

June 2010

# TROUBLED ASSET RELIEF PROGRAM

## Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs



GAO

Accountability \* Integrity \* Reliability



Highlights of [GAO-10-634](#), a report to congressional committees

## Why GAO Did This Study

Congress created the Troubled Asset Relief Program (TARP) to, among other things, preserve homeownership and protect home values. In March 2009, the U.S. Department of the Treasury (Treasury) announced the Home Affordable Modification Program (HAMP) as its cornerstone effort to achieve these goals. This report examines (1) the extent to which HAMP servicers have treated borrowers consistently and (2) the actions that Treasury has taken to address the challenges of trial modification conversions, negative equity, redefaults, and program stability. GAO obtained information from 10 servicers that account for 71 percent of HAMP funds and spoke with Treasury, Fannie Mae, and Freddie Mac officials.

## What GAO Recommends

GAO recommends that Treasury expeditiously move to establish (1) specific imminent default criteria, (2) additional guidance for servicers' quality assurance programs, (3) requirements for tracking HAMP complaints, (4) communications to inform borrowers to use the HOPE Hotline if they have incorrectly been denied HAMP, (5) consequences for noncompliance with HAMP requirements, (6) reporting of principal forgiveness activity, (7) performance measures and goals for all HAMP-funded programs, and (8) a prudent design for remaining programs. Treasury plans to provide the Congress a detailed description of the actions it has taken and intends to take regarding GAO's recommendations.

View [GAO-10-634](#) or [key components](#). For more information, contact Mathew J. Scire at (202) 512-8678 or [sciremj@gao.gov](mailto:sciremj@gao.gov).

## TROUBLED ASSET RELIEF PROGRAM

### Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs

## What GAO Found

While one of Treasury's stated goals for HAMP was to standardize the loan modification process across the servicing industry, GAO found inconsistencies in how servicers were treating borrowers under HAMP that could lead to inequitable treatment of similarly situated borrowers. First, because Treasury did not issue guidelines for soliciting borrowers for HAMP until a year after announcing the program, servicers notified borrowers about HAMP anywhere from 31 days to more than 60 days after a delinquency. Many borrowers also complained that they did not receive timely responses to their HAMP applications and had difficulty obtaining information about the program. Treasury has recently issued guidelines on borrower communications, and plans to monitor compliance with the guidelines. Second, Treasury has emphasized the importance of reaching borrowers before they are delinquent but has not issued guidelines for determining when borrowers are in imminent danger of default. As a result, the 10 servicers that GAO contacted reported 7 different sets of criteria for determining imminent default. Third, while Treasury required servicers to have internal quality assurance procedures to ensure compliance with HAMP requirements, Treasury did not specify how loan files should be sampled for review or what the reviews should contain. As a result, some servicers did not review trial modifications or HAMP denials as part of their quality assurance procedures. Fourth, Treasury has not specified which HAMP complaints should be tracked, and several servicers track only certain types of complaints. Fifth, Treasury has not clearly informed borrowers that the HOPE Hotline can be used to raise concerns about servicers' handling of HAMP loan modifications and to challenge potentially incorrect denials, likely limiting the number of borrowers who have used the hotline for these purposes. Finally, Treasury does not have clear consequences for servicers that do not comply with program requirements, potentially leading to inconsistencies in how instances of noncompliance are handled.

In March 2010, GAO reported that Treasury faced several additional challenges as it continued to implement HAMP, including (1) converting trial modifications to permanent status, (2) addressing the growing issue of negative equity, (3) reducing redefaults among borrowers with modifications, and (4) ensuring program stability and effective management. While Treasury has taken some steps to address these challenges, it urgently needs to finalize and implement remaining program components and ensure the transparency and accountability of these efforts. First, Treasury has taken steps to increase the number of conversions to permanent modifications, but conversion rates continue to be low. As of the end of May 2010, servicers had converted only 347,000 temporary modifications (31 percent of the total eligible) to permanent status. In addition, as servicers focused on conversions, the number of new trial modifications declined. Roughly 30,000 trial modifications were started in May 2010, down from nearly 63,000 in March 2010. Second, Treasury also announced a principal forgiveness component for HAMP to assist borrowers with negative equity; however, this program will be

voluntary, and Treasury will need to quickly implement reporting of when servicers consider principal forgiveness but choose not to offer it. Such reporting must provide sufficient program transparency and address potential questions of whether borrowers are treated equitably. Third, to help limit redefaults, Treasury requires that borrowers with high total debt agree to obtain counseling. In July 2009, GAO recommended that Treasury monitor and assess the effectiveness of this requirement. However, borrowers continue to have high total debt-to-income ratios (64 percent) after HAMP modifications, underscoring the importance of monitoring and assessing HAMP's counseling requirement. Finally, GAO has recommended that Treasury give high priority to staffing the office responsible for overseeing HAMP implementation and evaluating staffing levels and competencies. However, Treasury has reduced staffing levels in this office from 36 to 29 full-time positions. GAO believes that having sufficient staff is critical to Treasury's ability to design and implement HAMP-funded programs quickly and effectively. For example, Treasury has been slow to implement its previously announced programs, including its second-lien modification and foreclosure alternatives programs. Because the number of foreclosures has remained high, Treasury has announced additional HAMP components that must be prudently designed and

implemented as expeditiously as possible (see table 1). These include the previously discussed principal reduction component of HAMP, a forbearance program for unemployed borrowers, a new Federal Housing Administration refinance program, and a program to fund efforts to preserve homeownership and protect home values in the 10 states hardest hit by the foreclosure crisis.

Going forward, as Treasury continues to design and implement new HAMP-funded programs, it will be important to develop sufficient capacity—including staffing resources—to plan and implement programs, establish meaningful performance measures, and make appropriate risk assessments. In particular, Treasury needs to establish performance measures and goals for all HAMP-funded programs so that Treasury officials and others can effectively assess the design and outcomes of these programs and Congress can provide effective oversight. Treasury's HAMP program is part of an unprecedented response to a particularly difficult time in our nation's mortgage markets that has left many homeowners struggling. As part of its ongoing oversight of TARP, GAO will continue to monitor Treasury's implementation and management of HAMP and other programs designed to help homeowners and their communities.

Table 1: HAMP-Funded Programs

Program	Program Description	Program Status
HAMP First-Lien Modification	First-lien loan modifications	<ul style="list-style-type: none"> <li>Announced in March 2009</li> <li>Implemented in April 2009</li> <li>109 servicers have signed agreements</li> <li>More than 1.2 million trials started—340,000 active permanent modifications, 468,000 active trials, 430,000 trial cancellations, and 6,400 permanent modification cancellations through May 2010</li> <li>\$132 million disbursed in incentive payments as of May 17, 2010</li> </ul>
HAMP Second-Lien Modification	Second-lien loan modifications for HAMP first-lien borrowers	<ul style="list-style-type: none"> <li>Announced in March 2009</li> <li>Implemented in March 2010</li> <li>7 servicers have signed agreements</li> <li>No incentive payments have been made as of May 17, 2010</li> <li>Expected cost and number of borrowers to be helped unknown</li> </ul>
Home Affordable Foreclosure Alternatives	Incentives for short sales or deeds-in-lieu of foreclosure	<ul style="list-style-type: none"> <li>Announced in March 2009</li> <li>Implemented in April 2010</li> <li>No incentive payments have been made as of May 17, 2010</li> <li>Expected cost and number of borrowers to be helped unknown</li> </ul>
Housing Finance Agency (HFA) Hardest-Hit Fund	Funding for state housing finance agencies in the 10 states hardest-hit by the foreclosure crisis	<ul style="list-style-type: none"> <li>Announced in February and March 2010</li> <li>Implementation date yet to be determined</li> <li>\$2.1 billion designated for 10 state HFAs</li> <li>Expected number of borrowers to be helped unknown</li> </ul>
HAMP Principal Reduction	Principal reduction for HAMP-eligible borrowers with high loan-to-value ratios	<ul style="list-style-type: none"> <li>Announced in March 2010</li> <li>Estimated implementation by Fall 2010</li> <li>Expected cost and number of borrowers to be helped unknown</li> </ul>
HAMP Unemployed Borrowers	Temporary principal forbearance for unemployed borrowers	<ul style="list-style-type: none"> <li>Announced in March 2010</li> <li>Estimated implementation in July 2010</li> <li>No expected TARP funds and number of borrowers to be helped unknown</li> </ul>
Federal Housing Administration (FHA) Refinance	Principal reduction and loan refinancing into an FHA loan	<ul style="list-style-type: none"> <li>Announced in March 2010</li> <li>Estimated implementation by Fall 2010</li> <li>\$14 billion designated, but number of borrowers to be helped unknown</li> </ul>

Source: Treasury.

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Figure 4: GSE and Non-GSE HAMP Trial and Permanent Modifications Made Each Month

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**Abbreviations**

2MP	Second-Lien Modification Program
FHA	Federal Housing Administration
GPRA	Government Performance and Results Act of 1993
GSE	government-sponsored enterprise
HAFA	Home Affordable Foreclosure Alternatives Program
HAMP	Home Affordable Modification Program
HARP	Home Affordable Refinance Program
HERA	Housing and Economic Recovery Act of 2008
HFA	Housing Finance Agency
HPDP	Home Price Decline Protection
HPO	Homeownership Preservation Office
HUD	Department of Housing and Urban Development
MHA	Making Home Affordable
MHA-C	Making Home Affordable-Compliance
NPV	net present value
OCC	Office of the Comptroller of the Currency
OFS	Office of Financial Stability
OTS	Office of Thrift Supervision
SIGTARP	Office of the Special Inspector General for TARP
TARP	Troubled Asset Relief Program

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United States Government Accountability Office  
Washington, DC 20548

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### Congressional Committees

In response to the recent financial crisis, the federal government has been seeking ways to help stem the wave of foreclosures and defaults that has affected not only homeowners who have lost or are in danger of losing their homes, but also neighborhoods, local businesses, lenders, and investors. On October 3, 2008, the President signed into law the Emergency Economic Stabilization Act of 2008 (the act) which, among other things, called for the Department of the Treasury (Treasury) to stabilize the financial markets, preserve homeownership, and protect home values.<sup>1</sup> The act authorized Treasury to establish the \$700 billion Troubled Asset Relief Program (TARP), which initially focused on stabilizing financial markets and increasing lending to businesses and consumers.<sup>2</sup> Treasury initially intended to purchase troubled mortgages and mortgage-related assets and to use its ownership position to influence loan servicers and achieve more aggressive mortgage modification standards. However, within 2 weeks of the act's passage, Treasury determined it needed to move more quickly to stabilize financial markets and announced it would use \$250 billion of TARP funds to inject capital directly into qualified financial institutions by purchasing equity in them. On February 18, 2009, Treasury announced the Home Affordability and Stability Plan, which contained the framework for a mortgage modification plan that later became the Home Affordable Modification Program (HAMP). HAMP would use up to \$50 billion in TARP funds to help at-risk homeowners avoid potential foreclosure by modifying their mortgages to reduce their monthly mortgage payments.

Under HAMP, Treasury's Office of Financial Stability (OFS) provides financial incentives to servicers, borrowers, and mortgage holders (or investors for loans that have been securitized and sold in the secondary market) to modify loans that are not owned or guaranteed by Fannie Mae

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<sup>1</sup>Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq.

<sup>2</sup>The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632 (2009), amended the act to reduce the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.741 billion.

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or Freddie Mac.<sup>3</sup> Treasury shares the cost of reducing monthly payments on first-lien mortgages with mortgage holders or investors. The initial descriptions of HAMP also identified a number of subprograms—for example, to modify or pay off second-lien loans for borrowers whose first mortgages were modified under HAMP and to provide incentives to target specific groups of homeowners and geographic areas that were especially hard hit by foreclosures. More recently, in March 2010 Treasury announced additional HAMP-funded programs to assist unemployed borrowers and borrowers who were “underwater”—that is, those who owed more on their mortgages than the value of their homes. Further, Treasury announced that up to \$14 billion of the original \$50 billion in TARP funds allocated for HAMP would be put toward a refinancing program that would allow borrowers to receive principal reductions and refinance into loans insured by the Federal Housing Administration (FHA). Additionally, Treasury has designated \$2.1 billion of the \$50 billion to be provided to 10 states under the Housing Finance Agency (HFA) Innovation Fund for the Hardest-Hit Housing Markets (HFA Hardest-Hit Fund) with the expectation that the states will use this money to develop innovative programs that meet the act’s goals of preserving homeownership and protecting home values. To date, most of the subprograms have yet to be implemented.

The act also requires GAO to conduct ongoing oversight of actions taken under TARP and to report at least every 60 days on TARP activities and performance.<sup>4</sup> Under this statutory mandate, we are continuing to report

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<sup>3</sup>Fannie Mae and Freddie Mac—the government-sponsored enterprises (GSEs)—are private, federally chartered companies created by Congress to, among other things, provide liquidity to home mortgage markets by purchasing mortgage loans, thus enabling lenders to make additional loans. To be eligible for purchase by the GSEs, loans (and borrowers receiving the loans) must meet specified requirements. In September 2008, Fannie Mae and Freddie Mac were placed into federal government conservatorship. For the purposes of the report, we refer to mortgages securitized by the GSEs as guaranteed by the GSEs. Securitization is a process by which the GSEs purchase loans that mortgage lenders originate and put these loans into mortgage securities that are sold in global capital markets. The GSEs then guarantee the mortgage security, which means that when a borrower stops making payments on a loan included in the mortgage security, the GSE will step in and makes those payments to the security’s investors.

<sup>4</sup>GAO is required to report at least every 60 days on findings resulting from, among other things, oversight of TARP’s performance in meeting the purposes of the act, the financial condition and internal controls of TARP, the characteristics of both asset purchases and the disposition of assets acquired, TARP’s efficiency in using the funds appropriated for the program’s operation, and TARP’s compliance with applicable laws and regulations. 12 U.S.C. § 5226(a).

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on Treasury's use of TARP funds to preserve homeownership and protect home values. In July 2009, we reported on Treasury's design and initial implementation of HAMP, making a range of recommendations designed to improve HAMP's transparency and accountability.<sup>5</sup> In March 2010, we testified on continued HAMP implementation challenges that threatened the successful implementation of the program. This 60-day report expands on our March 2010 testimony and examines (1) the extent to which servicers have been treating borrowers consistently under HAMP and the actions that Treasury and its financial agents have taken to ensure consistent treatment of borrowers, and (2) the actions that Treasury has taken to address the challenges involved in converting trial modifications to permanent modifications, limiting potential foreclosures among borrowers with negative equity, reducing the likelihood of redefault among borrowers with permanent modifications, and ensuring program stability and effective program management.

To examine these questions, we spoke with and obtained information from 10 HAMP servicers of various sizes that collectively had been designated 71 percent of the TARP funds allocated to participating servicers to date and visited 6 of them. In addition, we reviewed the HAMP program documentation that Treasury issued, including supplemental directives for the first-lien program and announcements of new HAMP-funded homeowner assistance programs. We obtained and analyzed information from Treasury on servicer HAMP loan modification activity. Our work focused on non-GSE HAMP activity using TARP funds, but the information obtained from Treasury did not always break out GSE and non-GSE activity. We also spoke with officials at Treasury and its financial agents—Fannie Mae and Freddie Mac—to understand their rationale for program changes, their efforts to ensure compliance with HAMP guidelines, and their processes for resolving HAMP complaints. In addition, we spoke to the administrators of the HOPE Hotline and representatives of NeighborWorks, which funds a large network of housing counselors, to

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<sup>5</sup>See appendix II for more information on our July 2009 report recommendations and Treasury's corresponding actions to date.



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learn more about the process for resolving HAMP-related complaints.<sup>6</sup> We also met with a trade association that represents both investors and servicers, and an organization representing a national coalition of community investment organizations. Finally, we reviewed the Government Performance and Results Act of 1993 (GPRA), and the Standards for Internal Control in the Federal Government to determine the key elements needed to ensure program stability and adequate program management.<sup>7</sup> We coordinated our work with other oversight entities that TARP created—the Congressional Oversight Panel, the Office of the Special Inspector General for TARP (SIGTARP), and the Financial Stability Oversight Board.

