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HELPING FAMILIES SAVE THEIR HOMES IN BANKRUPTCY ACT OF 2009

FEBRUARY 24, 2009.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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Mr. CONYERS, from the Committee on the Judiciary, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 200]

[Including cost estimate of the Congressional Budget Office]

The Committee on the Judiciary, to whom was referred the bill (H.R. 200) to amend title 11 of the United States Code with respect to modification of certain mortgages on principal residences, and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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79–006

THE AMENDMENT

The amendment is as follows:
Strike all after the enacting clause and insert the following:

SECTION 1. SHORT TITLE.

This Act may be cited as the "Helping Families Save Their Homes in Bankruptcy Act of 2009".

SEC. 2. ELIGIBILITY FOR RELIEF.

Section 109 of title 11, United States Code, is amended—

(1) by adding at the end of subsection (e) the following: "For purposes of this subsection, the computation of debts shall not include the secured or unsecured portions of—

"(1) debts secured by the debtor's principal residence if the current value of such residence is less than the secured debt limit; or

"(2) debts secured or formerly secured by real property that was the debtor's principal residence that was sold in foreclosure or that the debtor surrendered to the creditor if the current value of such real property is less than the secured debt limit.", and

(2) by adding at the end of subsection (h) the following:

"(5) The requirements of paragraph (1) shall not apply in a case under chapter 13 with respect to a debtor who submits to the court a certification that the debtor has received notice that the holder of a claim secured by the debtor's principal residence may commence a foreclosure on the debtor's principal residence.".

SEC. 3. PROHIBITING CLAIMS ARISING FROM VIOLATIONS OF THE TRUTH IN LENDING ACT.

Section 502(b) of title 11, United States Code, is amended—

(1) in paragraph (8) by striking "or" at the end,

(2) in paragraph (9) by striking the period at the end and inserting "; or", and

(3) by adding at the end the following:

"(10) the claim for a loan secured by a security interest in the debtor's principal residence is subject to a remedy for rescission under the Truth in Lending Act notwithstanding the prior entry of a foreclosure judgment, except that nothing in this paragraph shall be construed to modify, impair, or supersede any other right of the debtor.".

SEC. 4. AUTHORITY TO MODIFY CERTAIN MORTGAGES.

Section 1322 of title 11, United States Code, is amended—

(1) in subsection (b)—

(A) by redesignating paragraph (11) as paragraph (12),

(B) in paragraph (10) by striking "and" at the end, and

(C) by inserting after paragraph (10) the following:

"(11) notwithstanding paragraph (2) and otherwise applicable nonbankruptcy law, with respect to a claim for a loan originated before the effective date of this paragraph and secured by a security interest in the debtor's principal residence that is the subject of a notice that a foreclosure may be commenced with respect to such loan, modify the rights of the holder of such claim (and the rights of the holder of any claim secured by a subordinate security interest in such residence)—

"(A) by providing for payment of the amount of the allowed secured claim as determined under section 506(a)(1);

"(B) if any applicable rate of interest is adjustable under the terms of such security interest by prohibiting, reducing, or delaying adjustments to such rate of interest applicable on and after the date of filing of the plan;

"(C) by modifying the terms and conditions of such loan—

"(i) to extend the repayment period for a period that is no longer than the longer of 40 years (reduced by the period for which such loan has been outstanding) or the remaining term of such loan, beginning on the date of the order for relief under this chapter; and

"(ii) to provide for the payment of interest accruing after the date of the order for relief under this chapter at a fixed annual rate equal to the currently applicable average prime offer rate as of the date of the order for relief under this chapter, corresponding to the repayment term determined under the preceding paragraph, as published by the Federal Financial Institutions Examination Council in its table entitled 'Average Prime Offer Rates—Fixed', plus a reasonable premium for risk; and

"(D) by providing for payments of such modified loan directly to the holder of the claim; and", and

(2) by adding at the end the following:

"(g) A claim may be reduced under subsection (b)(11)(A) only on the condition that if the debtor sells the principal residence securing such claim, before receiving a discharge under this chapter and receives net proceeds from the sale of such residence, then the debtor agrees to pay to such holder—

"(1) if such residence is sold in the 1st year occurring after the effective date of the plan, 80 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection;

"(2) if such residence is sold in the 2d year occurring after the effective date of the plan, 60 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection;

"(3) if such residence is sold in the 3d year occurring after the effective date of the plan, 40 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection; and

"(4) if such residence is sold in the 4th year occurring after the effective date of the plan, 20 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection.

"(h) With respect to a claim of the kind described in subsection (b)(11), the plan may not contain a modification under the authority of subsection (b)(11)—

"(1) in a case commenced under this chapter after the expiration of the 15-day period beginning on the effective date of this subsection, unless—

"(A) the debtor certifies that the debtor attempted, not less than 15 days before the commencement of the case, to contact the holder of such claim (or the entity collecting payments on behalf of such holder) regarding modification of the loan that is the subject of such claim; or

"(B) a foreclosure sale is scheduled to occur on a date in the 30-day period beginning on the date the case is commenced; and

"(2) in any other case pending under this chapter, unless the debtor certifies that the debtor attempted to contact the holder of such claim (or the entity collecting payments on behalf of such holder) regarding modification of the loan that is the subject of such claim, before—

"(A) filing a plan under section 1321 that contains a modification under the authority of subsection (b)(11); or

"(B) modifying a plan under section 1323 or 1329 to contain a modification under the authority of subsection (b)(11).".

SEC. 5. COMBATING EXCESSIVE FEES.

Section 1322(c) of title 11, United States Code, is amended—

(1) in paragraph (1) by striking "and" at the end,

(2) in paragraph (2) by striking the period at the end and inserting a semicolon, and

(3) by adding at the end the following:

"(3) the debtor, the debtor's property, and property of the estate are not liable for a fee, cost, or charge that is incurred while the case is pending and arises from a debt that is secured by the debtor's principal residence except to the extent that—

"(A) the holder of the claim for such debt files with the court (annually or, in order to permit filing consistent with clause (ii), at such more frequent periodicity as the court determines necessary) notice of such fee, cost, or charge before the earlier of—

"(i) 1 year after such fee, cost, or charge is incurred; or

"(ii) 60 days before the closing of the case; and

"(B) such fee, cost, or charge—

"(i) is lawful under applicable nonbankruptcy law, reasonable, and provided for in the applicable security agreement; and

"(ii) is secured by property the value of which is greater than the amount of such claim, including such fee, cost, or charge;

"(4) the failure of a party to give notice described in paragraph (3) shall be deemed a waiver of any claim for fees, costs, or charges described in paragraph

(3) for all purposes, and any attempt to collect such fees, costs, or charges shall constitute a violation of section 524(a)(2) or, if the violation occurs before the date of discharge, of section 362(a); and

"(5) a plan may provide for the waiver of any prepayment penalty on a claim secured by the debtor's principal residence.".

SEC. 6. CONFIRMATION OF PLAN.

Section 1325(a) of title 11, United States Code, is amended—

(1) in paragraph (8) by striking "and" at the end,

(2) in paragraph (9) by striking the period at the end and inserting a semicolon, and

(3) by inserting after paragraph (9) the following:

"(10) notwithstanding subclause (I) of paragraph (5)(B)(i), whenever the plan modifies a claim in accordance with section 1322(b)(11), the plan provides that the holder of such claim retain the lien until the later of—

"(A) the payment of such holder's allowed secured claim; or

"(B) discharge under section 1328; and

"(11) whenever the plan modifies a claim in accordance with section 1322(b)(11), the court finds that such modification is in good faith and that the debtor did not obtain the extension, renewal, or refinancing of credit that gives rise to a modified claim by the debtor's material misrepresentation, false pretenses, or actual fraud.".

SEC. 7. DISCHARGE.

Section 1328 of title 11, United States Code, is amended—

(1) in subsection (a)—

(A) by inserting "(other than payments to holders of claims whose rights are modified under section 1322(b)(11))" after "paid", and

(B) in paragraph (1) by inserting "or, to the extent of the unpaid portion of an allowed secured claim, provided for in section 1322(b)(11)" after "1322(b)(5)", and

(2) in subsection (c)(1) by inserting "or, to the extent of the unpaid portion of an allowed secured claim, provided for in section 1322(b)(11)" after "1322(b)(5)".

SEC. 8. RULE OF CONSTRUCTION.

Nothing in this Act or the amendments made by this Act shall be construed to modify any obligation of the Federal Housing Administration, the Veterans Administration, or the Department of Agriculture under a contract that guarantees or insures the payment of any part of a loan secured by a security interest in a principal residence.

SEC. 9. EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE.—Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect on the date of the enactment of this Act.

(b) APPLICATION OF AMENDMENTS.—The amendments made by this Act shall apply with respect to cases commenced under title 11 of the United States Code before, on, or after the date of the enactment of this Act.

PURPOSE AND SUMMARY

Our Nation is currently experiencing a mortgage foreclosure crisis unprecedented since the Great Depression. It is severely harming neighborhoods, communities, and the United States economy as a whole. Our economic recovery depends upon stabilizing the housing sector; and this requires more effective measures to stem the flood of foreclosures.

Voluntary loan modification efforts have not been enough. Enabling bankruptcy courts to implement economically appropriate loan modifications where the parties are unwilling or unable to do so can have an impact on a sufficient scale and time frame to meaningfully address the foreclosure crisis. H.R. 200, the "Helping Families Save Their Homes in Bankruptcy Act of 2009," gives the bankruptcy courts this ability, eliminating the anomaly in current law that prohibits judicial modification of primary residence mortgages.

