, stating, "Treasury has been less than consistent about how it has justified the program's costs or defined what success in the program would mean."[157] SIGTARP said that the number of trial offers was "not tied to how many borrowers are actually helped by entering

151. Goodman, *supra* note 146 (reporting that Mr. Barr said, "[t]hey're not getting a penny from the federal government until they move forward").

152. Allison, December 2009 Testimony, *supra* note 107, at 2–4.

153. *See* Andrew Ross Sorkin, *At Lehman, Watchdogs Saw It All*, N.Y. TIMES, March 16, 2010, at B1, *available at* http://www.nytimes.com/2010/03/16/business/16sorkin.html?scp=4&sq=lehman%20report&st=cse (concerning possible defense in civil actions for accounting irregularities at Lehman Brothers where SWAT teams of government regulators were imbedded at the company at the time, had access to everything being done, and may have vetted the accounting methods).

154. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4.

155. *Id.*

156. *Id.* at 4 n.3. Payoff could have been due to either refinancing or sale.

157. SIGTARP, March 2010 Report on HAMP, *supra* note 47, at 8–9.

permanent modifications."[158] The Congressional Oversight Panel echoed this criticism in April 2010, calling trial plan offers "a relatively meaningless measure of program effectiveness."[159] It also noted that trial starts provided only temporary cash-flow relief, and trials that failed to convert "prevent[ed] homeowners from using the time to prepare themselves legally and financially for foreclosure," and left borrowers still owing the difference between the original payment amount and the reduced trial payment amount for the time in a trial modification.[160] In other words, trial plans that did not convert left many borrowers worse off.

Even if measured by permanent modifications achieved, this was a number that overstated the long-term success of HAMP for two reasons: first, so-called permanent modifications could reset after five years, with both interest rates and payments subject to increases, potentially making payments unaffordable for some fraction of HAMP borrowers;[161] second, and more significantly, Treasury itself estimated that the redefault rate on permanent modifications would be 40% within their five-year fixed terms, with the Congressional Oversight Committee saying the redefault rate "could be significantly higher."[162] Failure of 2842 permanent modifications by the end of March 2010, when most of the permanent plans had only been achieved in the previous few months, showed that the redefault risk was already materializing in the first year of the program.[163]

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158. *Id.* at 8.

159. COP APRIL 2010 REPORT, *supra* note 11, at 63.

160. *Id.* at 64. Treasury responded with the justification that trial modifications that never became permanent could be beneficial by giving borrowers a chance to pursue a foreclosure alternative such as a short sale. *See The Recently Announced Revisions to the Home Affordable Modification Program (HAMP): Hearing Before H. Fin. Services. Subcomm. on Housing & Cmty. Opportunity*, 111th Cong. 2 (2010) (statement of Phyllis Caldwell, Chief Homeownership Preservation Officer, U.S. Dep't of the Treasury), *available at* http://makinghomeaffordable.gov/pr_04152010.html.

161. COP APRIL 2010 REPORT, *supra* note 11, at 10; *see also supra* notes 110–12; *infra* notes 173–75 and accompanying text (discussing interest rate resets after five years under HAMP).

162. COP APRIL 2010 REPORT, *supra* note 11, at 60–62 (noting Treasury estimate of the redefault rate at 40% in five years and stating that the rate could be "significantly higher" in light of market conditions, including unemployment and slow recovery or decline of real estate prices, leading to more strategic default).

163. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4 (reporting 2879 permanent modifications cancelled through the end of March 2010 and noting that only thirty-seven of those were cancelled as paid off, bringing the redefault number to 2842). Since those failures were on modifications that had only recently become permanent, they did not reflect annualized or five-year redefault rates. Using figures through March 1, 2010, and analyzing redefaults on the very small number of loans that had been permanent more than ninety days, COP found a 16.5% annualized serious delinquency rate, meaning greater than ninety days delinquent or foreclosed, noting that this rate was on loans that had recently passed a three-month test in which the borrower made all the payments and that there had been little time for anything to change, such as a job loss or further decline in home value. COP APRIL 2010 REPORT, *supra* note 11, at 61–62. On the other hand, it was also possible that most redefaults would occur early rather than late, so that the redefault percentage would not grow significantly.

Reduced income as primary hardship. To qualify for HAMP modifications, borrowers were required to document their hardships.[164] This requirement reflected the government's concern with moral hazard, that is, not encouraging overuse of the program by those who could afford their mortgage payments but who wanted breaks because they paid too much during the housing bubble. The Congressional Oversight Panel found that "curtailment of income," meaning reduced compensation short of unemployment, was the most common hardship reason given, one that was reported by 41% of borrowers in trials and 52% in permanent modifications.[165] Next, in order of magnitude, were "excessive obligations" (9% for trial, 11% for permanent); unemployment (6% for trial, 5% for permanent); and illness (2% for trial, 3% for permanent).[166] The oversight panel noted that the prevalence of curtailment of income as the basis of hardship suggested that general economic conditions rather than mortgage rate resets drove the mortgage crisis in 2009–2010,[167] meaning that those being served included many who were hit by spillover effects of the financial crisis.

Reductions in debt to income (DTI) ratio and payments. The Congressional Oversight Panel reported that HAMP permanent modifications on average brought first-lien DTI (using gross monthly mortgage payment and gross monthly income) down from 48% to 31%, with median (mean) first-lien monthly payments dropping $519 ($628) from $1431 ($1560) to $838 ($932), a 41 (40)% decline at the median (mean).[168] The panel noted that modifications "succeed[ed] at making homeownership more affordable by reducing payments" but were not necessarily sustainable for a constellation of reasons.[169] The average DTI drop, resulting from the HAMP reduction of mortgage payments to 31% of monthly income, included only first-lien mortgage payments. When all payments to creditors (including those on home equity loans, credit cards, auto loans, and student loans) were added, the average DTI reduction was from 87% to 70%, leaving HAMP permanent modification recipients with extremely high overall

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164. *See supra* note 103 and accompanying text.

165. COP APRIL 2010 REPORT, *supra* note 11, at 39.

166. *Id.* at 39–40 (all percentages in the text are rounded to the nearest whole numbers). The small percentage reporting unemployment as a hardship may have reflected the difficulty of showing income to qualify for a modification if the debtor was unemployed; such a debtor would need to be able to prove receipt of unemployment benefits. On the other hand, unemployment of one of two co-debtors could be a hardship that still left the household with income to support a modification. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 6 (reporting the following figures in a graph of "Predominant Hardship Reasons for Permanent Modifications": 59.1% for loss of income, including reduction in income as well as unemployed; 10.5% excessive obligation; and 2.8% illness of principal borrower).

167. COP APRIL 2010 REPORT, *supra* note 11, at 39–40.

168. *Id.* at 43, 48 (all figures in the text are rounded to the nearest whole number). COP based its report on active modifications as of March 8, 2010. *Id.* at 38; *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 6 (with data through the end of March 2010, reporting median savings of $512 per month, rounded to the nearest whole number, 36% of the median before-modification payment).

169. COP APRIL 2010 REPORT, *supra* note 11, at 49.

debt burdens[170] and thus with very strained budgets for regular expenses. Another challenge to sustainability, discussed below, was that most HAMP modifications left debtors in a negative equity position, owing more than the value of their homes.[171]

Interest rate reductions as the primary means to reduce payments. The Congressional Oversight Panel reported that reductions in monthly mortgage payments under HAMP were "almost exclusively" achieved by reducing interest rates, on average from 6.52% to 2.98%.[172] Interest rate reductions under the program were not permanent; they could begin to rise in five years, at the rate of 1% a year, to a market rate,[173] thus "calling into question the long-term sustainability of HAMP permanent modifications," according to the oversight panel, quite apart from concerns about loan-to-value ratio discussed below.[174] Based on the average HAMP monthly payment of $932 and average HAMP interest rate of 2.98%, and assuming a thirty-year amortization of the loan and 5.5% prime mortgage rate at modification, payments would rise in the eighth year to $1202; furthermore, those with higher payments and lower interest rates under HAMP would see larger increases in monthly payments, with some predictable impact on increasing redefault.[175] Most HAMP debtors, however, probably had a reasonable prospect of being able to handle increased payments after five years with increasing income.

The other parts of the waterfall were much less important in practice than the interest rate reductions. Extension of the loan term was "de minimis,"

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170. *Id.* at 43 (giving these percentages and noting "extremely high" debt burdens when other debts are added into the DTI ratio); *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 6 (giving slightly different figures for ratio of total debt to monthly gross income for permanent modifications through the end of March 2010, of median DTI reduction from 78% to 61%, but also stressing high debt burden, n.2, by noting, "[b]orrowers who have a back-end debt-to-income ratio of greater than 55% are required to seek housing counseling under program guidelines"); *supra* note 110 (concerning origins of 31% of gross income as a standard for housing affordability, before individuals typically had high other debts).

171. *See* COP APRIL 2010 REPORT, *supra* note 11, at 49 (noting lack of principal forgiveness through March 2010 in HAMP); *infra* notes 180–85 and accompanying text (concerning negative equity problem with HAMP modifications).