We conducted this performance audit from August 2009 through June 2010 in San Francisco, Santa Ana, and Simi Valley, California; Littleton, Colorado; West Palm Beach, Florida; Waterloo, Iowa; Boston, Massachusetts; and Washington, D.C., in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on the audit objectives.

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## Background

National default and foreclosure rates rose sharply from calendar year 2005 through 2009 to the highest level in at least 29 years (fig. 1). Default rates declined slightly from the fourth quarter of 2009 to the first quarter of 2010 but, at 4.91 percent, were still more than six times higher than they were at the start of 2005. Foreclosure start rates—the percentage of loans

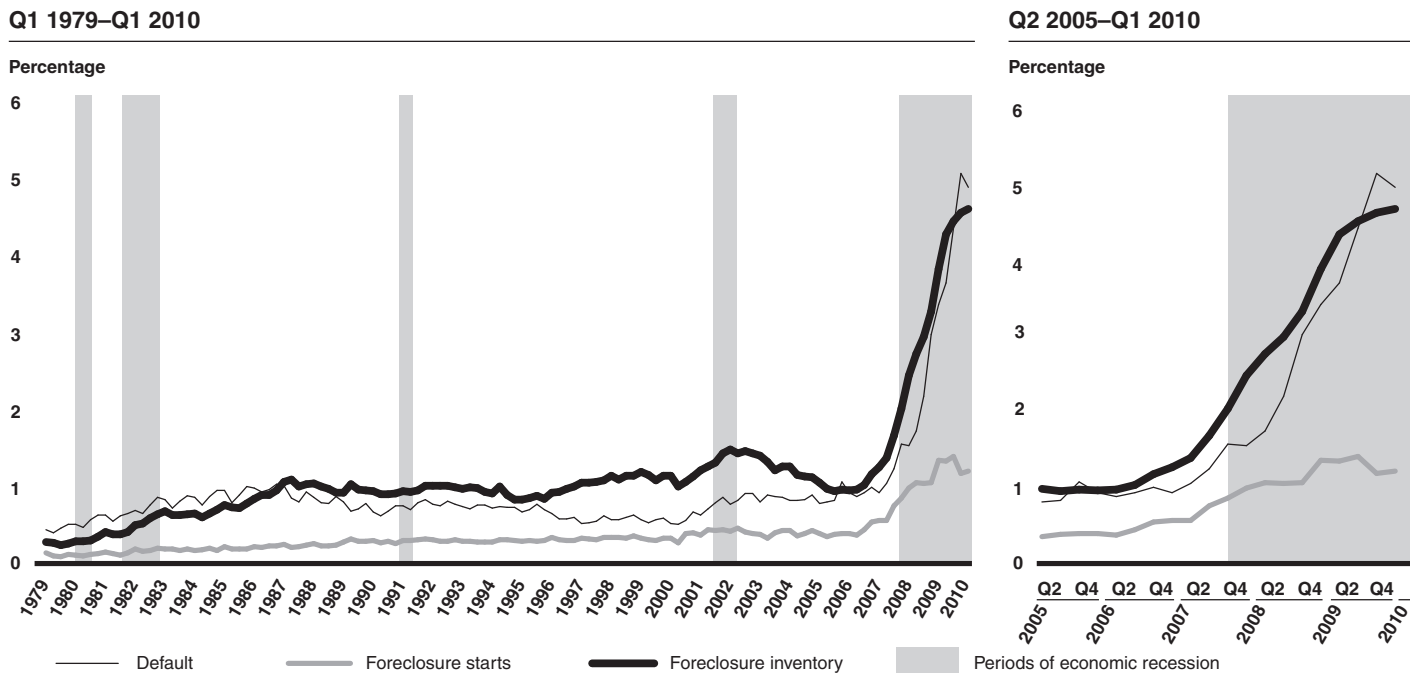
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<sup>6</sup>NeighborWorks America is an organization chartered by Congress that has been appropriated \$475 million in federal funds to operate the National Foreclosure Mitigation Counseling Program. Consolidated Appropriations Act of 2008, Pub. L. No. 110-161, Div. I, Title III, 121 Stat. 1844, 2441 (2007) (\$180 million); Economic Recovery Act of 2008, Pub. L. No. 110-289, Div. B, Title III, § 2305, 122 Stat. 2654, 2859 (2008) (\$180 million); Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, Div. I, Title III, 123 Stat. 524, 982 (2009) (\$50 million); and Consolidated Appropriations Act, 2010, Pub. L. No. 111-117, Div. A, Title III, 123 Stat. 3034, 3108 (2009) (\$65 million). Counseling from an agency approved by the Department of Housing and Urban Development typically includes advice on defaults, foreclosures, and credit issues.

<sup>7</sup>Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993), and GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

that entered the foreclosure process each quarter—grew nearly three-fold in the 5-year period from 0.42 percent to 1.23 percent in the first quarter of 2010. Put another way, more than half a million mortgages entered the foreclosure process in the first quarter of 2010, compared with about 165,000 in the first quarter of 2005. Finally, foreclosure inventory—the number of houses for which the lender has initiated foreclosure proceedings but has not yet sold the properties—rose more than 325 percent from the first quarter of 2005 to the first quarter of 2010, increasing from 1.08 percent to 4.63 percent, with most of that growth occurring after the second quarter of 2007. As a result, as of the end of the first quarter of 2010, more than 2 million loans were in the foreclosure inventory.

**Figure 1: National Default and Foreclosure Trends, Calendar Years 1979–2010**



Source: GAO analysis of MBA data, National Bureau of Economic Research.

As we reported in December 2008, Treasury has established an Office of Homeownership Preservation within OFS to address the issues of

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preserving homeownership and protecting home values.<sup>8</sup> On February 18, 2009, Treasury announced the broad outline of a three-pronged effort to help homeowners avoid foreclosure and provided additional program descriptions on March 4, 2009; April 28, 2009; and May 14, 2009:

- The Home Affordable Refinance Program (HARP), which provides a refinancing vehicle for homeowners who are current on their mortgage payments with mortgages held or guaranteed by Fannie Mae and Freddie Mac, interest rates higher than the prevailing market rates, and loan-to-value ratios of between 80 and 105.<sup>9</sup> Using the prevailing interest rates in February 2009, Treasury estimated that between four and five million borrowers could refinance their mortgages through this program. No TARP funds will be used to refinance these loans. Instead, Fannie Mae or Freddie Mac, as the owner or guarantor of the loan, purchased or guaranteed the refinanced mortgages. The program has resulted in relatively few refinances—between February 2009 and March 2010, fewer than 292,000 borrowers were refinanced through this program. In March 2010, the program’s end date was extended from June 10, 2010, to June 30, 2011.
- An increased funding commitment from Treasury for preferred stock purchases from Fannie Mae and Freddie Mac to strengthen confidence in the two government-sponsored enterprises (GSE) and help support low mortgage rates. The preferred stock purchase agreements, authorized by the Housing and Economic Recovery Act of 2008 (HERA), were amended in May 2009 to increase Treasury’s commitment to each GSE from \$100 billion to \$200 billion. On December 24, 2009, the preferred stock purchase agreements were again amended with the provision that the \$200 billion cap increase as necessary. The increased funding commitment would be made under HERA and would not require the use of TARP funds. Through March 2010, the cumulative reduction in the net worth of the two GSEs required them to draw \$111 billion from the Treasury under the senior preferred stock purchase agreements. In May 2010, the Federal Housing Finance Agency requested an additional \$10.6 billion in Treasury assistance for Freddie Mac and an additional \$8.4 billion for Fannie Mae.

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<sup>8</sup>GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008).

<sup>9</sup>On July 1, 2009, the Federal Housing Finance Agency announced that the maximum loan-to-value rate had been increased to 125 percent.

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- HAMP, which was designed to commit up to \$75 billion of GSE and TARP funds to offer loan modifications to up to three to four million borrowers who were struggling to pay their mortgages. According to Treasury officials, HAMP would use up to \$50 billion of TARP funds, primarily to encourage the modification of non-GSE mortgages that financial institutions owned and held in their portfolios (whole loans) and mortgages held in private label securitization trusts.<sup>10</sup> Fannie Mae and Freddie Mac together are expected to provide up to an additional \$25 billion to encourage servicers and borrowers to modify loans owned or guaranteed by the two GSEs.<sup>11</sup>

As outlined in the March 4, 2009, program guidelines, HAMP's eligibility requirements for first-lien modifications stipulate that:

- the property must be owner-occupied and the borrower's primary residence (the program excludes vacant and investor-owned properties);
- the property must be a single-family property (one to four units) with a maximum unpaid principal balance on the unmodified first-lien mortgage that is equal to or less than \$729,750 (for a one-unit property);<sup>12</sup>
- the loan must have been originated on or before January 1, 2009;
- the borrower must complete a HAMP Hardship Affidavit documenting a financial hardship; and

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<sup>10</sup>Loans held in private-label securitization trusts include loans not securitized by Fannie Mae, Freddie Mac, nor insured or guaranteed by the Department of Housing and Urban Development's FHA, the Department of Veterans Affairs, or rural housing loans. The \$50 billion will be used for loan modifications and other activities.

<sup>11</sup>Any funds provided by Treasury to the GSEs under the preferred stock purchase agreements will, like TARP programs, be funded through the issuance of public debt. Treasury will also issue public debt to cover any losses that the GSEs incur because of the additional \$25 billion they provide, as long as the GSEs have liabilities that exceed assets.

<sup>12</sup>Unpaid principal balance limits (prior to modification) are \$729,750 for a one-unit building; \$934,200 for a two-unit building; \$1,129,250 for a three-unit building; and \$1,403,400 for a four-unit building.

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- the first-lien mortgage payment must be more than 31 percent of the homeowner's gross monthly income.<sup>13</sup>

The HAMP first-lien modification program has four main features:

1. **Cost sharing.** Mortgage holders and investors will be required to take the first loss in reducing the borrower's monthly payments to no more than 38 percent of the borrower's income. For non-GSE loans, Treasury will then use TARP funds to match further reductions on a dollar-for-dollar basis, down to the target of 31 percent of the borrower's gross monthly income. The modified monthly payment is fixed for 5 years or until the loan is paid off, whichever is earlier, as long as the borrower remains in good standing with the program. After 5 years, investors no longer receive payments for cost sharing, and the borrowers' interest rate may increase by 1 percent a year to a cap of the Freddie Mac rate for 30-year fixed rate loans as of the date that the modification agreement was prepared, and the borrower's payments would increase to accommodate the increase in interest rate. The interest rate and monthly payments are then fixed for the remainder of the loan.
2. **Standardized net present value (NPV) model.** The NPV model compares expected cash flows from a modified loan to the same loan with no modification, based on certain assumptions. If the expected investor cash flow with a modification is greater than the expected cash flow without a modification, the loan servicer is required to modify the loan. According to Treasury, the NPV model increases mortgage investors' confidence that modifications under HAMP are in their best financial interests and helps ensure that borrowers are treated consistently under the program by providing a transparent and externally derived objective standard for all loan servicers to follow.
3. **Standardized waterfall.** Servicers must follow a sequential modification process to reduce payments as close to 31 percent of gross monthly income as possible. Servicers must first capitalize accrued interest and certain expenses paid to third parties and add this amount to the loan balance (principal) amount. Next, interest rates must be reduced in increments of one-eighth percent until the 31 percent debt-to-income target is reached, but servicers may not reduce

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<sup>13</sup>The mortgage, or front-end, debt-to-income ratio under the HAMP first-lien component is the percentage of a borrower's income comprising mortgage principal, interest, taxes, insurance, and either condominium, cooperative, or homeowners' association dues.

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interest rates below 2 percent. If the interest rate reduction does not result in a debt-to-income ratio of 31 percent, servicers must then extend the maturity and/or amortization period of the loan in 1-month increments up to 40 years. Finally, if the debt-to-income ratio is still over 31 percent, the servicer must forbear, or defer, principal until the payment is reduced to the 31-percent target. Servicers may also forgive mortgage principal at any step of the process to achieve the target monthly payment ratio of 31 percent, provided that principal reduction is allowed by the investor.<sup>14</sup>

4. **Incentive payment structure.** Treasury will use HAMP funds to provide both one-time and ongoing (“pay-for-success”) incentives for up to 5 years to non-GSE loan servicers, mortgage investors, and borrowers to increase the likelihood that the program will produce successful modifications over the long term and help cover the servicers’ and investors’ costs of modifying a loan.

Borrowers must also demonstrate their ability to pay the modified amount by successfully completing a trial period of at least 90 days before the loan is permanently modified and any government payments are made under HAMP. Treasury has entered into agreements with Fannie Mae and Freddie Mac to act as its financial agents for HAMP. Fannie Mae, as the HAMP program administrator, is responsible for developing and administering program operations including registering servicers and executing participation agreements with and collecting data from them. A separate division within Freddie Mac, the Making Home Affordable-Compliance (MHA-C) team is the HAMP compliance agent, and is responsible for assessing servicer compliance with non-GSE program guidelines, including conducting onsite and remote servicer reviews and audits.

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## Status of HAMP First-Lien Modification Program

As of mid-June 2010, 109 active servicers had signed HAMP Servicer Participation Agreements to modify first-lien mortgages not owned or guaranteed by Fannie Mae and Freddie Mac.<sup>15</sup> Roughly \$39.9 billion in

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<sup>14</sup>The principal forbearance amount is noninterest bearing and nonamortizing and cannot accrue interest under the HAMP guidelines or be amortized over the loan term. Rather, the amount of principal forbearance will result in a balloon payment fully due and payable upon the borrower’s transfer of the property, payoff of the interest bearing unpaid principal balance, or maturity of the mortgage loan.

<sup>15</sup>The GSEs have directed all of their approximately 2,000 servicers to implement parallel HAMP programs on first-lien mortgages owned or guaranteed by the GSEs.

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TARP funds has been committed to these servicers for modification of non-GSE loans. Based on the HAMP Servicer Performance Report through May 2010, more than 1.5 million HAMP trial modifications had been offered to borrowers of GSE and non-GSE loans, and more than 1.2 million of these had begun HAMP trial modifications.<sup>16</sup> Of the trial modifications begun, approximately 468,000 were in active trial modifications, roughly 340,000 were in active permanent modifications, roughly 430,000 trial modifications had been canceled, and roughly 6,400 permanent modifications had been canceled. As of May 17, 2010, more than \$132 million in TARP funds had been disbursed to HAMP servicers.

Borrowers who received permanent first-lien HAMP modifications had high levels of total debt and high loan-to-value ratios. Through the end of May 2010, borrowers receiving permanent HAMP modifications had a median back-end debt ratio (the ratio of total monthly debts to gross monthly income) of roughly 80 percent prior to loan modification. The median reduction in monthly mortgage payments as a result of HAMP was roughly \$514, which reduced these borrowers' median back-end debt-to-income ratio to 64 percent. In addition, according to Fannie Mae, through mid-April 2010, many borrowers continued to be underwater after a HAMP modification, with an average loan-to-value ratio more than 150 percent.

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## Recently Announced HAMP-Funded Programs

In addition to first-lien modifications, in March 2010 Treasury issued revised guidelines for the second-lien modification program under HAMP (2MP), as well as the Home Affordable Foreclosures Alternatives Program (HAFA). However, Treasury has not stated how much of the \$50 billion in TARP funds these two programs are expected to use. 2MP provides incentives to investors, servicers, and borrowers for the modification of second liens if the first lien has been modified under HAMP. Under 2MP, servicers who sign agreements to participate in the program must modify, partially extinguish, or fully extinguish second liens where the first lien has been modified under HAMP. As of June 2010, seven servicers had signed up for 2MP, and at least one of these servicers has initiated trial modifications for second liens. According to Treasury, four of these seven servicers hold more than 50 percent of all second liens. Regarding HAFA, as of April 5, 2010, non-GSE servicers could also begin offering foreclosure

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<sup>16</sup>Roughly 42 percent of borrowers who were either in trial or permanent modifications as of April 17, 2010, had non-GSE loans and therefore fell under the TARP-funded portion of HAMP.