BACKGROUND AND NEED FOR THE LEGISLATION

BACKGROUND

The Current Foreclosure Crisis

An Overview

Home foreclosures today are at an all-time high, and they are "poised to accelerate as the country's recession deepens," according to industry data released in December 2008.[1] During 2008, more than 2.3 million homes were in foreclosure,[2] with one in ten Americans falling behind on their mortgage payments or facing foreclosure during the third quarter of that year.[3] Compared to 2006, the number of properties in foreclosure during 2008 rose by 225 percent.[4] Mortgage foreclosures during 2007 through 2008 are estimated to have resulted in "a whopping $400 billion worth of defaults and $100 billion in losses to investors in mortgage securities."[5] The foreclosure rate is "approaching heights not seen since the Great Depression."[6]

Certain parts of the Nation are experiencing this crisis more intensely than others. For example, more than 7 percent of housing units in Nevada received at least one foreclosure notice in 2008.[7] Other top foreclosure States for 2008 were Florida, California, Colorado, Michigan, Ohio, Georgia, Illinois, and New Jersey.[8] In the City of Detroit, an average of 126 foreclosures are occurring every day.[9]

The glut of foreclosures has adversely affected new home sales, and has depressed home values generally. Last year, Federal Re-

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[1] Renae Merle, *Mortgage Troubles Rise to Record Level,* WASH. POST, Dec. 6, 2008 (reporting on data supplied by the Mortgage Bankers Association).

[2] Press Release, RealtyTrac, Foreclosure Activity Increases 81 Percent in 2008—Nearly 3.2 Million Foreclosure Filings on More Than 2.3 Million Properties Reported (Jan. 15, 2009), at http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=5681&accnt=64847; *see also Helping Families Save Their Homes: The Role of Bankruptcy Law: Hearing Before the S. Comm. on the Judiciary,* 110th Cong. (2008) (testimony of Michael D. Calhoun, President, Center for Responsible Lending). ("Using recent data from the Mortgage Bankers Association, we calculate that foreclosures on all types of mortgages are occurring at an annual rate of 2.3 million.").

[3] Kathleen M. Howley, *Mortgage Delinquencies, Foreclosures Rise to Record,* Bloomberg.com (Dec. 5, 2008), at http://www.bloomberg.com/apps/news?pid=20601087&sid=a37uyBrX6dvY&refer=worldwide.

[4] Press Release, RealtyTrac, Foreclosure Activity Increases 81 Percent in 2008—Nearly 3.2 Million Foreclosure Filings on More Than 2.3 Million Properties Reported (Jan. 15, 2009), at http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=5681&accnt=64847; In 2006, there were 1.2 million foreclosures in the United States, representing an increase of 42 percent over the prior year. Nelson D. Schwartz, *Can the Mortgage Crisis Swallow a Town?,* N.Y. TIMES, Sept. 4, 2007

[5] Mark Zandi, Op-ed, *The Mortgage Mess,* BOSTON GLOBE, July 22, 2007. Similarly, the Center for Responsible Lending, estimated that 20 percent of subprime home loans made between 2005 and 2006 could end in foreclosure. Geraldine Fabrikant, *After Foreclosure, a Big Tax Bill From the I.R.S.,* N.Y. TIMES, Aug. 20, 2007. In 2007, up to 2 million households were at risk of losing their homes through foreclosure. *See, e.g.,* Steve Lohr, *Loan by Loan, the Making of a Credit Squeeze,* N.Y. TIMES, Aug. 19, 2007, at 1 Bus. Sec.; *Evolution of an Economic Crisis? The Subprime Lending Disaster and the Threat to the Broader Economy: Hearing Before the Joint Economic Committee,* 110th Cong. (2007) (prepared testimony of Martin Eakes, CEO of the Center for Responsible Lending) (citing a range of projected foreclosures with the highest at 1.7 million); Roger Lowenstein, *Subprime Time—How Did Homeownership Become So Rickety,* N.Y. TIMES MAGAZINE, Sept. 2, 2007, at 11.

[6] Nelson D. Schwartz, *Can the Mortgage Crisis Swallow a Town?,* N.Y. TIMES, Sept. 4, 2007.

[7] Press Release, RealtyTrac, Foreclosure Activity Increases 81 Percent in 2008—Nearly 3.2 Million Foreclosure Filings on More Than 2.3 Million Properties Reported (Jan. 15, 2009).

[8] *Id.*

[9] *Helping Families Save Their Homes in Bankruptcy Act of 2009 and Emergency Homeownership and Equity Protection Act: Hearing on H.R. 200 and H.R. 225 Before the H. Comm. on the Judiciary,* 111th Cong. (2009) (testimony of Matthew Mason, Assistant Director, UAW-GM Legal Services Plan).

serve Chairman Ben Bernanke acknowledged that "housing starts and new home sales have both fallen by about 50 percent from their respective peaks." [10] And, as *The Wall Street Journal* reported in October 2008, "The relentless slide in home prices has left nearly one in six U.S. homeowners owing more on a mortgage than the home is worth, raising the possibility of a rise in defaults—the very misfortune that touched off the credit crisis last year." [11] The *Journal* explained that more foreclosures are likely "because it is hard for borrowers in financial trouble to refinance or sell their homes and pay off their mortgage if their debt exceeds the home's value." [12]

Home values nationwide have fallen an average of 19% from their peak in 2006, and this "price plunge has wiped out trillions of dollars in home equity." [13] And some predict that home values "may take decades to return to the heights of 2½ years ago." [14]

As enormous as the losses to date have been, projections of what lies ahead appear to be even more dire.[15] Some economists fear "the tide of foreclosures" may become "self-perpetuating." [16] As Susan Wachter, a real estate finance professor at the Wharton School of the University of Pennsylvania, explained, "In the market that we have in front of us, prices decline and supply increases, driving prices down further. The worst case is not a recession but a housing depression." [17] She projects that "foreclosures and tight credit could send home prices falling to the point that millions of families and thousands of banks are thrust into insolvency." [18]

Credit Suisse estimates that there may be more than eight million foreclosures over the next 4 years in the United States, accounting for 16 percent of all mortgages, including 59 percent of all subprime mortgages and more than 11 percent of all other mortgages, including Alt-A, option ARMS, and even prime mortgages.[19]

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[10] Federal Reserve Chairman Ben S. Bernanke, Speech at the Women in Housing and Finance and Exchequer Club Joint Luncheon, Washington, DC (Jan. 10, 2008), *at* http://www.federalreserve.gov/newsevents/speech/bernanke20080110a.htm; *see, e.g.,* Brian Louis, Paulson Mortgage Plan Surfaces Too Late to Stem Housing Slide, Bloomberg.com (Dec. 7, 2007) (reporting 48 percent drop in new home sales since 2005).

[11] James R. Hagerty & Ruth Simon, *Housing Pain Gauge: Nearly 1 in 6 Owners "Under Water"—More Defaults and Foreclosures Are Likely as Borrowers with Greater Debt Than Value in Their Homes Are Put in a Tight Spot,* WALL ST. J., Oct. 8, 2008, at A5.

[12] *Id.*

[13] Dennis Cauchon, *Why Home Values May Take Decades To Recover,* U.S.A. TODAY, Dec. 12, 2008, at 1A; *see also* Bob Willis & Shobhana Chandra, *U.S. Economy: Home Prices Fall at Near-Depression Pace,* Bloomberg.com (Dec. 23, 2008) ("Sales of single-family houses in the U.S. dropped in November [2008] by the most in two decades and resale prices collapsed at a pace reminiscent of the Great Depression, dashing hopes that the market was close to a bottom."); Shobhana Chandra, *U.S. Home Resales Fall; Prices Drop by Record 13.2%,* Bloomberg.com (Dec. 23, 2008); Kathleen M. Howley, *Mortgage Delinquencies, Foreclosures Rise to Record,* Bloomberg.com (Dec. 5, 2008) (reporting that the median home price in the fourth quarter of 2008 will be 19% lower from the record in 2006's second quarter, according to a November 24, 2008 forecast by Fannie Mae, the world's largest mortgage buyer).

[14] Dennis Cauchon, *Why Home Values May Take Decades To Recover—Some See 2006 as 'Lifetime' Peak in Prices,* USA TODAY, Dec. 12, 2008, at 1A.

[15] *See, e.g.,* Vikas Bajaj, *Home Prices Seem Far From Bottom,* N.Y. TIMES, Oct. 16, 2008, at A1 (reporting that the "American housing market . . . is far from hitting bottom").

[16] David M. Herszenhorn & Vikas Bajaj, *Tricky Task of Offering Aid to Homeowners,* N.Y. TIMES, Apr. 6, 2008.

[17] *Id.*

[18] Dennis Cauchon, *Why Home Values May Take Decades To Recover,* U.S.A. TODAY, Dec. 12, 2008, at 1A.

[19] Rod Dubitsky, *et al., Foreclosure Update: over 8 million foreclosures expected,* Credit Suisse, Fixed Income Research, Dec. 4, 2008. In 2007, Moody's Economy.com Chief Economist Mark Zandi estimated that approximately 2.8 million loan defaults will occur in 2008 and 2009, although "[n]ot all will end in foreclosure." "Of these," he stated, "1.9 million homeowners will go through the entire foreclosure process and ultimately lose their homes." *The Looming Foreclosure Crisis: How To Help Families Save Their Homes: Hearing Before the S. Comm. on the*

If the Nation were to experience a severe recession, Credit Suisse estimates that the number could rise to 10.2 million foreclosures.[20] This new forecast from Credit Suisse is up sharply from the two to six million foreclosure range cited in previous estimates from industry sources.[21] And this is in addition to the 1.2 million homes estimated to have been already lost to foreclosure.[22] Fannie Mae predicts that there may not be a turnaround until 2010, and that the current crisis and "its effect on the housing market will be a drag on the entire U.S. economy."[23]

Initially, the foreclosure crisis was driven by defaults on subprime mortgages. In 2007, analysts correctly predicted that the "worst lay ahead"[24] in that many subprime borrowers would face 40 percent or greater increases in their monthly mortgage payments once their initial 'teaser' rates expire and their fixed interest rates reset into higher-rate variable rates.[25] It is estimated that 65 percent of subprime loans originated in 2007 will end up in default, compared with 45 percent of those originated in 2006.[26]

But prime mortgages originated in 2007 are also expected to go bad at a greater rate than those from 2006. An analysis prepared in August 2008 for *The Wall Street Journal* revealed that 0.91 percent of prime mortgages from 2007 were seriously delinquent—either in foreclosure or at least 90 days past due—after 12 months. The equivalent figure for 2006 prime mortgages was just 0.33 percent in the first year.[27]

The spike in unemployment is certainly augmenting the mortgage foreclosure crisis.[28] Last year, nearly 2.6 million jobs were lost, with three-quarters of these losses occurring in the final 4 months of the year.[29] Job loss not only makes it hard for homeowners to keep up with payments on existing mortgages; it also

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Judiciary, 110th Cong. (2007) (prepared testimony of Mark Zandi, Chief Economist, Moody's Economy.com).

