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National Mortgage Settlement: Lessons Learned

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Introduction

In early 2012, the nation's five largest mortgage servicers entered into the largest joint state-federal settlement in US history. The action stemmed from questionable servicing practices that came to light in late 2010, when these banks were accused of processing foreclosures without properly reviewing materials associated with the loan. Added to other alleged abuses, the robo-signing scandal spurred an investigation involving 49 state attorneys general, state banking regulators, and numerous federal agencies. Accused of varying degrees of mortgage loan servicing and foreclosure fraud, Bank of America, Citi, JP Morgan Chase, Rescap/Ally, and Wells Fargo agreed to a landmark $25 billion settlement that was intended to provide relief to affected borrowers and to address the lack of consumer protections related to mortgage servicing (the Settlement). All the servicers involved have completed their relief, and the Office of Mortgage Settlement Oversight (the Monitor) recently released a report summarizing the relief actions.

Despite some lingering controversy over whether the Settlement went far enough in punishing the servicers involved, by all objective measures the Settlement has proven remarkably successful in providing the consumer relief it was designed to provide, dispersing more than $50 billion in relief to more than 600,000 families. In this commentary, we examine each servicer's actions, consider how those actions were impacted by the crediting system used in the settlement, and discuss how to improve on such efforts to provide relief in future settlements.

The National Mortgage Settlement Basics

The Settlement was divided into two components: relief provided to borrowers and the states, and a new regime of servicing standards to be implemented by the servicers. The Monitor recently released a report on how the servicers have done in meeting their obligations under the former component, so we focus our commentary on this part of the Settlement.

The relief required under the Settlement was broken into two parts: (1) $19.1 billion of financial relief provided directly to borrowers by the servicers for principal reductions, short sales, and anti-blight loss mitigation, as well as refinancing programs for underwater borrowers; and (2) $5.9 billion in payments to state and federal governments. Out of this $5.9 billion, $1.5 billion was earmarked for a Borrower Payment Fund, which provides cash payments to borrowers who lost their homes through foreclosure, with most of the balance distributed to the individual states.

In meeting the first of these relief obligations, servicers would be credited for *part* of each dollar of relief actually provided to borrowers, with the amount dependent on the characteristics of the loan, the kind of relief provided, and how quickly it was provided. For instance, they would receive more credit for reducing the principal on an underwater borrower than providing a short sale, more credit for writing down second liens that are performing, less credit for writing down second liens that have been nonperforming for more than six months, more credit for relief provided in the first year. In this way, the government created an incentive system that would optimize the overall mix and pace of relief provided.

As a result of that system of incentives, the servicers provided $47.6 billion in gross borrower relief through first- and second-lien principal forgiveness, short sales, and anti-blight loss mitigation, and $2.9 billion in relief through the refinancing of underwater mortgages. In the final tally, the servicers more than met their $19.1 billion crediting requirements, with credited relief totaling $20.7 billion, and they did so much more quickly than was mandated. The servicers had three years from the time the contract was signed in March 2012 to fulfill their $19.1 billion obligation, and they did so by June 30, 2013.

Settlement Results by Servicer

The servicers were responsible for varying shares of relief, based on the degree of alleged abuses. The credit required was then broken into several major categories: first-lien modifications, second-lien modifications, other creditable items (subtotaled as consumer relief), and refinancing activity. The first three columns of table 1 show the obligation of each servicer in each category. Thus, Bank of America was required to show $7.626 billion of credits in the category of consumer relief and $948 million in refinancing obligations, for a total of $8.6 billion.

In addition to the minimum requirements above, each servicer was subject to the following rules:

- At least 30 percent of credited consumer relief must come from first-lien principal forgiveness, and at least 60 percent must come through a combination of first- and second-lien modifications. This could be reduced by 10 percent of overall consumer relief funds for excess refinancing program credits above the minimum amounts required.
- Forbearance forgiveness can amount to no more than 12.5 percent of total consumer relief funds.
- Enhanced borrower transitional funds[1] can amount to no more than 5 percent of total consumer relief funds.
- Foreclosure sale deficiency waivers can amount to no more than 10 percent of total consumer relief funds.
- Anti-blight provisions may not amount to more than 12 percent of total consumer relief funds.