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alternatives, such as short sales and deeds-in-lieu, in cases where the servicer was unable to approve the borrower for HAMP, the borrower did not accept a HAMP trial modification, or the borrower defaulted on a HAMP modification. The program provides incentive payments to investors, servicers, and borrowers for completing these foreclosure alternatives in lieu of foreclosure.<sup>17</sup>

In March 2010, Treasury announced four additional HAMP-funded programs—one for principal reduction under HAMP, one for temporary forbearance for unemployed borrowers, an FHA refinancing program and the HFA Hardest-Hit Fund. Principal reduction and temporary forbearance for unemployed borrowers could be implemented in the summer of 2010, and the FHA refinancing program in the fall, but implementation of the HFA Hardest-Hit Fund programs will vary by state.

- The principal reduction program under HAMP will require servicers to consider principal reduction for HAMP-eligible borrowers with loan-to-value ratios greater than 115 percent. Treasury has not yet finalized the potential amount of TARP funds that will be spent on this HAMP program or the number of borrowers expected to receive principal reductions. Initial program guidelines were issued in June 2010 and the program is expected to be effective for participating HAMP servicers in the fall of 2010.
- Under the plan for temporary forbearance for unemployed borrowers, which will be effective July 1, 2010, servicers will be required to consider unemployed borrowers for a forbearance plan to reduce mortgage payments to an affordable level for the lesser of 3 months or upon notification that the borrower has become reemployed. To be considered, unemployed borrowers must request forbearance before falling behind on three monthly mortgage payments. The servicers must offer forbearance if the borrower's monthly mortgage payments exceed 31 percent of monthly gross income, including unemployment benefits. Treasury has not established how many borrowers are likely to be helped with this feature.

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<sup>17</sup>Under a deed-in-lieu of foreclosure, the homeowner voluntarily conveys all ownership interest in the home to the lender as an alternative to foreclosure proceedings. In a short sale, a house is sold by the homeowner through a real estate agency or other means, rather than through foreclosure, and the proceeds of the sale are less than what the homeowner still owes on the mortgage. The lender must give permission to such a transaction and can agree to forgive the shortfall between the loan balance and the net sales proceeds. Under HAFA, accepting a deed-in-lieu must satisfy the borrower's entire mortgage obligation in addition to releasing the lien on the subject property.



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Once the borrower has found employment, or 30 days before the forbearance period has expired, the servicer must evaluate the borrower for eligibility for a HAMP first-lien modification. According to Treasury, there will be no HAMP incentive payments made for these forbearance plans, so the program will not require TARP funds. Missed payments during the forbearance period are capitalized, and servicers may not collect late fees during the forbearance period. According to Treasury, representatives of investors and the four largest servicers, some servicers are already offering similar forbearance programs to unemployed borrowers.

- The new FHA refinance program will be designated a maximum of \$14 billion of the \$50 billion originally intended for HAMP and will be a voluntary program for servicers. However, if servicers choose this option, they must reduce borrowers' original first-lien principal by at least 10 percent, and the resulting ratio of all mortgage debt, including junior liens, to the value of the house can be no greater than 115 percent. The principal balance of the refinanced first-lien loan cannot exceed 97.75 percent of the home's value. The borrower must be current on existing mortgage payments to qualify and have a credit score of at least 500. The terms and uses of the \$14 billion have yet to be specified.
- The HFA Hardest-Hit Fund designated \$2.1 billion out of the \$50 billion originally intended for HAMP to 10 state housing finance agencies to develop more localized programs to preserve homeownership and protect home values. As of mid-May 2010, Treasury was in the process of reviewing program proposals submitted by the first five housing finance agencies that received funding and expected to receive proposals from the second five state agencies on June 1, 2010. However, according to initial proposals, some program efforts may require significant implementation periods. For example, one state agency reported that some of its program features may not be available until 5 months after Treasury approves the program.

As shown in table 1, the implementation dates for a number of the HAMP-funded homeowner assistance programs have not yet been specified, and Treasury has not announced how many borrowers the programs are expected to help. With the exception of the HFA Hardest-Hit Fund, the cutoff date for borrowers to be accepted into any of the HAMP-funded programs is December 31, 2012, and disbursements of TARP funds may continue until December 2017. The cutoff date and last possible disbursement for the HFA Hardest-Hit Fund has yet to be determined.

**Table 1: HAMP-Funded Programs**

<b>Program</b>	<b>Program description</b>	<b>Program status</b>
HAMP First-Lien Modification	First-lien loan modifications	<ul style="list-style-type: none"><li>• Announced in March 2009</li><li>• Implemented in April 2009</li><li>• 109 servicers have signed agreements</li><li>• More than 1.2 million trials started—340,000 active permanent modifications, 468,000 active trials, 430,000 trial cancellations, and 6,400 permanent modification cancellations through May 2010</li><li>• More than \$132 million disbursed in incentive payments as of May 17, 2010</li></ul>
HAMP Second-Lien Modification	Second-lien loan modifications for HAMP first-lien borrowers	<ul style="list-style-type: none"><li>• Announced in March 2009</li><li>• Implemented in March 2010</li><li>• 7 servicers have signed agreements</li><li>• No incentive payments have been made as of May 17, 2010</li><li>• Expected cost and number of borrowers to be helped unknown</li></ul>
Home Affordable Foreclosure Alternatives	Incentives for short sales or deeds-in-lieu of foreclosure	<ul style="list-style-type: none"><li>• Announced in March 2009</li><li>• Implemented in April 2010</li><li>• No incentive payments have been made as of May 17, 2010</li><li>• Expected cost and number of borrowers to be helped unknown</li></ul>
HFA Hardest-Hit Fund	Funding for state housing finance agencies in the 10 states hardest-hit by the foreclosure crisis	<ul style="list-style-type: none"><li>• Announced in February and March 2010</li><li>• Implementation date yet to be determined</li><li>• \$2.1 billion designated for 10 state HFAs</li><li>• Expected number of borrowers to be helped unknown</li></ul>
HAMP Principal Reduction	Principal reduction for HAMP-eligible borrowers with high loan-to-value ratios	<ul style="list-style-type: none"><li>• Announced in March 2010</li><li>• Estimated implementation by Fall 2010</li><li>• Expected cost and number of borrowers to be helped unknown</li></ul>
HAMP Unemployed Borrowers	Temporary principal forbearance for unemployed borrowers	<ul style="list-style-type: none"><li>• Announced in March 2010</li><li>• Estimated implementation in July 2010</li><li>• No expected TARP funds and number of borrowers to be helped unknown</li></ul>
FHA Refinance	Principal reduction and loan refinancing into an FHA loan	<ul style="list-style-type: none"><li>• Announced in March 2010</li><li>• Estimated implementation in Fall 2010</li><li>• \$14 billion designated, but number of borrowers to be helped unknown</li></ul>

Source: Treasury.

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## Servicers' Solicitation and Evaluation of Borrowers for HAMP Have Been Inconsistent, and More Treasury Action Is Immediately Needed To Ensure Equitable Treatment of Borrowers with Similar Circumstances

Although one of Treasury's stated goals for HAMP is to standardize the loan modification process across the servicing industry, we identified several areas of inconsistencies in how servicers treat borrowers under HAMP. These areas of inconsistency could lead to inequitable treatment of similarly situated borrowers, and borrowers in similar circumstances could have different outcomes. First, we found that servicers differed in when and how they solicited borrowers for HAMP, and numerous borrowers had complained that they did not receive timely responses to their HAMP applications or had difficulty getting information from their servicers about the program. Until March 2010, a year into the program, Treasury had only minimal requirements for soliciting borrowers for HAMP and had yet to finalize comprehensive measures that addressed servicers' performance in this area. Further, Treasury had not issued specific guidelines for servicers on how to determine whether borrowers current on their mortgage payments were in imminent danger of default or for conducting internal quality assurance reviews. Treasury also had not provided servicers with specific requirements detailing how servicers should handle and track borrowers' complaints about HAMP. As a result, some servicers that we contacted did not systematically track all HAMP complaints or their resolutions, and borrowers may not have been aware that an independent escalation process existed to handle complaints about servicers or to challenge HAMP eligibility denial determinations. Lastly, Treasury had not yet determined specific remedies for servicer noncompliance with HAMP program requirements—a key enforcement mechanism for ensuring that servicers treated borrowers equitably under HAMP.

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## Treasury Has Taken Steps to Improve Servicer Communications with Borrowers about HAMP but Issues Remain

For the first year of the HAMP first-lien program, Treasury's key guidance on its requirements for the initial outreach to or solicitation of borrowers for participation in HAMP stated that servicers should follow their existing practices for soliciting borrowers. The 10 servicers we contacted reported varying practices, with a few soliciting borrowers who were 31 days delinquent on payments and some others not soliciting borrowers until borrowers were at least 60 days delinquent on payments. However, even when servicers said their practice was to solicit borrowers who were 60 days past due, they very often did not. The proportion of borrowers who were 60 days delinquent on their mortgages and who were solicited for HAMP ranged from 16 to 95 percent. On average, the 10 servicers we

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contacted solicited approximately 60 percent of such borrowers.<sup>18</sup> Some servicers explained that they did not solicit certain borrowers because, for example, the borrowers did not meet basic eligibility criteria or because the investors for that particular pool of mortgage-backed securities did not allow HAMP modifications. However, as of December 2009, the MHA-C group within Freddie Mac, the compliance agent for HAMP, identified four servicers through their onsite Management Compliance Audits that could not always provide evidence that borrowers who were potentially eligible for HAMP had been solicited.

In March 2010, more than a year after the program was first announced, Treasury issued additional guidelines governing solicitation efforts. Effective June 2010, servicers must prescreen all first-lien loans with two or more mortgage payments are due and unpaid to determine if the loans meet the basic HAMP eligibility criteria (e.g. the home is an owner-occupied, primary residence and a single family one-to-four unit property; the loan originated before January 1, 2009; and the loan balance is within specified limits). Servicers must make a “reasonable effort” to solicit for HAMP any borrower who passes this prescreening—that is, servicers must make a minimum of four telephone calls to the borrower’s last known phone number at different times of the day and send two written notices, by different means, to the borrower’s last known address within 30 days. Because these are new requirements, we could not determine how effective they might be in standardizing solicitation practices, but standardizing solicitation requirements may help ensure that all potentially eligible borrowers are notified about HAMP in a timely manner.

Moreover, it appears that some borrowers had problems reaching their servicers and obtaining information on the status of their applications and on HAMP in general. For example, between the end of June 2009 and mid-April 2010, approximately 27,000 of the more than 48,000 borrower complaints to the HOPE Hotline—a 24-hour telephone line that provides borrowers with free foreclosure prevention information and counseling—were about this issue. The most common complaints involved the difficulty of reaching servicers or not hearing back from them in a timely manner after submitting documentation. During our visits to six HAMP servicers, we observed a small sample of phone calls between borrowers

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<sup>18</sup>Servicers reported the number of non-GSE borrowers who were 60 days delinquent at the time they signed a servicer participation agreement for HAMP, and the percentage of these borrowers that had been solicited as of December 31, 2009.

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and their servicers, several of which involved complaints about the difficulty of contacting servicers about HAMP. For example, four out of the nine calls we observed at one of the large HAMP servicers involved complaints related to servicers' communications with borrowers. These included complaints that the servicer had lost documentation and that the borrower was not able to speak with a representative knowledgeable about the status of the HAMP application.

In October 2009 and in March 2010 Treasury implemented guidelines attempting to address some of these issues. Guidelines issued in October 2009 mandated that servicers acknowledge in writing the receipt of borrowers' initial HAMP application packages within 10 business days and that they include in their responses a description of their evaluation process and timeline for processing paperwork. Additionally, in March 2010, servicers were required to include a toll-free number in all communications with borrowers, which would allow them to reach a representative capable of providing specific details about the HAMP modification process. In April 2010, the Congressional Oversight Panel recommended that Treasury monitor program participants and enforce the new borrower outreach and communication standards and timelines to increase program transparency.<sup>19</sup> Treasury plans to include the new program requirements in MHA-C's compliance reviews of HAMP servicers, and it will be important for Treasury to review findings from these reviews to determine whether these requirements do improve servicers' communications with borrowers and fully address differences among servicers in soliciting borrowers for HAMP.

Treasury first drafted metrics to assess HAMP servicers' performance in communicating with borrowers in October 2009, but these metrics have not yet been finalized. In December 2009, Treasury requested that nine of the largest HAMP servicers provide information on a revised version of these metrics, and Treasury officials told us they were using the results of this request to further revise the metrics to ensure consistent and comparable responses.<sup>20</sup> According to Treasury, the preliminary metrics include measures such as the average speed for answering loss mitigation calls and the number of attempts made to contact each borrower who is in

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<sup>19</sup>Congressional Oversight Panel, *April Oversight Report: Evaluating Progress on TARP Foreclosure Mitigation Programs* (Washington, D.C., Apr. 14, 2010).

<sup>20</sup>According to Treasury officials, 1 servicer among the top 10 servicers was inadvertently left out of the survey.

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the initial stages of foreclosure. Preliminary results showed inconsistencies among servicers' responses that could indicate differences either in how servicers were interpreting the questions or in how they treated borrowers. In our July 2009 report, we noted that Treasury lacked finalized performance measures for HAMP.<sup>21</sup> Since then, the Congressional Oversight Panel and SIGTARP have recommended that Treasury collect additional program data and publicly report on the metrics to ensure transparency and evaluate program success.<sup>22</sup> Treasury officials told us they would continue to work with servicers on their responses to these metrics to finalize them and establish a common reporting standard. Treasury plans to collect these metrics for the eight largest HAMP servicers and publicly disclose the results in July 2010. Without establishing key performance metrics and reporting of individual servicer performance with respect to those metrics, Treasury cannot achieve full transparency and accountability for the HAMP first-lien modification program results and progress.

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### Servicers May Be Inconsistently Treating Similarly Situated Borrowers for HAMP Due to Treasury's Lack of Guidance on Determining Imminent Default and Conducting Quality Assurance Reviews

While Treasury's goal is to create uniform, clear, and consistent guidance for loan modifications across the servicing industry, as we noted in March 2010, Treasury has not provided specific guidance on how to determine whether borrowers are in imminent danger of default.<sup>23</sup> As also noted in SIGTARP's March 2010 report on HAMP, this lack of consistent and clear standards could mean that servicers are inconsistently applying criteria in this area and thereby inequitably treating borrowers across the program.<sup>24</sup> According to HAMP guidelines, borrowers who are current or less than 60 days delinquent on their mortgage payments but in imminent danger of defaulting may be eligible for HAMP modifications, and Treasury has emphasized the importance of reaching borrowers before they are

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<sup>21</sup>GAO, *Troubled Asset Relief Program: Treasury Actions Needed to Make the Home Affordable Modification Program More Transparent and Accountable*, [GAO-09-837](#) (Washington, D.C.: July 2009).

<sup>22</sup>Congressional Oversight Panel, April 2010, and Office of the Special Inspector General for the Troubled Asset Relief Program, *Factors Affecting Implementation of the Home Affordable Modification Program*, SIGTARP-10-005 (Washington, D.C., Mar. 25, 2010).

<sup>23</sup>GAO, *Troubled Asset Relief Program: Home Affordable Modification Program Continues to Face Implementation Challenges*, [GAO-10-556T](#) (Washington, D.C.: March 2010).

<sup>24</sup>Office of the Special Inspector General for the Troubled Asset Relief Program, March 2010.

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delinquent. In particular, Treasury instituted additional incentives to servicers and investors for modifying loans for such borrowers. According to Treasury, 22.9 percent of all trial modifications started as of May 2010 were in this category. Treasury stated that it did not create such guidelines when developing HAMP because it was focused primarily on delinquent borrowers. However, Fannie Mae and Freddie Mac have had standardized imminent default criteria since late April 2009 for modifications of loans owned or guaranteed by the GSEs, and in January 2010 (with an effective date of March 1, 2010) further aligned these guidelines to provide greater consistency between the two GSEs.<sup>25</sup> Treasury officials have stated that they plan to monitor the impact of servicers' implementation of the new GSE imminent default guidance over the next few months. Treasury then plans to determine whether it will adopt similar criteria for non-GSE loans.

