DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

July 5, 2013

The Honorable Christy L. Romero
Special Inspector General for the Troubled Asset Relief Program
1801 L Street, NW, 4th Floor
Washington, DC 20036

Re: Treasury Response to SIGTARP HAMP Default Recommendations

Dear Ms. Romero:

I write in response to your recent letter to Secretary Lew that provides four recommendations for the Home Affordable Modification Program (HAMP). The Department of the Treasury (Treasury) welcomes oversight of all its programs, including HAMP, and values input from the Special Inspector General for the Troubled Asset Relief Program (SIGTARP).

Treasury agrees with the broad points you make regarding the importance of trying to minimize the number of borrowers who default on a HAMP-modified loan (re-default). The program was designed specifically with this in mind, and since SIGTARP first began to examine this issue in June 2010, Treasury has taken many additional steps to achieve this. Indeed, studies by the Office of the Comptroller of the Currency (OCC) have found that borrowers in HAMP have consistently exhibited lower delinquency and re-default rates than those in private industry modifications.[1] This letter sets forth below Treasury's thoughts on your specific recommendations and also notes some of the actions Treasury has already taken and is continuing to take to address this issue.

It is important to keep in mind that HAMP targets borrowers in demonstratively difficult financial situations, many of whom are deeply underwater or have financial hardships that have impeded their ability to maintain their mortgage payments. While the program is designed to reduce the default probability of these loans as much as possible, these loans present a higher-than-usual risk of default to begin with. While the housing market and the economy are improving, it is important to acknowledge the variety of challenges homeowners faced during the

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[1] OCC Mortgage Metrics Report, First Quarter 2013, available at http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/mortgage-metrics-2013/mortgage-metrics-q1-2013.pdf

economic crisis, including unemployment and underemployment. These facts limit the ability to achieve a very low re-default rate by program design alone. However, clearly without this program, national foreclosure rates would have been much higher.

OCC Findings on HAMP Modifications

A recent study by the OCC found that 62 percent of HAMP modifications implemented since the third quarter of 2009 either remain current today or had been paid-off by the the first quarter of 2013. The same holds true for only 54 percent of proprietary modifications.[2] The OCC attributes this success to HAMP's design, stating in their report, "these lower post-modification delinquency rates reflect HAMP's emphasis on the affordability of monthly payments relative to the borrower's income, verification of income, and completion of a successful trial-payment period." Attached you will find a chart from the OCC report showing re-default rates for HAMP modifications compared to private modification efforts.

SIGTARP Recommendations

<u>Research and Analysis of HAMP Re-Defaults</u>

SIGTARP's first recommendation is that "Treasury should conduct in-depth research and analysis to determine the causes of re-defaults of HAMP" and should make the findings of this research accessible to the public. Treasury has been conducting research on HAMP modifications since the program began. Treasury will continue to do so and, therefore, is happy to accept the recommendation.

In the interest of being efficient, in addition to doing its own research, Treasury has sought to take advantage of third-party research on this subject. Academic research has typically focused on the causes of default rather than re-default out of a modification, but the economic drivers of both default and re-default are very similar. Such research has generally found that the economic shocks resulting in loss of disposable income combined with negative equity and low home price expectations are important drivers of default. This line of research, combined with preliminary research on the outcomes of privately-executed mortgage modifications, led us to initially focus on mortgage affordability as the critical feature to ensure long-term stability.[3]

This focus has proven to be successful – the research on modifications since our program began has continued to identify payment reduction as the most important driver of stability.

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[2] OCC Mortgage Metrics Report, First Quarter 2013.

[3] OCC Mortgage Metrics Report, First Quarter 2008.

- Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang, and Eileen Mauskopf. 2009.. "Designing Loan Modifications to Address the Mortgage Crisis and the Making Home Affordable Program." Uniform Commercial Code Law Journal 42(1).
- Foote, Christopher L., Kristopher Gerardi, and Paul S. Willen. 2008. "Negative Equity and Foreclosure: Theory and Evidence." The Journal of Urban Economics 64(2): 234–245.
- Haughwout, Andrew, Ebiere Okah, and Joseph S. Tracy. 2009. "Second Chances: Subprime Mortgage Modification and Default." FRB of New York Staff Report No. 417.

Since the beginning of the program, on a quarterly basis, Treasury has summarized HAMP performance data – including information on re-defaults – in the Making Home Affordable (MHA) Program Performance Report. Providing this information helps to ensure that HAMP is being operated to the very highest standards of transparency and accountability.

Our own research has also included a paper we published in July 2012 that discusses the factors influencing HAMP re-defaults.[4] This found that deeper payment reductions lower the probability of re-default. In addition, HAMP re-default rates fall as the post-mark-to-market loan to value ratio (LTV) decreases. We are working on another paper, which we hope to publish later this year, which will look at HAMP re-default rates and their relationship to other key borrower attributes such as credit score, LTV ratios, and pre-modification delinquency status.

Because re-defaults will occur, Treasury also looks at what happens to borrowers who have re-defaulted and whether they continue to avoid foreclosure. Based on the most recent survey data of the largest HAMP servicers, it appears that only a small percentage of borrowers who have re-defaulted in HAMP ultimately go into foreclosure. Approximately eight percent either reinstate or pay off the modified loan. An additional 37 percent receive an alternative modification or payment plan, and 12 percent receive a short sale or deed-in-lieu of foreclosure.[5] This data suggests that, even if a HAMP modification loses good standing, the program has helped many families temporarily who are then able to achieve some other solution that avoids foreclosure. As the housing market and our economy continue to improve, all of these steps further help alleviate the suffering caused by the crisis.

Currently, Treasury is exploring the possibility of conducting consumer-focused surveys on the reasons why homeowners re-default on HAMP modifications. Upon Treasury's invitation for feedback, we recently received suggestions from your staff regarding this research. We are considering these suggestions and will reach out in the future if we have any follow-up questions.

<u>Changes to Reduce HAMP Re-Defaults</u>

SIGTARP's second recommendation is that, "Treasury should modify aspects of HAMP and the other TARP housing programs in ways to reduce the number of re-defaults." Treasury is always looking to improve the program and therefore will of course consider whether further research suggests program changes. As a result of the research that both Treasury and third parties have done to date, we have made a number of adjustments to help avoid re-defaults. These include:

- Increasing the upfront servicer incentive to encourage servicers to modify loans in the early stages of delinquency, since research shows that reaching borrowers earlier is likely to result in a more successful modification;

[4] The Effects of Principal Reduction on HAMP Early Redefault Rates, July 2012. http://www.treasury.gov/resource-center/economic-policy/economic-policy/Pages/Econ-Policy-Research-Paper-Series.aspx.
[5] Source: MHA Servicer survey data for actions completed through March 31, 2013.

- Increasing the incentives for principal reduction on first and second liens, since research shows that modifications with greater payment reductions and lower LTVs tend to have lower re-default rates; and

Every quarter Treasury also releases detailed assessments of servicer performance as part of the monthly MHA Program Performance Report. These assessments have led to improvements in servicer performance and faster help for homeowners seeking assistance.

Early Outreach to Borrowers and Evaluation for Other Assistance Options

SIGTARP's third recommendation is that servicers should be required to "identify and reach out to homeowners that may be at risk of re-defaulting on a HAMP mortgage modification." The fourth recommendation is that "Treasury should require the servicers to include other available alternative assistance options under TARP." We agree with these recommendations and have already taken actions to implement them. Treasury will also assess what types of additional actions can be taken.

Last year, when we launched HAMP Tier 2 (which has more flexible debt-to-income criteria than HAMP Tier 1) we included in its eligibility criteria borrowers who re-default on HAMP Tier 1 modifications. In addition, Treasury has provided that borrowers who have re-defaulted are still eligible for assistance under the Home Affordable Unemployment Program (UP), HAFA, and the Hardest Hit Fund.