The government designed this system of minimum requirements to ensure that a certain amount of relief would flow through each channel, with more flowing through those channels that they deemed of greatest use to struggling borrowers and a recovering market.

The last three columns in table 1 show the final credited relief by servicer for each category. To our earlier point, total credited relief was $20.7 billion, well in excess of the $19.1 billion requirement. Each servicer exceeded the minimum by a comfortable amount.

Overall Strategy

Each of the banks had a different approach to meeting their relief obligations, depending on their mix of assets, the extent to which they were servicing for investors, and the amount of their

Table 1: Credited Relief by Servicer: Required versus Actual

	Consumer Relief Obligations *(credits)*	Refinancing Obligations *(credits)*	Total Relief Obligations *(credits)*	Actual Consumer Relief *(credits)*	Actual Refinancing *(credits)*	Actual Total Relief *(credits)*
Bank of America	$7,626,200,000	$948,000,000	$8,574,200,000	$8,596,648,810	$1,013,769,682	$9,610,418,492
Chase	$3,675,400,000	$537,000,000	$4,212,400,000	$3,840,099,505	$623,424,70	$4,463,524,210
Citi	$1,411,000,000	$378,000,000	$1,789,000,000	$1,273,869,015	$519,098,690	$1,792,967,705
Rescap/Ally	$185,000,000	$15,000,000	$200,000,000	$209,062,086	$48,349,699	$257,411,785
Wells Fargo	$3,434,000,000	$903,000,000	$4,337,000,000	$3,185,304,856	$1,383,030,038	$4,568,334,894
Total	**$16,331,600,000**	**$2,781,000,000**	**$19,112,600,000**	**$17,104,984,272**	**$3,587,672,814**	**$20,692,657,086**

obligations. Driven by the aforementioned standards set forth in the settlement documents, it appears, not surprisingly, that the servicers' strategy was to maximize their credited relief while minimizing the cost to the bottom line and tailoring their mix of activities to those that fit best with their existing infrastructure. The five servicers allocated their relief as shown in table 2.

The table is expressed both in terms of total crediting and in terms of consumer relief, defined in the Settlement as total crediting less refinancing activity. The difference in approaches is readily apparent. Of the four main categories of relief, all servicers focused at least 30 percent of their consumer relief on first-lien modifications, as mandated by the Settlement requirements.

Each of the servicers had an area of focus in which they provided a disproportionate amount of consumer relief relative to the other servicers. For example, Ally gave the most weight to first-lien modifications, comprising more than 50 percent of its total, while Bank of America gave significant weight to second-lien modifications, earning about 23 percent of its credit in this category, compared with the other banks, which were each under 20 percent. For all servicers except for Citi, the second-highest amount of relief was focused in "Other Creditable Items," or more specifically, on short sales/deeds-in-lieu, which made up a significant portion of this category for all servicers. Chase did more in this category than the other servicers.

Refinancing assistance was most important for Citi and Wells Fargo, which both earned nearly 30 percent of their credit in this category.

First-Lien Modifications

Within the category of first-lien relief, there were significant differences across servicers. Table 3 shows the crediting for first-lien relief activities for each servicer.[2] Citi was the only servicer to spread effort among all types of first-lien modification, with no particular preference for one type of relief. For example, both government modifications and forbearance forgiveness earned equal amounts of credit, just more than 9 percent of the total. Others focused primarily in one area or the other. For example, Wells Fargo earned about six times as much credit in federal program forgiveness[3] as it did in its next-biggest category of forbearance forgiveness. Bank of America and Rescap/Ally's strategies are most pronounced, with both placing significant focus on standard principal reduction modifications (those in which the borrowers payment is brought down to 31 percent debt-to-

