AMERICANS FOR FINANCIAL REFORM
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Misleading "Study" On Servicer Settlement

The bank-funded study on the supposed economic costs of the state AGs proposed settlement with mortgage servicers is a patchwork of unsupported assumptions all designed to lead to one conclusion – that the big servicers who funded the study ought to get a free ride.

Financial journalist Felix Salmon has already done a devastating take on the problems with this study. Iowa Attorney General Tom Miller pointed out that contrary to the study's assumptions, a goal of the settlement is to speed up legitimate foreclosures, which have ground to a halt in many states due to the cloud of legal problems surrounding servicer behavior. Georgetown Law professor Adam Levitin reminded us that the servicers should expect to pay a cost for breaking the law and depriving both homeowners and investors of legal protections they were entitled to. And both Levitin and economics blogger Mike Konczal provided the evidence that servicers haven't been willing or able to perform sustainable modifications on their own.

This 'study' takes three easy steps to make the servicer settlement look like a bad deal:

- **First, assume away the problem:** The authors start by assuming there's no problem we need a legal settlement to fix. This completely ignores the endemic problems with servicer performance and incentives. Incredibly, the report assumes that servicers are already making all the mortgage modifications that would be economically efficient – that save money as compared to a foreclosure. But we've seen beyond doubt that the servicers lack both the proper incentives and the competence to do economically rational mortgage modifications.

- **Next, make up some costs of the settlement:** Then, they mischaracterize costs to the servicers – in other words, transfers from the big banks to the rest of us – as costs to the economy as a whole. Other assumed costs result from a completely unsubstantiated claim of a 25 percent increase in so-called "strategic defaults" due to a settlement. They also simply assume that a settlement will delay future foreclosures by close to a year – despite the fact that a settlement would speed appropriate foreclosures by ending servicer delays in processing modification requests

- **Finally, ignore the benefits of a settlement**: Of course, the major reason to ask servicers to do a better job preventing foreclosures is that foreclosures have big social and economic costs. The authors' own extremely conservative assumptions in this paper imply that the 2 million loan modifications targeted by a settlement would prevent at least

> 700 thousand foreclosures. The latest research finds social costs of $80,000 per foreclosure. So the authors own assumptions imply that the settlement agreement would create economic benefits of $56 billion. But you won't find those benefits mentioned anywhere in this study.

Add it all up, and there's nothing there. More detail below…

Assume away the problem. Incredibly, the report assumes that servicers are already making all the mortgage modifications they should be making. ("That servicers have not modified more loans indicates that, under their NPV analyses, additional modifications would not result in higher payouts for investors, despite the benefits of avoiding a protracted and expensive foreclosure process" – page 7). But we've seen beyond doubt that the servicers lack both the proper incentives and the competence to do economically rational mortgage modifications. The government HAMP program has provided data on the reasons why servicers fail to perform modifications when borrowers apply. Just 6 percent of modification applications are turned down because they fail the NPV test and don't make economic sense – but over one fifth are turned down for paperwork reasons.

Make up the costs. The report estimates various costs of a settlement. They start by describing the requirement that servicers transfer $25 billion in principal reductions to selected borrowers. The 25 billion penalty is a transfer from banks to homeowners that reflects estimated excess servicer profits from breaking the law. Then the authors add an admitted guess as to the cost to servicers of complying with the law and their contracts by providing adequate servicing of loans. Finally, they assume that every dollar of these costs will be passed on to future home buyers in the form of higher interest rates – none will come from bank profits.

They authors also add on additional costs resulting from a guesstimate of a 25 percent increase in "strategic defaults" induced by a settlement. This figure is completely made up and has no substantiation (see footnote 47 of the paper – "We use a 25 percent increase in strategic defaults for illustrative purposes only. It is unclear how much strategic defaults would increase under the settlement"). The assumption that the settlement would lead to any increase in strategic defaults ignores the heavy costs to homeowners of strategic default – humiliation, the risk of home loss, and a ruined credit rating – as well as the fact that the modifications contemplated under the settlement are carefully targeted to homeowners who demonstrate a real need for the assistance. Indeed, the authors' main substantiation for the idea that strategic defaults will increase is a study of tiny cash loans to poor, high-risk borrowers in South Africa, not home mortgage lending to families in the United States (see pp. 9-10 of the study). The authors then assume that each and every strategic default will lead to a costly foreclosure (see footnote 48 of the paper), despite the fact that their only rationale for claiming increased strategic defaults is that making loan modifications more accessible will tempt homeowners to default in order to get a modification and keep their home.

In a final leap of logic, the authors then assume unspecified costs due to foreclosure delays supposedly created by the settlement. The only substantiation for these supposed delays is a long list of the various timeframes set out in the settlement term sheet, which generally require servicers to evaluate borrowers for a loan modification without delay. But the authors assert that the imposition of those limits on servicer delay would cause delay. Delays occasioned by the servicers' malfeasance, such as the submission of false documents in the foreclosure process, are also attributed to the settlement.   There are only two timeframes listed by the authors that would delay a foreclosure: the requirement that borrowers denied a loan modification be given 30 days to challenge the denial, and the three month trial modification period. But this trial modification period will only last three months if the borrower is making payments: otherwise servicers are free to proceed with a foreclosure.   A settlement should actually increase the pace of legitimate foreclosures, by forcing servicers to modify or foreclose in a timely way, as opposed to the endless stalling, losing documents, and servicer-initiated delay we see now--which benefits servicers, but not homeowners or investors, and by clearing aside legal barriers to appropriate foreclosure and by.

Ignore the benefits. The authors generate their costs based on an estimate of 2 million mortgage modifications for homeowners created by the settlement (see footnote 43). Elsewhere in the paper, they cite a figure that 30 percent of mortgages in default self-cure without modification (see page 9 of the paper) and that 50 percent of modified mortgages re-default (see page 3 of the paper). These figures are likely too high (government data clearly shows that the re-default rate has been well under 50 percent for properly designed mortgage modifications). Nevertheless, taking the authors' own assumptions implies that the 2 million additional mortgage modifications created by the settlement will lead to 700 thousand foreclosures averted.

So the settlement will prevent at least 700 thousand foreclosures. A recent study by the Urban Institute shows that each foreclosure leads to economic costs to society of about $80,000 each. So the 700 thousand foreclosures averted by the settlement would create economic savings of $56 billion. Unlike the 'costs' estimated in the report, these benefits are actual increases in total economic output – not savings to servicers. These economic benefits – generated from the authors own assumptions and figures – are nowhere mentioned in the report.

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AARP
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans for Fairness in Lending
- Americans United for Change
- Calvert Asset Management Company, Inc.
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute

- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National People's Action
- National Training and Information Center/National People's Action
- National Council of Women's Organizations
- Next Step
- OMB Watch
- Opportunity Finance Network
- Partners for the Common Good
- PICO
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer's for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group

- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

Partial list of State and Local Signers

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC

- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
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- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY

- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
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