As a result of the lack of specific guidance, we found seven different sets of criteria for determining imminent default among the 10 servicers we contacted. The seven sets of criteria that we found varied in both the types of information the servicers considered and in the thresholds they set for factors such as income and cash reserves. Two servicers considered borrowers who met the basic HAMP eligibility requirements (greater than 31 percent monthly mortgage debt-to-income ratio, one-to-four unit single family residence, etc.) in imminent default and the servicers did not impose any additional criteria on them. Three servicers aligned their imminent default criteria for their non-GSE portfolios with the imminent default criteria that the GSEs required for their loans prior to March 1, 2010. In addition to the basic HAMP eligibility requirements, these criteria require borrowers to have cash reserves of no more than 3 months of housing payments (including monthly principal, interest, property tax, insurance, and either condominium, cooperative, or homeowners' association payments) and a ratio of disposable net income to monthly housing payments (debt coverage ratio) of less than 120 percent. One servicer had begun using the new GSE criteria that sets a new maximum cash reserves limit of \$25,000 and does not have debt coverage ratio requirements for its non-GSE loans. The remaining four servicers included various additional considerations among their criteria, including:

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<sup>25</sup>In order to identify borrowers in imminent default, Freddie Mac has created the Imminent Default Indicator™, a statistical model that predicts the likelihood of default or serious delinquency for mortgage loans that are current or less than 60 days delinquent. On March 1, 2010, and June 1, 2010, this tool and maximum borrower cash reserves of \$25,000 became the primary imminent default criteria for Freddie Mac and Fannie Mae loans, respectively.

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- a sliding income scale for the borrower's mortgage debt-to-income ratio;
  - an increase in expenses or decrease in income that is more than a certain percentage of income;
  - a loan-to-value ratio that is above a certain percentage; and
  - a "hardship" situation lasting longer than 12 months.

These differences in criteria may result in one borrower being approved for HAMP, and another with the same financial situation and loan terms being denied by a different servicer. In addition, if a servicer has few or no additional imminent default criteria, the servicer may be offering HAMP modifications to borrowers who may not actually be at true risk of defaulting on their loan. However, if a servicer has very stringent criteria, it may be denying HAMP modifications to borrowers who will ultimately default on their loans because of unaffordable monthly mortgage payments.

To account for differences in servicers' loan portfolios, Treasury specifically allows some differences in how servicers evaluate borrowers for HAMP that could result in inconsistent outcomes for borrowers. For example, servicers may add a risk premium of up to 2.5 percent to the Freddie Mac rate for 30-year fixed mortgages when inputting the discount rate to the NPV model used in evaluating eligibility for HAMP. The NPV model compares the net present value of expected cash flows to the investor from a loan that receives a HAMP modification with the expected cash flows of the same loan with no modification (also considering the likelihood that the loan would end in foreclosure). If the estimated cash flow with a modification is "positive" (i.e., equal to or more than the estimated cash flow of the unmodified loan), the loan servicer is required to make the HAMP modification. The higher the risk premium a servicer chooses, the fewer the number of loans that are likely to pass the NPV model, because expected future cash flows would have less value. Servicers must apply one risk premium to all loans held in their portfolio and one to loans serviced for other investors. Treasury noted that it chose to allow this variation because mortgage holders and investors could have different opportunity costs of capital and different interpretations of risk. Of the 10 servicers we interviewed, 3 servicers (2 large and 1 medium-sized servicers) added the full 2.5 percent risk premium allowable, while the other 7 servicers did not add an additional risk premium. According to our analysis of Treasury data, as of April 17, 2010, 11 servicers used a risk premium, most of them the full 2.5 percent.



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Of concern, MHA-C, through its compliance audits, found that 15 of the largest 20 participating servicers did not comply with various aspects of the program guidelines in their implementation of the NPV model. This lack of compliance likely resulted in differences in how borrowers were evaluated, and could have resulted in the inequitable treatment of similarly situated borrowers. Servicers have two options for implementation of the NPV model. Either they may use the Treasury version of the NPV model housed on a Web portal hosted by Fannie Mae in its capacity as Treasury's financial agent, or they may recode the NPV model to run it on their own internal systems. Among seven servicers that had recoded the NPV model to run it on their own internal systems, MHA-C found that the servicers had failed to hold certain data constant when rerunning the NPV model for borrowers they were evaluating for a permanent HAMP modification. HAMP guidelines state that only income-related inputs or incorrect data can be changed during a second NPV model run. But because these servicers often linked the NPV model with their servicing system, values for inputs such as property values and credit scores were erroneously updated during the rerunning of the NPV model. In these cases, MHA-C required the servicer to make the appropriate fixes so that their in-house models were consistent with the Treasury model. Until such fixes were made, MHA-C required the servicers to refrain from denying permanent modifications because of negative NPV results unless these results were validated by the Treasury version of the NPV model housed on the Fannie Mae Web portal with the appropriate data values. In addition, MHA-C has required these servicers to proactively resolicit any borrowers who were incorrectly denied a permanent HAMP modification due to the NPV errors.

Eight servicers that exclusively use the Fannie Mae Web portal had similar problems with their NPV inputs when rerunning the NPV model while evaluating borrowers for a permanent modification. In these cases, servicers have been required to reanalyze loans that were affected by the error and outline a corrective action plan. Although MHA-C notified almost all of the 15 servicers of these errors in February 2010, some of the servicers are still in the process of analyzing which borrowers were affected, and MHA-C is monitoring the servicers' progress in these analyses and has instructed servicers not to conduct foreclosure sales until remediation activities are complete. According to Treasury, the number of borrowers who were denied because of a servicer's NPV errors could range from a handful to thousands, depending on the size of the servicer and the extent of the error.

In addition, servicers themselves have identified process errors that led to inconsistencies in how they were evaluating borrowers for HAMP through

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their quality assurance reviews. We reviewed quality assurance reports from the 10 servicers we interviewed and found that the error rates for the calculation of borrower income were well above the servicers' own established error thresholds, often set at 3 to 5 percent. In fact, half of these servicers reported at least a 20-percent error rate for the loan modifications sampled during the most recent review provided to us. Without accurate income calculations, similarly situated borrowers applying for HAMP may be inequitably evaluated for the program and may be inappropriately deemed eligible or ineligible for the program. Some servicers also found other types of errors, such as failing to include condominium association dues in the monthly target housing payment; charging borrowers fees prohibited by HAMP guidelines—for example, for property valuation; and not reducing the monthly mortgage payment for the HAMP modification to 31 percent or less of the borrower's gross monthly income. As a result of these audit findings, servicers implemented process improvements and corrective actions. Some of the servicers resolicited borrowers who were incorrectly turned down for HAMP, while others implemented additional controls to their evaluation processes, such as additional reviews and enhanced technology systems to aid in the income calculation process. Most of the servicers implemented additional training for staff in the specific areas in which errors were found. For example, one servicer held training on calculating rental income and income for self-employed borrowers, since these types of income calculations accounted for a large portion of errors.

However, a lack of specific guidelines has also led to significant variations in servicers' quality assurance programs for HAMP. According to the Standards for Internal Control in the Federal Government, the scope of internal program evaluations should be appropriate and reflect the associated risks.<sup>26</sup> Treasury guidance requires servicers to develop and execute internal quality assurance programs to ensure compliance with HAMP, but its guidelines are not sufficiently specific to ensure that servicers are mitigating all of the potential program risks. For example, potential program risks include improper offers of permanent and trial HAMP modifications, as well as improper denials of both permanent and trial modifications. However, while Treasury's guidelines state that servicers must include either a statistically based sample (with a 95 percent confidence level) or a 10-percent stratified sample of loans modified, drawn within 30 to 45 days of the final modification, Treasury

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<sup>26</sup>[GAO/AIMD-00-21.3.1](#).

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does not specify whether trial and permanent modifications should be sampled separately or whether denied modifications should be sampled at all. According to Treasury, MHA-C has suggested to servicers that their quality assurance procedures should include evaluations of the whole HAMP population, including those in trial modifications and those denied HAMP, but servicers receive this feedback only after MHA-C completes its compliance reviews. Only 4 of the 10 servicers we interviewed separately sampled active trial modifications, approved permanent modifications, denied trial modifications, and denied permanent modifications, a methodology that allowed them to review statistically significant samples within each of these categories. Three of the servicers we interviewed did not review a representative sample of approved trial modifications, and two of the servicers did not review a representative sample of denied modifications. In addition, one servicer we interviewed did not sample its HAMP modifications separately from its proprietary modifications and therefore reviewed too few HAMP modifications to result in HAMP-specific findings.

Treasury guidelines also do not specify required areas of review, and we found variations in the content of servicers' quality assurance reviews. For example, while most servicers we interviewed recalculated borrowers' income for the loans that they sampled as part of their quality assurance procedures, half of the servicers did not review the inputs for the NPV model despite the key role that the model plays in determining whether or not a borrower qualifies for HAMP. In addition, while 8 of the 10 servicers we interviewed performed some type of quality assurance review on denied HAMP modifications, one of these servicers focused its reviews only on whether denial letters were sent to the borrowers and not on whether the borrowers were appropriately denied HAMP. As part of its HAMP compliance procedures, MHA-C has outlined more specific expectations for what servicers should include in their internal quality assurance reviews, but these expectations are not published or shared with servicers prior to their MHA-C compliance reviews. Without more specific guidance in this area from Treasury, some servicers may continue to have less robust quality assurance procedures and thereby risk not identifying practices that may lead to inequitable treatment of borrowers or harm taxpayers through greater potential for fraud or waste in the program.

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**Servicers Had Different Processes for Handling HAMP Complaints and Treasury Had Not Clearly Communicated to Borrowers about or Ensured the Effectiveness of the Process for Challenging HAMP Eligibility Determinations**

Treasury has directed HAMP servicers to have procedures and systems in place to respond to HAMP inquiries and complaints and to ensure fair and timely resolutions. However, some servicers were not systematically tracking HAMP complaints or their resolutions, making it difficult for Treasury to determine whether this requirement was being met. For example, according to Treasury, a compliance review conducted by MHA-C in the fall of 2009 cited a servicer for not tracking, monitoring, or reporting HAMP-specific complaints. In the absence of an effective tracking system, the compliance agent could not determine whether the complaints had been resolved. Similarly, several of the servicers we interviewed indicated that they tracked resolutions only to certain types of complaints. For instance, several servicers told us that they tracked only written HAMP complaints and handled these written complaints differently depending on the addressee. Without tracking all complaints, it is not possible for any internal or external review to determine whether complaints had been properly handled.

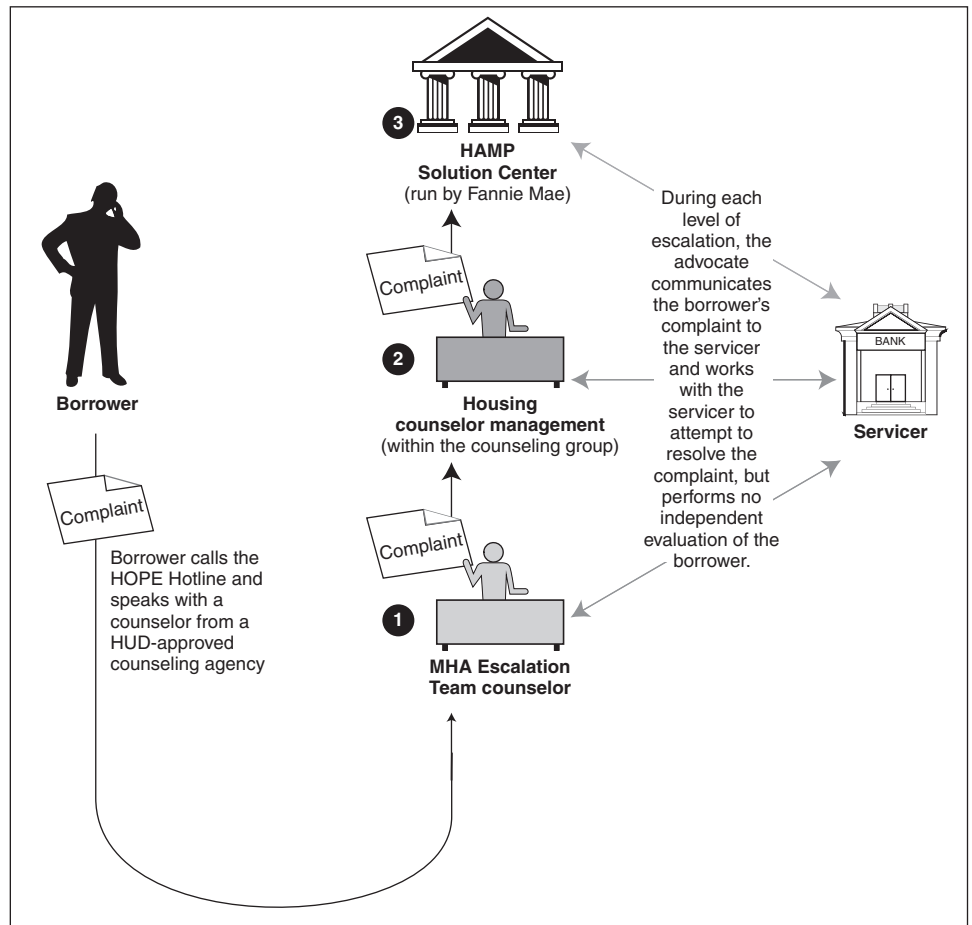
Fannie Mae, in its role as the administrator for HAMP, has contracted with the HOPE Hotline to handle incoming borrower calls about HAMP. Borrowers may obtain information about the program and assess their preliminary eligibility, or discuss their individual situations, which may include complaints about their servicer or about potentially incorrect denials. Borrowers calling the hotline with a HAMP complaint can be transferred to a housing counseling agency approved by the Department of Housing and Urban Development (HUD), and when the complaint pertains to a borrower assertion that they have been wrongfully denied a modification or that their servicer has not applied program guidelines appropriately, the borrower is transferred to the Making Home Affordable (MHA) Escalation Team, which is housed within a HUD-approved counseling agency. If additional intervention is needed, the counselor is to “escalate” the complaint to the housing counseling agency’s management (fig. 2). As of mid-April 2010, more than 37,000 borrower complaints had been escalated to the MHA Escalation Team, and an unknown number had been escalated to the housing counseling agency’s management. Through mid-April 2010, more than 4,000 calls to the HOPE Hotline were about potentially incorrect denials for a HAMP modification. According to Fannie Mae, between January and April 2010 the housing counseling agency that handles HOPE Hotline escalations resolved 99 percent of its complaints within 4 days.

Complaints that the counseling agency’s management cannot resolve are referred to an escalation team within Fannie Mae known as the HAMP Solution Center, which also handles escalations on behalf of borrowers

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referred by housing counselors and government agencies outside of the HOPE hotline. As of April 1, 2010, more than 3,700 complaints had been escalated to this team. Of these escalated complaints, nearly 2,900 had been resolved, with 19 percent of the resolved escalations resulting in the initiation of a trial or permanent modification and approximately 35 percent in a determination of ineligibility. An additional 17 percent were referred back to the servicers or the HOPE Hotline, and the remaining 29 percent had other outcomes—for example, some were referred to other loss mitigation alternatives, and no action was taken on others. Fannie Mae has set a goal of 7 business days for the HAMP Solution Center to resolve complaints, but as of mid-April 2010, the average resolution time was 23 days.