[20] *Id.; cf. Helping Families Save Their Homes: The Role of Bankruptcy Law: Hearing Before the S. Comm. on the Judiciary,* 110th Cong. (2008) (testimony of Michael D. Calhoun, President, Center for Responsible Lending) (estimating that 6.5 million homes, i.e., "one in eight homes with outstanding mortgages, will be lost to foreclosre over the next 5 years," according to industry data).

[21] In the spring of 2008, "industry analysts estimated that as many as three million subprime mortgages could end up in foreclosure over the next several years." Edmond L. Andrews, *Relief for Homeowners Is Given to a Relative Few,* N.Y. TIMES, Mar. 4, 2008.

[22] Center for Responsible Lending, Loan Foreclosures & Delinquencies vs. Lender Workouts, Sept. 2008.

[23] *Fannie Mae: No Home Market Rebound Till 2010,* DETROIT NEWS, Jan. 8, 2008.

[24] *Evolution of an Economic Crisis? The Subprime Lending Disaster and the Threat to the Broader Economy: Hearing Before the Joint Economic Committee,* 110th Cong. (2007) (prepared testimony of Martin Eakes, CEO of the Center for Responsible Lending); *see, e.g.,* Op ed., Jack Kemp, *Bringing Bankruptcy Home,* L.A. TIMES, Jan. 18, 2008 ("It is clear that sub-prime loan foreclosures are only going to get worse."); Edmund L. Andrews, *In Washington, Measuring a Lifeline,* N.Y. TIMES, Aug. 28, 2007 (" 'This is really just the beginning,' said Karen Weaver, global director for securitization research at Deutsche Bank. 'There's a big wave of defaults coming over the next 12 to 18 months.' ").

[25] *Evolution of an Economic Crisis? The Subprime Lending Disaster and the Threat to the Broader Economy: Hearing Before the Joint Economic Committee,* 110th Cong. (2007) (prepared testimony of Martin Eakes, CEO of the Center for Responsible Lending); *see, e.g.,* Edmund L. Andrews, *In Washington, Measuring a Lifeline,* N.Y. TIMES, Aug. 28, 2007 ("Deutsche Bank estimates that $400 billion in subprime loans are scheduled for rate increases of 30 percent or more by the end of 2008).

[26] Ruth Simon, *Mortgages Made in 2007 Go Bad at Rapid Clip,* +WALL ST. J., Aug. 7, 2008.

[27] *Id.*

[28] Stephanie Armour, *Job Cuts Adding to Growing Number of Housing Defaults,* U.S.A. TODAY, Dec. 15, 2008, at 1A.

[29] Letter from Gerald M. Howard, President & Chief Executive Officer, National Association of Home Builders, to Members of Congress (Jan. 14, 2009) (on file with the Committee).

makes it hard for homeowners with adjustable rate mortgages to refinance at an more affordable fixed rate.[30]

The societal and economic costs of home foreclosures are not only devastating to the families that directly experience them. Foreclosures depress home values across entire communities. A single foreclosure "could impose direct costs on local government agencies totaling more than $34,000."[31] Federal Reserve Chairman Ben Bernanke noted, "At the level of the individual community, increases in foreclosed-upon and vacant properties tend to reduce house prices in the local area, affecting other homeowners and municipal tax bases."[32] As a consequence of nearby foreclosures on subprime loans, forty million homeowners will see their property values decline as by more than $350 billion.[33] And these are just the effects of subprime foreclosures; foreclosures on prime and "Alt-A" loans will push the losses much higher.

Chairman Bernanke further noted, "At the national level, the rise in expected foreclosures could add significantly to the inventory of vacant unsold homes—already at more than 2 million units at the end of 2007—thereby putting further pressure on house prices and housing construction."[34] In fact, the National Association of Realtors estimates that 35 to 40 percent of resold homes nationwide were distressed assets.[35] And, as Moody's Economy.com Chief Economist Mark Zandi observed, "All indications are that we have a long way to go before the housing market stabilizes."[36] In light of the tight credit market and the reluctance of Americans to purchase a home when they expect prices to keep falling, he added, "It's about as bad a market as you can get."[37]

In the 18 months since the Judiciary Committee first began exploring the foreclosure crisis, solutions offered by the industry and the Federal Government have failed to address the problem, and may have exacerbated it. Voluntary solutions from the industry have fallen far short of what is necessary to contain the problem. The urgency of more potent government intervention could not be overstated. As FDIC chairman Sheila Bair recently testified, "We are behind the curve. . . . We are falling behind. . . . [W]e need to act and we need to act quickly and we need to act dramatically."[38]

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[30] *Id.* (""Many people have adjustable-rate mortgages that they were planning on refinancing,' says Elena Rivkin Franz, a real estate lawyer in the San Francisco area. 'Unfortunately, if you don't have a steady stream of income, you can't get a refinance, or at least an affordable one.'").

[31] William C. Apgar *et al.,* The Municipal Cost of Foreclosures: A Chicago Case Study, Homeonwership Preservation Foundation Housing Finance Policy Research Paper No. 2005–1, at 1 (Feb. 27, 2005).

[32] Ben Bernanke, Federal Reserve Chairman, Remarks at the Independent Community Bankers Conference (Mar. 4, 2008) (reprinted by Bloomberg.com, available at http://www.bloomberg.com/apps/news?pid=20601068&sid=apeU.0IaETdM&refer=economy).

[33] *See* Center for Responsible Lending, Updated Projections of Subprime Foreclosures in the United States and Their Impact on Home Values and Communities, Aug. 2008, available at http://www.responsiblelending.org/pdfs/updated-foreclosure-and-spillover-brief-8-18.pdf.

[34] Ben Bernanke, Chairman, Federal Reserve, Remarks at the Independent Community Bankers Conference (Mar. 4, 2008) (reprinted by Bloomberg.com, available at http://www.bloomberg.com/apps/news?pid=20601068&sid=apeU.0IaETdM&refer=economy).

[35] Catherine Rampell, *Housing Resales Rose 5.5% in September,* N.Y. TIMES, Oct. 24, 2008, at B7.

[36] *Id.*

[37] *Id.*

[38] Vikas Bajaj, *U.S. Vows More Help for Homeowners,* N.Y. TIMES, Oct. 24, 2008 (Chairman Bair was testifying about an FDIC proposal to use Federal loan guarantees to encourage servicers to voluntarily modify failing loans).

Origins of the Crisis

Starting in the 1990's and then surging up through 2006, millions of subprime[39] and nontraditional[40] mortgages were issued. According to the U.S. Treasury Department, there were fewer than one million of these mortgages in 2000; today there are an estimated six million of them,[41] at an approximate value of $1 trillion.[42]

As a result of these mortgages, homeownership rates "among minorities increased to new highs."[43] The Congressional Research Services found, however, that subprime mortgages were "disproportionately used by the elderly and members of minority groups," and that there is some evidence that minorities who could have qualified for cheaper prime loans instead borrowed in the more expensive subprime market."[44]

These mortgages were also often marketed to people with "credit scores high enough to qualify for conventional loans with far better terms," according to an analysis prepared for *The Wall Street Journal.*[45] In 2005, the peak year of the subprime mortgage boom, "borrowers with such credit scores got more than half—55%—of all subprime mortgages that were ultimately packaged into securities for sale to investors[.]"[46] As *The Wall Street Journal* observed, "The surprisingly high number of subprime loans among more credit-worthy borrowers shows how far such mortgages have spread into the economy—including middle-class and wealthy communities where they once were scarce."[47]

Losses started in the subprime market, where the most common loan marketed during the past 4 years was a highly risky loan called a hybrid adjustable-rate mortgage (ARM), often known as a 2/28 or 3/27 because the interest rate is fixed for either two or 3 years, and then is adjustable typically every 6 months for the balance of the 30-year term. There are three particularly problematic aspects of this type of loan: (1) the rate increases, often sharply, at the end of the initial period, and often without regard to whether interest rates in the economy stay the same or even decline; (2), lenders typically made these loans with the understanding that the borrower could not afford the rate increase, and will be required to refinance before the rate reset; and (3) refinancing before reset en-

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[39] A "subprime mortgage" is typically considered to be a security interest in the borrower's home that secures a debt for a loan that has an annual percentage rate that is higher than that of a conventional 30-year mortgage. *See, e.g.,* H.R. 3519, the Mortgage Reform and Anti-Predatory Lending Act of 2007, 110th Cong. (2007).

[40] A "nontraditional mortgage" is typically defined as a security interest in the debtor's principal residence that secures a debt for a loan that at any period during the term of the loan provides for the deferral of the payment of principal or interest by permitting periodic payments that do not cover the full amount of interest due or that cover only the interest rate. The definition does not include a home equity line of credit that is in a subordinate loan position or a reverse mortgage. Interagency Guidance on Nontraditional Mortgage Product Risks—Final Guidance, 71 Fed. Reg. 58609–18 (Oct. 4, 2006), at http://www.fdic.gov/regulations/laws/federal/2006/06noticeFINAL.html.

[41] Robert K. Steel, Undersecretary, U.S. Treasury, Remarks to the NYC Subprime Lending and Foreclosure Summit, Dec. 12, 2007.

[42] *Id.*

[43] *Id.*

[44] Edward Vincent Murphy, Congressional Research Report to Congress, Subprime Mortgages: Primer on Current Lending and Foreclosure Issues, RL33930, at 3 (Mar. 19, 2007).

[45] Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy,* WALL. ST. J., Dec. 3, 2007, at A1.