172. *See* COP APRIL 2010 REPORT, *supra* note 11, at 45; *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 6 (reporting in chart of "Permanent Modifications by Modification Steps" that 100% involved interest rate reduction, 38.9% involved term extension, and 27.6% involved principal forbearance).

173. *See supra* note 112 and accompanying text.

174. COP APRIL 2010 REPORT, *supra* note 11, at 45.

175. *See supra* notes 168, 172 and accompanying text (referring to the average HAMP monthly payment and interest rate, which were used to compute the example and which is based on the assumptions stated in the text). The monthly payment would rise from $932 during the first five years to $1037 in the sixth year, $1145 in the seventh year, and $1202 in the eighth year. Since the example is based on average monthly payment and interest rate, larger and smaller increases than this would be seen by some HAMP borrowers. The example is crude (for example, it uses the average gross monthly mortgage payment figure rather than the unavailable average loan payment only and does not include loan amortization due to incentive payments to borrowers) but is meant to be suggestive.

according to the COP.[176] Principal forbearance, the last step in the standard waterfall,[177] was unusual, occurring in only 28% of permanent modifications.[178] Principal forgiveness, not required under HAMP but permitted at the servicer's option, was rare, occurring in only 6.2% of permanent modifications.[179]

Loan to value (LTV) ratios: negative equity as the norm. A striking finding of the Congressional Oversight Panel was that more than three-quarters of permanent modifications (76%) under HAMP left the borrower under water, with a median (mean) LTV ratio of 126 (143)%.[180] Because of capitalization of certain arrearages and escrow requirements, HAMP modifications modestly increased the LTV ratio, which before modification was at the median (mean) 119 (135)%; after modification, 51% had a first-lien LTV ratio of greater than 125%, and inclusion of junior liens would increase the percentage under water and their LTV ratios.[181] In sum, most debtors started under water and received no principal forgiveness, raising a serious question about the sustainability of HAMP modifications.[182]

Home values, of course, are not fixed, and home value shifts can quickly change how many homeowners are under water on their loans. About one-third of

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176. COP APRIL 2010 REPORT, *supra* note 11, at 45–46 (noting median extension of two months but also that 47% of permanent modifications involved term extensions and for that group, the median extension was ninety-two months); *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 6 (based on data through the end of March 2010, reporting that 39%, rounded to nearest whole number, of permanent modifications involved term extensions); COP OCTOBER 2009 REPORT, *supra* note 3, at 29 (discussing that pooling and servicing agreements usually did not allow extension beyond the final maturity date of other loans in the pool and that pools were usually of loans made within one year, meaning an extension of one year at most was possible under such agreements).

177. *See supra* note 111 and accompanying text.

178. COP APRIL 2010 REPORT, *supra* note 11, at 46 (figure rounded to the nearest whole number); *see also* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 6 (also reporting 28%, rounded to nearest whole number, of permanent modifications involved principal forbearance).

179. COP APRIL 2010 REPORT, *supra* note 11, at 46–47 (also noting a sizeable balloon payment at the maturity of the mortgage, on average $67,673.19, for those modifications involving principal forbearance); *see also supra* notes 11, 111 and accompanying text (concerning optional nature of principal forgiveness under HAMP, before and after program enhancements announced in March 2010).

180. COP APRIL 2010 REPORT, *supra* note 11, at 47 (figures in the text are rounded to the nearest whole numbers); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 53 (before modification, LTV ratio was at the mean (median) 121 (134)%).

181. COP APRIL 2010 REPORT, *supra* note 11, at 47–48 (discussing impact of junior liens on sustainability); *id.* at 118 (noting 43% of borrowers generally had second liens on their homes as of the time of the report); *see also supra* note 119 and accompanying text (concerning Treasury estimate that half of at-risk mortgages in 2009 had second liens).

182. COP APRIL 2010 REPORT, *supra* note 11, at 48–50 (noting that because most HAMP modifications were underwater, they had a high redefault risk, and "to the extent that a permanent modification is not sustainable, it merely delays a foreclosure and the stabilization of the housing market"); *see also* NCLC REPORT, *supra* note 19, at 33 (discussing risk of default without principal reduction); Cordell et al., *supra* note 34, at 10–11 (concerning association of default with negative equity).

residential mortgage borrowers had negative equity in mid-2009.[183] While that figure declined nationally to about a quarter at the end of the year, some areas remained very hard hit in early 2010, with over half of homeowners under water in the two states hit hardest by the mortgage crisis—51% in Arizona and 70% in Nevada.[184] Unemployment or life events that can prompt a desire to move typically combine with negative equity to trigger redefault, a looming problem with HAMP as of the end of its first year.[185]

III. THE DIFFICULTY OF PUTTING THE HOUSING MARKET BACK TOGETHER AGAIN: WHY FIXING HAMP WAS SO HARD

A. Overview

The situation of HAMP at the end of its first year was reminiscent of an old joke with which Woody Allen opened his film *Annie Hall:* "[T]wo elderly women are at a Catskill mountain resort, and one of [th]em says, 'Boy, the food at this place is really terrible.' The other one says, 'Yeah, I know; and such small portions.'"[186]

The Obama Administration was primarily focused in the first year on the small portions. It was very concerned about the low quantity of modifications, particularly permanent ones, with poor quality hardly discussed until the very end of the first year of HAMP.[187] Servicer and investor incentives cut against producing more modifications, so the Administration stepped up compliance review to try to boost numbers.[188] It did not turn to enforcement actions, discussed below, or to required improvement of loan quality through principal reduction. The quantity and quality problems are related, however: servicers and investors avoid entering into modifications that are not sustainable because they end up with two layers of transaction costs—modification and then foreclosure or short sale[189]—and possible loss of collateral value in the meantime.

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183. COP OCTOBER 2009 REPORT, *supra* note 3, at 13–14.

184. COP APRIL 2010 REPORT, *supra* note 11, at 115 (noting that 24% of homeowners were likely under water at the end of fourth quarter 2009); *id.* at 144 (showing negative equity percentages for worst-hit states, including Arizona, California, Florida, Nevada, and Michigan) (figures in the text are rounded to the nearest whole number).

185. *Id.* at 22–23 (discussing negative equity, combined with life events, as driver of foreclosure and lack of initial efforts in HAMP to reduce negative equity through principal forgiveness); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 98 (referring to "Four Ds"—Death, Disability, Divorce, and Dismissal, as well as childbirth and employment opportunities elsewhere); *id.* at 103–05 (concerning high unemployment as increasing default risk).

186. ANNIE HALL (Rollins-Joffe Productions 1977).

187. *See supra* notes 144–60 and accompanying text (describing efforts to ramp up quantity of modifications).

188. *See supra* notes 35–37, 84–95, 146–53 and accompanying text.

189. *See supra* notes 54–74 (discussing redefault risk as reason not to want to do modifications and short sales and deed-in-lieu-of-foreclosure transfers as sometimes more realistic).

Low quality of modifications was built into HAMP because most borrowers who sought its aid were under water[190] and affordable gross monthly mortgage payments, at 31% of gross monthly income, were primarily achieved using interest rate reductions[191] rather than loan forgiveness, which was not a required feature of the program during the first year or even thereafter.[192] Principal forgiveness was used only rarely on a voluntary basis in the first year.[193] Debtors who are under water are at greater risk of redefaulting, a factor that HAMP acknowledged by including that risk in its net present value (NPV) analysis.[194] If the NPV analysis is done right, investors are better off even with the predicted level of redefaults, but the redefaulting borrowers do not experience success.

While the quality of many HAMP modifications in the first year could have been better, they represented an improvement upon the private voluntary modifications done in 2007–2008, which typically did not even reduce payments.[195] Monthly mortgage payments under HAMP were reduced to 31% of gross monthly income,[196] at least when HAMP was complied with, which was not always the case, as will be discussed below.[197] This reduction in mortgage payments made them more affordable, absent further income or expense shocks. About a quarter of HAMP modifications did not involve negative equity and thus were more likely to provide sustainable relief.[198] Even for borrowers with negative equity (over three-quarters), if they did not lose income and were able to stay put in their homes for at least five to eight years, they could take advantage of the reduced payments, typically lasting that length of time.[199] HAMP brought payments down and avoided foreclosure, at least in the short term, for most of those lucky enough to get permanent modifications.

While some foreclosure mitigation was achieved, HAMP could have done more with requirements to bring down principal and to take into account overall debt burden. Redefault risk in the HAMP modification pool as a whole remained high. Stretched budgets and negative equity at the outset could combine with loss of income, increased expenses, or need or desire to move, prompting redefault.[200]

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190. *See supra* notes 180–81 and accompanying text.

191. *See supra* notes 172–79 and accompanying text.

192. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 10 ("There is no requirement to forgive principal under the HAMP."); *see also supra* notes 10–15 and accompanying text (concerning incentives for voluntary principal forgiveness announced at the end of the first year of HAMP, but without requirement of this element even if NPV analysis favored it).

193. COP OCTOBER 2009 REPORT, *supra* note 3, at 53; *see also supra* note 179 and accompanying text.

194. *See supra* note 107 and accompanying text; *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at Annex C, 130 (discussing decline of NPV of a mortgage as LTV ratio increases above 125%).

195. *See* White, *supra* note 95, at 1116–18.