**Figure 2: Steps in the Escalation Process Available to Borrowers through the HOPE Hotline**



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

It is unclear whether the HOPE Hotline and escalation processes are effective mechanisms for resolving concerns about potentially incorrect HAMP denials. At each level of the escalation process, the party handling the complaint works with the servicer and the borrower (or borrower advocate) to obtain information or actions that would resolve it. Neither the MHA Escalation Team counselor nor HAMP Solution Center staff review the borrower's application or loan file; rather, further reviews of borrowers are to be conducted by the servicers. According to Treasury, it would be difficult to obtain borrower's loan files because they are so large. Instead, Treasury officials told us that they were working toward providing MHA Escalation Team counselors and HAMP Solution Center

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staff with access to some information from the loan files, such as whether the investor would allow the loan to be modified under HAMP, that could be used during the escalation process. In addition, Fannie Mae has set up a quality assurance process for housing counselors who handle MHA escalations that includes monitoring and scoring of counselors' calls with borrowers. Although this quality assurance process evaluates the way counselors resolve borrowers' concerns, it is not clear how the evaluators could determine whether the resolutions were correct, since the evaluators also lack access to the borrowers' loan files. As a result, servicers maintain discretion in determining how to resolve borrowers' concerns about potentially incorrect HAMP denials. Further calling into question the effectiveness of the escalation process, in its April 2010 report on HAMP, the Congressional Oversight Panel raised additional concerns about the effectiveness of the HOPE Hotline by stating that it is unclear whether the HUD-approved housing counseling agencies that work with the HOPE Hotline have sufficient capacity or adequate training to properly handle borrower requests for assistance.<sup>27</sup>

While the HOPE Hotline escalation process is the primary means for borrowers to raise concerns about their servicer's handling of their HAMP applications and potentially incorrect denials, Treasury has not explicitly informed borrowers that the hotline can be used for these purposes. For example, the Making Home Affordable Web site states only that the HOPE Hotline provides help with the program and no-cost access to counselors at a HUD-approved housing counseling agency. Treasury also requires that servicers provide information in their denial letters about the HOPE Hotline, with an explanation that the borrower can seek assistance at no charge from a counselor at a HUD-approved housing counseling agency and can request assistance in understanding the denial notice. Neither of these communication mechanisms fully informs borrowers that they can call the HOPE Hotline to voice concerns about their servicer's performance or decisions and therefore may limit the number of borrowers who use the hotline for these purposes. For example, as of mid-April 2010, less than 2 percent of the more than 48,000 calls to the hotline were from borrowers who felt they had wrongfully been denied under the Making Home Affordable program, which could include HAMP.

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<sup>27</sup>Congressional Oversight Panel, April 2010.

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## Treasury has Taken Steps to Address Servicers' Compliance with HAMP Requirements but Has Not Clearly Stated the Consequences for Noncompliance

Treasury has taken some steps to ensure that servicers comply with HAMP program requirements, including those related to the treatment of borrowers, but has yet to establish specific consequences or penalties for noncompliance with HAMP guidelines. We first reported in July 2009 that Treasury had not yet formalized a policy to assess remedies for noncompliance among servicers.<sup>28</sup> The HAMP servicer participation agreement describes actions that Fannie Mae, as program administrator (at Treasury's direction), may take if a servicer fails to perform or comply with any of its material obligations under the program, but does not lay out the specific conditions under which these actions should be taken. In October 2009, Treasury established the HAMP Compliance Committee to monitor the performance and activities of servicers based on information gathered by Fannie Mae, MHA-C, and others. According to Treasury, the compliance committee—comprised of staff from Treasury, Fannie Mae, and MHA-C—has drafted a policy to establish consequences for servicer noncompliance with HAMP program requirements. Treasury officials told us that the policy was initially approved in October 2009, but following an internal review the compliance committee determined that it needed more experience with servicers' performance before finalizing the policy. The committee is still redrafting the policy, and Treasury expects that it will be internally reviewed again in June 2010. Until the policy is finalized, the committee has instructed MHA-C to report all issues of servicer noncompliance to the committee which then evaluates these issues on a case-by-case basis, leaving open opportunities for inconsistencies in how incidences of noncompliance are remedied. According to Treasury, no financial remedies have been issued to date, though Treasury has required MHA-C to perform more targeted reviews, as well as directed MHA-C to require some servicers to take action to correct areas of noncompliance. In its April report on HAMP, the Congressional Oversight Panel recommended that Treasury ensure compliance through established enforcement mechanisms that provide a clear message of the consequences for servicer actions to increase program accountability.<sup>29</sup> Without standardized remedies for noncompliance, Treasury risks inconsistent treatment of servicer noncompliance and lacks transparency with respect to the severity of the steps it will take for specific types of noncompliance.

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<sup>28</sup> [GAO-09-837](#).

<sup>29</sup> Congressional Oversight Panel, April 2010.



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## Treasury Has Taken Steps to Address Conversion, Negative Equity, Redefault, and Program Stability but Needs to Expediently Implement a Prudent Design for Remaining HAMP-Funded Programs

In our testimony on March 25, 2010, we noted that Treasury faced several additional challenges as it continues to implement HAMP. These challenges include (1) converting trial modifications to permanent status, (2) addressing the growing issue of negative equity, (3) reducing redefaults among borrowers with modifications, and (4) ensuring program stability and effective program management.<sup>30</sup> While Treasury has taken some steps to address these challenges, such as announcing a principal reduction program under HAMP and finalizing the second-lien modification program, it needs to expeditiously finalize and implement remaining programs in a manner that ensures transparency and accountability. Our review of HAMP suggests that potential concerns exist in the areas of program stability and adequacy of program management as Treasury continues to add or revise HAMP-funded programs.

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## Treasury Has Reached Out to Servicers and Simplified Program Requirements to Increase the Number of Permanent Modifications, but Conversion Rates Remain Low

HAMP servicers reported a wide range of conversion rates and gave a variety of reasons to explain why trial modifications were not converting to permanent modifications. Through the end of May 2010, servicers reported conversion rates ranging from 11 percent to 86 percent. Furthermore, a few servicers reported that more than half of their active trial modifications had been in the trial period for more than 6 months. The 10 servicers we contacted reported conversion rates ranging from 1 percent to 57 percent for non-GSE HAMP modifications that had been in trial periods for 3 or more months as of December 31, 2009 (fig. 3). Of these 10 servicers, the 3 we contacted that required borrowers to provide full documentation of their income before starting trial modifications reported the highest conversion rates (38 percent to 57 percent). The seven servicers that used stated income to determine eligibility for trial modifications had conversion rates ranging from 1 percent to 18 percent.

We asked these servicers for the percentages of nonconversions that had resulted from incomplete or problematic documentation, missed trial period payments, or having to wait for a servicer to take action to complete the conversion. Several of the servicers reported that these scenarios were responsible for fewer than half of their nonconversions (fig. 3). Not surprisingly, the servicers that used verified income reported

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<sup>30</sup>GAO-10-556T.

lower rates of nonconversions because of incomplete or problematic documentation (1 percent to 14 percent) compared with the servicers that used stated income (4 percent to 58 percent). Servicers also reported a wide range of nonconversions that could be attributed to missed payments during trial modifications—roughly 2 percent to more than 70 percent. However, 9 of the 10 servicers reported that these types of nonconversions accounted for less than a quarter of the total, and the highest percentage (71 percent) was reported by a servicer that primarily serviced subprime loans. Finally, some servicers reported having borrowers who had submitted all documentation and made all trial payments but were waiting on action from the servicer to receive permanent modifications. For example, one servicer reported that nearly a third of borrowers who had been in trial modifications for at least 3 months, but had not been converted to permanent modifications, were in this situation.

**Figure 3: Conversion Rates and Nonconversion Reasons for 10 HAMP Servicers, through December 31, 2009**

Servicer (type of validation)	Conversion rate	Reasons for nonconversions				Total
		Incomplete or problematic documentation	Missed trial payments	Waiting on servicer action	Other reason <sup>a</sup>	
Servicer 1 (verified)	55 %	13%	11%	0%	76%	100 %
Servicer 2 (verified)	57	14	71	0	15	100
Servicer 3 (verified)	38	1	9	19	71	100
Servicer 4 (stated)	2	Did not report				n/a
Servicer 5 (stated)	1	4	3	4	89	100
Servicer 6 (stated)	6	13	2	16	69	100
Servicer 7 (stated) <sup>b</sup>	10	41	7	5	47	100
Servicer 8 (stated)	7	50	3	32	15	100
Servicer 9 (stated)	5	58	16	26	0	100
Servicer 10 (stated)	18	16	23	2	59	100

Source: GAO analysis of data from 10 HAMP servicers.

<sup>a</sup>Servicers indicated various other reasons for nonconversions, such as borrowers' inability to pass the NPV model when evaluated for a permanent modification and a resetting of the trial period if the servicer found a difference in stated and verified income of more than 25 percent at the time of conversion.

<sup>b</sup>Stated for borrowers at least 60 days delinquent, verified for imminent default borrowers.

In November 2009, Treasury launched a conversion campaign and revised the first-lien HAMP guidelines in an effort to address the challenges

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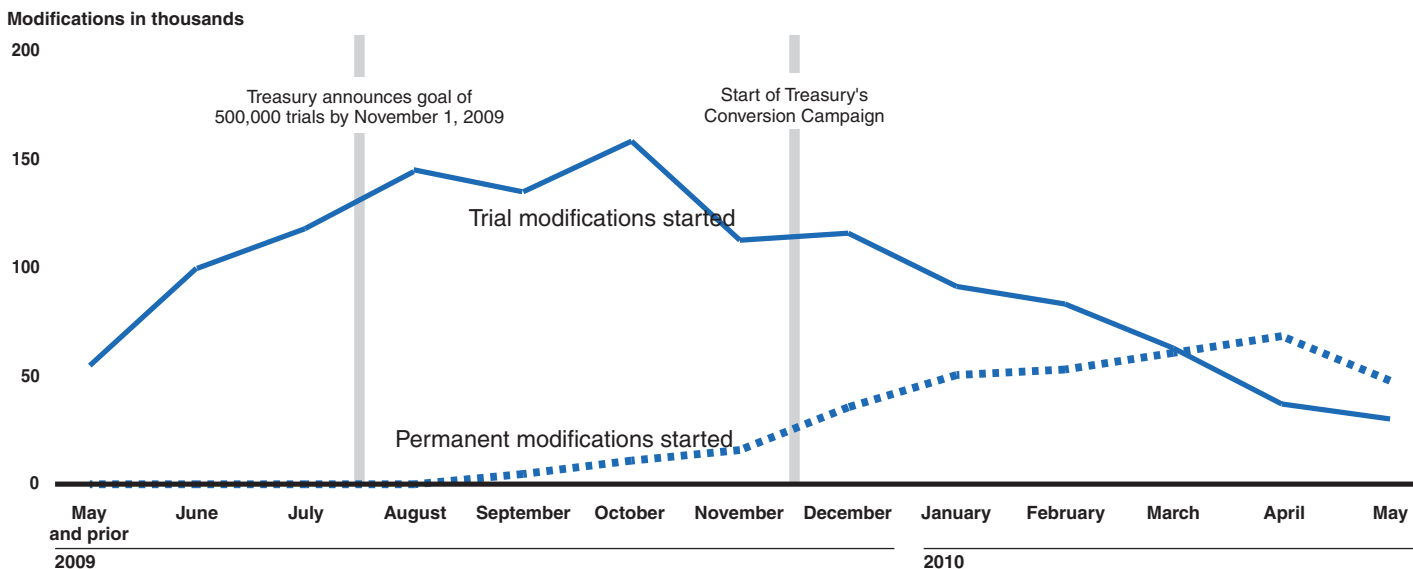
associated with converting trial modifications to permanent modifications. The conversion campaign included a temporary review period lasting through January 31, 2010, that did not allow servicers to cancel trial modifications for any reason other than failure to meet HAMP property requirements (for example, if the property was not owner-occupied). In addition, Treasury required the eight largest servicers to submit conversion action plans that included strategies such as having people knock on doors to collect missing documentation from borrowers, having call center staff follow up on trial payments, and developing call scripts to include a description of incentives available to borrowers after completion of the trial period. Treasury also formed “SWAT” teams comprised of Treasury and Fannie Mae staff to visit large servicers’ offices and offer on-site assistance with conversions. During the conversion campaign, the number of new conversions each month increased from roughly 26,000 in November to roughly 35,000 in December and roughly 50,000 in January.

To address the specific challenge of obtaining complete documentation from borrowers, Treasury has made several changes to streamline and improve documentation requirements. In October 2009, Treasury announced a streamlining of required documentation that, among other things, allows borrowers to use a standard application form that incorporates income, expense, and hardship information. Treasury further simplified the documentation requirement in January 2010 when it announced that pay stubs used to verify income no longer needed to be consecutive, provided the pay stubs included year-to-date income and the servicer judged that the borrower’s income had been accurately established. While the streamlining of documentation could make it easier for certain borrowers to provide all required documentation, therefore improving conversion rates, it could also increase the risk of fraud or abuse in the program. Also in January 2010, Treasury announced that beginning in mid-April, servicers would be required to evaluate borrowers for trial modifications based on fully documented income. While using fully documented income will potentially be a significant change for some servicers, particularly given Treasury’s July 2009 statement that servicers should evaluate borrowers for trial modifications based on stated income, it could help improve conversion rates. As we have seen, among the 10 servicers we spoke with, the 3 already requiring full documentation up front generally reported higher conversion rates.

However, converting trial modifications continues to be a challenge. As of the end of May 2010, Treasury data showed that only 31 percent of trial modifications started at least 3 months prior, and therefore potentially eligible for conversion, had converted to a permanent modification. In

fact, the total number of permanent modifications started through May 2010 was less than the total number of trial modifications canceled during the same time period (roughly 347,000 versus 430,000). Furthermore, as servicers focus on conversions and began the transition to evaluating borrowers using verified income, the number of trial modifications begun has decreased significantly. In May 2010, roughly 30,000 trial modifications were started, compared with nearly 63,000 in March 2010 (fig. 4). As of the end of May 2010, Treasury reported that there were roughly 1.7 million estimated eligible 60-day delinquent borrowers. According to Treasury officials, Treasury is not planning on taking any additional steps to address nonconversions because the agency's current focus is on clearing the backlog of trial modifications awaiting conversion decisions. The officials noted that servicers had committed to clearing their backlogs by the end of June 2010. Going forward, Treasury anticipates that the requirement for up-front documentation will reduce the challenge of converting trial modifications to permanent modifications.

**Figure 4: GSE and Non-GSE HAMP Trial and Permanent Modifications Made Each Month**



Source: GAO analysis of Treasury data.

Borrowers may not convert to permanent modifications for several reasons, including ineligibility for HAMP and failure to make the required trial modification payments. Some borrowers who do not receive permanent modifications may be eligible for other non-HAMP loan modification programs that servicers offer or for alternatives to foreclosure such as those offered under the HAFA program. For example,

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Treasury reported that through April 2010, among the top eight HAMP servicers, nearly half of borrowers who had trial modifications canceled received non-HAMP loan modifications.

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### Recent Program Announcements Aim to Address Negative Equity, but Programs May Lack Transparency

The proportion of homeowners who owe more than the value of their homes continues to be high in many states and, as we reported in July 2009, HAMP as initially designed may not address the growing number of foreclosures among borrowers with negative equity (“underwater” borrowers). According to data reported by CoreLogic, a company that collects and analyzes U.S. real estate and mortgage data, more than 11.2 million (24 percent) of borrowers across the country had negative equity at the end of the first quarter of 2010.<sup>31</sup> In addition, of borrowers with loan-to-value ratios greater than 150 percent, more than 14 percent had received a notice of default—the first step in the public recording of default—compared with roughly 2 percent of those with at least some equity in their homes. As we have seen, according to Fannie Mae, borrowers have loan-to-value ratios of roughly 150 percent, on average, after a HAMP modification. While HAMP’s initial design focused on bringing mortgage payments to an affordable level, severe levels of negative equity and expectations that house prices will continue to decline may lead some borrowers to choose to default on their mortgage payments even if the payments are affordable or could be modified to affordable levels.

In an effort to help address the challenge of negative equity, in March 2010 Treasury announced a principal reduction program under HAMP. According to the initial program guidelines issued in June 2010, the principal reduction HAMP program will allow some underwater homeowners to reduce the balance owed on their mortgage in steps over 3 years, if they remain current on their payments. Servicers will be required to run both the standard NPV test and an alternative that considers principal reduction and to compare the results. Under the alternative approach, servicers will assess the NPV of a modification that starts by forbearing the principal balance to 115 percent of the home’s value, or to an amount necessary to bring the borrower’s payments to 31 percent of income, whichever requires less principal reduction.

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<sup>31</sup>CoreLogic, *New Corelogic Data Shows Decline In Negative Equity*, Media Alert (May 10, 2010).