[46] *Id.*

[47] *Id.*

tails the payment of a substantial "prepayment" penalty, which typically equals three to 4 percent of the loan balance.[48]

Federal Reserve Chairman Ben Bernanke in January 2008 noted that "poor underwriting and, in some cases, fraud and abusive practices contributed to the high rates of delinquency that we are now seeing in the subprime ARM market."[49] He explained, "[T]he more fundamental reason for the sharp deterioration in credit quality was the flawed premise on which much subprime ARM lending was based: that house prices would continue to rise rapidly."[50] He continued:

> When house prices were increasing at double-digit rates, subprime ARM borrowers were able to build equity in their homes during the period in which they paid a (relatively) low introductory (or "teaser") rate on their mortgages. Once sufficient equity had been accumulated, borrowers were often able to refinance, avoiding the increased payments associated with the reset in the rate on the original mortgages. However, when declining affordability finally began to take its toll on the demand for homes and thus on house prices, borrowers could no longer rely on home-price appreciation to build equity; they were accordingly unable to refinance and found themselves locked into their subprime ARM contracts. Many of these borrowers found it difficult to make payments at even the introductory rate, much less at the higher post-adjustment rate. The result, as I have already noted, has been rising delinquencies and foreclosures, which will have adverse effects for communities and the broader economy as well as for the borrowers themselves.[51]

It appears that many borrowers who are losing their homes to foreclosure could have qualified for more affordable, conventional loans. A study for *The Wall Street Journal* found that of the subprime loans originated in 2006 that were packaged into securities and sold to investors, 61 percent "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms."[52] Financial incentives encouraged mortgage brokers and lenders to aggressively market highly risky exploding ARM loans instead of the sustainable loans for which borrowers qualified.[53] As former Federal Reserve Chairman Alan Greenspan explained:

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[48] Additionally, subprime lenders generally did not escrow for taxes and insurance as prime lenders do, which left many families reeling when those bills came due. This practice gives the borrower the impression that the payment is affordable when, in fact, there are significant additional costs. A study by the Home Ownership Preservation Initiative in Chicago found that for as many as one in seven low-income borrowers facing difficulty in managing their mortgage payments, the lack of escrow of tax and insurance payments were a contributing factor. Partnership Lessons and Results: Three Year Final Report, Home Ownership Preservation Initiative, at 31 (July 17, 2006), at http://www.nhschicago.org/downloads/82HOPI3YearReport__Jul17-06.pdf

[49] Ben S. Bernanke, Federal Reserve Chairman, Speech at the Women in Housing and Finance and Exchequer Club Joint Luncheon, Washington, DC (Jan. 10, 2008), at http://www.federalreserve.gov/newsevents/speech/bernanke20080110a.htm

[50] *Id.*

[51] *Id.*

[52] Rick Brooks & Ruth Simon, *Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market,* WALL ST. J., Dec. 3, 2007, at A1.

[53] Mortgage brokers play a key role in today's mortgage market. According to the Mortgage Bankers Association, mortgage brokers in 2006 originated 45 percent of all mortgages, and 71 percent of subprime loans. See Mortgage Bankers Association, Research Data Notes: Residential Mortgage Origination Channels (Sept. 2006).

> The big demand was not so much on the part of the borrowers as it was on the part of the suppliers who were giving loans which really most people couldn't afford. We created something which was unsustainable. And it eventually broke. If it weren't for securitization, the subprime loan market would have been very significantly less than it is in size.[54]

Impact of the Crisis

Impact on Home Values Nationwide

In 2007, Mark Zandi, chief economist of Moody's Economy.com, correctly predicted that "[e]xisting home prices may fall as much as 15 percent by 2009 from their peak" in 2006[55] and that the "fallout" would hit nearly all of us.[56] He explained:

> First, home values will sink. Loans will be tougher to get, meaning fewer families will qualify for mortgages. Foreclosure sales will put more properties on the market at steep discounts. Less housing demand and more supply add up to lower prices.
>
> Homeowners will find it more difficult to tap the equity in their homes for cash via home-equity loans or cash-out refinancing. Such lending is already fading quickly.
>
> On the other side of the coin are investors who chose the riskier flavors of the new mortgage securities and now face big losses. If that sounds like someone else's problem, think again. Lots of pension plans that manage the savings of millions of ordinary workers and retirees have invested in hedge funds in recent years. Many of those funds are exposed.[57]

Depressed economic conditions in an area can further depress the housing market there. According to the Mortgage Bankers Association, "[H]eavy job losses in the Midwest states of Ohio, Michigan and Indiana and the collapse of previously booming housing markets in California, Florida, Nevada and Arizona" exacerbated the

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[54] Jon Meacham & Daniel Gross, *The Oracle Reveals All—Did the Fed Cause the Real-Estate Bubble To Burst? Are We Entering a Recession? And Who Should Be Our Next President? A Candid Conversation.,* NEWSWEEK, Sept. 24, 2007, at 32, 33. Similarly, Federal Reserve Chairman Ben Bernanke outlined the need for further analysis:

> The recent developments in U.S. and foreign financial markets will stimulate considerable review and analysis in the months and years to come. Around the world, legislatures, regulators, supervisors, accounting boards, central banks, and others with responsibility for oversight of the financial system are already hard at work trying to distill the lessons to be drawn from this experience and their implications for policy. Many in the private sector, including banks, credit-rating agencies, and the investment community, are likewise actively reviewing and responding to these developments. Some of the areas that will draw scrutiny are the appropriate use of credit ratings by investors, banks, and supervisors; the need for enterprise-wide, better-integrated risk-management techniques in large financial institutions; the appropriateness of accounting rules governing asset valuation and the use of off-balance-sheet vehicles; and weaknesses in the originate-to-distribute model and in the design of structured credit products, among many others. In the longer term, the response of the public and private sectors to this experience should help create a stronger financial system.

Ben S. Bernanke, Federal Reserve Chairman, Speech at the Women in Housing and Finance and Exchequer Club Joint Luncheon, Washington, D.C. (Jan. 10, 2008), at http://www.federalreserve.gov/newsevents/speech/bernanke20080110a.htm.

[55] Brian Louis, *Paulson Mortgage Plan Surfaces Too Late to Stem Housing Slide,* Bloomberg.com (Dec. 7, 2007).

[56] Mark Zandi, Op-ed, *The Mortgage Mess,* BOSTON GLOBE, July 22, 2007.

[57] *Id.*

foreclosure rates in these areas.[58] In Michigan, for example, where several major manufacturers have filed for bankruptcy, unemployment rates have spiked. Representative John Dingell (D-MI) has noted the "vicious cycle" as homes in affected communities depreciate in value, are foreclosed upon, and left to decay, with little hope of attracting new buyers.[59]

Impact on Communities

Not only is foreclosure in neither the homeowner's nor the lender's interest; it also adversely affects entire neighborhoods and communities. As Treasury Secretary Paulson noted, "Foreclosure is to no one's benefit."[60] He acknowledged, for example, "estimates that mortgage investors lose 40 to 50 percent on their investment if it goes into foreclosure."[61] The damage of foreclosure, he noted, is "not limited only to those who lose their homes" as "[homes in foreclosure can pose costs for whole neighborhoods, as crime goes up and property values decline."[62] Another Treasury Department official observed, "Concentrated foreclosures drive down property values and undermine the financial stability of families, communities and ultimately our economy."[63] Economists and the mortgage lending industry agree.[64]

The rising incidence of foreclosures is also having broader societal impacts. While municipal tax revenues fall, greater demands for fire and police protection are presented by abandoned properties that become havens for arson, drug use, and prostitution. According to a study commissioned by the Homeownership Preservation Foundation of Minneapolis, various costs incurred by government agencies responding to foreclosures in Chicago and Cook County, Illinois amounted to $34,199 for each foreclosure.[65]

The City of Baltimore has filed a Federal suit against Wells Fargo for allegedly predatory subprime lending practices targeting African American residents.[66] Among other relief, Baltimore is seeking damages for the increased l costs it has incurred for fire, police, and other services as a result of home mortgage foreclosures.[67]

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[58] Martin Crutsinger, New Mortgage Foreclosures Set Record, Yahoo!Finance—Associated Press, Sept. 6, 2007, at http://www.washingtonpost.com/wp-dyn/content/article/2007/09/06/AR2007090601677_2.html.

[59] Erika Lovley, *Mortgage Meltdown Leads to Lost Jobs in Arizona,* POLITICO, Sept. 5, 2007, at 12.

[60] Paul Krugman, Op-ed, *Henry Paulson's Priorities,* N.Y. TIMES, Dec. 10, 2007 (quoting U.S. Treasury Secretary Henry Paulson).

[61] *Id.*

[62] Henry Paulson, Secretary, U.S. Treasury, Remarks on Actions Taken and Actions Needed in U.S. Mortgage Markets at the Office of Thrift Supervision National Housing Forum (Dec. 3, 2007).

[63] Robert K. Steel, Undersecretary, U.S. Treasury, Remarks to the NYC Subprime Lending and Foreclosure Summit, Dec. 12, 2007.

[64] *See, e.g.,* Carolyn Said, *Modified Mortgages: Lenders Talking, Then Balking,* SAN FRANCISCO CHRONICLE, Sept. 13, 2007 (reporting that a Mortgage Bankers Association representative acknowledged that a "foreclosure can cost the lender from 20 to 40 percent of the loan balance"); Mark Zandi, A Step Behind, Moody's Economy.com, Dec. 13, 2007 (noting that "[e]ven in less stressed times, homes in foreclosure sell at a 20% to 30% discount to prevailing market values, driving down surrounding house prices").

[65] William C. Apgar *et al.,* The Municipal Cost of Foreclosures: A Chicago Case Study, Homeonwership Preservation Foundation Housing Finance Policy Research Paper No. 2005–1, at 1 (Feb. 27, 2005).

[66] Gretchen Morgenson, *Baltimore Is Suing Bank Over Foreclosure Crisis,* N.Y. TIMES, Jan. 8, 2008.