196. *See supra* notes 100, 110 and accompanying text.

197. *See infra* notes 239–41 and accompanying text (concerning reports of noncompliance with HAMP guidelines).

198. *See supra* notes 180–85 and accompanying text.

199 . *See supra* notes 172–75 and accompanying text.

200. *See supra* notes 24–26, 59–64, 180–85 and accompanying text.

The Congressional Oversight Panel speculated that the redefault rate might be significantly higher than 40% for permanent modifications.[201] As will be discussed below, HAMP did not adopt steps to make its modifications more sustainable, apparently because the Administration was concerned about negative effects on the economy of more generous relief and dared not risk being more aggressive in foreclosure mitigation.[202]

As an emergency program, HAMP's administration was worked out over time, during implementation, rather than planned fully in advance. The U.S. Treasury Department designated the Federal National Mortgage Association, known as Fannie Mae, as the administrator and record-keeper for the program and the Federal Home Loan Mortgage Corporation, known as Freddie Mac, as the compliance agency.[203] Fannie Mae was charged with collecting elaborate data and Freddie Mac with conducting compliance assessments.[204] HAMP was based on contractual relationships between the government and servicers. The standard contract gave the government certain enforcement rights upon contract default, including withholding payments under the program and requiring the participating servicer to "submit to additional Program administrator oversight"[205]—not very strong remedies. The contract also noted that its remedies did not displace those provided "at law or in equity."[206] Its Exhibit B listed applicable laws, including the

201. COP APRIL 2010 REPORT, *supra* note 11, at 60–62 (discussing reasons Treasury estimate of 40% redefault on permanent modifications within five years might be too low).

202. *See infra* notes 286–96.

203. *See* HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 19, 25 (concerning the roles of Fannie Mae and Freddie Mac).

204. *Id.* at 19–21, 25–26.

205. HAMP, Commitment to Purchase Financial Instrument and Servicer Participation Agreement, at 6 [hereinafter HAMP, Servicer Participation Agreement], *available at* https://www.hmpadmin.com/portal/docs/hamp_servicer/servicerparticipation agreement.pdf.

206. *Id.* at 8. The possibility of third-party beneficiary rights was litigated with mixed results in one federal district. *Compare* Reyes v. Saxon Mortg. Servs., Inc., No. 09-cv-1366, 2009 WL 3738177 (S.D. Cal. Nov. 5, 2009) (order granting in part and denying in part defendant's motion to dismiss) (finding a plausible claim based on third party beneficiary theory), *with* Escobedo v. Countrywide Home Loans Inc., No. 09-cv-1557, 2009 WL 4981618 (S.D. Cal. Dec. 15, 2009) (order granting in part and denying in part defendant's motion to dismiss) (finding HAMP created incidental rather than intended beneficiaries among homeowners) *and* Villa v. Wells Fargo Bank, N.A., No. 10-cv-0081, 2010 WL 935680 (S.D. Cal. Mar. 15, 2010) (order granting defendant's motion to dismiss) (same). In addition, the National Consumer Law Center, with co-counsel, brought four class actions on behalf of Massachusetts residents to challenge the alleged failure of Wells Fargo Bank, Bank of America, J.P. Morgan Chase Bank, and IndyMac Mortgage Servicers/OneWest Bank to modify eligible mortgages under HAMP. *See* National Consumer Law Center, *Case Index*, NCLC, http://www.nclc.org/index.php?option=com_content&view=article&id=79&Itemid=95 (last visited Aug. 21, 2010) (describing these actions in an index under the category "HAMP mortgage modifications"); Reyes v. OneWest Bank No. 10-10389 (D. Mass. filed May 4, 2010); Durmic v. J.P. Morgan Chase Bank, No. 10-10380 (D. Mass. filed Mar. 3, 2010); Bosque v. Wells Fargo Bank, N.A., No. 10-10311 (D. Mass. filed Feb. 23, 2010); Johnson v. Bank of America Home Loans Servicing, No. 10-10316 (D. Mass. filed Feb. 23, 2010). Rather than using a

Truth in Lending Act, the Home Ownership and Equity Protection Act, the Federal Trade Commission Act, the Fair Credit Reporting Act, "other Federal and state laws designed to prevent unfair, discriminatory or predatory lending practices," federal criminal laws involving fraud, and the civil False Claims Act.[207] The contract reserved a unilateral right on the part of Treasury to modify or supplement the program requirements but provided that material changes would give servicers a prospective opt-out right.[208] Thus, the government retained the ability to improve the program in the future as well as to enforce contract compliance, but material changes in the program risked flight from its ranks, a disincentive to adopting more aggressive modification guidelines.

HAMP involved rapidly putting a bureaucracy in place to manage a reluctant corps of servicers. It also quickly became apparent that the low quality of modifications HAMP produced raised questions about their sustainability. The most obvious possible changes were then: (1) compliance and enforcement efforts to reduce evasive and fraudulent servicer behavior and thus increase the quantity of modifications; and (2) changes in bankruptcy law or in HAMP itself to introduce mandatory principal forgiveness and improve the quality of HAMP modifications. The major changes actually adopted included stepped-up compliance review as well as foreclosure forbearance pending solicitation and review for a HAMP modification.

B. The Need for Compliance Review and Enforcement

The need for compliance and enforcement can best be understood by looking at the points at which participation in HAMP fell off and the reasons why this happened. The following review of the compliance issues that arose helps to paint a picture of the difficulty of getting an effective back-end regulatory solution up and running smoothly in time to help those caught up in a crisis.

There were four falloff points for HAMP participation: (1) the servicer never offered a trial modification, either because the borrower did not complete a request or the servicer refused to make an offer; (2) the borrower did not accept an offer that was made; (3) a trial modification failed to become permanent; and (4) the borrower redefaulted on a permanently modified loan. Fixing the participation problem at points (1) and (3) was easier than at (2) and (4) because the former have primarily to do with servicer behavior that could be better monitored to increase the quantity of participation. Falloff at points (2) and especially (4) probably had more to do with the quality of the modifications being offered. Principal reduction was the key way HAMP might have addressed falloff at points (2) and (4), but better compliance and enforcement efforts would have helped at points (1) and (3) and perhaps also at the other points. Overall, HAMP compliance was built on self-reporting by servicers, combined with compliance review, and

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third-party beneficiary theory, these complaints allege formation of a contract between the plaintiffs and defendants and breach by the defendants, including breach of the covenant of good faith and fair dealing.

207. HAMP, Servicer Participation Agreement, *supra* note 205, at B-3 to B-4.

208. *Id.* at 11.

every aspect of data reporting needed oversight to ensure accuracy.[209] Given the lack of servicer enthusiasm for making modifications, reliance on self-reporting was problematic.

1. Servicer Not Offering a Trial Modification

The largest falloff point deserving focused compliance attention was the failure of HAMP servicers to offer trial plans to many eligible borrowers. Only 31% of those eligible and sixty or more days in default were getting into the program, even for a trial, as of the end of November 2009; this figure increased to 42% as of the end of March 2010 but left out borrowers whose servicers chose not to sign up for HAMP.[210]

a. Outreach and Adequate Systems to Review Requests for Modification

To get to the point of offers of trial modifications, servicers first had to do outreach to let borrowers know that relief was available. Treasury recognized that such efforts were essential[211] and needed to be sustained and well-designed to attract requests for modifications.[212]

Servicers also needed systems to deal with two interrelated parts of a modification program—providing information about available modifications and processing requests for modifications. These systems included having telephone information lines on which borrowers could actually reach someone, trained employees with accurate information, software for analyzing requests that were submitted, good organization of documents, and aggressive follow-up to get missing information necessary to make offers. Servicers scrambled to put this capacity in place to participate in HAMP, but it was doubtful that their efforts—whether unintentionally or by design—were sufficient.[213] At the very end of the

209. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 19–22, 25–26 (concerning reporting of data and compliance review); *see also* COP APRIL 2010 REPORT, *supra* note 11, at 91–94 (concerning need for additional data to make HAMP "more credible, transparent, understandable and effective").

210. *See* MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 4 (31% figure is a computation based on HAMP data showing 3,299,780 eligible and sixty or more days delinquent, compared to 1,032,837 trial offers cumulatively through the end of November 2009); *see also supra* note 136 and accompanying text (42% computation through the end of March 2010). These figures leave out borrowers whose servicers did not sign up for HAMP. *See* COP APRIL 2010 REPORT, *supra* note 11, at 67 (noting that 800,000 homeowners with delinquent loans were unable to modify them because their servicers did not participate in HAMP, something completely out of the control of borrowers, who do not pick their servicers).

211. *See* HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 13 (concerning borrower solicitation); *see also* Allison, December 2009 Testimony, *supra* note 107, at 3–4 (concerning new emphasis on outreach as of December 2009).

212. COP OCTOBER 2009 REPORT, *supra* note 3, at 106–09 (discussing importance of compliance and also that "little is known about the schedule, nature, or outcome of Freddie Mac's compliance reviews").