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If forbearing principal to 115 percent of the home's value does not reduce monthly payments to 31 percent of income, the servicer will follow HAMP's standard procedures for modifying loans—lowering the interest rate, extending the term of the loan, forbearing additional principal, or a combination of these steps in this order. If the NPV under this approach is higher than it is for a modification without principal forbearance, the servicer will have the option—but will not be required—to forgive principal. Servicers will initially treat the reduced principal amount as forbearance and will forgive the forbore amount in three equal steps over 3 years, as long as the homeowner remains in good standing. Investors will receive incentives for reducing principal, and the incentive amounts vary based on the delinquency level of the borrower and the current loan-to-value ratio. Servicers will be required to establish written policies detailing when principal reduction will be offered, and, according to Treasury, MHA-C will review these policies to ensure that similarly situated borrowers are treated equitably with respect to principal reduction.

Some program details continue to be unspecified. In particular, the alternative NPV model has not yet been specified, and it is unclear how it will evaluate the impact of principal reduction, including the changes in the likely redefault rate of borrowers receiving principal reductions. According to Treasury, the alternative NPV model will be ready in September or October 2010. In addition, although the original program announcement stated that servicers would be required to retroactively consider borrowers for principal forgiveness who had already received a trial or permanent modification, it is unclear whether and how servicers will be required to do this. According to Treasury, additional guidance addressing this issue will be issued in July 2010. Servicers will be required to start evaluating borrowers for principal reduction on the later of October 1, 2010, or the implementation date of the new version of the NPV model, though servicers could begin offering principal reduction and receiving incentives as of June 3, 2010. Due to the continued severity of the foreclosure crisis and negative equity problem, Treasury will need to expeditiously finalize all program details.

While this program could help some borrowers whose loans are greater than 115 percent of the home's value, servicers could vary in when they choose to offer principal reduction. In some cases, servicers may reasonably refuse to reduce principal, even when the NPV using principal reduction is higher than the NPV without using it. For example, servicers may have contractual agreements with investors that prohibit principal reduction. According to Treasury, principal reduction is not mandatory because HAMP is a voluntary program and the HAMP Servicer

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Participation Agreement allows servicers to opt out of material program changes made after the agreement was signed. In addition, the Congressional Oversight Panel reported in April 2010 that allowing servicers to choose whether to offer principal reduction could help limit moral hazard.<sup>32</sup> Specifically, if borrowers do not know whether their servicers will forgive principal, they will not be motivated to change their behavior in order to receive it. According to Treasury, servicers will be required to report to Treasury the NPV outcomes with and without principal reduction, as well as whether the borrower was offered it. Further, Treasury officials noted that beginning in late 2010 or early 2011, public reports on servicer performance will include information such as the proportion of borrowers who were offered principal reduction. Because servicers will have significant discretion in whether and when to offer principal reduction under this program, Treasury will need to ensure that public reporting of servicer activity related to principal forgiveness provides sufficient program transparency and addresses potential questions of whether similarly situated borrowers are being treated fairly and consistently.

Households with second-lien mortgages are more likely to be underwater than those without second-lien mortgages. According to CoreLogic, in the first quarter of 2010, 38 percent of borrowers with junior liens such as second-lien mortgages were underwater, compared with 19 percent of borrowers with only first-lien mortgages. Offering relief on second-lien mortgages is therefore an important factor in addressing the challenge of underwater borrowers. According to the initial guidelines for the principal reduction program, second-lien holders must agree to reduce principal on the second lien mortgage in the same proportion as the principal reduction on the first lien mortgage. Separately, under the guidelines for 2MP, incentives are offered for the extinguishment or partial extinguishment of second liens.

In addition, Treasury announced a new FHA refinancing program, which is expected to be implemented by the fall of 2010 and will allow lenders to refinance underwater first-lien loans into FHA-insured loans if the borrower is current on mortgage payments. This program has been designated up to \$14 billion in funds that were originally intended for HAMP and, as with the principal reduction program under HAMP, will be voluntary for servicers. According to initial program descriptions,

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<sup>32</sup>Congressional Oversight Panel, April 2010.

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investors must agree to a principal write-down on the original first-lien loans of at least 10 percent and the combined loan-to-value ratio, which includes both first and junior liens, cannot be greater than 115 percent after the refinancing (97.75 percent for the first lien only). The new FHA refinance option is available only to homeowners who are current on an existing first-lien mortgage that is not insured by FHA. Eligible underwater loans are refinanced into FHA loans on FHA terms based on full documentation, income ratios, and complete underwriting. Total debt including all forms of household debt cannot be greater than approximately 50 percent except for some borrowers with especially strong credit histories.

Investors we spoke with supported principal reduction in conjunction with an FHA refinance, because even though they would suffer a loss on the reduction, they would not bear the risk of the borrower redefaulting, as the loan would then be FHA-insured and out of their pools. However, they also noted that the program might reach only a limited number of borrowers as it would only help borrowers who are current on existing first-lien mortgage payments, underwater, and have mortgage payments that could be reduced to 31 percent of income with a loan-to-value ratio for the new loan no greater than 97.75 percent of the appraised value of the home. Treasury has stated that FHA will publish quarterly data on numbers of loans refinanced in this way, including average percentages for loans that are written down and amounts of principal that are reduced. However, Treasury has not yet specified what servicers will be required to report for borrowers considered for the program, including those considered for, but not offered, the refinance. Also, though Treasury has designated up to \$14 billion for this program, it has not specified how these funds will be used or the number of borrowers likely to be helped by this program.

Finally, Treasury has designated \$2.1 billion in HAMP funds for the HFA Hardest-Hit Fund, providing 10 states with the opportunity to design programs to prevent foreclosure and improve housing market stability, potentially including programs to address negative equity. As of May 11, 2010, Treasury had not yet approved any programs under this fund, so the extent to which the programs will address negative equity remains to be seen. The first five states were required to submit proposals on April 16, 2010, and according to Treasury, it is evaluating them to determine whether they meet the act's requirements and support its goals of preserving homeownership and protecting housing market stability. However, according to initial proposals, some program efforts may require significant implementation periods. For example, one state reported that



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some of its program features might not be available until 5 months after Treasury approved the program. To promote transparency, each state HFA will be required to establish monitoring mechanisms and to implement a system of internal controls that minimize the risk of fraud, mitigate conflicts of interest, and maximize operational efficiency and effectiveness. In addition, HFAs will report data to Treasury on a periodic basis, including the metrics that are used to measure program effectiveness against stated objectives. According to Treasury, all program designs will be posted online, along with metrics measuring performance of each HFA program. Treasury has stated that the principal reduction program under HAMP, the FHA refinance program, and the HFA Hardest-Hit Fund will be the primary efforts to address the challenge of negative equity, and no new programs are expected.

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### Treasury Has Not Fully Implemented Measures to Limit Redefault

Limited information is available on redefaults on permanent modifications to date, largely because few trials have become permanent. Treasury's expectations of the number of redefaults may be changing, although Treasury has not specified the number of successful permanent HAMP modifications it expects. Through the end of May 2010, 6,233 of the 346,816 permanent modifications had redefaulted and 124 loans had been paid off. Treasury has begun to publish the debt levels of those receiving permanent HAMP modifications. As we have seen, as of the end of May 2010, these borrowers had a median total debt-to-income ratio of roughly 64 percent after the HAMP modification.<sup>33</sup> In April 2010, the Congressional Oversight Panel noted that with such high debt levels, a small disruption in income or increase in expenses could result in many redefaults.<sup>34</sup> Treasury said that it would examine redefault rates after borrowers had been in HAMP permanent modifications for longer than 3 months.

As we reported in July 2009, the redefault rates Treasury anticipated at the inception of HAMP were consistent with the Office of the Comptroller of the Currency's (OCC) and the Office of Thrift Supervision's (OTS) analyses of loan modifications, as well as with the Federal Deposit Insurance Corporation's estimates for the IndyMac loan modification program.<sup>35</sup> At

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<sup>33</sup> According to Treasury, the information is determined at the time of the HAMP application.

<sup>34</sup> Congressional Oversight Panel, April 2010.

<sup>35</sup> [GAO-09-837](#).

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the time, OCC and OTS reported that about 52 percent of modifications redefaulted after 12 months, and IndyMac estimated a redefault rate of 40 percent. However, more recently Treasury officials told us that the redefault rate could be higher for a typical HAMP modification, noting that borrowers entering the HAMP program to date had low credit scores and high loan-to-value ratios relative to those in other modification programs, further increasing the risk of redefault. As noted, Treasury has not publicly disclosed its redefault estimates or the number of successful permanent modifications it expects.

In December 2008, we noted that limiting the likelihood of redefault would be a significant challenge as Treasury began its efforts to establish a loan modification program, and Treasury continues to struggle with this challenge.<sup>36</sup> As we pointed out, Treasury's primary effort to limit redefaults under the HAMP first-lien program was to require that borrowers with high total debt agree to obtain counseling.<sup>37</sup> However, it is unclear how many borrowers have actually received this counseling, and Treasury does not plan either to monitor whether borrowers actually obtain counseling or to assess the requirement's effectiveness in limiting redefaults. According to Fannie Mae, the HOPE Hotline had received 104,253 calls about this counseling through April 4, 2010, but Fannie Mae did not track whether these borrowers actually obtained counseling. However, the best available information shows that few borrowers have obtained such counseling to date. Specifically, according to NeighborWorks, whose National Foreclosure Mitigation Counseling network consists of roughly 1,700 entities that must be either HUD-approved counseling agencies or state housing finance agencies, as of March 2010 it had only funded about 2,700 HAMP counseling sessions for borrowers with high total debt.<sup>38</sup> This further underscores the importance of monitoring and assessing HAMP's counseling requirement, as we recommended in July 2009.

In March 2010, Treasury issued revised guidelines for the HAMP second-lien program, 2MP, which, to the extent that it reduces borrowers' total debt, could help limit redefaults on first-lien modifications. However,

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<sup>36</sup>GAO, *Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages*, [GAO-09-231T](#) (Washington, D.C.: December 2008).

<sup>37</sup>[GAO-09-837](#).

<sup>38</sup>Although there are additional HUD-approved counseling agencies that do not receive National Foreclosure Mitigation Counseling funds which may provide this kind of HAMP counseling, HUD's database does not track this information.

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although a second-lien modification program was initially announced at the inception of HAMP, Treasury has yet to issue estimates of the number of borrowers that the program could help. Treasury officials noted that they would examine the redefault rates of borrowers receiving 2MP modifications. As of June 2010, seven servicers have signed agreements to modify or extinguish second liens under HAMP. However, Treasury will not begin making incentive payments or tracking modifications under 2MP until the fall of 2010. Until recently, servicers may not have been able to identify whether borrowers of second liens in their portfolios have been modified by the first-lien servicer if they do not also service the first lien. First liens must be in HAMP trial periods before second liens begin trial modifications, so in order to modify a second lien, a servicer must first know whether the corresponding first lien has been modified. Treasury developed a database to match first and second liens, which, according to Treasury, was ready in May 2010.

Under 2MP, non-GSE servicers can receive up-front and pay-for-success incentive payments, borrowers can receive pay-for-performance incentives, and investors can receive payment reduction cost-share incentives. When a borrower's first lien is modified under HAMP, a participating second-lien servicer must offer to modify the borrower's second lien. The modification steps for 2MP are similar to those for HAMP first-lien modifications. As with first liens, servicers first capitalize accrued interest and servicing advances, then reduce the interest rate, then extend the term of the mortgage, and finally, forbear or forgive principal. However, with second liens, the interest rate is generally reduced to 1 percent; the term is extended to match, at a minimum, the term of the HAMP-modified first lien; and the principal forbearance or forgiveness is expected to be proportional to the amount of principal forbearance or reduction on the first lien. Servicers are not required to reduce principal under 2MP, unless principal was forgiven on the first lien, but may offer principal reduction and will receive additional incentives for doing so. The incentive amount for reducing second liens varies depending on the combined loan-to-value ratio, or the ratio of the first and second liens to the value of the home.

The terms of the first-lien modification will be used to determine the terms of the second-lien modification, and no additional evaluation is done to determine eligibility for 2MP. The second-lien servicer relies on the information the borrower provides for the first-lien loan modification. In particular, the second-lien servicer is not required to perform an additional NPV model of the related second-lien mortgage, since it can be reasonably concluded that the combined modifications will result in a positive NPV

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outcome if the first lien was NPV positive. According to Treasury, because the HAMP-modified first-lien mortgage is delinquent or facing imminent default, the servicer may reasonably conclude that the borrower is in imminent danger of defaulting on the second lien. Further, Treasury has stated that postforeclosure recoveries on second liens are likely to be minimal if the first lien is delinquent or at risk of default, so it is reasonable for servicers to conclude that modifications of second liens are likely to result in higher expected cash flows than foreclosure.

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### Implementation of Other HAMP-Funded Homeowner Assistance Programs Could Benefit from Lessons Learned from Initial HAMP Design and Implementation Challenges

While servicers were performing loan modifications prior to HAMP, HAMP is a new, complex, and large-scale program that places a significant amount of taxpayer dollars at risk. We have previously reported that Treasury faced challenges in implementing first-lien modifications, including finalizing program guidelines and establishing a comprehensive system of internal controls. Since then, Treasury has announced several new programs and program features. Going forward, in designing and implementing the programs, Treasury could benefit from lessons learned from the initial design and implementation of HAMP. In particular, it will be important for Treasury to expeditiously develop and implement these programs while also developing sufficient program planning and implementation capacity, meaningful performance measures, and appropriate risk assessments in accordance with standards for effective program management. In its April 2010 report, the Congressional Oversight Panel likewise noted that Treasury's response has lagged behind the pace of the crisis and underscored the need for Treasury to get its new initiatives up and running quickly and to ensure program accountability.<sup>39</sup> We will continue to monitor Treasury's implementation and management of HAMP-funded programs as part of our ongoing oversight of TARP to ensure that new programs are appropriately designed and operating as intended.

- **Program planning and implementation capacity.** In July 2009, we recommended that Treasury finalize a comprehensive system of internal control for HAMP.<sup>40</sup> According to GAO's Standards for Internal Control in the Federal Government, effective internal controls include activities to ensure the appropriate planning and implementation of government

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<sup>39</sup>Congressional Oversight Panel, April 2010.

<sup>40</sup>[GAO-09-837](#).

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programs.<sup>41</sup> Effective program planning includes having complete policies, guidelines, and procedures in place prior to program implementation. As we noted in March 2010, servicers told us that they faced significant challenges implementing HAMP first-lien modifications because of numerous changes to program guidance. For example, Treasury's new requirement that servicers evaluate borrowers for trial modifications using verified rather than stated income will likely mean that some servicers will need to alter their policies and processes, as well as retrain staff. Treasury officials told us that it did not anticipate any new programs or significant changes to HAMP going forward. Nonetheless, to avoid potential implementation challenges with the newly announced programs Treasury must balance the need to fully establish guidelines and reporting requirements in advance of implementation by servicers while implementing these programs as quickly as possible.

In addition, GAO's Internal Control Management and Evaluation Tool, which is based on GAO's Standards for Internal Control in the Federal Government, states that program managers must identify and define tasks required to accomplish particular jobs and fill all necessary positions.<sup>42</sup> In July 2009, we recommended that Treasury place a high priority on fully staffing vacancies in the Homeownership Preservation Office (HPO) and evaluating staffing levels and competencies. However, Treasury has reduced staffing levels in HPO from 36 to 29 full-time positions without formally assessing staffing levels or determining whether HPO staff have the necessary skills to govern the program effectively. Treasury officials told us that it was in the process of approving two additional positions for administering the HFA Hardest-Hit Fund. In addition, they noted that the responsibilities of the policy development staff in HPO would be largely concluded after the final policy documents were issued, and these staff would then be able to support program implementation. However, as of May 14, 2010, Treasury still had not conducted a workforce assessment of HPO, despite the office's additional administrative responsibilities for the recently announced FHA refinancing program, and ongoing HAMP implementation, including first- and second-lien modifications, HAFA, principal reductions, and forbearance for unemployed borrowers. We noted in July 2009 that having enough staff with appropriate skills was essential to governing HAMP effectively, and we continue to believe that it

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<sup>41</sup>[GAO/AIMD-00-21.3.1](#).

<sup>42</sup>GAO, *Internal Control Management and Evaluation Tool*, [GAO-01-1008G](#) (Washington, D.C.: August 2001).

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will be an important factor in Treasury's ability to design and implement the new HAMP-funded programs both quickly and effectively.