MHA rules already require that, "in the event a borrower defaults on the modified loan, a servicer must work with the borrower to cure the modified loan. If that is not possible the servicer must evaluate the borrower for any other loss mitigation alternatives" including HAFA. Borrowers must be contacted between the 31st and 60th day of the delinquency. As we noted earlier, most borrowers who re-default receive some other form of assistance, with only a small percentage of borrowers who re-default ending up in foreclosure.

Treasury is also exploring whether additional steps can be taken to assist borrowers that are at risk of re-defaulting. These might include, for example, ensuring that borrowers are aware of scheduled increases to their monthly mortgage payment well in advance, and encouraging those borrowers to proactively assess their financial situations and plan ahead.

HAMP has Proven to be the Best Option for Struggling Homeowners

While re-default remains an unfortunate outcome for some borrowers, HAMP continues to be the strongest available program for mortgage modification. Since it began, approximately 1.2 million homeowners have received a permanent first-lien modification through HAMP. HAMP has set new standards for mortgage modifications and prompted changes in industry practices. These changes have contributed to a total of 6.6 million public and private modifications and other loss mitigation interventions since early 2009 (including HAMP). Today, borrowers in HAMP continue to demonstrate a high likelihood of long-term success in the program.

Thank you again for your letter. Although you have declined to publish several of our previous responses to your reports and recommendations, I ask that you publish this letter in your next quarterly report to further the public discussion of this important issue. We appreciate your suggestions and look forward to continuing to work with you.

Sincerely,

Tim Massad

Timothy G. Massad
Assistant Secretary for Financial Stability

Appendix[1]

Table 33. **Performance of HAMP Modifications Compared With Other Modifications** (60 or More Days Delinquent)*	Number of Modifications	3 Months After Modification	6 Months After Modification	9 Months After Modification	12 Months After Modification	15 Months After Modification
HAMP First Quarter 2011	53,250	5.8%	9.9%	13.4%	14.9%	16.6%
Other First Quarter 2011	**106,660**	**10.7%**	**20.7%**	**27.6%**	**30.3%**	**32.8%**
HAMP Second Quarter 2011	70,071	5.4%	9.5%	12.1%	13.8%	15.5%
Other Second Quarter 2011	**80,397**	**10.0%**	**22.1%**	**27.7%**	**30.9%**	**32.8%**
HAMP Third Quarter 2011	53,941	5.5%	9.1%	11.5%	14.4%	15.6%
Other Third Quarter 2011	**83,596**	**9.6%**	**17.4%**	**22.1%**	**27.2%**	**29.5%**
HAMP Fourth Quarter 2011	42,275	4.6%	7.6%	10.7%	13.0%	14.2%
Other Fourth Quarter 2011	**73,875**	**10.1%**	**17.0%**	**23.5%**	**27.0%**	**28.3%**
HAMP First Quarter 2012	37,456	4.9%	8.3%	11.2%	12.9%	-
Other First Quarter 2012	**64,701**	**9.3%**	**17.5%**	**23.1%**	**25.4%**	**-**
HAMP Second Quarter 2012	28,673	4.4%	7.9%	10.1%	-	-
Other Second Quarter 2012	**67,949**	**7.4%**	**14.4%**	**17.8%**	**-**	**-**
HAMP Third Quarter 2012	31,746	4.3%	7.7%	-	-	-
Other Third Quarter 2012	**104,570**	**8.0%**	**14.6%**	**-**	**-**	**-**
HAMP Fourth Quarter 2012	29,280	3.8%	-	-	-	-
Other Fourth Quarter 2012	**114,109**	**8.2%**	**-**	**-**	**-**	**-**

[1]Data include all modifications that have had time to age the indicated number of months.