[67] *Id.*

The growing foreclosure crisis has confronted suburban law enforcement officials with an unfamiliar challenge: policing empty houses. As evictions mount and houses remain vacant for months or even years, these properties become havens for squatters, vandals, thieves, partying teenagers, and worse.[68] In some areas, police officers are targeting vacant houses for regular patrols, using maps of foreclosed properties as guides, while working with community watch groups to identify trouble spots.

A joint study by the Georgia Institute of Technology and the Woodstock Institute showed that when the foreclosure rate increases 1 percentage point, neighborhood violent crime rises 2.33 percent.[69] As one of the study's researchers explained, "The key here is the concentration of those foreclosures at a neighborhood level. When you have more than one foreclosure in a few block area, that's when you start to think about the effects on property values and the effects on crime."[70]

Home foreclosure has brought increased criminal activity into middle class neighborhoods such as the historic Westview neighborhood of Atlanta, Georgia, where 22 of the 85 bungalows in were vacant in 2007 as the result of foreclosure and mortgage fraud, and "house fires, prostitution, vandals and burglaries" have terrorized the remaining residents.[71] Similarly, a subdivision near Sacramento, California that "sprouted 10,000 homes in 4 years" now has many homes that "stand empty, weeds overtaking lawns, signs lining the street: 'Bank Repo,' 'For Rent,' 'No trespassing—bank owned property.' A typical home's value has dropped from about $570,000 to the low $400,000's."[72] The remaining "homeowners are fighting what typically have been considered inner city problems of gangs, drugs, theft and graffiti."[73]

Impact on Women and Minorities

Women and minorities have been particularly impacted by the foreclosure crisis. The New York Times reported that for each of the past 4 years, more than half the foreclosures in a Baltimore neighborhood were homes owned primarily by women.[74] Nationwide, women are 32 percent more likely to have received subprime loans than men, according to the Consumer Federation of America.[75] African-American and Latino borrowers likewise appear to have been disproportionately marketed subprime mortgages.[76] For instance, lending data for 2005 show that more than half of African-American borrowers, and four out of ten Latino mortgage borrowers, received loans that were higher-cost, an indicator of subprime status.[77]

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[68] Jonathan Mummolo & Bill Brubaker, *As Foreclosed Homes Empty, Crime Arrives,* WASH. POST, Apr. 27, 2008, at A1.

[69] J.W. Elphinstone, *Foreclosures, Vacancies and Crime—The Surge in Defaults on Risky Mortgages is Having a Ripple Effect in Some Cities,* PORTLAND PRESS HERALD—MAINE SUNDAY TELEGRAM, Nov. 14, 2007.

[70] *Id.*

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] John Leland, *Baltimore Finds Subprime Crisis Snags Women,* N.Y. TIMES, Jan. 15, 2008.

[75] *Id.*

[76] Susan Schmidt & Maurice Tamman, *Housing Push for Hispanics Spawns Wave of Foreclosures,* WALL ST. J., Jan. 5, 2009.

[77] *Id.*

Compared with their white counterparts, African American and Latino borrowers were more than 30 percent more likely to receive a higher rate on many types of loans, even after accounting for differences in risk, according to a 2006 report from the Center for Responsible Lending, a research and policy nonprofit.[78] As Wade Henderson, President and Chief Executive Officer of the Leadership Conference on Civil Rights, observed, "It has long been clear to our groups that America has a separate and unequal lending system, and that African American, Latino and other minority consumers disproportionately secure credit from an unscrupulous and unregulated lending market."[79]

Impact on Older Americans

Although senior citizens have long been considered among the most frugal and resistant to incurring debt, changing economic conditions—particularly declining pension and investment income and rising costs for basic expenses such as prescription drugs, health care, and utilities—have made it difficult for many to make ends meet on fixed incomes. Some of these "cash-poor" but "equity-rich" seniors used the equity in their homes to help meet medical and living expenses, and in the process were targeted by unscrupulous subprime mortgage lenders. These unwary borrowers received subprime refinance loans with low initial teaser rates that were not properly underwritten. Now, as those teaser rates expire and are replaced with escalating higher rates, some seniors, including many who owned their homes outright just a few years ago, are now finding that they simply cannot afford to stay in their homes, and are facing the nightmare of foreclosure.

Analysts at the American Association of Retired Persons (AARP) have found that "Americans age 50 and over represent about 28 percent of all delinquencies and foreclosures in the current crisis."[80] That translates into a full 684,000 Americans age 50 and over who were either delinquent or in foreclosure at the end of 2007; about 50,000 were actually in foreclosure or had already lost their homes. The analysis concludes that "older Americans appear particularly vulnerable to house price declines and subprime loans."[81]

Having a subprime loan is associated with a higher delinquency and foreclosure rate among all age groups. Nevertheless, AARP states that the impact of subprime lending appears to be disproportionately harder on older Americans. Homeowners under age 50 with subprime loans are 13 times more likely to be in foreclosure than those with prime loans. At age 50, the number jumps to 17 times more likely to be in foreclosure.[82]

Why seniors fall into this debt trap is aptly explained in the following news report:

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[78] Debbie Gruenstein *et al.,* Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages, Center for Responsible Lending, at 3 (May 31, 2006).

[79] *Ending Mortgage Abuse: Safe Guarding Homebuyers: Hearing Before the Subcomm. on Housing, Transportation, and Community Development of the S. Comm. on Banking, Housing, and Urban Affairs,* 110th Cong. (2007) (testimony of Wade Henderson, President and Chief Executive Officer, the Leadership Conference on Civil Rights).

[80] AARP Public Policy Institute, "A First Look at Older Americans and the Mortgage Crisis," *Insight on the Issues* (Sept. 2008).

[81] *Id.*

[82] Emily Brandon, *Study: Falling Housing Prices are Jeopardizing Retirement Security,* U.S. NEWS & WORLD REP., Sept. 22, 2008.

> "All my clients tell the same story; it's almost like a script," said Donna Dougherty, a staff attorney with Queens Legal Services for the Elderly. Typically, a homeowner falls behind on taxes, a credit card bill or is hit with an unexpected medical bill. As a result, he or she ends up on a list of homeowners in debt or with a less than perfect credit score, but with substantial home equity. That's when the phone calls begin. "When somebody calls out of the blue and says 'We'll help you so you don't lose your home,' it's almost like a white knight showing up," says Dougherty. "Seniors are absolutely one of the key targeted groups."[83]

An analysis of more than 4,000 loans by Ameriquest Mortgage conducted by the *Seattle Times* found that one in three borrowers in King County, Washington was aged 50 or older and one in seven was 60 or older when they took out a mortgage with the lender.[84] Nearly all of the borrowers already owned their homes. As a case in point, the *Seattle Times* reported on a 93-year-old woman who "took out a high-cost, high-interest mortgage against her home of more than four decades" that went into foreclosure within months.[85] It also examined the case of a 79-year-old janitor, who obtained ten subprime refinancings over 9 years after the death of her husband. As a result of these refinancings, the homeowner's mortgage debt swelled from $32,000 in 1998 to $382,000 in 2005.[86]

Although losing a home to foreclosure is a disaster no matter what the homeowner's age is, it is an overwhelming catastrophe for older people. According to the Public Policy Institute, seniors "rely on their homes both for shelter and as a retirement asset," and therefore "[l]osing a home jeopardizes long-term financial security, with limited time to recover."[87] AARP reports that the problem of older households and foreclosures is likely to grow, as homeowners increasingly carry mortgage debt in their retirement years. In 2007, 53 percent of all owners with a head of household age 50 or older had a mortgage, up from 34 percent just two decades ago.[88]

Impact on Renters

Across the country, thousands of renters have become innocent victims of the foreclosure crisis. They have been forced to move because the owner of the property was in foreclosure. Security deposits have been lost, and lives turned upside-down, as people scramble to find a new place to live on short notice.

Almost 15 million renters—40 percent of all renters nationwide—live in single-family homes, townhouses, condos or duplexes, ac-

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[83] Joseph Huff-Hannon, *Facing Foreclosure: Brooklyn Retiree on Verge of Losing Home as Subprime Lenders Target Cash-Poor Black Seniors,* INDEPENDENT, Apr. 25, 2008, at http://www.indypendent.org/2008/04/25/facing-foreclosure/

[84] Susan Kelleher & Justin Mayo, *Homeowners in Debt, Seniors Prime Targets of Riskiest Loans,* SEATTLE TIMES, Dec. 17, 2007.

[85] *Id.*

[86] *Id.*

[87] *Foreclosures Hit Older Americans; 28% of Affected Homeowners Are Age 50 and Up,* Associated Press, Sept. 19, 2008 (quoting Susan Reinhard, Senior Vice President, Public Policy Institute).

[88] William Apgar, Joint Center for Housing Studies, Harvard University, presentation at AARP Forum, Sept. 19, 2008.

cording to U.S. Census data.[89] While there are no national figures on foreclosure-related evictions, these types of rental properties have been vulnerable to foreclosure because they tend to be owned by small investors. In most States, when a bank forecloses on a landlord, the tenant has no guarantee of being allowed to stay in the property. In addition, neither the lender nor the landlord has any legal obligation to inform the tenant of the foreclosure. As a result, it is common for the renter to first learn of the foreclosure when he or she is being told to vacate the property within a few days or weeks.

Although the data are incomplete on the number of renters who are evicted due to foreclosure, the National Low Income Housing Coalition estimates that as many as 40 percent of the families who have or could lose their homes due to foreclosure are renters.[90] These individuals are unlikely to get their security deposits returned, and they will also incur unforeseen expenses to relocate to new rental housing. And if they live paycheck to paycheck with no savings to rely on in emergencies, they are at high risk of joining the ranks of America's homeless.