Table 2: Distribution of Relief by Servicer

		Credited Dollars	Percent of Total Crediting	Percent of Consumer Relief
Bank of America	First-lien modifications	$3,365,196,272	35%	39%
	Second-lien modifications	$2,210,934,257	23%	26%
	Other creditable items	$3,020,518,281	31%	35%
	Refinance	$1,013,769,682	11%	—
Chase	First-lien modifications	$1,851,496,721	41%	48%
	Second-lien modifications	$308,672,792	7%	8%
	Other creditable items	$1,679,929,992	38%	44%
	Refinance	$623,424,705	14%	—
Citi	First-lien modifications	$524,062,757	29%	41%
	Second-lien modifications	$348,564,573	19%	27%
	Other creditable items	$401,241,685	22%	31%
	Refinance	$519,098,690	29%	—
Rescap/Ally	First-lien modifications	$130,324,492	51%	62%
	Second-lien modifications	$22,589,924	9%	11%
	Other creditable items	$56,147,670	22%	27%
	Refinance	$48,349,699	19%	—
Wells Fargo	First-lien modifications	$1,718,197,498	38%	54%
	Second-lien modifications	$214,390,813	5%	7%
	Other creditable items	$1,252,716,545	27%	39%
	Refinance	$1,383,030,038	30%	—

Table 3: First-Lien Modification Activity by Servicer

		First-Lien Modifications	Principal Reduction Modifications Standard	Principal Reduction Modifications Nonstandard	Federal Program Forgiveness	Forbearance Forgiveness
Bank of America	Credited relief	$3,365,196,272	$2,704,129,626	$529,746,090		$131,320,556
	Gross dollar relief	$4,869,347,311	—	—		—
	Percent of total crediting	35.0%	28.1%	5.5%		1.3%
Chase	Credited relief	$1,851,496,721	$107,072,262	$906,111,501	$626,682,515	$211,630,443
	Gross dollar relief	$2,914,871,594	—	—	—	—
	Percent of total crediting	41.5%	2.4%	20.3%	14.0%	4.7%
Citi	Credited relief	$524,062,757	$155,209,268	$25,758,644	$166,719,894	$176,374,951
	Gross dollar relief	$695,316,336	—	—	—	—
	Percent of total crediting	29.2%	8.7%	1.4%	9.3%	9.8%
Rescap/Ally	Credited relief	$130,324,492	$129,061,497			$1,262,995
	Gross dollar relief	$108,686,970	—			—
	Percent of total crediting	50.6%	50.1%			0.5%
Wells Fargo	Credited relief	$1,718,197,498	$45,295,106	$76,991,481	$1,373,862,100	$222,048,811
	Gross dollar relief	$1,762,406,092	—	—	—	—
	Percent of total crediting	37.6%	1.0%	1.7%	30.1%	4.9%

income ratio, with the principal reduced before the interest rate is reduced), with considerably less effort in other types of relief. This was, in part, because Bank of America and Rescap/Ally had "mandatory solicitation" requirements that the other servicers did not.

Some of the servicers focused on maximizing credit for each dollar of relief provided, while others focused on minimizing their losses. For example, by modifying investor-owned loans, rather than loans in the bank's own portfolio, Bank of America and JP Morgan Chase were able to gain some Settlement credit without taking the loss themselves. It can be argued that the modifications are also in the interest of investors, because all modifications must pass a so-called NPV (net present value) test. That is, servicers are permitted to do only modifications in which the present discounted value of the modified loan is greater than the value of the home if it were to be foreclosed on. However, many investors noted that the tests on proprietary modifications are not at all transparent, and they cannot see the test results to determine reasonableness. Over all five servicers, 24 percent of the total crediting reflected loans owned by investors. Bank of America earned 39 percent of its credits this way; JP Morgan Chase earned 29 percent. This number should be far higher if measured in terms of the number of loans, because loans owned by investors are credited at a lower rate. Citi, Rescap/Ally, and Wells Fargo used a negligible amount of investor loans to earn credit, providing virtually all of their first-lien relief on loans in their own portfolios.

We believe most of the crediting of investor loans was in the category of first-lien modifications.

