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"Housing Finance Reform: National Mortgage Servicing Standards"

Chairman Johnson, Ranking Member Shelby, and other distinguished members of the Committee, thank you for inviting me to participate in this hearing on national mortgage servicing standards. As staff is aware, I had previously committed to speak at an event in Oregon today, and I thank the Committee and its staff for the extraordinary flexibility of having me testify online today, over Skype. In addition to my work on housing and finance issues, my other main area of research is in technology and the Internet. I believe that using online technologies in this way can help open up Congress and our political process to effective participation by an ever-greater portion of the American people.

My testimony today will draw on two previously-published items, which are attached to the testimony. The first is a report called "What the Fair Credit Reporting Act Should Teach Us About Mortgage Servicing," which was published by the Center for American Progress in January, 2011.[1] The second is an article in the Los Angeles Times from March 6, 2011, which described some of my personal experiences as a homeowner with the mortgage servicing industry.[2] In 2006 and 2007 my servicer, Washington Mutual, repeatedly purchased duplicate flood insurance for my house in Bethesda. After dozens of calls, and the erroneous imposition of numerous late fees, I was eventually able to resolve this problem with WaMu without paying such fees. I have also attached a timeline of the dispute that I sent to WaMu in 2007.

<u>Background of the witness</u>

I am now C. William O'Neill Professor of Law at the Moritz College of Law of the Ohio State University, and Senior Fellow at the Center for American Progress. From July, 2009 through August, 2010 I served as Special Assistant to the President for Economic Policy, serving under Lawrence Summers in the National Economic Council. At the NEC, my biggest task was to coordinate the inter-agency process for housing and housing finance issues. In this role, I worked extensively on mortgage servicing issues, including the Home Affordable Mortgage Program (HAMP), and servicing and other issues affecting the Federal Housing Administration, government sponsored enterprises (GSEs), and possible reform of the GSEs. In this role, I met on a number of occasions with mortgage servicing executives, as well as a wide variety of other stakeholders concerned about the mortgage servicing process.

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[1] http://www.americanprogress.org/issues/2011/01/fcra_mortgage_servicing.html.
[2] Lew Sichelman, "Mortgage Servicing Errors Highlight Need for Change," L.A. Times, March 6, 2011, available at http://articles.latimes.com/2011/mar/06/business/la-fi-lew-20110306.

Before and after my NEC service, I have worked on a range of other policy issues. My work is likely best known in the privacy area. I served as Chief Counselor for Privacy in the Office of Management and Budget under President Clinton, and I testified on the Fair Credit Reporting Act before the Housing Financial Services Committee in 2003.

<u>What the Fair Credit Reporting Act Should Teach Us About Mortgage Servicing</u>

My report on the Fair Credit Reporting Act (FCRA) makes a simple point. The sorts of market failures that led to the creation of the FCRA in 1970 also exist for mortgage servicers. The single most important fact is that the consumers – the homeowners – are not the clients. The clients for the credit reporting agencies are the companies that pay for the credit reports, such as lenders or employers. The clients for the mortgage servicers are the companies that invest in mortgages. Mortgage servicers owe their legal duties and market loyalties to the investors, not the homeowners.

This testimony will not repeat the report's discussion of the history of mortgage servicing and all of the policy analysis. Instead, it is important to understand that consumers have no market or legal checks on the servicers. The homeowner doesn't choose the servicer – that choice is made by the company originating the loan or by a subsequent owner of the mortgage. If the homeowner has a bad experience with the servicer – as so many consumers have – the homeowner can't even quit. Even if the homeowner refinances the loan, concentration in the servicing market means the homeowner quite possibly will get the same servicer the next time.

Homeowners not only lack any market choice, but they currently lack legal remedies if the servicer performs badly. That is the reason that national standards for mortgage servicing are so important. Where there are no market forces to protect consumers, then something else must fill the gap. An effective set of consumer rights could be embodied in national mortgage servicing standards. I hope that that will happen.

<u>Dispute on my mortgage with Washington Mutual's servicing arm in 2006-2007</u>

To prepare for this testimony, I have reviewed the files from my dispute with Washington Mutual in 2006 and 2007 about flood insurance on my family's home on a hill in Bethesda. This dispute was the subject of the Los Angeles Times article by Mr. Sichelman in March.

I am sorry to report that I stated some details incorrectly to Mr. Sichelman when I did the interview with him for the story. The interview began as a discussion about the FCRA and mortgage servicing policy, and so I did not review the file before speaking with him. Specifically, my family did have flood insurance on the house from the time we bought it in 2002. The house is within a couple of hundred yards of the top of a large hill in Bethesda, it has never flooded to my knowledge since it was built in the 1960's, and I personally did not believe it needed flood insurance. Upon review of the file, however, I learned that we had prudently kept flood insurance in effect from the time we bought the house and throughout the dispute with WaMu.

I provide that detail because the file vividly shows the cascade of mistakes that the servicing company made, despite several dozen calls by me to the company and detailed documentation. The basic problem, beginning in early 2006, was that WaMu bought "force placed insurance" – duplicate flood insurance on my house despite the fact that State Farm repeatedly sent them proof of coverage. In numerous instances, WaMu would impose a "late fee" on my family. We had automatic payment each month for our mortgage payment, and so we were never late on any payment. The WaMu practice, however, was to charge us for flood insurance without telling us, and then declare us "late" for the entire monthly mortgage payment. The next month would also be "late," and subject to additional fees, because of the second month's duplicate flood insurance fee.

In May, 2007 I informed WaMu that I would contact regulators and the Congress if they did not resolve the problem. My letter to WaMu said:

> "The amount of time it is taking for me to resolve this matter resembles a major piece of litigation. I feel very sorry for the other customers who get caught in this cycle of uninformed debt collectors, automatic threatening letters of no insurance, lost faxes by WaMu, an apparent policy of ignoring many proofs of insurance coverage, systems that suppress notes saying a customer will not be subject to collection calls and late fees, large late fees due to no fault of the customer, and so on."

This letter led to a phone response that made me believe that the problem was resolved. Soon, however, the problems began again, and it was not until October, 2007 that the matter was finally resolved.

In conclusion, I have taught both banking law and consumer protection, and I feel fortunate that I could advocate for myself and avoid the thousands of dollars of fees that the servicer erroneously sought to impose on my family. Most homeowners, however, are not banking law professors. Before the financial crisis of 2008, my experience with WaMu sensitized me to the flaws in our current mortgage servicing system. My experience in government and since has taught me there are numerous hard-working and talented individuals in the mortgage servicing industry. The incentives, however, do not work for consumers. In the absence of market discipline on servicers, an effective national set of mortgage standards is essential.

I thank the Committee for its attention to these important matters, and I welcome any questions you may have.