As the Coalition explains, "Foreclosure usually means eviction for renters. Because renters as a group have lower incomes than homeowners and because most renters who are evicted due to foreclosure never get their security deposits back, they face a period of housing instability at the very least and many are at risk of homelessness."[91] Catholic Charities USA, the Nation's largest network of social services agencies, concurs. It notes, "Foreclosure is causing a significant increase in homelessness within our network all across the country."[92]

Impact on the Financial Marketplace—Both Here and Abroad

Turmoil in the mortgage industry has had a domino effect on the financial marketplace and lending community generally. Since 2006, at least 100 mortgage companies have halted operations or sought buyers.[93] With respect to the financial marketplace, the Treasury Department's Under Secretary for Domestic Finance, in testimony before the House Financial Services Committee, explained:

> The uncertainty regarding both the future prospects of these mortgage-backed securities and the methodologies the credit rating agencies used to rate these securities compelled investors to reassess the risk of these securities and subsequently reassess price. Given the uncertainty of the underlying credit and cash flows, few buyers were willing to risk their capital. Valuation became extremely difficult as a no-bid environment seized certain segments of

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[89] Doug Guthrie, Renters caught in foreclosure meltdown, DETROIT NEWS, Oct. 17, 2008.

[90] Letter from Coalition to Protect Renters in the Foreclosure Crisis to House Speaker Nancy Pelosi *et al.* (Oct. 21, 2008), at http://www.nlihc.org/doc/House-letter-on-renter-assistance-in-stimulus.pdf.

[91] Press Release, National Low Income Housing Coalition, Renters Make Up 45% of Households Whose Homes Are in Foreclosure in Four New England States (May 7, 2008), at http://www.utahhousing.org/documents/NLIHC-Letterhead-templat-2008-good3.pdf.

[92] Steve Brandt & Warren Wolfe, *Wave of Foreclosures Hits Renters,* STAR TRIB.—MINNEAPOLIS-ST. PAUL, Oct. 29, 2007 (quoting Jane Stensen, Senior Director for Human Services, Catholic Charities USA).

[93] Rick Green, *Lehman Shuts Unit; Toll of Lenders Tops 100: Subprime Scorecard,* Bloomberg.com, Sept. 18, 2007.

> the market. This reappraisal has spread across the credit market spectrum, first affecting residential-mortgage backed securities and then spreading to other asset classes, and, particularly, securitized products. Spreads have widened and a lack of liquidity has affected these other asset classes. The financing of buy-out transactions has been challenged as higher risk premia resurfaced after a long period of favorable conditions. Volatility has increased, from Treasury bills to the stock markets.

> In early August [2007], this uncertainty began to spread to the asset-backed commercial paper market, typically a very liquid market. . . . Subsequently, banks became increasingly concerned about their own liquidity in view of the possibility that they might have to provide backup for commercial paper and take other assets onto their balance sheets. In response to such developments, the Federal Reserve took several measures to increase liquidity and promote the orderly functioning of financial markets.[94]

These measures included making additional reserves available to the Nation's banking system and lowering the interest discount rate, among other actions.[95] The mortgage crisis has had international ramifications and has been blamed for causing "a global credit crunch."[96]

Hedge funds pool invested money to buy and sell stocks, bonds, and many other assets, with the prospect of yielding high returns, but based on risky investment strategies.[97] Hedge fund investment is limited by law to the very wealthy "who are presumed to be capable of understanding the risks and bearing the losses of financial speculation."[98] Attracted by high returns, institutional investors, such as pension funds and university endowments, are placing more of their money in hedge funds.[99] And as hedge funds invested in the risky subprime mortgage market,[100] some high-profile funds incurred major losses, and several have filed for bankruptcy.[101] As

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[94] *Recent Events in the Credit and Mortgage Markets and Possible Implications for U.S. Consumers and the Global Economy: Hearing Before the H. Comm. on Financial Services,* 110th Cong. (2007) (statement of Robert Steel, Treasury Department Under Secretary for Domestic Finance).

[95] *Id.*

[96] Eric Pfanner, *British Mortgage Lender Is Offered Emergency Loan,* N.Y. TIMES, Sept. 14, 2007.

[97] Mark Jickling, Hedge Funds: Should They Be Regulated, Congressional Research Service Report for Congress, at 1 (July 2, 2007). Studies find that the mortality rate for hedge funds is about 20% per year and that the average life span is about 3 years.

[98] Mark Jickling & Alison A. Raab, Hedge Fund Failures, Congressional Research Service Report for Congress, summary (Aug. 1, 2007). Hedge funds are open to "accredited investors," defined as those with over $1 million in assets. *Id.*

[99] *Id.*

[100] Nara Der Hovanesian & Matthew Goldstein, *The Mortgage Mess Spreads,* BUSINESS WEEK, *Mar. 7, 2007.*

[101] *See, e.g., Bear Stearns Hedge Funds File for Bankruptcy,* Associated Press, Aug. 1, 2007; Alex Markels, *Taking Credit's Temperature—Risky Home Lonas Run a Fever, and the Market Prays It Doesn't Spread,* U.S. NEWS & WORLD REPORT, July 23/30, 2007, at 37 ("Several hedge funds, which used hundreds of millions of dollars in investor capital to borrow billions more for big bets on subprime-backed debt, have been shut down or needed bailing out."). For example, two Bear Stearns hedge funds heavily invested in bonds backed by home loans recently collapsed and filed for bankruptcy protection on July 31, 2007 under chapter 15 of the Bankruptcy Code. *Bear Stearns Hedge Funds File for Bankruptcy,* Associated Press, Aug. 1, 2007. The funds filed for chapter 15 (which pertains to transnational insolvencies) because they are registered in the Cayman Islands. *Id.*

a result, "rank-and-file workers, retirees, and others may be unwittingly exposed to hedge fund losses."[102] Thus, the mortgage crisis not only has had ripple effects throughout financial markets, but it has also undermined the economic security of many working-class Americans.

Impact on Secondary Mortgages and Other Industries

Still others are concerned about the spillover effects of the foreclosure crisis into other areas.[103] As *BusinessWeek* explained:

> What's more, there's little that can be done to prevent the pain from the deterioration of this $850 billion market. A lender on a mortgage has the first claim on the underlying property. In the case of foreclosure, it can sell the property and recoup some money. The bank with the home-equity piece has no such collateral and is usually out the money. "The home-equity lender is going to get hosed," says Amy Crews Cutts, deputy chief economist at mortgage giant Freddie Mac[.][104]

Various industries involved in the housing market have been adversely affected. Last November, pending home sales in the United States "fell to the lowest level on record," according to the National Association of Home Builders.[105] At a 2007 hearing before the House Financial Services Committee, the Association testified that its "members and their customers have been significantly impacted by the mortgage upheaval and there is deep concern that the dislocations in the financing markets will increase the depth and length of the housing downturn."[106] In addition, "many people in the retail real estate industry are bracing themselves for a slowdown in spending as the subprime mortgage crisis and the decline in housing values continue to send ripples through the economy."[107]

Some assert that the "fundamental problem with housing is oversupply."[108] Economist Mark Zandi correctly predicted in 2007 that even if interest rates were frozen on one fifth of 2006 subprime loans resetting in 2008, existing home prices could fall by as much as 15 percent.[109] Others cite Americans' pessimism itself as the cause. As the Chief Executive Officer of Toll Brothers, Inc., the Nation's largest luxury home builder, explained, "Right now I think it takes a brave soul to buy a home because there's so much chatter about housing prices dropping. . . . As soon as that fear leaves the market and we have some kind of equilibrium, we'll be back on

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[102] Mark Jickling & Alison A. Raab, Hedge Fund Failures, Congressional Research Service Report for Congress, summary (Aug. 1, 2007). Hedge funds are open to "accredited investors," defined as those with over $1 million in assets. *Id.*

[103] Mara Der Hovanesian, *The Home Equity Crisis Ahead—Even Banks that Dodged the Subprime Bullet Face Losses from Loans Based on Homes Now at Risk,* BUSINESSWEEK, Jan. 16, 2008.

[104] *Id.; see, e.g.,* Marc Labonte, Would a Housing Crash Cause a Recession?, Congressional Research Report for Congress, RL34244 (Nov. 7, 2007).

[105] *Legislative and Regulatory Options for Minimizing and Mitigating Mortgage Foreclosures: Hearing Before the H. Comm. on Financial Services,* 110th Cong. (2007) (prepared testimony submitted by the National Association of Home Builders).

[106] *Id.*

[107] Terry Pristin, *Shopping Centers Begin to Feel Ripples of Housing's Ills,* N.Y. TIMES, Sept. 12, 2007, at C6.

[108] Brian Louis, *Paulson Mortgage Plan Surfaces Too Late to Stem Housing Slide,* Bloomberg.com (Dec. 7, 2007) (quoting Nicolas Retsinas, Director of Harvard University's Joint Center for Housing Studies).

[109] *Id.* (citing Mark Zandi, Chief Economist, Moody's Economy.com).

top." [110] Still others blame the complexity of the securitization process and the reluctance of mortgage servicers (entities that collect mortgage payments on behalf of investors) to enter into loan modifications because they fear being sued by mortgage investors.[111] Some critics questioned whether the Paulson Plan was "intended to achieve real results." [112]

NEED FOR THE LEGISLATION

Responses to the Mortgage Foreclosure Crisis Have Been Inadequate To Date

Overview

As of 2008, 30 percent of families holding recent subprime mortgages owed more on their mortgage than their home was worth.[113] These families are at an increased risk of foreclosure because "negative equity" precludes the homeowner from selling, refinancing, or getting a home equity loan or other mechanism for weathering short-term financial difficulty.[114]

Regulators and economists are increasingly cautioning that loan balances must be reduced to avoid unnecessary foreclosures that will further damage the economy.[115] Federal Reserve Chairman Ben Bernanke observed in March 2008:

> [T]he current housing difficulties differ from those in the past, largely because of the pervasiveness of negative equity positions. With low or negative equity, as I have mentioned, a stressed borrower has less ability (because there is no home equity to tap) and less financial incentive to try to remain in the home. In this environment, principal reductions that restore some equity for the homeowner may be a relatively more effective means of avoiding delinquency and foreclosure.[116]

Notwithstanding industry leaders' public endorsements of these principles, support for loan modifications from the Bush Administration,[117] exhortations by Federal banking agencies and the Con-

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[110] *Id.* (quoting Robert Toll, Chief Executive Officer, Toll Brothers, Inc.). The article also noted that Toll Brothers, Inc. has "lost about $5 billion of market value since July 2005, when new home sales peaked in the U.S." *Id.*

[111] *See, e.g.,* Editorial, *Show Us the Mortgage Relief,* N.Y. TIMES, Dec. 9, 2007.