Table 4: Ratio of First-Lien Credited Relief to Gross Dollar Relief

		First-Lien Modifications
Bank of America	Credited relief	$3,365,196,272
	Gross dollar relief	$4,869,347,311
	Ratio gross dollar relief: credited relief	**0.691**
Chase	Credited relief	$1,851,496,721
	Gross dollar relief	$2,914,871,594
	Ratio gross dollar relief: credited relief	**0.635**
Citi	Credited relief	$524,062,757
	Gross dollar relief	$695,316,336
	Ratio gross dollar relief: credited relief	**0.753**
Rescap/Ally	Credited relief	$130,324,492
	Gross dollar relief	$108,686,970
	Ratio gross dollar relief: credited relief	**1.19**
Wells Fargo	Credited relief	$1,718,197,498
	Gross dollar relief	$1,762,406,092
	Ratio gross dollar relief: credited relief	**0.97**

Because banks received only $0.45 credit for each dollar of first-lien relief on an investor-serviced loan, the ratio of credited relief to dollar relief for first-lien modifications was much lower for Bank of America and JP Morgan Chase than for the others (table 4).

Second-Lien Modifications

Across all servicers, most of the credit for second-lien relief resulted from a focus on second-lien extinguishment forgiveness (table 5). In this type of relief, Bank of America and Citi were leaders, earning the majority of their high amounts of second-lien credits from this activity.

However, it is apparent that many of the loans written off were seriously delinquent. Credit for second-lien modifications was based on a sliding scale related to the delinquency status of the loan as follows:

- For performing loans (0 to 90 days delinquent): $1 write-down = $0.90 credit
- For seriously delinquent loans (91 to 179 days delinquent): $1 write-down = $0.50 credit
- For nonperforming loans (180 days or more delinquent): $1 write-down = $0.10 credit

Examining the crediting ratios in table 6, we can see that all five servicers have written off seriously delinquent second liens, and a very significant portion of these were 180 or more days delinquent. It is likely most of the loans would have eventually been written off anyway, even without the Settlement. This is why the government provided substantially less credit for this relief.

From these numbers, we can surmise that both JP Morgan Chase and Wells Fargo extinguished more loans that were seriously delinquent and nonperforming. It is unclear how much of Bank of America and Chase's second-lien write-offs were investor loans, as opposed to loans held in portfolio.

Citi was the only servicer to put a substantial effort into government programs and proprietary second-lien modifications, again demonstrating its relatively even distribution among the types of relief. In contrast, both Chase and Wells Fargo earned a negligible amount of credit in these categories.

Overall, both Bank of America and Citi earned 19–23 percent of their overall credit in second-lien modifications, with the remaining three earning less than 10 percent in this category. The Settlement also required that servicers earn 60 percent of their total

Table 5: Distribution of Second-Lien Modification Activity

		Second-Lien Modifications for Borrowers Who Are in Default or at Risk	Second-Lien Principal Reduction/ Forgiveness	Principal Reduction Conducted through Other Second-Lien Forgiveness Programs	Second-Lien Extinguishment Forgiveness
Bank of America	Credited relief	$2,210,934,257			$2,210,934,257
	Gross dollar relief	$9,655,705,939			–
	Percent of total crediting	23.0%			23.0%
Chase	Credited relief	$308,672,792	$21,543,213	$36,729,719	$250,399,860
	Gross dollar relief	$2,234,144,451		$0	
	Percent of total crediting	6.9%	0.5%	0.8%	5.6%
Citi	Credited relief	$348,564,573	$53,609,772	$54,948,767	$240,006,034
	Gross dollar relief	$1,530,203,988	–		–
	Percent of total crediting	19.4%	3.0%	3.1%	13.4%
Rescap/Ally	Credited relief	$22,589,924	$4,385,262		$18,204,662
	Gross dollar relief	$86,452,677	–		–
	Percent of total crediting	8.8%	1.7%		7.1%
Wells Fargo	Credited relief	$214,390,813	$13,962,541	$7,454,767	$192,973,505
	Gross dollar relief	$1,616,236,125	–	–	–
	Percent of total crediting	4.7%	0.3%	0.2%	4.2%