According to Treasury, its financial agents—Fannie Mae and MHA-C—are developing a two-stage approach to assessing the capacity and readiness of the top 25 HAMP servicers to implement the recently announced programs. First, servicers will conduct a self-assessment of their readiness using a HAMP checklist. According to Treasury, the self-assessment will be provided to Fannie Mae for review, and Fannie Mae will provide further training, additional guidance, and other support as needed. Treasury officials told us that the second stage would involve on-site walk-throughs conducted by MHA-C that will consist of discussions with management, reviews of documentation such as project plans and testing results, and an end-to-end walk-through of processes. Treasury officials told us that as of the end of April 2010, 21 servicers had been sent a self-assessment on capacity to implement HAFA, and that as of May 2010 on-site readiness reviews for HAFA and 2MP had begun. However, Treasury has not specified a time frame for the completion of either of the two stages of readiness assessment for the other recently announced HAMP-funded programs.

- **Meaningful performance measures.** We reported in July 2009 that Treasury must establish specific and relevant performance measures that will enable it to evaluate the program's success against stated goals in order to hold itself and servicers accountable for these TARP-funded programs. As noted in GPRA, meaningful and useful performance measures should focus on program outcomes and provide a basis for comparing actual program results with performance goals.<sup>43</sup> However, Treasury did not develop performance measures before implementing the first-lien modifications. According to Treasury, revised performance measures were drafted in March 2010, a year after program implementation. Performance measures include process measures such as the number of servicers participating in the program, as well as outcome measures such as average debt-to-income ratios (pre- and postmodification) and redefault rates. Treasury had not yet developed expected performance measures for 2MP, or the recently announced principal reduction, forbearance for unemployed borrowers, or FHA refinance programs as of May 14, 2010.

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<sup>43</sup>Government Performance Results Act of 1993, *supra*.

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To ensure clear standards for accountability for the newly announced programs, Treasury will need to establish specific outcomes-based performance measures at the outset of the programs. For example, to assess the success of the HAMP principal reduction and FHA refinance programs, Treasury will need to develop measures and goals to assess the extent to which these programs are helping borrowers with negative equity and limiting foreclosures among this population—Treasury’s stated goals for the program. Similarly, early development of meaningful performance measures and goals could help Treasury evaluate the extent to which the 3-month forbearance program is helping unemployed borrowers avoid foreclosure. Such measures could be used to determine whether program parameters, including the amount of time allowed for borrowers to find new employment, are appropriate and sufficient for ensuring program success. As noted by both the Congressional Oversight Panel and SIGTARP, it will be imperative for Treasury to clearly define performance measures for HAMP to ensure program accountability.<sup>44</sup>

Furthermore, Treasury has yet to develop benchmarks, or goals, for specific performance measures. According to Treasury, draft first-lien performance measures include metrics such as conversion and redefault rates. But in the absence of predefined goals to indicate what Treasury considers acceptable conversion and redefault rates, assessing the results of these measures will be difficult. Likewise, as Treasury develops performance measures for the recently announced HAMP-funded programs, it must also establish benchmarks for them.

- **Appropriate risk assessments.** Also in our July 2009 report, we noted that while some processes and internal controls had been developed during the early stages of HAMP’s implementation, many more controls needed to be finalized as the program progressed to ensure that taxpayer dollars were safeguarded, program objectives achieved, and program requirements met. The adequacy of Treasury’s internal controls for HAMP continues to be an area of concern as Treasury refines the first-lien program and adds new HAMP programs. According to GAO’s Standards for Internal Control in the Federal Government, there are five key components or standards for effective internal control: (1) the control environment, (2) risk assessment, (3) control activities, (4) information and communications, and (5) monitoring.<sup>45</sup> The internal control standards

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<sup>44</sup>Congressional Oversight Panel, April 2010 and Special Inspector General for TARP, March 2010.

<sup>45</sup>[GAO/AIMD-00-21.3.1](#).

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state that agencies must identify the risks that could impede the success of the newly announced programs and determine appropriate methods of mitigating these risks. After risks have been identified, the agency should undertake a thorough and complete analysis of the possible effects of the risks that includes an assessment of how likely the risks are to materialize. Finally, agencies should determine how best to manage or mitigate risk and what specific actions they should take.

Treasury, in conjunction with Fannie Mae as the HAMP program administrator, has developed risk control matrixes that identify various risks associated with the first-lien modification process, such as potential inaccuracies in accruals of incentive payments or data reporting, and the controls they have developed to mitigate the identified risk. However, other programmatic risks may exist that Treasury has not addressed. For example, as noted above, Treasury requires that borrowers demonstrate a hardship to qualify for HAMP but does not require servicers to verify the hardship. For example, if the borrower indicates that the household has experienced a decrease in income, the servicer is not required to obtain documentation on past income to compare to current income. As a result, taxpayer funds may be used to support modifications of borrowers who have not in fact experienced a hardship. Furthermore, in December 2008 we noted that one of the key challenges for loan modification programs was mitigating the risk of moral hazard—the possibility that borrowers might choose to default when they otherwise would not in order to benefit from the loan modification.<sup>46</sup> Requiring borrowers to demonstrate hardship is one means of mitigating this risk, but by not requiring servicers to verify the hardship, Treasury has not fully realized the potential benefits of this control.

Our prior work looking at the implementation of the first-lien program underscores the importance of fully identifying and assessing the potential risks associated with the newly announced HAMP-funded homeowner assistance efforts. Further, Treasury needs to develop appropriate controls to mitigate those risks prior to the implementation date for the newly announced HAMP programs. For example, moral hazard is of particular concern for the programs that include principal reduction. Treasury has built some features into HAMP to manage the risk of moral hazard, such as requiring a positive NPV model in order to have principal reduced, something that borrowers cannot easily calculate in advance. Further, the

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<sup>46</sup>[GAO-09-231T](#).



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principal reduction is initially treated as forbearance and forgiven in three equal steps over 3 years as long as the homeowner remains current on payments. Under the FHA refinance program, borrowers must be current on their mortgage payments to qualify, eliminating the risk that they will default on their mortgages when they otherwise would not in order to qualify for this program. However, the issue of moral hazard is one that will require Treasury's continued attention to ensure that the safeguards that are put in place sufficiently limit this risk. The adequacy of Treasury's risk assessments and control activities for the newly announced HAMP-funded programs is an area that we plan to monitor and report on as part of our ongoing oversight of Treasury's use of TARP funds to preserve homeownership and protect property values.

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## Conclusions

Treasury's HAMP program is part of an unprecedented response to a particularly difficult time in our nation's mortgage markets. The Emergency Economic Stabilization Act called for Treasury to, among other things, preserve homeownership and protect home values, and HAMP continues to be Treasury's cornerstone effort for doing this. However, more than a year after Treasury's initial announcement of HAMP and the program's goal of bringing consistency to foreclosure mitigation, servicers continue to treat borrowers seeking to avoid foreclosures inconsistently in part because of a lack of specific guidelines from Treasury. In particular, Treasury did not specify requirements for soliciting potentially eligible borrowers for HAMP during the first year of the program, even though outreach is important in the early phases of program implementation. While Treasury has recently issued more specific requirements on communicating with borrowers, it is continuing to finalize measures of servicer performance in this area. In addition, while Treasury's stated goals are to standardize the loan modification process and reach borrowers before they are delinquent on their loans, Treasury's lack of guidelines on how servicers should determine whether borrowers who are current in their payments but may be in imminent danger of default has led to significant differences in how servicers are evaluating these borrowers for HAMP. By specifying clear and specific guidelines, such as those implemented by the GSEs for their HAMP modifications, Treasury could better ensure that similarly situated borrowers receive equitable treatment under HAMP. Furthermore, Treasury has not fully specified parameters for servicers' internal quality assurance programs for HAMP and therefore is not maximizing the potential for servicers' quality assurance procedures to ensure equitable treatment of borrowers. With greater specificity from Treasury on how to categorize loans for sampling and what servicers should be evaluating in their reviews, servicers would

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be more likely to have robust HAMP quality assurance programs. Finally, although Treasury drafted a policy that established consequences for servicer noncompliance with HAMP requirements in October 2009, as of May 2010 it had not yet finalized the policy. As a result, Treasury lacks transparency and risks inconsistency in how it enforces HAMP servicer requirements.

Treasury requires servicers to have procedures and systems in place to respond to HAMP complaints and utilizes the HOPE Hotline to escalate borrowers' concerns about servicers' handling of HAMP applications and potentially incorrect denials. However, because Treasury has not specified requirements on the types of complaints that servicers should track, some servicers are tracking only certain types of complaints such as those addressed to a company executive. Without consistent tracking of HAMP complaints, Treasury cannot determine with certainty whether servicers are ensuring fair and timely resolutions of HAMP complaints. Treasury has set up the HOPE Hotline escalation process as the primary means for borrowers to raise concerns about their servicer's performance on the HAMP loan modification request and potentially incorrect denials. But whether this is an effective mechanism to resolve such concerns remains unclear because neither MHA Escalation Team counselors, their quality assurance reviewers, nor HAMP Solution Center staff independently review borrowers' applications or loan files. As a result, discretion over how to resolve borrowers' concerns about potentially incorrect HAMP denials largely remains with the servicers. Therefore, Treasury needs to monitor the effectiveness of this escalation mechanism, particularly to resolve potentially incorrect denials, and make improvements to this mechanism or replace it as appropriate. In addition, Treasury has not taken steps to specifically inform borrowers that the hotline can be used to escalate concerns about servicers' handling of HAMP applications and potentially incorrect denials. As a result, borrowers facing foreclosure who have been told by their servicers that they do not qualify for a HAMP loan modification may feel that they cannot challenge the servicer's determination and may lose their homes to foreclosures that might have been prevented.

As we noted in our March 2010 testimony, Treasury faces several challenges in implementing HAMP going forward, including converting trial modifications to permanent modifications, addressing the growing number of foreclosures among borrowers with negative equity, limiting redefaults among borrowers who receive HAMP modifications, and ensuring adequate program stability and management. While Treasury has taken some steps toward addressing these challenges, the multitude of

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problems facing U.S. mortgage markets call for swift and deliberate action, and it remains to be seen how effective Treasury's efforts will be. For example, to address the challenge of converting trial modifications to permanent modifications, Treasury launched a conversion campaign, streamlined required documentation, and switched to verified income documentation to start a trial. In addition, in March 2010 Treasury announced several potentially substantial new HAMP-funded efforts, but it did not say how many borrowers these programs were intended to reach or discuss the specifics of these programs. In particular, Treasury announced a principal reduction program under HAMP that could help borrowers with negative equity. However, Treasury has stated that principal reduction will be voluntary for servicers and will need to ensure that future public reporting of this program ensures program transparency and addresses potential questions about whether all borrowers are being treated fairly.

In our July 2009 report, we made a number of recommendations to improve HAMP's effectiveness, transparency, and accountability. For example, we recommended that Treasury consider methods of monitoring whether borrowers who receive HAMP modifications and continue to have high total household debt (more than 55 percent of their income) obtain the required HUD-approved housing counseling. While Treasury has told us that monitoring borrower compliance with the counseling requirement would be too burdensome, we continue to believe that it is important that Treasury determine whether consumers are actually receiving counseling and whether the counseling requirement is having its intended effect of limiting redefaults. In addition, we recommended that Treasury place a high priority on fully staffing HPO and noted that having enough staff with appropriate skills was essential to governing HAMP effectively. However, Treasury has since reduced the number of HPO staff without formally assessing staffing needs. We believe that having sufficient staff is critical to Treasury's ability to design and implement HAMP-funded programs both quickly and effectively. We also recommended that Treasury finalize a comprehensive system of internal controls for HAMP that will continue to be important as Treasury implements new HAMP-funded programs.

Finally, as Treasury continues with first-lien modifications, and implements 2MP, HAFA, and the newly announced programs, it will be important to adhere to standards for effective program management and to establish sufficient program planning and implementation capacity, meaningful performance measures, and appropriate risk assessments. As we, the Congressional Oversight Panel, and SIGTARP have previously noted, establishing key performance metrics and reporting on individual

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servicers' performance with respect to those metrics are critical to the program's transparency and accountability. Additionally, without preestablished performance measures and goals, Treasury will not be able to effectively assess the outcomes of the newly announced programs. Given the magnitude of the investment of public funds in HAMP, it will be imperative that Treasury take the steps needed to expeditiously implement a prudent design for the remaining HAMP-funded programs. We will continue to monitor Treasury's implementation and management of HAMP-funded programs as part of our ongoing oversight of TARP to ensure that such programs are appropriately designed and operating as intended.

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## Recommendations for Executive Action

As part of its efforts to continue improving the transparency and accountability of HAMP, we recommend that the Secretary of the Treasury take actions to expeditiously:

- establish clear and specific criteria for determining whether a borrower is in imminent default to ensure greater consistency across servicers;
- develop additional guidance for servicers on their quality assurance programs for HAMP, including greater specificity on how to categorize loans for sampling and what servicers should be evaluating in their reviews;
- specify which complaints servicers should track to ensure consistency and to facilitate program oversight and compliance;
- more clearly inform borrowers that the HOPE Hotline may also be used if they are having difficulty with their HAMP application or servicer or feel that they have been incorrectly denied HAMP, monitor the effectiveness of the HOPE Hotline as an escalation process for handling borrower concerns about potentially incorrect HAMP denials, and develop an improved escalation mechanism if the HOPE Hotline is not sufficiently effective;
- finalize and issue consequences for servicer noncompliance with HAMP requirements as soon as possible;
- report activity under the principal reduction program, including the extent to which servicers determined that principal reduction was beneficial to investors but did not offer it, to ensure transparency in the implementation of this program feature across servicers;

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- finalize and implement benchmarks for performance measures under the first-lien modification program, as well as develop measures and benchmarks for the recently announced HAMP-funded homeowner assistance programs; and
  - implement a prudent design for remaining HAMP-funded programs.

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## Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for its review and comment. We received written comments from the Assistant Secretary for Financial Stability that are reprinted in appendix III. We also received technical comments from Treasury that we incorporated into the report as appropriate. In its written comments, Treasury stated that it would review our final report and provide Congress with a detailed description of the actions that Treasury had taken and intended to take regarding the recommendations in the report. Treasury also stated that while GAO notes the progress Treasury has made in implementing HAMP, it believed that the draft report did not sufficiently take into the account the scope and complexity of the challenges Treasury faced when it developed and implemented a modification initiative, the scale of which had never been previously attempted. We acknowledge that the HAMP program is part of an unprecedented response to a particularly difficult time in our nation's mortgage markets. As noted by Treasury when it first announced the HAMP framework in February 2009, the deep contraction in the economy and the housing market had devastating consequences for homeowners and communities throughout the country. However, more than a year after Treasury first announced HAMP, the number of permanent modifications has been limited and key HAMP program components have not been fully implemented. Treasury noted in its written comments that the servicing industry did not have the capacity or infrastructure needed to implement a national loan modification program such as HAMP. This issue of servicer capacity to successfully implement HAMP was one that we raised in our July 2009 report as needing Treasury's attention and remains a concern as Treasury implements the additional programs and components it has announced to supplement the HAMP first-lien modification program. While Treasury has taken some steps to address the challenges we and others have previously identified, the continuing problems in the U.S. mortgage markets call for swift and deliberate action. Given the challenges involved and the magnitude of public funds invested—up to \$50 billion in TARP funds and \$25 billion in GSE funds—it remains to be seen how effective Treasury's efforts will be. As part of our ongoing monitoring of Treasury's implementation of TARP, we will continue to monitor

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Treasury's progress in implementing these and other planned initiatives in future reports.

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We are sending copies of this report to the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, interested congressional committees and members, Treasury, the federal banking regulators, and others. This report is also available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact Richard J. Hillman at (202) 512-8678 or [hillmanr@gao.gov](mailto:hillmanr@gao.gov), Thomas J. McCool at (202) 512-2642 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov), or Mathew J. Scirè at (202) 512-8678 or [sciremj@gao.gov](mailto:sciremj@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is written in a cursive style with a long horizontal stroke extending to the right.

