TESTIMONY OF

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Before the

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SUBCOMMITTEE ON ADMINISTRATIVE OVERSIGHT AND THE COURTS

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Thank you, Chairman Schumer and Ranking Member Sessions, for the opportunity to speak with you today to address your concerns with respect to bankruptcy servicing and foreclosures. Countrywide is committed to helping our borrowers avoid foreclosure whenever they have a reasonable source of income and a desire to remain in the property. Further, I want to assure this Subcommittee that Countrywide also is committed to being supportive of the bankruptcy process when used by borrowers who are experiencing significant financial hardship to help them sustain homeownership. A successful Chapter 13 plan is in everyone's interest – the borrower's, the investor's, and the mortgage servicer's. Recent media reports alleging that mortgage servicers are systematically charging excessive fees and using the bankruptcy process to push borrowers into foreclosure or abusing the process more generally are inaccurate. Moreover, those claims run completely counter to Countrywide's commitment to help borrowers avoid foreclosure whenever feasible.

Today's market conditions have created unprecedented challenges for servicers and mortgage investors to develop new methods to help keep as many borrowers in their homes as possible. Countrywide recognizes and appreciates the goal of a Chapter 13 bankruptcy to provide borrowers with a fresh start and the opportunity to retain their most valued asset, their home. Countrywide is committed to cooperating with its borrowers who seek protection through the bankruptcy process and working with them to successfully complete a court-approved plan. Accordingly, Countrywide has always strived to accurately report and reflect the amounts due from borrowers so they can complete their bankruptcy plans and avoid foreclosure altogether.

My testimony will highlight recent enhancements we have implemented or are in the process of implementing relating to our bankruptcy servicing that focus on three objectives: *Transparency*, *Accuracy* and *Integrity*. The changes are designed to improve the disclosure of

fees, ensure the accuracy of all amounts charged and ensure the integrity of the entire process. Countrywide's three point plan evidences our commitment to continuous improvement. This plan includes:

- An *Independent Review* by a qualified outside auditor on a random sample of loans in bankruptcy focusing on the accuracy of pre- and post-petition filings and the accounting for plan payments.
- Establishment of the *Bankruptcy Ombudsman's Office* to ensure that borrowers and their counsel can have a means to seek a high level review of any perceived discrepancies on accounts in bankruptcy.
- Adoption of certain *Best Practices* recommended by the National Association of Chapter 13 Trustees.

These initiatives are discussed in detail later in my testimony.

Mortgage Servicing and the Bankruptcy Process

I would like to discuss the basic process surrounding bankruptcy filings and subsequent mortgage servicing requirements to give context to this testimony. Most borrowers who file for Chapter 13 bankruptcy have reached a point where they have fallen behind in making payments to their mortgage loans. Indeed, many borrowers are often so far in default that the foreclosure process has already begun prior to their filing bankruptcy. By filing for bankruptcy relief they are hoping to establish a bankruptcy plan that allows them to pay back their debt and avoid foreclosure. Once a borrower files bankruptcy, there are certain limitations placed on a servicer's subsequent communications with the borrower going forward.

After a borrower files bankruptcy, the servicer retains an attorney to file a proof of claim to identify the amounts the borrower owes. Typically, the majority of the amount reflected in a

proof of claim is comprised of the prior unpaid principal and interest payments. The proof of claim may also include back taxes or insurance payments the loan servicer has already advanced on behalf of the borrower. If the borrower had been severely delinquent or in foreclosure prior to filing bankruptcy, the proof of claim may also include fees and costs incurred by the servicer for foreclosure attorneys' fees or inspection costs. These items are called pre-petition amounts. At that point, the borrower, the borrower's attorney, and the trustee have an opportunity to review the amounts claimed and to raise any disagreement with the amounts presented. The delinquent pre-petition amounts are included in the borrower's bankruptcy plan, which is approved by the court. Notwithstanding the Chapter 13 bankruptcy and the confirmation of the plan, the borrower in most instances is still required to continue to pay ongoing mortgage obligations as they come due and to pay the taxes and insurance due on the property either directly or through an escrow established in connection with the loan. These amounts are called the post-petition debt.