213. Criticism of inadequate servicer operations was common in the first year of HAMP. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 108–09 (stating that "[s]ervicers must iron out the wrinkles in their implementation of HAMP, and Treasury must quickly

first year, a new HAMP directive was issued concerning borrower solicitation and communication, to be effective June 1, 2010; it required prescreening of all first-lien mortgages with two or more payments past due for HAMP eligibility and, for those that passed this prescreen, it required solicitation by both phone and mail.[214] The Congressional Oversight Panel praised the effort for "enunciat[ing] clear expectations and timelines" for soliciting and evaluating borrowers for HAMP.[215]

Anecdotal evidence suggested that servicers were not initially being responsive to requests for information or requests for trial modifications, so that borrowers suffered long wait times on the telephone, only to be misinformed when they got through, and then long delays in getting responses to requests for information and requests for trial plan offers, with paperwork lost and denials without explanation.[216] Overall, many observers had the impression that borrowers often got a runaround in their efforts to get a HAMP modification. The Congressional Oversight Panel described the situation as follows:

> Since HAMP began, housing counselors and borrowers have recounted stories of servicers losing their paperwork, lacking adequate staff, failing to tell borrowers why they are being denied, and in some cases failing to follow the program's rules. Although this information is anecdotal, it has come with enough frequency and consistency to raise questions about whether servicers are fully committed to HAMP's success.[217]

As has been noted, HAMP was set up as a crisis-response program, so its administration was planned on the fly and subject to constant changes, leading to a complex accumulation of guidance in the form of updates, directives, and FAQs. This led to calls for a reconciliation of information in one current program guide to make it easier for servicers to understand exactly what was expected of them and for housing counselors to inform themselves in order to better advise borrowers.[218]

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put its compliance plan into place in order for all eligible borrowers to fully benefit from HAMP"); *see also* Allison, December 2009 Testimony, *supra* note 107, at 2–3 (concerning new efforts as of December 2009 to improve servicers' operations).

214. HAMP, SUPPLEMENTAL DIRECTIVE 10-02, *supra* note 104, at 1–2 (amending policies and procedures related to borrower outreach and communication).

215. COP APRIL 2010 REPORT, *supra* note 11, at 17–18 (praising the new outreach directive but also stating that its guidance should be "viewed as a floor rather than a measure of maximum servicer effort").

216. *The Worsening Foreclosure Crisis: Is It Time to Reconsider Bankruptcy Reform?: Hearing Before S. Judiciary Subcomm. on Admin. Oversight and the Courts,* 111th Cong. 4, 28, 30, 45 (2009) (written testimony of Alys Cohen, National Consumer Law Center) [hereinafter Cohen Testimony], *available at* http://judiciary.senate.gov/pdf/07-23-09CohenTestimony.pdf (concerning borrowers' difficulties in getting information and timely and accurate processing of requests for modifications).

217. COP APRIL 2010 REPORT, *supra* note 11, at 71.

218. *See* Cohen Testimony, *supra* note 216, at 32 (making this recommendation); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 108–09; COP APRIL 2010 REPORT, *supra* note 11, at 82 (concerning repeated changes in guidelines placing implementation burdens on servicers); *supra* note 98 (discussing HAMP's use of guidance rather than regulations).

There were also calls for release of the HAMP NPV model in some form so that borrowers and their counselors could better assess the probability of qualifying for a modification.[219] In December 2009, Treasury recognized the need for greater transparency and said it would "increas[e] public access to the NPV whitepaper, which explains the methodology used in the NPV model" and also would provide new tools for counselors to use when assisting homeowners applying for modifications.[220] Although not publishing the NPV model could be justified as a way to prevent gaming of the application process, which might have increased moral hazard, it also meant bowing to servicers' desire to keep their analyses private and made it more difficult for borrowers to understand their chances of getting a modification or to assess whether denials were appropriate.

b. Suspending Action to Foreclose

From the beginning of HAMP, servicers were not supposed to proceed with a foreclosure sale while a HAMP modification review was in progress, during the time a borrower had to accept a trial plan offer, or while a trial plan was in effect.[221] It was initially unclear, however, whether servicers were permitted to initiate foreclosure proceedings and pursue them short of an actual sale during any of these times. In December 2009, Treasury acknowledged requests for clarification "about the rules regarding foreclosure when borrowers apply for a trial modification and during the trial period," and stated:

> [A]ny pending foreclosure sale must be suspended and no new foreclosure proceedings may be initiated during the trial period. Foreclosure proceedings may not be initiated or restarted until the borrower has failed the trial period and the borrower has been considered and found ineligible for other available foreclosure prevention options. Servicers who violate any of these rules are considered non-compliant. Counselors and borrowers should report violations through the escalation channels.[222]

This statement still left doubt about whether waiting periods for initiated foreclosures could be left running. Treasury seemed to recognize as much in congressional testimony in December 2009, stating that it had convened a working group to "review and develop improvements to our existing foreclosure suspension rules."[223]

On March 24, 2010, Treasury issued a supplemental directive, effective June 1, 2010, replacing in its entirety the initial directive on foreclosure actions;

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219. *See* Cohen Testimony, *supra* note 216, at 32 (making this recommendation); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 111; COP APRIL 2010 REPORT, *supra* note 11, at 82 & n.270 (concerning continuing lack of transparency of NPV analysis and resulting unpredictability of whether a borrower would be offered a modification); *supra* note 107 and accompanying text (discussing that NPV model was not released, although a paper about it was).

220. *See* Allison, December 2009 Testimony, *supra* note 107, at 7 (concerning plans to increase the transparency of the NPV model).

221. HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 14.

222. Allison, December 2009 Testimony, *supra* note 107, at 7.

223. *Id.*

most dramatically, it generally required solicitation and evaluation for HAMP before referral for foreclosure.[224] A Treasury official summarized the new directive's provisions as follows:

> Currently, servicers may not refer a mortgage to foreclosure if the borrower is in a trial modification. The guidance would prohibit foreclosure referral for all potentially eligible loans unless the borrower does not respond to solicitation, was not approved for HAMP, or failed to make their trial modification payments. Servicers will be required to provide borrowers with clear written communications explaining the concurrent foreclosure/modification processes and stating that a foreclosure sale will not take place during the trial period. If a borrower is found ineligible for HAMP, a foreclosure sale cannot be scheduled sooner than 30 days after the date of a Non-Approval Notice so that the borrower has a chance to respond. Servicers must also certify to their foreclosure attorneys that a borrower is not eligible for HAMP before a sale may be conducted.[225]

Putting off foreclosure referral until solicitation and review for HAMP was desirable to give servicers incentives to seek and review applications promptly (to minimize the time they would have to carry advances to investors on loans in default).[226] The requirement that foreclosure referral not be made prior to solicitation for HAMP increased the scope of foreclosure forbearance beyond those who had applied for or received a trial plan.[227] The requirement of thirty days' notice after non-approval for a trial before foreclosure sale was short but would permit response by the borrower and, if the notice period was observed, would prevent a surprise foreclosure from occurring immediately after a denial. Unfortunately, there were reports of surprise foreclosures during HAMP review and trials in the program's first year, and it remained to be seen how effective the March 2010 directive would be in changing servicer practices.[228]

c. Reasons for Denial and Appeals

Another question was whether servicers had good reasons for denying offers of trial plans or permanent modifications. HAMP began requiring reporting of reasons of denial in November 2009.[229] Denial codes were supposed to be

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224. HAMP, SUPPLEMENTAL DIRECTIVE 10-02, *supra* note 104, at 4–5 (concerning new requirements for solicitation and evaluation prior to referral for foreclosure).

225. Allison, March 2010 Testimony, *supra* note 54.

226. *See* NCLC REPORT, *supra* note 19, at 32.

227. *See* COP APRIL 2010 REPORT, *supra* note 11, at 17 ("applauding" this change).

228. *See infra* notes 241, 258 and accompanying text (concerning reports of foreclosure sales while HAMP reviews or trial plans were in progress).

229. HOME AFFORDABLE MODIFICATION PROGRAM, SUPPLEMENTAL DIRECTIVE 09-06, SERVICER REPORTING REQUIREMENTS—DATA COLLECTION AND REPORTING REQUIREMENTS 3 (Nov. 9, 2009), *available at* https://www.hmpadmin.com/portal/docs/hamp_servicer/sd0906reportingrequirements.pdf (requiring reasons for not offering a plan, for a plan not becoming permanent, and for fallout of a permanent plan); *see also* COP

reported in writing to Treasury and to borrowers, with letters to borrowers providing a phone number for a hotline to get an explanation for the denial and to learn of other possible modification or foreclosure-prevention options,[230] but servicer reporting of denial codes only began in February 2010.[231] Furthermore, the Congressional Oversight Panel expressed concern about erroneous denial codes and called for monitoring report accuracy.[232] Availability of the NPV model would have helped borrowers and their advisors evaluate the basis of denial.[233] The oversight panel questioned in April 2010 whether information about reasons for denial was reaching borrowers and yielding an efficient appeals process.[234]

d. Lack of Enforcement

Treasury's stepped-up compliance activities could have been the basis for federal enforcement activities, but as of the end of the disappointing first year, there were no signs that this was happening. Involvement of the Federal Trade Commission could have been a means to piggyback enforcement action on HAMP compliance reviews, using the information thus generated. Servicers signed up to evaluate eligible borrowers, and if they were giving them the runaround instead, this was an unfair or deceptive practice, misleading borrowers into thinking that they had a chance at foreclosure prevention.[235] Routinely "losing" documents at any stage of the evaluation or trial process, even if by incompetence rather than as a matter of intention, would also be deceptive to borrowers, who were entitled to a fair review by servicers who held themselves out as participating in HAMP.