Table 6: Ratio of Second-Lien Credited Relief to Gross Dollar Relief

		Second-Lien Extinguishment Forgiveness
Bank of America	Credited relief	$2,210,934,257
	Gross dollar relief	$9,655,705,939
	Ratio gross dollar relief: credited relief	**0.229**
Chase	Credited relief	$308,672,792
	Gross dollar relief	$2,234,144,451
	Ratio gross dollar relief: credited relief	**0.138**
Citi	Credited relief	$348,564,573
	Gross dollar relief	$1,530,203,988
	Ratio gross dollar relief: credited relief	**0.228**
Rescap/Ally	Credited relief	$22,589,924
	Gross dollar relief	$86,452,677
	Ratio gross dollar relief: credited relief	**0.261**
Wells Fargo	Credited relief	$214,390,813
	Gross dollar relief	$1,616,236,125
	Ratio gross dollar relief: credited relief	**0.133**

consumer relief credits in first and second-lien modification, which could be reduced to 50 percent with extra refinancing credits. Four of the servicers (Bank of America, Chase, Citi, and Ally) met the 60 percent minimum; Wells Fargo made up a shortfall of about $128 million with excess refinancing credits.[4]

Other Creditable Items

Most of the credits in this category stemmed from short sales and deeds-in-lieu (table 7). Servicers were granted $0.45 per dollar for these strategies if first-lien portfolio loans were involved, but only $0.20 if first-lien investor loans were involved. They were granted $0.90 per dollar for second liens that were 0–90 days delinquent, $0.50 per dollar for second liens that were 91–179 days delinquent, and $0.10 per dollar for second liens that were 180 days delinquent or more.

It appears from the credit ratios in table 8 that Bank of America, JP Morgan Chase, and Ally/Rescap have disproportionately forgiven or written down investor loans or written off lots of seriously delinquent second liens.

Aside from short sales and deeds-in-lieu, only a few other strategies were used to any degree. Six percent of Rescap's credited relief came from foreclosure sale deficiency waivers. These write-downs were on loans that were worth barely anything, earning only $0.10 credit per $1 of write-down. Additionally, Citi was the only servicer to earn credits from forgiveness in lieu of foreclosure, totaling 4.61 percent of its total credited relief.

Table 7: Distribution of Other Creditable Items by Servicer

		Other Creditable Items	Enhanced Borrower Transitional Funds	Short Sales/ Deeds-in-Lieu	Foreclosure Sale Deficiency Waiver	Payment to Unrelated Second-Lien Holder	Payments of Cash for Demolition of Property	Forgiveness in Lieu of Foreclosure	REO Properties Donated
Bank of America	Credited relief	$3,020,518,281	$68,349,672	$2,952,168,609					
	Gross dollar relief	$12,008,773,699	$162,354,522	$11,846,419,147					
	Percent of total crediting	31.4%	0.7%	30.7%					
Chase	Credited relief	$1,679,929,992	$136,957,159	$1,495,692,789		$9,780,918			$37,499,126
	Gross dollar relief	$5,483,171,634	$170,177,249	$5,259,532,309		$15,962,950			$37,499,126
	Percent of total crediting	37.6%	3.1%	33.5%		0.2%			0.8%
Citi	Credited relief	$401,241,685	$842,377	$316,159,020		$1,614,481		$82,625,807	
	Gross dollar relief	$885,393,029	$1,253,377	$569,472,785		$1,853,943		$312,812,924	
	Percent of total crediting	22.4%	0.0%	17.6%		0.1%		4.6%	
Ally	Credited relief	$56,147,670	$1,600,000	$39,425,927	$15,121,743				
	Gross dollar relief	$320,891,813	$1,600,000	$168,074,388	$151,217,425				
	Percent of total crediting	21.8%	0.6%	15.3%	5.9%				
Wells Fargo	Credited relief	$1,252,716,545	$12,675,400	$1,186,566,813	$39,397,160	$9,133,711	$82,463		$4,860,998
	Gross dollar relief	$3,437,970,179	$12,675,400	$3,017,246,010	$393,971,597	$9,133,711	$82,463		$4,860,998
	Percent of total crediting	27.4%	0.3%	26.0%	0.9%	0.2%	0.0%		0.1%