Unfortunately, there are times when borrowers fall behind on their post-petition loan payments or their plan payments or both. Some borrowers make only partial loan payments over time; some borrowers skip loan payments entirely for a few months; and some borrowers fail to pay their taxes or insurance, requiring the servicer to advance those costs and seek their recovery from the borrower. In addition, plan payments routed through the bankruptcy trustee often come to the servicer irregularly, in amounts that bear no relationship to what is expected, and sometimes in checks that lump together the payments on many unrelated borrowers' accounts. We strive to do our best to accommodate these varied situations. At the same time, the servicer has an obligation to protect the investors' interests, who have a right under their contracts and the borrowers' plans to expect timely and full payments.

The uneven flow of payments causes servicers like Countrywide to incur further fees and costs in a borrower's bankruptcy. For example, when a borrower falls substantially behind on post-petition loan payments, a servicer typically requests that the bankruptcy court grant relief from the bankruptcy stay so the servicer may move forward with default proceedings. This requires the servicer to retain an attorney and incur third party fees. Sometimes, in response to the motion for relief from the stay, the borrower then makes the back payments and becomes current. Some borrowers become current after one motion has been filed, only to fall behind again, requiring yet another motion to be filed. In other situations, the borrower does not become current, and a court may grant the servicer relief from the automatic stay so that the servicer may proceed with default proceedings. Servicers prefer to continue to work with borrowers to bring their loans current; however, these actions are necessary to protect certain rights under the mortgage on behalf of the investor.

There have been a number of allegations made public in the press recently relating to the bankruptcy servicing practices of Countrywide and other servicers. Bankruptcy servicing is a complex process and involves the kind of legal proceedings I have mentioned, and possibly others. Moreover, the rules governing the bankruptcy process vary significantly across bankruptcy jurisdictions, from district to district and judge to judge. As a result, bankruptcy loan servicing is, by necessity, a borrower-by-borrower process as each circumstance is different. As such, to some unavoidable extent, the servicing process requires manual input or by-hand processing of data unique to each borrower. This type of processing can result in mistakes from time to time. However, those mistakes are few in number. Countrywide has completed a number of internal reviews that indicate an error rate of less than one percent for mistakes that adversely impact a borrower. As I will describe later in my testimony, Countrywide is

implementing a three point plan to help us further increase this accuracy rate. However, many of the issues for which Countrywide and other lenders are being criticized arise in the first instance as a result of a Chapter 13 debtor not making timely post-petition loan payments, as required under the borrower's bankruptcy plan.

As noted above, complications arise when a borrower is unable to meet his or her post-petition Chapter 13 obligations even when given a grace period of several weeks or, in some cases, months following the due date. Chapter 13 does not relieve a debtor of the obligation to make timely post-petition payments. When they fail to do so, the only remedy available to the lender is to file a motion for relief from stay. Sometimes, a debtor will make a late payment at or shortly after the time that Countrywide refers a matter to its attorney to file a motion for relief from stay. This creates a situation where a motion for stay relief may be filed at almost the same time that the late payment is received from the borrower. In such cases, Countrywide withdraws the motion for relief.

Servicers have also been accused of intentionally assessing inappropriate fees and costs to borrowers in bankruptcy. With respect to Countrywide, these allegations are simply not true. Most of the arrearage amounts that accrue on a post-petition bankruptcy account are the result of unpaid principal and interest, taxes and insurance not previously paid by the borrower and advanced by the servicer, increases in a borrower's contractual interest rate on variable rate loans, or attorneys' fees and costs incurred by the servicer and payable to third party law firms as a result of motions for relief from the bankruptcy stay. Countrywide's policies and practices are designed to avoid incurring unnecessary fees on accounts, particularly those in bankruptcy, for example:

- Countrywide *does not* charge late fees on post-petition delinquencies. Countrywide forgoes these fees even though we are contractually allowed to collect them. Many other servicers do charge these fees.
- Countrywide *does not* collect pre-payment penalties on payoffs for loans in bankruptcy, though contractually allowed to do so.
- Countrywide generally waits *45 to 60 days into a post-petition delinquency*, depending on the requirements of the investor, before referring post-petition delinquent accounts to attorneys to file motions for relief. Rather than filing a motion for relief as soon as we are entitled to do so, Countrywide avoids raising costs to the borrower or the investor.