In addition to Federal Trade Commission enforcement, state level enforcement was a distinct possibility, also not employed during the first year of HAMP. State unfair or deceptive acts or practices (UDAP) statutes give enforcement powers to state attorneys general or some other state official, and the state acts, unlike the Federal Trade Commission Act, also typically provide for

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OCTOBER 2009 REPORT, *supra* note 3, at 109 (concerning announcement of reason codes and required reporting of them to Treasury and borrowers).

230. Allison, December 2009 Testimony, *supra* note 107, at 7.

231. *See* COP APRIL 2010 REPORT, *supra* note 11, at 9 (noting that Treasury stated servicer reporting of denial codes was only starting in February 2010, but that it expected it to improve over the next several months).

232. *Id.* at 9, 54–55.

233. *Id.* at 78–80 (concerning lack of access to NPV information); *see also supra* notes 103, 213 and accompanying text.

234. COP APRIL 2010 REPORT, *supra* note 11, at 79; *see also* Cohen Testimony, *supra* note 216, at 34 (calling for independent review); COP OCTOBER 2009 REPORT, *supra* note 3, at 109 (concerning need for borrower recourse when reasons were invalid).

235. Federal Trade Commission Act, 15 U.S.C. §§ 41–58 (2006 & Supp. 2008) (giving the FTC broad powers to prevent and redress unfair or deceptive practices). The Obama Administration had a coordinated program to address mortgage modification scams. *See* Press Release, Dep't of Treas. & Dep't of Housing, Federal, State Partners Announce Multi-Agency Crackdown Targeting Foreclosure Rescue Scams, Loan Modification Fraud (April 6, 2009), *available at* http://makinghomeaffordable.gov/pr_040609.html. The Administration did not, however, publicly acknowledge through the spring of 2010 the possibility that HAMP-participating servicers might be among the scammers.

private rights of action.[236] A pattern or practice of evasion of HAMP responsibilities could have been addressed through public or private enforcement under these state UDAP laws. While borrowers might also have had third-party beneficiary rights under the servicer-participation agreements with the U.S. Treasury or direct contract rights based on their interactions with servicers,[237] state UDAP actions typically provide remedies that are better than those of contract law, including multiple damages, statutory damages, and attorneys' fees.[238]

In addition to problems with insufficient servicer capacity to review applications, dampening HAMP participation, some more malevolent actions were reportedly occurring, amounting to fraud if true. In December 2009, HAMP finally put in place systems for referring reports of such behavior.[239] This was prompted by reports of such fraudulent behavior as: servicers claiming to offer HAMP modifications, but instead offering plans requiring higher payments or limited to five years; routinely refusing to accept requests for modifications despite having signed up for HAMP; charging fees to consider requests for modifications in violation of HAMP rules;[240] and conducting foreclosure sales while a review or trial plan was in progress, keeping payments made in the meantime.[241] Despite such reports, there were no signs of federal or state consumer protection enforcement activity as of the end of the first year of HAMP.

2. Borrower Not Accepting an Offer of a Three-Month Trial Plan

Even when offers of three-month trial modifications were made, for unexplained reasons more than 27% of those offers were not accepted by the

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236. *See* JONATHAN SHELDON & CAROLYN L. CARTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES 1, 737–836, 931–89 (7th ed. 2004) (discussing the fact that all states have consumer protection statutes, all but one provide a private right of action, all provide for state agency enforcement, and most broadly prohibit not only fraud but also unfair or deceptive practices); *see also supra* note 112 and accompanying text (concerning possibility of interest rate and payment amount reset for HAMP modifications, beginning after five years, but with a continuing loan after the reset of the interest rate to the prime rate as of the time of the modification).

237. *See supra* note 206.

238. *See* SHELDON & CARTER, *supra* note 236; *see also* State Foreclosure Prevention Working Group, *Analysis of Mortgage Servicing Performance, Data Report No. 4* (Jan. 2010), http://www.state.ia.us/government/ag/latest_news/releases/jan_2010/Foreclosure_Prevention_REPORT.pdf (discussing analysis of foreclosure-prevention efforts by a group consisting of representatives of fifteen states, but not mentioning enforcement activity as a possible strategy).

239. Allison, December 2009 Testimony, *supra* note 107, at 4 (announcing an "escalation call center" for reporting servicer non-compliance with the HAMP program).

240. *See supra* note 118 (concerning prohibition on fees for servicer administrative costs of modification or servicer late fees and penalties).

241. *See* Cohen Testimony, *supra* note 216, at 27 (describing incidents of this noncomplying behavior); *see also* COP OCTOBER 2009 REPORT, *supra* note 3, at 107–09 (summarizing reports of "serious" violations of HAMP guidelines, including "offering non-compliant loan modifications, refusing to offer HAMP modifications, charging fees for modifications, and selling homes at foreclosure while a review was pending," in addition to reports of long wait times, personnel not familiar with program details, and misplaced documents).

borrowers as of November 2009, a figure reduced to 19% by March 2010.[242] Thus, the participation rate was 23% of potentially eligible borrowers at participating servicers through November, a rate that increased to 34% by the end of March 2010, perhaps in part because the requirement of execution of a trial plan was eliminated in November 2009 and replaced by treating a payment as evidence that the borrower accepted a trial plan.[243]

Borrowers were supposed to have at least thirty days to accept an offer, but it was doubtful that servicers in fact consistently gave them that long given all of the general compliance problems.[244] Some borrowers may simply have neglected to respond to offers. Others may have acted deliberately when they did not accept offers, for some combination of substantive reasons such as finding that the terms were still unaffordable, having lost income in the meantime, or needing to move, or already being out of the home. Servicer procedures could have been part of the problem. For example, servicers may not have provided borrowers clear instructions about how to accept offers, including explanations of which documents to return, and when and where to return them. The lack of telephone operators available to answer questions may also have deterred borrowers from responding to offers. The Congressional Oversight Panel found some unexplained, significant variation in servicer performance in converting trial plans to permanent modifications and called for Treasury to investigate.[245] In addition to the need for compliance review of procedures for acceptance, to understand the falloff at this stage there was a need to monitor and analyze both the quality of offered

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242. *See* MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 3–4 (27% rate for non-acceptance of offers is a computation based on 759,058 trial starts out of 1,032,837 trial offers, meaning 273,779 of those who had offers did not start trials); *supra* notes 128–29 (concerning revisions over time for certain figures, including for trial plans and permanent modifications started, based on later servicer information; since the numbers of offers of trial plans were not updated in the same way, the computation uses contemporaneous reports of both trial plans and trial plan offers); *see also supra* note 136 and accompanying text (computation using figures through March 2010 produced the 19% figure in the text).

243. *See* MHA, NOVEMBER 2009 SERVICER PERFORMANCE REPORT, *supra* note 128, at 3–4 (computation of 23% based on 3,299,780 eligible borrowers sixty or more days delinquent and 759,058 trials started); *see also supra* note 242 (explaining why the trial-plans-started figure is not updated by later servicer reports); *supra* note 140 and accompanying text (computation using figures through March 2010 produced the 34% figure in the text); *supra* note 103 and accompanying text (discussing November 2009 change that began treating making a payment as accepting a trial plan).

244. *See supra* note 138 and accompanying text (noting program requirement of thirty days to accept an offer); *supra* notes 229–34, 239–41 and accompanying text (concerning reports of noncompliance with program guidance).

245. *See* COP APRIL 2010 REPORT, *supra* note 11, at 59–60 (noting split among servicers as to whether they required verification of income before a trial start, with the verified-income servicers enrolling fewer borrowers in trial plans but converting more trial plans to permanent modifications, but also finding unexplained variation in performance at the individual servicer level and calling for Treasury investigation of reasons for large variations); *infra* notes 255–57 and accompanying text (concerning change in the program to require verification of income before a trial start).

modifications and other possible explanations for non-acceptance by borrowers, such as job loss between the time of application and the modification offer.

3. Trial Failing to Become Permanent

The numbers of three-month trial modifications that were started finally reached promising levels in the fall of 2009, with the cumulative number in trial or permanent modifications at the end of November at 825,188, taking into account servicer updates through March 2010.[246] The rate of conversion of trials to permanent modifications was, however, disappointingly low, with only 31,424 becoming permanent by the end of November 2009.[247] As discussed above, compared to the 419,163 trials in progress at the end of August, with three months to become permanent, only 7% successfully made the transition from trial to permanent status as of the end of November.[248]

The initial low rate of conversion from trial to permanent plans was a red flag, calling out for a thorough examination and intensive compliance reviews. Treasury finally acknowledged this need in December 2009,[249] using a combination of police and military rhetoric.[250] Treasury also invited telephone reports of servicer noncompliance to an "escalation call center."[251]

Herbert Allison, Treasury Assistant Secretary acknowledged that there were two competing accounts about missing documents, including the possibility that servicers could be at fault: "Housing counselors and homeowners report that servicers are losing documents, while servicers report that homeowners are not providing documents despite repeated outreach."[252] The conversion drive seemed to suggest a serious effort by the Administration to get to the bottom of the story and to correct the situation, whatever its cause.