Gene L. Dodaro  
Acting Comptroller General of the United States

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*List of Committees*

The Honorable Daniel K. Inouye  
Chairman  
The Honorable Thad Cochran  
Vice Chairman  
Committee on Appropriations  
United States Senate

The Honorable Christopher J. Dodd  
Chairman  
The Honorable Richard C. Shelby  
Ranking Member  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Kent Conrad  
Chairman  
The Honorable Judd Gregg  
Ranking Member  
Committee on the Budget  
United States Senate

The Honorable Max Baucus  
Chairman  
The Honorable Charles E. Grassley  
Ranking Member  
Committee on Finance  
United States Senate

The Honorable David R. Obey  
Chairman  
The Honorable Jerry Lewis  
Ranking Member  
Committee on Appropriations  
House of Representatives

The Honorable John M. Spratt, Jr.  
Chairman  
The Honorable Paul Ryan  
Ranking Member  
Committee on the Budget  
House of Representatives

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The Honorable Barney Frank  
Chairman  
The Honorable Spencer Bachus  
Ranking Member  
Committee on Financial Services  
House of Representatives

The Honorable Sander M. Levin  
Acting Chairman  
The Honorable Dave Camp  
Ranking Member  
Committee on Ways and Means  
House of Representatives



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# Appendix I: Scope and Methodology

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To examine servicers' treatment of borrowers under the Home Affordable Modification Program (HAMP), between November 2009 and March 2010, we spoke with and obtained information from 10 HAMP servicers of various sizes that collectively represented 71 percent of the Troubled Asset Relief Program (TARP) funds allocated to participating servicers, visiting 6 of them. The six servicers we visited were: Aurora Loan Services, LLC; Bank of America, NA; Carrington Mortgage Services, LLC; GMAC Mortgage, Inc.; Ocwen Financial Corporation, Inc.; and Wells Fargo Bank, NA. The four additional servicers we spoke with and obtained data from were: CitiMortgage, Inc.; J.P. Morgan Chase Bank, NA; Saxon Mortgage Services, Inc.; and Select Portfolio Servicing. For each of these 10 servicers, we reviewed their HAMP policies, procedures, and quality assurance reports; and interviewed management and quality assurance staff. We also requested and reviewed data about these servicers' solicitations of borrowers for HAMP between when they began participating in the program and December 31, 2009. We determined that these data were reliable for the purposes of our report. In addition, for the servicers we visited, we observed a sample of HAMP-related phone calls between borrowers and their servicers. We also reviewed HAMP program documentation issued by the Department of the Treasury (Treasury), including the supplemental directives related to first-lien modifications and servicer communications with borrowers, press releases detailing aspects and goals of the program, and draft operational metrics. We obtained and analyzed information from Treasury on servicers' HAMP loan modification activity. Our work focused on non-GSE HAMP activity using TARP funds, but the information obtained from Treasury did not always break out GSE and non-GSE activity. We also spoke with officials at Treasury and its financial agents—Fannie Mae and Making Home Affordable-Compliance—to understand their rationale for program changes, what they were doing to ensure compliance with HAMP guidelines, and their processes for resolving HAMP complaints. In addition, we reviewed data on the content and resolution of these complaints. To understand the characteristics of borrowers in the program, we analyzed data from IR/2, the HAMP database managed by Fannie Mae to track the status of HAMP modifications, and we determined that these data were reliable for the purposes used in our report. To learn more about the process for and resolution of HAMP-related complaints, we spoke to the administrators of the HOPE Hotline and representatives of NeighborWorks, a national nonprofit organization created by Congress to provide foreclosure prevention and other community revitalization assistance to the more than 230 community-based organizations in its network. We also met with a trade association that represents both

investors and servicers, and an organization representing a national coalition of community investment organizations.

To examine actions Treasury has taken to address the challenges of (1) converting trial modifications to permanent modifications, (2) addressing potential foreclosures among borrowers with negative equity, (3) limiting the likelihood of redefault among borrowers with permanent modifications, and (4) ensuring program stability and effective program management, we reviewed the program announcements of current and upcoming HAMP-funded homeowner assistance programs to determine the extent to which they address these challenges. We also spoke with Treasury officials to understand the goals of these programs, and the steps Treasury has taken to ensure program stability and adequate program management in light of these programs. In addition, we requested and reviewed data from Treasury and servicers relevant to each challenge. Specifically, we requested information from the 10 HAMP servicers described above on the number of borrowers who had been in trial modifications for at least 3 months, as of December 31, 2009, and of these, the number that had converted to permanent modifications. We also reviewed Treasury reports on conversion rates and documentation related to Treasury's conversion campaign. To understand the extent to which borrowers may be facing negative equity, we reviewed data from American Core Logic for the first quarter of 2010. Finally, we reviewed the Government Performance and Results Act and the Standards for Internal Control in the Federal Government to determine the key elements needed to ensure program stability and adequate program management.<sup>1</sup> We coordinated our work with other oversight entities that TARP created—the Congressional Oversight Panel, the Office of the Special Inspector General for TARP, and the Financial Stability Oversight Board.

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<sup>1</sup>Government Performance and Results Act of 1993, Pub. L. No. 103-62, 107 Stat. 285 (1993), and GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: November 1999).

# Appendix II: Treasury's Actions in Response to GAO's July 2009 HAMP Recommendations

GAO recommendation	Treasury actions to date
<p>Consider methods of monitoring whether borrowers with total household debt of more than 55 percent of their income who have been told that they must obtain housing counseling do so, and assessing how this counseling affects the performance of modified loans to see if the requirement is having its intended effect of limiting redefaults.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, it considered options for monitoring what proportion of borrowers is obtaining counseling, but determined that it would be too burdensome to implement.</li> <li>• Treasury does not plan to assess the effectiveness of counseling in limiting redefaults because it believes that the benefits of counseling on the performance of loan modifications is well documented and the assessment of the benefits to HAMP borrowers is not needed.</li> </ul>
<p>Reevaluate the basis and design of the Home Price Decline Protection (HPDP) program to ensure that HAMP funds are being used efficiently to maximize the number of borrowers who are helped under HAMP and to maximize overall benefits of utilizing taxpayer dollars.</p>	<ul style="list-style-type: none"> <li>• On July 31, 2009, Treasury announced detailed guidance on HPDP that included changes to the program's design that, according to Treasury, improve the targeting of incentive payments to mortgages that are at greater risk because of home price declines.</li> <li>• Treasury does not plan to limit HPDP incentives to modifications that would otherwise not be made without the incentives, due to concerns about potential manipulation of inputs by servicers to maximize incentive payments and the additional burden of re-running the net present value model for many loans.</li> </ul>
<p>Institute a system to routinely review and update key assumptions and projections about the housing market and the behavior of mortgage-holders, borrowers, and servicers that underlie Treasury's projection of the number of borrowers whose loans are likely to be modified under HAMP and revise the projection as necessary in order to assess the program's effectiveness and structure.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, on a quarterly basis it is updating its projections on the number of TARP-funded first-lien modifications expected when it revises the amount of TARP funds allocated to each servicer under HAMP.</li> <li>• Treasury is gathering data on servicer performance in HAMP and housing market conditions in order to improve and build upon the assumptions underlying its projections about mortgage market behavior.</li> </ul>
<p>Place a high priority on fully staffing vacant positions in the Homeownership Preservation Office (HPO)—including filling the position of Chief Homeownership Preservation Officer with a permanent placement—and evaluate HPO's staffing levels and competencies to determine whether they are sufficient and appropriate to effectively fulfill its HAMP governance responsibilities.</p>	<ul style="list-style-type: none"> <li>• A permanent Chief Homeownership Preservation Officer was hired on November 9, 2009.</li> <li>• According to Treasury, staffing levels for HPO have been revised from 36 full-time equivalent positions to 29.</li> <li>• According to Treasury, as of April 2010, HPO had filled 27 of the total of 29 full time positions.</li> </ul>
<p>Expediently finalize a comprehensive system of internal control over HAMP, including policies, procedures, and guidance for program activities, to ensure that the interests of both the government and taxpayer are protected and that the program objectives and requirements are being met once loan modifications and incentive payments begin.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, it will work with Fannie Mae and Freddie Mac to build and refine the internal controls within these financial agents' operations as new programs are implemented.</li> <li>• Treasury expects to finalize a list of remedies for servicers not in compliance with HAMP guidelines by June 2010.</li> </ul>
<p>Expediently develop a means of systematically assessing servicers' capacity to meet program requirements during program admission so that Treasury can understand and address any risks associated with individual servicers' abilities to fulfill program requirements, including those related to data reporting and collection.</p>	<ul style="list-style-type: none"> <li>• According to Treasury, a servicer self-evaluation form, which provides information on the servicer's capacity to implement HAMP, has been implemented beginning with servicers who started signing Servicer Participation Agreements in December 2009.</li> </ul>

Source: GAO and analysis of Treasury information.

# Appendix III: Comments from the Department of the Treasury



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

June 14, 2010

Thomas J. McCool  
Director, Center for Economics  
Applied Research and Methods  
U.S. Government Accountability Office  
441 G Street, N.W.  
Washington, D.C. 20548

Dear Mr. McCool:

The Department of the Treasury ("Treasury") appreciates the opportunity to review the official draft of the GAO's latest report on Treasury's Troubled Asset Relief Program (TARP), "Further Action Needed to Fully and Equitably Implement Foreclosure Mitigation Programs" (the "Draft Report"). Generally, the Draft Report judges Treasury for not implementing its Home Affordable Modification Program ("HAMP") more quickly and not providing more specific guidance to servicers. More specifically, the GAO evaluated servicer performance and compliance efforts under HAMP. While the GAO notes the progress Treasury has made in implementing HAMP, we believe the GAO did not sufficiently take into account the scope and complexity of the challenges Treasury faced when it developed and implemented a modification initiative, the scale of which has never been previously attempted.

#### **Treasury's Response to the Mortgage Crisis was Unprecedented**

Despite the absence of consistent industry standards and infrastructure for modifying loans on a massive scale, Treasury took swift and unprecedented action to address a national housing crisis that had been two years in the making. There were millions of responsible homeowners grappling with the possibility of foreclosure and displacement. To address this crisis as quickly as possible, Treasury designed a program to provide immediate relief to at risk homeowners as quickly as possible.

There was little precedent on how to design a modification program of the scale required and limited data on which to base estimates of potential performance. There was no existing infrastructure in the mortgage finance market or the government to carry out a national modification program at a loan level. Program implementation required recruiting servicers, developing policies and servicer guidance, and mounting a massive effort to reach homeowners.

At the launch of the program, there were many unknowns regarding program implementation. Those included the number of servicers that would participate, the rate at which they could build capacity to implement the program, and the acceptance of overall program design. Treasury designed a system where mortgage servicers would undertake the core implementation responsibilities and Treasury would appoint capable financial agents to administer the program and to audit compliance. Before HAMP, the servicing industry did not have the capacity or infrastructure needed to implement such a national loan modification program. Their former business models were primarily payment processing structures – a much simpler and lower cost type of business. Consequently, servicers were slow to implement HAMP, resulting in a slow start for the program.

To accelerate the relief to homeowners, we gave servicers the option of providing trial modifications based on stated income and hardship, with the understanding that documentation would be provided before conversion to permanent modification. That policy enabled more families to receive immediate payment relief and gave servicers time to build out platforms to process underwriting documents. It also led to challenges collecting and tracking documents and reconciling income documentation when received. A large number of the trials based on stated income will not convert to permanent modification. Based on lessons learned from stated income modifications, Treasury issued guidance in January 2010 requiring income and hardship verification before beginning a trial modification. The Draft Report should reflect the GAO's consideration of those challenges when assessing Treasury's efforts.

**The GAO Recognizes Treasury's Progress**

Our strategy to address the crisis has evolved because our challenges have evolved. The improvements Treasury has announced are responsive to the changing needs of homeowners across the country and have accelerated the pace of modifications. In light of the primary goal of helping homeowners eligible for HAMP prevent avoidable foreclosures through modifications, since your July 2009 report, Treasury has announced and/or implemented:

- a forbearance plan to reduce or suspend eligible unemployed homeowners' mortgage payments temporarily;
- an alternative principal reduction waterfall to encourage servicers and investors to write down a portion of the outstanding principal balance of homeowners' mortgage loans, with increased incentives to encourage those writedowns;
- the Home Affordable Foreclosure Alternatives program, which provides a streamlined process and financial incentives to servicers and homeowners who use a short sale or deed-in-lieu to avoid foreclosure on an eligible loan under HAMP;
- new up-front documentation requirements; and
- the Second Lien Modification Program (to date, six servicers have signed agreements to participate).

HAMP is providing immediate relief to homeowners affected by the mortgage crisis. Those accomplishments should have been weighted more heavily in the Draft Report.

We appreciate the GAO's recognition that Treasury has continued to enhance HAMP since the GAO's initial audit report on the program in July 2009. The GAO acknowledges in the Draft Report that Treasury has taken steps to address conversions, negative equity, re-defaults, and program stability; improve servicer communication to homeowners; and streamline program requirements to increase permanent modifications.

**Treasury's Compliance Program Remains Focused on Benefiting the Homeowner**

Our compliance activities have primarily focused on ensuring that homeowners are appropriately treated in accordance with HAMP guidelines. As the program has evolved, by employing consistent principle-based compliance assessments, we have educated servicers, clarified expectations, and implemented remedies that have shaped servicer behavior in order to address the most vital issue: the ultimate impact on the homeowner.

For example, while the GAO asserted that Treasury lacked guidance regarding servicers' required Quality Assurance (QA) activities, those activities are assessed during compliance on-site reviews against specific criteria, including those mentioned by the GAO. The results of the assessments are communicated to the servicers, so that, if required, enhancements can be implemented. Similarly, compliance activities focused on servicers' use of the NPV model have identified areas of necessary

remediation. Where non-compliance is found, servicers are required to analyze whether there was any impact to those homeowners who were tested during the time that the servicers' NPV processes were not in conformance with HAMP requirements; and, when necessary, the servicers may be required to re-perform NPV testing on these homeowners to reasonably ensure that the outcomes were appropriate for those homeowners. These examples demonstrate some of the ways in which the compliance effort has positively affected servicer behavior to the benefit of homeowners. In addition, servicer specific data on compliance will be published in future HAMP public reports, further increasing transparency into compliance activities.

With respect to Treasury's enforcement of HAMP requirements, Treasury has created the HAMP Compliance Committee to review the results of all compliance activities and ensure consistent treatment of servicers. The HAMP Compliance Committee has established a process which evaluates the nature and scope of instances of non-compliance and assesses appropriate responses, including remedies, in a consistent manner. These remedies may include those that are non-financial such as process improvements, analysis of impact on homeowners, and re-evaluation of homeowners (as described above), and financial remedies such as withholding incentives or clawing back incentives already paid. The HAMP remedies policy currently being reviewed for approval simply documents Treasury's existing robust process. The GAO's evaluation of Treasury's HAMP compliance program should consider those factors.

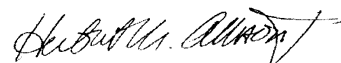
**More Than a Million Homeowners' Mortgage Payments Have Been Reduced**

Unlike any previous foreclosure-mitigation effort, HAMP established a standard for an affordable and sustainable modification across the industry that substantially reduced mortgage payments, set at 31% of gross monthly income. Over 100 servicers are participating in HAMP. These servicers, when combined with thousands of Fannie Mae and Freddie Mac servicers participating in the program, service nearly 90% of eligible outstanding mortgage debt in all 50 states, the District of Columbia, and the U.S. territories. Nearly one million borrowers are now in trial or permanent modifications, with median payment reduction of over \$500 per month. In aggregate, HAMP modifications have reduced total mortgage payments for American homeowners by over \$2.2 billion already.

We appreciate the time your staff dedicated to learning about this complex program and your consideration of our input regarding differences of opinion in the characterization of HAMP in the Draft Report. We will review the final audit report and provide a detailed description of the actions Treasury has already taken and intends to take regarding the GAO's recommendations within the statutory period.

We look forward to continuing to work with the GAO regarding our efforts to improve HAMP and Treasury's implementation of other programs to stabilize the financial system.

Sincerely,



Herbert M. Allison, Jr.  
Assistant Secretary for Financial Stability

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# Appendix IV: GAO Contacts and Staff Acknowledgments

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## GAO Contacts

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## Staff Acknowledgments

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