[112] Op. Ed., Paul Krugman, *Henry Paulson's Priorities,* N.Y. TIMES, Dec. 10, 2007.

[113] Edmund Andrews, *Relief for Homeowners is Given to a Relative Few,* N.Y. TIMES, Mar. 4, 2008 (loans originated in 2005 and 2006).

[114] Kristopher Gerardi et al., Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures, Federal Reserve Bank of Boston Working Papers, No 07–15 (Dec. 3, 2007) at 3–4.

[115] *See also* Edmund L. Andrews, *Fed Chief Urges Breaks for Some Home Borrowers,* N.Y. TIMES, Mar. 4, 2008; John Brinsley, Bernanke Call for Mortgage Forgiveness Puts Pressure on Paulson, Bloomberg.com (Mar. 5, 2008); Phil Izzo, *Housing Market Has Further to Fall,* WALL ST. J., Mar. 13, 2008 ("Last week, Federal Reserve Chairman Ben Bernanke suggested that lenders could aid struggling homeowners by reducing their principal—the sum of money they borrowed—to lessen the likelihood of foreclosure. Some 71% of respondents [i.e., economists surveyed by the *New York Times*] agreed with the suggestion. ").

[116] Ben S. Bernanke, Chairman, Federal Reserve, Speech at the Independent Community Bankers of America Annual Convention (Mar. 4, 2008).

[117] Press Release, Office of the White House, Aug. 31, 2007. *See also* the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, at http://www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm (encouraging lenders to address subprime hybrid ARM resets by pursuing "appropriate loss mitigation strategies designed to preserve homeownership. . . . Appropriate loss mitigation strategies may include, for example, loan modifications, deferral of payments, or a reduction of principal.").

ference of State Banking Supervisors,[118] and voluntary efforts by lenders and servicers have resulted in a minimal number of viable loan modifications. In December 2008, Secretary of Housing and Urban Development Steve Preston acknowledged that the "centerpiece of the Federal Government's effort to help struggling homeowners has been a failure."[119] The problems are two-fold: too few people are in foreclosure prevention programs; and of those who are being reached for loan modifications, too few are getting sustainable new terms.

An empirical study released in August 2008 examined negotiated mortgage modifications based on data compiled from monthly servicer remittance reports from July 2007 through June 2008, found "that while the number of modifications rose rapidly during the crisis, mortgage modifications in the aggregate are not reducing subprime mortgage debt."[120] Of even greater significance, the study found that these modifications "rarely if ever reduced principal debt, and in many cases increased the debt."[121] In addition, "many modifications actually increased the monthly payment."[122] As Sheila Bair, Chair of the Federal Deposit Insurance Corporation, remarked, "Why there's been such a political focus on making sure we're not unduly helping borrowers but then we're providing all this massive assistance at the institutional level, I don't understanding it. . . . It's been a frustration for me."[123]

Last fall, the State Foreclosure Prevention Working Group, comprised of State attorneys general and State banking regulators, issued its third in a series of reports looking at the state of foreclosures in this country. Key findings include the following: (1) nearly eight out of ten seriously delinquent homeowners are not on track for any loss mitigation outcome, down from seven in ten in previous reports; (2) new efforts to prevent foreclosures are on the decline, despite a temporary increase in loan modifications through the second quarter of 2008; and (3) one out of five loan modifications made in the past year is currently delinquent.[124]

Of the various types of modifications that lenders have provided, the second largest category of modification actually *increased* the homeowner's monthly mortgage payments.[125] These figures include modifications done by the Hope Now Alliance, the program convened by the Treasury Department to encourage loan modification. As acknowledged by the vice chair of Washington Mutual, who helped run the program, many of the homeowners who have sought assistance from Hope Now "will not receive long-term relief and could ultimately face higher total costs."[126] Chairman Bernanke

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[118] Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages http://www.federalreserve.gov/boarddocs/srletters/2007/SR0716.htm.

[119] Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages a Failure,* +WASH. POST, *Dec. 17, 2008, at A1.*

[120] Alan M. White, Abstract, Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports (Aug. 2008), at http://papers.ssrn.com/sol3/papers.cfm?abstract__id=1259538

[121] *Id.*

[122] *Id.*

[123] *Id.*

[124] State Foreclosure Prevention Working Group Reports, Analysis of Subprime Mortgage Servicing Performance, Data Report No. 3, Sept. 2008, at http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf.

[125] Rod Dubitsky *et al.,* Subprime Loan Modifications Update, Credit Suisse Fixed Income Research (Oct. 1, 2008) at 2.

[126] David Cho & Renae Merle, *Merits of New Mortgage Aid Are Debate—Critics Say Treasury Plan Won't Bring Long-Term Relief,* WASH. POST, Mar. 4, 2008 (citing remarks of Bill

noted that loan modifications involving "reductions of principal balance have been quite rare." [127]

Professor Alan White of Valparaiso University School of Law examined the modifications that are taking place and concluded that "we are going backwards" and that "voluntary modifications are putting people underwater more than they already are[.]" [128] The result is that there is a high level of defaults after a modification. Specifically, Professor White found that less than 10 percent of the time do the voluntary programs result in a reduced principal loan balance, with more than half of modifications capitalizing unpaid interest and fees into larger and more drawn-out debt on the back end of the mortgage ; and only about a third of voluntary mortgage modifications reduce monthly payment burdens for homeowners, with nearly half actually saddling distressed homeowners with *increased* payments under the modifications.[129]

There are a number of reasons why voluntary loss mitigation cannot keep up with demand. One reason is that the way servicers are compensated by lenders often creates a bias for moving forward with foreclosure rather than engaging in foreclosure prevention. As reported in *Inside B&C Lending,* "Servicers are generally disincented to do loan modifications because they don't get paid for them but they do get paid for foreclosures." [130] So even when a loan modification would better serve investors and homeowners, some loan servicers have an undue economic incentive to proceed to foreclosure. As one expert explained:

> One problem is that servicers are compensated for their costs of foreclosing, but not for their costs of renegotiating. Another problem is that servicers impose fees when debtors pay late or default, and the servicing contracts allow them to keep the fees if they can be collected. Since renegotiating a mortgage often involves giving up these fees, they give servicers an additional incentive to foreclose rather than negotiate. Thus most mortgage servicing contracts are unsuited to dealing with the housing crisis.[131]

Even when servicers do want to engage in effective loss mitigation, they face other structural obstacles. One major obstacle is the number of homes that have more than one mortgage or lien against them. Between one-third and one-half of the homes purchased in 2006 with subprime mortgages have second mortgages,[132] and

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Longbrake, senior policy adviser for the Financial Services Roundtable and vice chair of Washington Mutual).

[127] Ben S. Bernanke, Chairman, Federal Reserve, Speech at the Independent Community Bankers of America Annual Convention (Mar. 4, 2008).

[128] Kate Berry, *Early Read Finds Many Loan Mods Falling Short,* AM. BANKER, Nov. 24, 2008.

[129] Alan White, Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications From 2007 and 2008 Remittance Reports, at http://ssrn.com/abstract=1259538; Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications,* ____ CONN. L. REV. ____ (forthcoming 2009) (reporting on updated data)

[130] Inside Mortgage Finance Reprints, Subprime Debt Outstanding Falls, Servicers Pushed on Loan Mods (Nov. 16, 2007) (quoting Karen Weaver, a managing director and global head of securitization research at Deutsche Bank Securities).

[131] Michelle J. White, Bankruptcy: Past Puzzles, Recent Reforms, and the Mortgage, National Bureau of Economic Research Working Paper No. 14549, at 14–15 (Dec. 2008); *see also* Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications,* ____ CONN. L. REV. ____ (2009) (forthcoming) ("No single servicer or group of servicers, however, has any economic incentive to organize a pause in foreclosures or an organized deleveraging program to benefit the group.").

[132] Credit Suisse, Mortgage Liquidity du Jour: Underestimated No More, at 5 (Mar. 12, 2007).

many other homeowners have open home equity lines of credit secured by their home. The holder of the first mortgage will generally not want to provide modifications that would simply free up the homeowner's resources to make payments on a formerly worthless junior lien, nor to modify a loan where there is a second mortgage in default.[133] Second mortgage holders "have the right to prevent refinancing or renegotiation of first mortgages unless the second mortgage is paid off."[134] As Credit Suisse reports, "It is often difficult, if not impossible, to force a second-lien holder to take the pain prior to a first-lien holder when it comes to modifications," thereby dooming the effort.[135]

Another structural obstacle is posed by securitization. When servicing securitized loans, servicers are bound by the terms of the agreement with investors, known as a "pooling and servicing agreement" (PSA), which may limit what they can do by way of modification. For example, some PSAs limit the number or percentage of loans in a pool that can be modified.[136] Moreover, even if the PSA is not a problem, most modifications will have differing impacts on different groups of investors; for example, a change in interest rate may impact different investors than a waiver of a prepayment penalty. Servicers may decline to enter into a modification out of fear of an investor lawsuit. As Federal Reserve Chairman Ben Bernanke explained:

> Unfortunately, even though workouts may often be the best economic alternative, mortgage securitization and the constraints faced by servicers may make such workouts less likely. For example, trusts vary in the type and scope of modifications that are explicitly permitted, and these differences raise operational compliance costs and litigation risks. Thus, servicers may not pursue workout options that are in the collective interests of investors and borrowers. Some progress has been made (for example, through clarification of accounting rules) in reducing the disincentive for servicers to undertake economically sensible workouts. However, the barriers to, and disincentives for, workouts by servicers remain serious problems that need to part of current discussions about how to reduce preventable foreclosures.[137]

The necessity of government action also is gaining recognition among Wall Street leaders. A senior economic advisor at UBS Investment Bank has observed that "when markets fail, lenders and borrowers need some sort of regulatory and legislative framework within which to manage problems, rather than be forced to act in

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[133] Jody Shenn, *'Piggyback' Mortgages May Cut Modifications, Fed Says,* Bloomberg.com (Dec. 30, 2008) (reporting on Federal Reserve study that attempts "to loosen terms on hundreds of thousands of delinquent home loans may be hindered by so-called piggyback second mortgages that gained popularity during the U.S. housing boom").