Table 8: Ratio of Credited Relief to Gross Dollar Relief for Short Sales/Deeds-in-Lieu

		Short Sales/ Deeds-in Lieu
Bank of America	Credited relief	$2,952,168,609
	Gross dollar relief	$11,846,419,147
	Ratio dollar: credited relief	**0.249**
Chase	Credited relief	$1,495,692,789
	Gross dollar relief	$5,259,532,309
	Ratio dollar: credited relief	**0.284**
Citi	Credited relief	$316,159,020
	Gross dollar relief	$569,472,785
	Ratio dollar: credited relief	**0.555**
Rescap/Ally	Credited relief	$39,425,927
	Gross dollar relief	$168,074,388
	Ratio dollar: credited relief	**0.235**
Wells Fargo	Credited relief	$1,186,566,813
	Gross dollar relief	$3,017,246,010
	Ratio dollar: credited relief	**0.393**

Refinance

Wells Fargo was a leader in refinancing underwater mortgages conducting 30 percent of its relief in this category, with Citi just behind at 29 percent (table 9). All servicers spent significant effort in this area, encouraged by a $1 credit per dollar spent.

Spurred by an extra 25 percent credit for timeliness, all servicers conducted their refinance activity early, earning extra credited relief in the process. This is evidenced by the 1.249 ratio of credit to gross dollars for each of them in this category, a reflection of this extra 25 percent boost (table 10).

Suggestions for the Future

Given the outcome of the Settlement, a few trends are apparent that may affect how future settlements are handled and the future of the housing market in general.

Investor Funds

In the National Mortgage Settlement, servicers wrote off more than $50 billion in gross dollar relief, with only 76 percent of the total coming from portfolio holdings. For Bank of America and JP Morgan Chase in particular, investor loans were responsible for an enormous amount of credited relief, approximately $3.7 billion and $1.2 billion, respectively. In other settlements of this scale, loans held by investors have had to take similar hits, including the recent Ocwen settlement in which investors carried the vast majority of the $2 billion burden.

Table 9: Distribution of Refinancing Activity by Servicer

		Refinance
Bank of America	Credited relief	$1,013,769,682
	Gross dollar relief	$811,006,154
	Percent of total crediting	11%
Chase	Credited relief	$623,424,705
	Gross dollar relief	$492,247,276
	Percent of total crediting	14%
Citi	Credited relief	$519,098,690
	Gross dollar relief	$404,795,612
	Percent of total crediting	29%
Rescap/Ally	Credited relief	$48,349,699
	Gross dollar relief	$38,055,289
	Percent of total crediting	19%
Wells Fargo	Credited relief	$1,383,030,038
	Gross dollar relief	$1,107,251,002
	Percent of total crediting	30%

Table 10: Ratio of Credited Relief to Gross Dollar Relief for Refinancing Activity

		Refinance
Bank of America	Credited relief	$1,013,769,682
	Gross dollar relief	$811,006,154
	Ratio dollar: credited relief	**1.249**
Chase	Credited relief	$623,424,705
	Gross dollar relief	$492,247,276
	Ratio dollar: credited relief	**1.249**
Citi	Credited relief	$519,098,690
	Gross dollar relief	$404,795,612
	Ratio dollar: credited relief	**1.249**
Rescap/Ally	Credited relief	$48,349,699
	Gross dollar relief	$38,055,289
	Ratio dollar: credited relief	**1.249**
Wells Fargo	Credited relief	$1,383,030,038
	Gross dollar relief	$1,107,251,002
	Ratio dollar: credited relief	**1.249**

Settlements are careful to provide credit only where lenders are writing down investor loans when doing so is determined to be in the investor's economic interest, and even then they provide credit only at a steep discount. Nonetheless, because many investor groups take issue with the modeling used to determine when a write-down is in their interest, the role that their loans have played in these settlements has been controversial.