Countrywide is aware that some of the counsel it uses in certain districts have been criticized in other cases for the work they have performed. I can tell you that Countrywide takes these criticisms very seriously. Countrywide must rely on outside counsel to file pleadings in bankruptcy matters – it cannot represent itself in all aspects of a case -- and we expect our lawyers to follow all laws, regulations and individual court rules and policies, and to present the proofs of claim accurately. We evaluate our lawyers and law firms for quality and effectiveness, and make changes when necessary, including penalizing and terminating attorneys or law firms that do not meet our standards.

Recent Enhancements to CHL's Bankruptcy Servicing

As I have stated, because of the detailed bankruptcy accounting necessary and the varying rules in different bankruptcy jurisdictions regarding the information that can be provided to the borrower about pre- and post-petition debt, servicing loans for borrowers who are in bankruptcy is a very manual, individualized process. Countrywide is one of the largest mortgage

servicers and accordingly handles a large bankruptcy portfolio – upwards of 65,000 ongoing cases at any one time. Although we have observed a low error rate, on occasion employees in Countrywide's bankruptcy servicing department make mistakes. Countrywide is committed to reducing the number of opportunities there might be for individual employee errors. To that end, over the past year we have implemented new policies and procedures, increased the number of employees within the relevant departments, and provided for greater checks and balances to minimize these errors. If we do make a mistake, the borrower's account records will be corrected and a refund will be paid if necessary.

Transparency

One key goal of Countrywide's policy revisions is to increase the transparency of the charges to the borrower. This includes providing borrowers with substantially enhanced notice to keep them accurately informed of their payment status, within the limits of the various laws and rules governing communications with debtors in bankruptcy. Though not required to do so on delinquent accounts involved in a bankruptcy, Countrywide now conducts an escrow analysis on each loan shortly after a bankruptcy filing date and will do so at least once during every 12 month period thereafter. In jurisdictions where such notification is allowed, Countrywide then sends resulting payment change notifications to the debtor, the debtor's attorney, the trustee and Countrywide's counsel.

Accuracy

Countrywide has also created a Validation Team to review each proof of claim, motion for relief from stay, or other document to be filed with a Bankruptcy Court. The Validation Team also performs an audit of each loan after the bankruptcy case is over, and before the loan is released from our Bankruptcy Servicing Department. There will be occasions when the loan is

in delinquent status at that time, such as if the borrower failed to make his or her most recent payment on the post-petition debt, and thus will be transferred from the Bankruptcy Servicing Department to our collections or foreclosure groups. However, if the loan is leaving the Bankruptcy Servicing Department in a delinquent status, it will require approval at the Vice President level or higher to validate the delinquency and that such a transfer is appropriate. This will ensure loans are not being improperly referred from the Bankruptcy Servicing Department for collection activity or foreclosure on amounts discharged by the bankruptcy.

In addition, Countrywide is making technological enhancements to our cash management application by re-programming the servicing platform to more accurately track pre-petition and post-petition balances during the bankruptcy. This process is well under way with a goal of implementation by December 2008. We expect this technological improvement will further reduce the possibility of human error.

Integrity

In a further effort to ensure the integrity of our bankruptcy servicing process, today we announced a three point plan to validate our processes and assure continuous improvement. Countrywide will undertake these three new major initiatives to ensure we are doing everything we can to accurately monitor and service the loans of borrowers in bankruptcy:

- **Independent Review:** Countrywide will retain a qualified independent auditor to review a number of randomly selected loans in which the borrower has been in bankruptcy at any point within the last 3 years. The examination will focus on the accuracy of our bankruptcy accounting for pre and post-petition payments. The audit will also review the accuracy of pleadings filed in bankruptcy matters, including but not limited to motions for relief from stay and proofs of claim. If

the audit identifies mistakes that caused a loss to borrowers, affected borrowers will be compensated or their accounts adjusted. Further, we will work with the independent auditor to determine if additional enhancements are necessary to improve our processes, and we will take steps to quickly implement appropriate recommendations.