The conversion drive succeeded in producing a total of 230,801 permanent modifications through March 2010.[253] This meant that by the end of the first year of HAMP, 25% of trial plans at least three months old converted to permanent status.[254] While progress was made, the number of permanent modifications remained disappointing.

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246. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4.

247. *See id*; *see also supra* notes 128–29 (discussing changes in some figures in later servicer-performance reports based on updated information provided by servicers).

248. *See supra* notes 148–50 and accompanying text.

249. *See* Allison, December 2009 Testimony, *supra* note 107, at 2.

250. *Id.* at 2–4.

251. *Id.* at 4. MHA's website added a "Conversion Campaign" link, and that site provided a phone number to seek help: 1-888-995-HOPE (4673). *See Understanding The Trial Period*, MAKING HOME AFFORDABLE, http://makinghomeaffordable.gov/understandtp.html (last visited Aug. 2, 2010).

252. Allison, December 2009 Testimony, *supra* note 107, at 2.

253. *See* MHA, MARCH 2010 SERVICER PERFORMANCE REPORT, *supra* note 4, at 4.

254. *See supra* note 142 and accompanying text. Even after the end of the first year of HAMP, the Administration remained disappointed with the performance of servicers. U.S. Treasury Secretary Timothy Geithner, testifying concerning HAMP said, "I think it is very important to say that servicers have done a terrible job. . . . They still have

HAMP initially permitted servicers to choose whether to require paperwork before or after a trial began.[255] In late January 2010, a new directive was issued requiring use of verified rather than stated income before offering a trial plan, with the verified income requirement applicable to trial plans with effective dates on or after June 1, 2010.[256] Although this change was likely to reduce the number of trial plans started, it was also likely to have the beneficial effect of increasing their conversion to permanent modifications.[257] On the other hand, the Congressional Oversight Panel noted that many factors contribute to conversion ratios:

> Some housing counselors note continued frustration and problems regarding the HAMP program: foreclosure proceedings do not always stop during the modification process, communication is difficult, servicers continue to lose information, transitions from trial periods to permanent modifications have been slow, the quality of loan modifications have [sic] been haphazard, the NPV analysis is still not transparent, and denials appear to be arbitrary and hamper appeals.[258]

Overall, there was a huge potential for more of a runaround during a trial plan, repeating the runaround problem that homeowners complained of earlier in the process when they sought trial offers; the differential conversion ratios of different servicers strongly suggested that various differences in their procedures were contributing to their varying results.[259]

4. Redefault

As noted above, trial modifications were becoming permanent at a 25% rate by the end of HAMP's first year,[260] but permanent modifications were already starting to redefault.[261] As the quantity of permanent modifications climbed toward

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some distance to go." Congressional Oversight Panel, *Hearing with Treasury Secretary Timothy Geithner*, June 22, 2010, in minute 77 of video, *available at* http://cop.senate.gov/hearings/library/hearing-062210-geithner.cfm.

255. *See* HAMP, SUPPLEMENTAL DIRECTIVE 09-01, *supra* note 2, at 5, 17 (allowing servicers to use "verbal" information to offer a trial period or to require documentation of eligibility in advance).

256. *See* HOME AFFORDABLE MODIFICATION PROGRAM, SUPPLEMENTAL DIRECTIVE 10-01—PROGRAM UPDATE AND RESOLUTION OF ACTIVE TRIAL MODIFICATIONS 1 (Jan. 28, 2010), *available at* http://www.hmpadmin.com/portal/docs/hamp_servicer/sd1001.pdf.

257. *See supra* note 245 (concerning higher conversion ratios of servicers who had chosen to require income before offering a trial plan in advance of the requirement). Indeed, the rate of production of trial modifications slowed in 2010, particularly early in the second year of HAMP. *See* MHA, JUNE 2010 SERVICER PERFORMANCE REPORT, *supra* note 135, at 2 (showing in chart of "HAMP Trials Started (Cumulative)" a flattening out of production of trials in April–June 2010).

258. *See* COP APRIL 2010 REPORT, *supra* note 11, at 82.

259. *See id.* at 59–60 (noting that servicer-by-servicer data suggested that multiple factors affected conversion ratios); *supra* notes 216–17 (discussing problems with runaround in getting an offer of a trial plan).

260. *See supra* note 142 and accompanying text.

261. *See supra* notes 6, 161–63 and accompanying text.

the end of the year, the quality and resulting sustainability of those modifications loomed as the next focus of concern and challenge; redefault rates were expected to be high because more than three quarters of permanent modifications left borrowers under water.[262] In addition, many HAMP participants were left with very high total debt-to-income ratios and thus were at risk of being unable to afford their modified loans in the event of reductions in their incomes or increases in their expenses. With negative equity, they would be unable to sell their homes to pay off their loans before moving to cheaper housing. These factors threatened the supposedly permanent nature of the modifications, which at any rate was subject to reset of interest rate and payment amount after five years.[263] Barring a rapid recovery of the housing market to reduce the incidence of negative equity, forgiveness of principal was the most obvious way to reduce redefault.

C. The Need for Forgiveness of Principal

The Obama Administration originally proposed bankruptcy modification of home mortgages to write down the principal obligation to home value as part of its overall HAMP plan.[264] Its March 4, 2009, HAMP Program Description stated that the Administration "will seek carefully crafted changes to bankruptcy provisions" allowing "a bankruptcy judge . . . to reduce the outstanding principal balance of a primary residence home mortgage loan to current fair market value" after "borrowers have tried unsuccessfully to obtain affordable loan modifications from their lenders or servicers."[265] Bills to permit modification of home mortgage loans in Chapter 13 bankruptcies were on the congressional agenda in 2008 and 2009 and twice passed in the House, only to stall in the Senate.[266] An attempt to revive the legislation failed in the House on December 11, 2009.[267] If HAMP continues to flounder into its second and third years, and if many debtors remain under water on their loans, Congress might do well to reconsider bankruptcy modification.

Bankruptcy courts actually did modify home mortgages in about half of the judicial districts before the Supreme Court's 1993 decision in *Nobelman v. American Savings Bank*,[268] which held that loans supported by some collateral

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262. *See supra* notes 161–63, 180–85 and accompanying text.

263. *See supra* note 112 and accompanying text.

264. *See* MARCH 4, 2009, HAMP PROGRAM DESCRIPTION, *supra* note 2, at 7–8.

265. *Id.*

266. Helping Families Save Their Homes Act of 2009, H.R. 1106, 111th Cong. (2009) (passed by the U.S. House of Representatives on March 5, 2009); Helping Families Save Their Homes in Bankruptcy Act of 2009, S. 61, 111th Cong. (2009) (did not make it out of the Judiciary Committee in the Senate). Similar legislation, the Helping Families Save Their Homes in Bankruptcy Act of 2008, S. 2136, 110th Cong. (2008), passed the House in 2008 but never came to a floor vote in the Senate.

267. H. Amendment 534 (failed Dec. 11, 2009) to H.R. 4173, 111th Cong. (2009), substantively identical to H.R. 1106, *supra* note 266. The change in the vote may have reflected a desire not to make it more difficult to pass H.R. 4173, major financial regulatory reform legislation ultimately signed into law on July 21, 2010, as the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203.

268. 508 U.S. 324 (1993).

value[269] and secured only by real property that is the debtor's principal residence could not be bifurcated under the Bankruptcy Code into secured and unsecured claims in Chapter 13. This decision had the effect of barring plans to repay less or nothing on the unsecured portion.[270] Interestingly, an empirical study comparing mortgage markets and bankruptcy filings in districts allowing or not allowing bankruptcy modification before *Nobelman* found only a small impact from allowance of modification.[271]

The arguments for bankruptcy modification as a means of foreclosure mitigation, thoroughly explored in an article by Professor Adam J. Levitin,[272] include that it is administratively efficient because bankruptcy courts are already operating and available immediately,[273] a stark contrast to the need to ramp up a new bureaucracy as well as private capacity under HAMP. Also, servicers, with their perverse incentives,[274] and junior-lien holders are removed as obstacles in bankruptcy modification.[275] Furthermore, bankruptcy is not an appealing choice to any borrower and is unlikely to draw borrowers who can afford their payments,[276]

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269. Junior liens without collateral value to support them can be stripped down in Chapter 13. Every U.S. Court of Appeals to decide the issue has held that wholly unsecured junior liens on principal residences can be stripped. *See, e.g.*, Zimmer v. PSB Lending Corp. (*In re* Zimmer), 313 F.3d 1220, 1227 (9th Cir. 2002); Lane v. W. Interstate Bancorp (*In re* Lane), 280 F.3d 663, 669 (6th Cir. 2002); Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 126 (2d Cir. 2001); Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 288 (5th Cir. 2000); McDonald v. Master Fin., Inc. (*In re* McDonald), 205 F.3d 606, 608 (3d Cir. 2000); Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1360 (11th Cir. 2000).