Future settlements need to be careful and explicit about the terms under which investor loans may be used in meeting servicer obligations. The challenge is going to be particularly acute when setting the terms of settlements with nonbank servicers who do not own loans, and thus are settling much of their soft loan obligation with loans owned by investors.

Any settlement in which servicers can meet their obligations by modifying investor loans will draw some objections from those investors. However, several concrete steps could be taken to alleviate many investor concerns, such as providing greater transparency on modification activity, disclosing details of the NPV model used, and allowing a credible independent monitor to assess the reasonableness of the model and certify that is has been applied correctly.

Improved Clarity

A disappointing finding from the results of this Settlement is the lack of REO (real estate owned) properties donated.[5] Of the five servicers, only Chase and Wells Fargo put effort into this form of relief, and only earned 1 and 0.11 percent of credit in this category, respectively. This may be due to some confusion in the initial rule-making, during which some servicers were not certain that this behavior would earn credits. It is important to clarify the crediting at the outset.

There are proponents and opponents to the use of this type of relief in settlements, mainly centered on the focus of the relief. Should the settlement focus only on helping borrowers who still have outstanding loans, even if (as with a short sale or deed-in-lieu) they have to move out of the property, or should it also incent behavior that benefits communities? We are of the latter view and would like to see future settlements give heaver crediting to this activity.

Lighter Crediting on Second Liens

All five servicers provided a significant number of second-lien modifications in meeting their obligations, much of which appear to have gone to low-quality second liens, many (most) of which they would have had to write off eventually anyway.

There is reason to believe that crediting rates may have contributed to this misalignment of incentives. Even at $0.10 on the dollar, servicers could still earn large amounts of accumulated credit by writing off troubled second liens, which are essentially worthless, in large volumes. This is a strategy Bank of America and Citi clearly used, writing off 141,539 and 23,098 loans, respectively. This behavior would suggest that an even lower credit conversion could create enough incentives to move the focus from large volumes of low-quality write-offs to helping borrowers who are performing better keep their homes.

Power of Incentives

The results of the Settlement make a compelling case that the banks were very responsive to the incentive structure. A well thought out crediting structure guided servicers toward more impactful behavior than just measuring gross relief.

For example, the extra $0.25 credit for early refinancing activity was reaped by all five banks, because they all successfully fulfilled their obligation to this form of relief within the first 12 months of the Settlement. Additionally, a 30 percent credit requirement for first-lien modifications forced all five servicers to put additional focus in this area, which may not have occurred as much without this recommendation. Citi was most clearly moved to act where it would not have otherwise, fulfilling exactly its obligation to the Monitor and no more, earning just barely 30 percent of credit in this category.

In short, this Settlement's selective crediting and carefully constructed rules shaped bank behavior in a way that achieved impressive results. Though there are some lessons to be taken from the experience that should make future settlements still more effective, this Settlement was a significant and underappreciated success, providing a promising model going forward.

Endnotes

[1] Enhanced borrower transitional funds refer to additional transitional funds given to homeowners in connection with a short sale or deed-in-lieu of foreclosure to homeowners for the amount above $1,500.

[2] Note that gross dollar relief is not reported for the subcategories. Where the cell is otherwise blank, there was no activity.

[3] Federal program forgiveness refers to modifications conducted through the Making Home Affordable Program, Treasury/FHA Second-Lien Program, HFA Hardest Hit Program, or other relevant government programs.

[4] Wells Fargo's obligation was 60 percent of $3.434 billion or $2.060 billion. First- and second-lien credits totaled $1.932 billion, for a shortfall of $128 million. Wells Fargo had more than sufficient refinancing credits to offset this, while meeting the 50 percent minimum.

[5] In the Settlement, REO properties donated refers to REO properties donated to accepting municipalities, nonprofits, disabled servicemembers, or relatives of deceased servicemembers.

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