- **Bankruptcy Ombudsman's Office:** Countrywide will establish the *Bankruptcy Ombudsman's Office* to ensure that borrowers and their counsel will have a means to seek a high level review of disputes in the bankruptcy servicing process. Going forward, the Ombudman's Office will be a resource for borrowers in bankruptcy to initiate a review of their Countrywide bankruptcy servicing records, if they or their counsel believe they have been charged fees in error or otherwise adversely affected by allegedly improper actions by Countrywide during the bankruptcy process. The Ombudsman's Office will research individual matters and, if Countrywide has made an error that has caused a loss, will make appropriate refunds or account adjustments.
- **Best Practices**: Finally, Countrywide will continue to assess and enhance systems, internal controls, and compliance programs to ensure the accuracy of our proofs of claims, motions for relief from stay and other filings in bankruptcy cases, and all charges imposed on borrowers in connection with the servicing of these accounts during bankruptcy. As you may know the National Association of Chapter 13 Trustees is developing a set of "best practices" for bankruptcy servicing. We have reviewed the NACTT's draft "Best Practices for Trustees and Mortgage Servicers in Chapter 13" and we intend to adopt those suggested

standards that are legally and contractually permissible for us, that enhance the efficiency of the bankruptcy servicing operation, and that protect the interests of our borrowers. We will work with the NACTT to ensure that the proposed best practices do not increase costs for borrowers in bankruptcy by causing unnecessary attorney involvement and associated fees.

The Intricacies of Bankruptcy Servicing Warrant Uniform Bankruptcy Court Rules

As noted above, the unique issues associated with each loan in bankruptcy make servicing these local rules, practices, and case law in the many bankruptcy courts are often different and conflicting. We believe that a cooperative effort by industry, the NACTT and all bankruptcy jurisdictions to create uniform processes and procedures will result in better customer service, more accurate filings and a more sensible system.

This lack of uniformity across jurisdictions is most evident in the following areas: notice requirements and recoverability of attorney's fees and costs.

Notice Requirements

Depending on the jurisdiction, courts suggest or require different notice requirements to preserve a servicer's right to collect post-petition amounts. Many jurisdictions are completely silent on this issue, other jurisdictions have decisions on the point, and still other jurisdictions have issued local rules. The differences can be highlighted by a review of two recent orders from bankruptcy courts in Vermont and Kansas. Vermont does not require a mortgage servicer to send monthly statements to the Chapter 13 trustee. Kansas, on the other hand, requires the mortgage servicer to send such statements to the Chapter 13 trustee when an adjustable rate on the debtor's mortgage is about to change. Kansas also requires the mortgage servicer to send a quarterly notice to the debtor and Chapter 13 trustee, detailing upcoming changes in an

adjustable rate, charges paid by the servicer for taxes, insurance, attorney's fees, or other expenses, the nature of the expense, and the date of payment. Vermont does not. The law is not clear on these issues generally, to the point where Countrywide, along with a half dozen other major loan servicers, are defendants in a class action in Ohio where we are being sued for sending monthly mortgage statements at all.

Attorneys' Fees and Costs

Another example of the variation among the courts concerns the recoverability of attorney's fees and costs incurred by a mortgage servicer, and the proper procedure for recovering such fees and costs. Vermont and Kansas do not require court approval if the servicer follows detailed notification procedures for identifying fees and costs owed by the borrower. Other jurisdictions, such as California, allow such fees and costs to be listed on the proof of claim. At least one court in Florida has refused to allow such fees to be paid in the bankruptcy, but stated that the fees could be recovered from the borrower in full after the case is over. Still other bankruptcy courts, such as in North Carolina, interpret the Federal Rules of Bankruptcy Procedure as requiring mortgage servicers to file formal applications and obtain formal court approval before recovering fees and costs. Though some courts believe fee applications are helpful, such applications, if taken to extremes, can result in higher fees and costs to the debtor and servicer because the cost of the application itself is a recoverable cost.

Countrywide respects and strives to abide by all courts' orders and requirements for servicing loans in bankruptcy. Nonetheless, the variations imposed by different courts in different jurisdictions, while individually attainable, collectively create an environment more susceptible to human error. Countrywide understands that servicers must be diligent to avoid errors that could be injurious to the borrowers. As noted above, Countrywide conducted a

number of internal reviews of its bankruptcy servicing and found that errors adversely impacting borrowers are at a rate of less than 1%. Nevertheless, we are committed to doing even better. Countrywide's 3 step plan discussed above, including a further audit, an ombudsman program and continuous improvement through implementation of further best practices will help us further reduce avoidable errors. We also believe that consumers and the industry as a whole would benefit from a uniform set of rules that are applicable across all bankruptcy courts to establish consistent procedures.

Thank you.