270. *See* 11 U.S.C. § 1322(b)(2) (2006) (the bankruptcy provision at issue in *Nobelman*, 508 U.S. 324). Although after *Nobelman*, cramdown was not generally available on home mortgages, Chapter 13 debtors could cure arrearages and maintain regular payments, allowing them to keep homes despite default if this much repayment was feasible. *See* 11 U.S.C. §§ 1322(b)(5), 1325(a)(6). This had the perverse effect of making some of the worst-off debtors file in Chapter 13 to save homes. *See* Jean Braucher, *A Fresh Start for Personal Bankruptcy Reform: The Need for Simplication and a Single Portal*, 55 AM. U. L. REV. 1295, 1319–20 (2006).

271. *See* Levitin, *supra* note 37, at 598–99 (finding no statistically significant impact from mortgage modification on availability of mortgage credit or number of bankruptcy filings and only modest impact upon loan to value ratios, reducing them slightly, and interest rates, increasing them slightly; these effects were strongest for high risk borrowers, which could be considered a good result, to discourage the most risky loans).

272. *See id.* at 641–47. For an opposing view, see Mark S. Scarberry, *A Critique of Congressional Proposals to Permit Modification of Home Mortgages in Chapter 13 Bankruptcy*, 37 PEPP. L. REV. 635 (2010).

273. Levitin, *supra* note 37, at 576–77.

274. *See supra* notes 35–38, 85–92 and accompanying text.

275. Levitin, *supra* note 37, at 641; *see supra* note 119 and accompanying text (noting Treasury estimate in 2009 that half of at-risk mortgages had second liens); *see also* John Eggum, Katherine Porter & Tara Twomey, *Saving Homes in Bankruptcy: Housing Affordability and Loan Modification*, 2008 UTAH L. REV. 1123, 1141, 1164 (finding that seven out of ten Chapter 13 debtors had unaffordable housing costs under a standard government measure and arguing that these data support permitting modification of mortgages in Chapter 13).

276. *See* COP OCTOBER 2009 REPORT, *supra* note 3, at 101.

thus minimizing the moral hazard of providing debt relief to those who do not need it. Debtors in Chapter 13 must reveal their finances in public and submit to three- to five-year repayment plans funded out of disposable income.[277] If they have nonexempt property, such as financial assets or investment properties, they must pay at least the property's value in their plans.[278] Chapter 13 debtors are also subject to a good faith test—which can be used to deal with those who attempt to game the system unfairly—and to a feasibility test.[279] For all these reasons, speculators and the relatively wealthy or high-income earners are unlikely to file.[280]

Another advantage of bankruptcy modification is that it would likely stimulate more voluntary write-down of principal by servicers, who might prefer to keep more control of the terms than they would have in bankruptcy, where the judge would weigh the evidence, decide the current value of the home and set the terms. By giving notice of a desire to modify in lieu of bankruptcy, borrowers might overcome servicer reluctance to modify outside bankruptcy. In the foreclosure crisis that began in 2007, servicers apparently preferred short sales, which reduced the principal collected, to partial chargeoffs, meaning principal reduction, even when a partial chargeoff would have produced greater returns for investors. There are at least two explanations for this preference for short sales. One is the punitive nature of this type of transaction, in that the borrower loses the home, which from the servicer and investor perspective has the advantage of deterring requests for relief. The other is that a short sale is more of a "usual and customary practice," minimizing the potential for servicer liability to investors.[281] But if the borrower had a right to principal reduction in bankruptcy, investors would have difficulty claiming a failure to protect their interests if the servicer gave a modification with a partial principal reduction to avoid the bankruptcy. Furthermore, with a change in bankruptcy law, HAMP could more easily have written into its program description the possibility of principal reduction to avoid bankruptcy modification, turning it into a "usual and customary practice."[282]

The possibility of bankruptcy is commonly used as leverage to get loan modifications. In either Chapter 7 or Chapter 13, a debtor can surrender collateral to a secured lender and ultimately discharge personal liability for any deficiency in whole or part.[283] Before or in bankruptcy, a proposal to surrender a home on which

277. *See* Levitin, *supra* note 37, at 644.

278. 11 U.S.C. § 1325(a)(4).

279. 11 U.S.C. §§ 1325(a)(3), (6).

280. Levitin, *supra* note 37, at 644–45 (noting that mean income of Chapter 13 debtors in 2007 was $35,688 and that less than 10% had incomes over $60,000; also discussing lack of appeal of bankruptcy to speculators with other assets).

281. NCLC REPORT, *supra* note 19, at 7–9.

282. *See id.* at 8–9 (concerning aspects of government programs such as Making Home Affordable as standard industry practice insulated from investor litigation; also discussing lack of investor lawsuits against servicers for making loan modifications); *see also supra* notes 101–102 and accompanying text.

283. 11 U.S.C. §§ 521(a)(2)(A), (a)(6), 524(a) (2006) (concerning surrender of collateral in Chapter 7 and discharge of unsecured debts); 11 U.S.C. §§ 1325(a)(5)(C), (b), 1328(a) (2006) (concerning surrender of collateral in Chapter 13; part of any deficiency

the debtor has negative equity can be an occasion for negotiation to modify the loan, which is why HAMP specifically permitted servicers to enter into HAMP modifications with debtors in bankruptcy.[284] HAMP was ultimately changed to require servicers to evaluate debtors in bankruptcy for HAMP upon request, but with perhaps some ambiguity about whether an offer of a modification was required even if the NPV analysis was positive.[285] It was possible that, with the requirement of evaluation for the program, HAMP modifications in bankruptcy would become more common after the program's first year, especially if debtors' lawyers started trying to use HAMP routinely in bankruptcy, with the filing as a strong signal that a failure to modify might be met with surrender and discharge. A key point is that legislation to permit Chapter 13 modification, with the judge writing down the loan to collateral value, would have represented only a slight increase in borrower leverage from what already exists. A debtor with a bankruptcy right to modify and reduce principal to current value would be more likely to get a modification reducing principal somewhat less than that without the need to actually file in bankruptcy.

Failing a statutory change to give debtors the right to modify in Chapter 13 bankruptcy, HAMP itself could have been changed to include mandatory rather than just permissive principal reduction for participating services,[286] although the moral-hazard might have been greater than with Chapter 13 modification.[287] Interestingly, in early 2009, the Federal Reserve published a policy guide "to avoid preventable foreclosures . . . through sustainable modifications," which called for Federal Reserve Banks, with respect to certain of their residential mortgage holdings, to prioritize reduction of the principal balance where it was 125% or more of the estimated current value of the property.[288] Furthermore, because a

may be paid out of disposable income in a plan, with discharge of the remainder upon completion of the plan).

284. *See supra* note 104 and accompanying text.

285. *See supra* notes 10–16, 104 and accompanying text.

286. *See supra* notes 10–15 and accompanying text.

287. *See supra* notes 276–80 and accompanying text.

288. *See* Federal Reserve Board, Home Ownership Preservation Policy for Residential Mortgage Assets, at 1, 5 (Jan. 30, 2009), http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20090130a1.pdf (calling for foreclosure prevention through sustainable loan modifications and directing Federal Reserve Banks to prioritize reduction of the principal balance of residential mortgages in certain of their holdings where that principal balance was 125% or more of the estimated current value of the property, consistent with maximizing expected net present value). This policy was announced in a press release on January 30, 2009, and the Federal Reserve Board announced in the same release that it had "decided to apply the policy to the residential mortgage assets held by Maiden Lane, LLC, Maiden Lane II, LLC and Maiden Lane III, LLC . . . formed to facilitate the acquisition of The Bear Stearns Companies, Inc. by JPMorgan Chase." The press release also noted that the three Maiden Lane entities "were established in connection with the restructuring of the assistance provided by the government to American International Group, Inc." Press Release, Federal Reserve Board (Jan. 20, 2009), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20090130a.htm; *see also supra* note 48 (concerning the Federal Reserve Open Market Committee sticking with commitment to purchase $1.25 trillion in mortgage-backed securities, which were not explicitly within the Home Ownership Preservation Policy for

federal refinance program was made available for loans with LTV ratios of up to 125%,[289] requiring write-down to that ratio as part of HAMP would have provided access to refinancing.[290] Principal reduction could have been incorporated into the HAMP waterfall, perhaps before interest rate reduction, to get the LTV ratio to 125% or less.[291] Bankruptcy modification in Chapter 13 was not the only way that principal reduction could have been made a standard part of HAMP.

Of course, investors had reason to resist mortgage modifications to the extent they required loss recognition under accounting rules.[292] Principal reduction might have had the most negative impact on balance sheets of mortgage investors, including financial institutions, thus threatening their stability, contrary to a key goal of the government's economic recovery efforts.[293] On the other hand, writing down loans toward collateral value and reducing redefault rates would have led to more accurate and thus confidence-inspiring balance sheets.[294] The fact that the Federal Reserve Board backed prioritizing principal reduction in modifications of mortgages to make them sustainable[295] suggested this approach had the advantage of realism. Even after program enhancements were announced at the end of its first year, however, HAMP left it to investors and their servicers to decide whether to write down principal.[296]

D. Lessons About the Difficulty of Back-End Solutions

This Article has explored the problems with HAMP. Its lackluster first year can be mined for lessons about the risks of back-end solutions. To try to act fast, the Administration used bureaucratic guidelines and contracts with industry participants rather than attempting to get a detailed statute enacted or administrative regulations promulgated.[297] As a crisis-response program, HAMP set its requirements and procedures as it went along.[298] Unfortunately, this approach turned out to be anything but speedy in getting relief to distressed homeowners. The U.S. Treasury itself, as well as the private businesses it signed up to participate in HAMP, had to work out their systems over time, which meant inevitable slowness of response.[299] Furthermore, because the underlying goal was

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Residential Mortgage Assets because that policy excluded holdings in connection with Federal Reserve open market operations).

