State Of California
Business, Transportation And Housing Agency
DEPARTMENT OF CORPORATIONS
California's Investment and Financing Authority

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Arnold Schwarzenegger
Governor

Preston DuFauchard
California Corporations Commissioner

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ARRANGING WORKOUTS FOR BORROWERS, PREPARING FOR SPECIAL SERVICING REPORTS TO THE COMMISSIONER, AND ESTABLISHING A WORKING GROUP IN CONNECTION WITH NONTRADITIONAL AND OTHER MORTGAGE LOAN PRODUCTS

This Release encourages lenders and servicers of loans under the California Finance Lenders Law and the California Residential Mortgage Lending Act to provide appropriate workout arrangements with financially stressed borrowers, such as providing loan modifications and other workout arrangements. This Release also provides notification of a special report requested by the Department of Corporations ("Department') in connection with workout arrangements being arranged by licensees performing loan-servicing activities. Additionally, this Release announces plans to form a new working group to advise the Department, and provide further assistance to help measure licensee performance in providing workout arrangements to borrowers.

Workout Arrangements With Financially Stressed Borrowers

The California Corporations Commissioner encourages licensees to work with financially stressed homeowners to provide, as necessary and appropriate, workout arrangements that provide modified terms or converted loan products with predictable and manageable payments. Loss mitigation techniques for servicers have proven useful to preserve homeownership and to avoid foreclosure. Accordingly, the Commissioner urges servicers to identify borrowers who are potentially in distress early, to notify them of reset provisions, and to work with them as appropriate, consistent with the following additional statements dated September 4, 2007: (1) the "Statement on Loss Strategies for Servicers of Residential Mortgages" published by the Federal Deposit Insurance Corporation ("FDIC"), the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the currency, the Office of Thrift Supervision, the National Credit Union Administration, and the Conference of State Bank Supervisors ("CSBS"); and (2) the Joint Release published by the FDIC, the CSBS, and the American Association of Residential Mortgage Regulators ("AARMR") entitled "FDIC, CSBS and AARMR Suggest Servicers Avoid Debt-to-Income (DTI) Ratios Above 50 Percent for Modified Obligations."

Special Report Regarding Adherence to Homeownership Preservation Principles

In a separate form that will be sent to licensees, the Department will be requesting information by December 31, 2007, relating to compliance by loan servicers with principles dated May 2, 2007 by the United States Senate Committee on Banking, Housing and Urban Affairs and entitled, "Homeownership Preservation Statement of Principles" (hereinafter the "Principles"). In general, six of these important Principles impacting licensees (exclusive of those that apply to government sponsored entities) are as follows:

1. Early Contact and Evaluation: Servicers should attempt to contact subprime adjustable rate mortgage (ARM) borrowers prior to the loan reset to determine whether the borrower can afford the new, higher payments, or whether the higher payments create a reasonable risk of default. If it is clear, after reviewing all the available facts and circumstances, that the borrower will be unable to make the new payment when the loan resets, then the servicer may presume that default on the mortgage is reasonably likely to occur. This conclusion may permit the servicer to modify the loan.

2. Modify to Create Longterm Affordability: If the borrower cannot afford the reset payment (as described above), servicers should seek to modify loans prior to the reset. The objective of the modification should be to create a permanent solution for the borrower to ensure that the loan is sustainable for the life of the loan rather than, for example, deferring the rate reset period. Such modification options should include, as appropriate, one or more of the following:

- Change of terms. Switching from an adjustable to a fixed rate loan at an affordable rate by, for example, making the introductory rate permanent.
- Reduce the interest rate. Reducing the interest rate is one way to assist a borrower to afford the mortgage. Ability to repay should take into account the borrower's total debt-to-income ratio, including factoring in the costs of taxes and insurance.
- Reduce principal. Reducing the loan principal in order to ensure affordability and a continued revenue stream on the loan.
- Reamortize the loan. Reamortizing the loan to account for any changed loan terms or to make the payments more affordable.
- Escrows. If possible, servicers should begin to escrow for taxes and insurance as part of the modification process to ensure the home loan will remain sustainable for the life of the loan.

3. Dedicated Teams or Resources: Servicers should adopt a modification policy so that modifications can be done on the scale required in the time required by dedicated teams or dedicated resources. Where feasible, servicers should partner with experienced third party counselors and non-profits to make outreach as effective as possible.

4. <u>Low-Cost Refinancing</u>: For those who are eligible, refinancing to prime loans should be made in as streamlined and low-cost fashion as possible.

5. <u>Maximize Success, Minimize Damage</u>: The participants understand that not every foreclosure can be prevented nor every home saved. All parties should work to minimize the damage to borrowers, communities, and the mortgage market when saving the home is not possible.

6. <u>Accountability</u>: A system should be developed for measuring progress on achieving the principles outlined above so that the parties can track progress, and so that the process is as transparent as possible.

Many Department licensees have already agreed to the above Principles including, but not limited to, Countrywide, Litton Loan Servicing, HSBC, and others. For those licensees that have not yet adopted these Principles, the Commissioner encourages them to adopt and comply with the Principles on an ongoing basis and to inform the Department accordingly. A special form being developed by the Department will be designed to assist in monitoring licensee compliance with these Principles as well as current laws, and will help provide a quick overview of ongoing efforts to help financially distressed borrowers receive modified loan products. Although the above-referenced Principles are designed to address certain adjustable rate mortgage loans, it is anticipated that licensees will be asked to answer questions relating to other loan types as well.

Establishing A Mortgage Loan Working Group

In addition, the Department will convene a working group by October 31, 2007, comprised of interested stakeholders from industry and consumer groups. Among other things, this group will help to advise the Department (including with regard to the special form described above), and to analyze the efficacy of assistance provided to financially stressed borrowers including, but not limited to, a more comprehensive report to measure licensee performance in providing workout arrangements.

For Further Information

Copies of the above-referenced documents, including the Principles published by the United States Senate Committee on Banking, Housing and Urban Affairs and entitled, “Homeownership Preservation Statement of Principles,” the federal financial agencies’ “Statement on Loss Strategies for Servicers of Residential Mortgages,” and the Joint Release of FDIC, CSBS and AARMR, are all are available on the Department’s web page at www.corp.ca.gov in the Education and Outreach link under the heading of Nontraditional Mortgage and Loan Information.

Should you have any questions concerning this Release, please contact the Department's Consumer Resource Center at 1-866-275-2677.

Preston DuFauchard
California Corporations Commissioner

By ________________________________

TIMOTHY L. Le BAS
Deputy Commissioner
Office of Legislation and Policy