



CRA Insights: Financial Economics

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Emerging HAMP-related lawsuits

Several lawsuits have recently been filed against mortgage loan servicers participating in the Home Affordable Modification Program (HAMP) alleging that servicers are not meeting their obligations. HAMP was designed to help financially struggling homeowners avoid foreclosure by modifying loans so that payments are affordable for borrowers in the near term and sustainable over the long term.

The program aims to provide consistent loan modification guidelines for the mortgage industry and to provide incentives for borrowers, servicers, and investors to participate. To be eligible for a HAMP loan modification, a borrower must, in addition to meeting other criteria, be either delinquent on their mortgage or facing an imminent risk of default. Once approved, the borrower must complete a three-month trial period to demonstrate that they can meet their modified monthly loan payment. They also must submit to the servicer certain required documentation before the modification becomes permanent. As of March 2010, only about 25 percent of trial modifications have made it to permanent status.¹

Recent claims against loan servicers

The class action lawsuits filed against HAMP loan servicers allege breach of contract and other claims, including:

- Claims that the servicer failed to modify loans and perform its obligations under HAMP. For example, a class action was brought against Bank of America alleging that borrowers were informed, erroneously, that they have to be in default before being eligible for a HAMP modification. The complaint alleged that Bank of America had an incentive not to modify loans, because modification might cause it to repurchase more loans, collect lower servicing fees, or assess lower default charges on its financial statements because fewer payments would be deemed late.²

¹ *Servicer Performance Report Through March 2010*, Making Home Affordable Program. <http://www.makinghomeaffordable.gov/docs/Mar%20MHA%20Public%20041410%20TO%20CLEAR.PDF>. Calculated as the cumulative total number of permanent modifications started through March 2010, divided by the cumulative total number of trial modifications started through December 2009 (i.e., the total number that would be seasoned at least three months as of March 2010).

² *Kahlo et al v. Bank of America NA et al*, case number 2:2010cv00488, filed March 22, 2010, Western Washington District Court.

- Claims that loan servicers failed to fulfill their agreements to make trial loan modifications permanent after the borrower allegedly had met the documentation and payment requirements of the trial period. Similar class action lawsuits were brought against four loan servicers by the National Consumer Law Center.³
- Claims that lenders failed to provide borrowers with notice that they were denied access to HAMP loan modifications and denied borrowers their right to contest the denials. For example, the Legal Aid Society of New York City filed suit against Aurora Loan Services alleging, among other things, that Aurora wrongfully denied Plaintiffs access to the benefits of HAMP by refusing to evaluate their non-GSE loans for modification, even when borrowers requested to be considered under HAMP; took foreclosure actions against borrowers who asked for a HAMP modification; offered certain borrowers forbearance agreements that violate the HAMP program guidelines; and failed to guarantee a modification even when the borrower fully complied with the terms of the forbearance agreement.”⁴
- Claims of unfair and deceptive loan modification agreements and inadequate or incompetent customer service. For example, the Attorney General of Ohio filed suit alleging that servicers failed to provide borrowers with timely and affordable loan modifications to prevent foreclosures.⁵

Uncertain economic damages

The potential economic damages in such cases might include the foregone benefits from reduced interest payments or principal forgiveness that may come with a loan modification, or the costs of a foreclosure that a borrower might have avoided had their loan been modified. Establishing the potential class sizes and amounts of damages in such claims would be very challenging because available data are limited. For example, in cases alleging that a servicer failed to offer modifications to eligible borrowers, it would be difficult to estimate the number of borrowers who might have qualified for a loan modification but did not receive one. While servicers can readily identify loans that are actually in default, determining which of those loans may be candidates for modification hinges on information about the borrower’s income, assets, and debts as well as their willingness to cure the default. Such information is not available to servicers if the borrower has not applied for a loan modification. However, data on the number of modifications completed relative to the number of borrowers who applied can help to determine the pool of parties potentially aggrieved.

In addition, any estimates of damages would have to be discounted appropriately to account for the high rate of failure of modified loans. The latest government HAMP data indicates that the share of modified mortgages that became 60 days or more delinquent is about 15 percent within three months after modification, one-third within six months, and one-half within nine months. Such high re-default rates indicate that modifications may merely defer rather than prevent foreclosure in many cases.⁶

³ The following were filed in United States District Court for the District of Massachusetts: Bosque et al v. Wells Fargo, case number 4:2010cv10311, filed February 23, 2010; Johnson et al v. BAC Home Loans Servicing, a subsidiary of Bank of America N.A., C.A. No. 10-10316, filed February 23, 2010; Durmic et al v. J.P. Morgan Chase Bank N.A., case number 1:2010cv10380, filed March 3, 2010; and Reyes et al v. IndyMac Mortgage Services, F.S.B., a division of OneWest Bank F.S.B., case number 1:2010cv10389, filed March 4, 2010. Similar allegations are made in Wright v. Bank of America, case number 1-10-CV-166846, filed March 18, 2010 in the Superior Court of the State of California, County of Santa Clara.

⁴ Edwards et al v. Aurora Loan Services, LLC et al, filed November 9, 2009, in the United States District Court for the District of Columbia. This suit also names the US Treasury Department, the Federal Housing Finance Agency and Fannie Mae as defendants, under the theory that the contract Aurora signed with Fannie Mae, which acted as a financial agent of the US Government, to participate in HAMP denied the plaintiffs’ rights to due process.

⁵ State of Ohio v. Barclays Capital Real Estate Inc., dba HomEq Servicing, case number 09 10136, filed December 16, 2009, Montgomery, Ohio. The Ohio Attorney General also filed similar suits, not directly related to HAMP, against American Home Mortgage Servicing Inc. and Carrington Mortgage Services, LLC.

⁶ *OCC and OTS Mortgage Metrics Report*, Fourth Quarter 2009, published March 2010. <http://www.ots.treas.gov/?p=Mortgage%20Metrics%20Report>

About the Financial Economics Practice at CRA

CRA's Financial Economics Practice provides economic and financial analysis and advice to financial institutions, financial regulators, and counsel representing financial institutions. Our experts are skilled in quantitative modeling and econometrics, particularly as applied to issues in credit and compliance risk in primary and secondary consumer lending markets.

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