289. *See supra* note 131 and accompanying text.

290. *See* Cohen Testimony, *supra* note 216, at 36 (discussing HARP refinancing availability up to 125% LTV as a reason to write down principal to that amount under HAMP).

291. *See supra* notes 109–12 (concerning the HAMP waterfall).

292. COP APRIL 2010 REPORT, *supra* note 11, at 74–76 (discussing accounting rules for "troubled debt restructuring," regulatory capital ratios required for depositary institutions, and threat to capital levels of banks with large second mortgage holdings).

293. COP OCTOBER 2009 REPORT, *supra* note 3, at 100.

294. *Id.*

295. *See supra* note 288 and accompanying text.

296. *See supra* notes 10–15 and accompanying text.

297. *See supra* notes 98, 203–07 and accompanying text.

298. *See supra* notes 98, 203–07 and accompanying text; *supra* note 152 and accompanying text (concerning "conversion drive").

299. *See supra* notes 144–57.

loss mitigation, there was also jockeying by the mortgage industry to try to minimize the losses that servicers and investors would take and put more of them on borrowers.[300] Thus, this crisis program had to deal at the same time with administrative start-up challenges and powerful resistance of industry players. The government depended on these very entities in its efforts to see more progress, and thus progress was slow and weak.

The Administration seemed to believe it could get cooperation by working with industry players. It chose compliance review and jawboning[301] rather than enforcement, even when foot-dragging became apparent,[302] perhaps out of concern that law suits would further slow down the program.

The Administration also did not use its political capital to overcome reluctance in the Senate to bankruptcy modification, which would have put pressure on the industry to use HAMP to avoid greater losses in bankruptcy.[303] The "enhancements" of HAMP adopted at the end of its first year left it to industry participants to decide whether to use the strongest substantive cure, principal reduction.[304] It took a year even to provide guidance strengthening procedures for outreach and review of applications for modifications.[305] With the requirement that debtors in bankruptcy be evaluated for HAMP upon request—also part of the year-end "enhancements"[306]—it was possible that bankruptcy lawyers would start using it routinely as a tool, meaning as a result that debtors would be more likely to have the aid of professionals in obtaining HAMP modifications.[307] Use of HAMP modifications in bankruptcy, however, was likely to be less effective in providing relief than bankruptcy modification would have been.

Another difficulty for fixing HAMP was the raw politics of populist resistance. After the economic stimulus package was signed into law on February 17, 2009, amending and adding to the U.S. financial system bailout of the previous fall and providing the authorization and funding for HAMP,[308] the Administration announced the Making Home Affordable program that included HAMP on February 18, 2009.[309] The very next day, February 19, 2009, CNBC correspondent

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300. *See supra* notes 213, 216–20 and accompanying text.

301. *See supra* notes 126–28 and accompanying text.

302. *See supra* notes 126–31 and accompanying text. *See also* James R. Hagerty, *High Default Rate Seen for Modified Mortgages*, WALL ST. J., June 16, 2010, *available at* http://online.wsj.com/article/SB10001424052748703280004575308992258809442.html (noting observation by Andrew Jakabovics, an associate director at the Center for American Progress in Washington, D.C., that HAMP would have worked better if the government had taken over decisions about which applicants qualified for HAMP modifications, rather than delegating decision-making to servicers). Of course, fewer servicers might have agreed to participate if this had been the system adopted.

303. *See* discussion *supra* Part III.C.

304. *See supra* notes 10–15 and accompanying text.

305. *See supra* notes 11, 214 (concerning plans for better solicitation).

306. *See supra* notes 104, 285 and accompanying text.

307. *See supra* notes 285–86 and accompanying text.

308. *See* American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 7002 (2009).

309. *See supra* note 3 (concerning President Obama's announcement of HAMP).

Rick Santelli delivered his famous on-air "rant" against the HAMP program, saying "[t]he government is promoting bad behavior," and suggesting a referendum on whether "we want to subsidize the losers' mortgages."[310] He then turned to a group of traders at the Chicago Board of Trade, seated at computers behind him, shouted, "[t]his is America!", and asked, somewhat incoherently, "[h]ow many of you people want to pay for your neighbor's mortgage that has an extra bathroom and can't pay their bills?"[311] He then added, "We're thinking about having a Chicago tea party in July."[312] In short, the announcement of the $75 billion Home Affordable Modification Program served as the immediate trigger of a powerful if not necessarily majority backlash against the Obama Administration and activist government in general in the form of the tea party movement.[313]

The Administration never seemed to have its heart in HAMP program and settled for something that initially sounded big and bold but turned out to be slow and weak and to have only modest results, at least in its first year. Bailout fatigue set in and sapped the will to overcome administrative and political challenges and provide quick and effective mortgage relief to millions of distressed homeowners.

CONCLUSION

On February 18, 2009, shortly after taking office and in a seeming spirit of hope on a beautiful day in Mesa, Arizona, President Obama announced his administration's response to the mortgage crisis, including plans for a new mortgage-modification program:

> So here's what my plan does: establishes clear guidelines for the entire mortgage industry that will encourage lenders to modify mortgages on primary residences . . . .
>
> Here's what this means: If lenders and home buyers work together, and the lender agrees to offer rates that the borrower can afford, then we'll make up part of the gap between what the old payments were and what the new payments will be. Under this plan, lenders who participate will be required to reduce those payments to no more than 31 percent of a borrower's income. And this will

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310. *See Rick Santelli and the Rant of the Year*, YOUTUBE (Feb. 19, 2009), *available at* http://www.youtube.com/watch?v=zp-Jw-5Kx8k&feature=related (showing Rick Santelli responding to questions from his anchors about what he thought of the HAMP program).

311. *See id.*

312. *See id.*; *see also* Michael Barone, Editorial, *The Transformative Power of Rick Santelli's Rant*, NAT'L REV. (June 10, 2010), *available at* http://article.nationalreview.com/435966/the-transformative-power-of-rick-santellis-rant/michael-barone; William Voegeli, *The Meaning of the Tea Party*, CLAREMONT REV. BOOKS (May 27, 2010), *available at* http://www.claremont.org/publications/crb/id.1704/article_detail.asp.

313. Barone, *supra* note 312 (claiming that Santelli provided "both an economic and a moral argument" helping "to explain something contrary to the New Deal historians' teaching that economic distress increases support for big government . . ." and providing "the founding document of the tea-party movement").

> enable as many as 3 to 4 million homeowners to modify the terms of their mortgages to avoid foreclosure.
>
> So this part of the plan will require both buyers and lenders to step up and do their part, to take on some responsibility. Lenders will need to lower interest rates and share in the costs of reducing monthly payments in order to prevent another wave of foreclosures. Borrowers will be required to make payments on time in return for this opportunity to reduce those payments.
>
> And I also want to be clear that there will be a cost associated with this plan. But by making these investments in foreclosure prevention today, we will save ourselves the costs of foreclosure tomorrow—costs that are borne not just by families with troubled loans, but by their neighbors and communities and by our economy as a whole. Given the magnitude of these crises, it is a price well worth paying.[314]

In April 2009, the Home Affordable Modification Program (HAMP) began operations,[315] but it quickly bogged down under servicer reluctance and bureaucratic implementation challenges. Permanent modifications turned out to be incredibly difficult to produce; they accumulated gradually—to 1711 through August and 4742 through September, then to 31,424 through November, and ultimately to 230,801 through March 2010, the end of the first year.[316] But redefaults had already begun and seemed likely to grow quickly, given the high debt burdens and negative equity of borrowers in the program.[317] Meanwhile, over two million homeowners received foreclosure notices in 2009, and millions more were expected to receive them over the next three years.[318]

After the economy recovers and financial stability is regained, Americans and their regulators may eventually be tempted to give in once more to the bubble psychology that produced the foreclosure crisis. They should then remember the disappointing first year of HAMP, a cautionary tale about the difficulty of back-end solutions to a financial crisis, which are likely to be too slow and too weak to reach most of those who suffer the consequences. Prevention of extreme risk-taking in the financial products marketplace is a much better strategy to minimize loss than trying to piece together a fix after a fall.

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314. President Barack Obama, Remarks by the President on the Home Mortgage Crisis (Feb. 18, 2009), http://www.whitehouse.gov/the_press_office/remarks-by-the-president-on-the-mortgage-crisis/.

315. *See supra* note 4.

316. *See supra* notes 144–54 and accompanying text; *supra* Figure 2, Part II.B.4.c.

317. *See supra* notes 162–63, 261–63 and accompanying text.

318. *See supra* note 9 and accompanying text.