[134] Michelle J. White, Bankruptcy: Past Puzzles, Recent Reforms, and the Mortgage, National Bureau of Economic Research Working Paper No. 14549, at 15 (Dec. 2008).

[135] Ivy Zelman *et al.,* Credit Suisse, Subprime Loan Modifications Update, at 8 (Oct. 1, 2008).

[136] *See* Credit Suisse, The Day After Tomorrow: Payment Shock and Loan Modifications (Apr. 5, 2007) (noting specific examples of PSAs with various modification restrictions, including 5% by balance, 5% by loan count, limits on frequency, and limits on interest rate).

[137] Ben S. Bernanke, Chairman, Federal Reserve, Remarks to the Independent Community Bankers of American Annual Conference (Mar. 4, 2008).

the chaos of the moment."[138] Moreover, as former Federal Reserve Board Vice Chairman Alan Blinder recently noted, the fact that most of the mortgages at issue have been securitized and sold to investors across the globe "bolsters the case for government intervention rather than undermining it. After all, how do you renegotiate terms of a mortgage when the borrower and the lender don't even know each other's names?"[139]

Judicial Modification of Mortgages

A mechanism for enabling a court to break the deadlock and provide an economically rational solution that avoids foreclosure and nets the lender at least as much as would be recovered through a foreclosure sale is needed.

Current Bankruptcy Law

While the fallout from the subprime mortgage "extends from hedge fund managers to rank-and-file investors," the "most personally punishing setback is a family losing its home."[140] In an effort to forestall a foreclosure sale, a borrower may resort to filing for bankruptcy relief, which stays most creditor collection attempts, including foreclosure sales, at least for a period of time.[141] Such protection—known as the automatic stay—is limited, however. If the debtor does not cure the default leading to the foreclosure, i.e., pay the arrearages due under the mortgage, and remain current on all future payments, the mortgage lender can obtain a court order terminating the automatic stay and thereby allow the foreclosure sale to proceed.[142]

For most consumers facing a foreclosure sale who want to retain their homes, chapter 13 of the Bankruptcy Code[143] provides some modicum of protection. In the context of a chapter 13 repayment plan, a debtor may cure a default under a mortgage "within a reasonable time," providing the debtor remains current on his or her post-petition mortgage payments.[144] While this ability to cure a default under a residential mortgage is valuable, chapter 13 does not protect a consumer debtor from having to pay escalating interest costs and hidden fees that are often involved in subprime mortgage agreements.

It should be noted that, while a chapter 13 debtor may modify the rights of most other types of secured or unsecured creditors in the context of a chapter 13 repayment plan,[145] the current law ex-

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[138] George Magnus, *Large-scale Action Is Needed To Tackle the Credit Crisis,* FINANCIAL TIMES, Apr. 8, 2008.

[139] Alan S. Blinder, *From the New Deal, a Way Out of a Mess,* N.Y. TIMES (Feb. 24, 2008).

[140] Steve Lohr, *Loan by Loan, the Making of a Credit Squeeze,* N.Y. TIMES, Aug. 19, 2007, at 1 Bus. Sec.

[141] 11 U.S.C. § 362(a) (2008).

[142] 11 U.S.C. § 362(d) (2008). Typically, the basis for granting relief from the automatic stay is that the mortgagee lacks "adequate protection." 11 U.S.C. §§ 361, 362(d)(1) (2008).

[143] Chapter 13 is a form of bankruptcy relief by which a debtor, in exchange for retaining possession of his or her assets, proposes a repayment plan pursuant to which the debtor devotes all of his or her disposable income for a period of up to 5 years. Creditors in a chapter 13 case must receive under the plan at least as much as they would receive if the case was converted to chapter 7 for liquidation.

[144] 11 U.S.C. § 1322(b)(5) (2008).

[145] As a result of an amendment to the bankruptcy law in 2005, a purchase money security interest in a motor vehicle acquired for the debtor's personal use may not be bifurcated if the debt was incurred during the 910-day period preceding the bankruptcy filing. The same prohibition applies to a claim secured by anything else of value if the debtor incurred the debt within 1 year of the bankruptcy filing. 11 U.S.C. § 1325(a) (2008).

pressly prohibits a chapter 13 debtor from modifying the rights of a creditor secured "only by a security interest in real property that is the debtor's principal residence."[146] Not only does this treat principal residences less favorably than second homes, vacation homes, and other properties. Curiously, if the mortgage lender also has a security interest in other property of the debtor—so that the debt is not secured *only* by a security interest in the debtor's principal residence—the prohibition on modifying the mortgage terms does not apply.

The Supreme Court has held that this exception to a chapter 13's ability to modify the rights of creditors applies even if the mortgagee is undersecured.[147] Thus, if a chapter 13 debtor owes $300,000 on a mortgage for a home that is worth less than $200,000, he or she must repay the entire amount in order to keep his or her home, even though the maximum that the mortgage lender would receive upon foreclosure is the home's value—i.e., $200,000—less the costs of foreclosure.

HEARINGS

The Committee on the Judiciary held 1 day of hearings on H.R. 200, the "Helping Families Save Their Homes in Bankruptcy Act of 2009," and H.R. 225, the "Emergency Homeownership and Equity Protection Act," on January 22, 2009. Testimony was received from Representative Brad Miller (D-NC); Representative Jim Marshall (D-GA); David M. Certner, Legislative Policy Director, American Association of Retired Persons; Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center; Christopher J. Mayer, Senior Vice Dean, Columbia Business School; and Matthew Mason, Esq., Assistant Director, UAW-GM Legal Services Plan.

COMMITTEE CONSIDERATION

On January 27, 2009, the Committee met in open session and ordered the bill, H.R. 200 favorably reported with an amendment, by a rollcall vote of 21 to 15, a quorum being present.

COMMITTEE VOTES

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the Committee advises that the following rollcall votes occurred during the Committee's consideration of H.R. 200.

1. An amendment by Mr. Smith: (1) specifying that a claim for a loan secured by a security interest in the debtor's principal residence may be modified in certain specified respects to the extent necessary so that the monthly mortgage payment is not less than 31 percent and not more than 38 percent of the debtor's current monthly income; and (2) providing that if the claim has been modified to an amount below the original principal of the loan pursuant to section 1322(b)(11)(A) and the residence is sold, transferred or refinanced during the term of the plan, the plan requires the debtor to enter into an enforceable agreement with the holder that it

[146] 11 U.S.C. § 1322(b)(2) (2008).
[147] Nobelman v. American Sav. Bank, 508 U.S. 324 (1993).

is entitled to receive, in addition to the unpaid portion of the allowed secured claim, the net proceeds of the sale or the amount of the allowed unsecured claim, whichever is less. Defeated 14 to 20.

ROLLCALL NO. 1

	Ayes	Nays	Present
Mr. Conyers, Jr., Chairman		X	
Mr. Berman			
Mr. Boucher			
Mr. Nadler		X	
Mr. Scott		X	
Mr. Watt		X	
Ms. Lofgren		X	
Ms. Jackson Lee		X	
Ms. Waters		X	
Mr. Delahunt		X	
Mr. Wexler		X	
Mr. Cohen		X	
Mr. Johnson		X	
Mr. Pierluisi		X	
Mr. Gutierrez		X	
Mr. Sherman			
Ms. Baldwin		X	
Mr. Gonzalez		X	
Mr. Weiner		X	
Mr. Schiff		X	
Ms. Sánchez		X	
Ms. Wasserman Schultz		X	
Mr. Maffei		X	
[Vacant].			
Mr. Smith, Ranking Member	X		
Mr. Goodlatte	X		
Mr. Sensenbrenner, Jr.	X		
Mr. Coble	X		
Mr. Gallegly	X		
Mr. Lungren	X		
Mr. Issa	X		
Mr. Forbes			
Mr. King	X		
Mr. Franks	X		
Mr. Gohmert	X		
Mr. Jordan	X		
Mr. Poe	X		
Mr. Chaffetz	X		
Mr. Rooney			
Mr. Harper	X		
Total	14	20	

2. An amendment by Mr. Franks limiting the legislation to: (1) mortgages originated in the period beginning January 1, 2004 through December 31, 2007 and (2) to cases commenced in the 3-year period beginning on the Act's date of enactment. Defeated 15 to 20.

ROLLCALL NO. 2

	Ayes	Nays	Present
Mr. Conyers, Jr., Chairman		X	
Mr. Berman		X	
Mr. Boucher			
Mr. Nadler		X	
Mr. Scott		X	
Mr. Watt		X	

ROLLCALL NO. 2—Continued

	Ayes	Nays	Present
Ms. Lofgren		X	
Ms. Jackson Lee		X	
Ms. Waters			
Mr. Delahunt		X	
Mr. Wexler		X	
Mr. Cohen		X	
Mr. Johnson		X	
Mr. Pierluisi		X	
Mr. Gutierrez		X	
Mr. Sherman		X	
Ms. Baldwin		X	
Mr. Gonzalez		X	
Mr. Weiner		X	
Mr. Schiff		X	
Ms. Sánchez		X	
Ms. Wasserman Schultz		X	
Mr. Maffei			
[Vacant].			
Mr. Smith, Ranking Member	X		
Mr. Goodlatte	X		
Mr. Sensenbrenner, Jr.	X		
Mr. Coble	X		
Mr. Gallegly	X		
Mr. Lungren	X		
Mr. Issa	X		
Mr. Forbes	X		
Mr. King	X		
Mr. Franks	X		
Mr. Gohmert	X		
Mr. Jordan	X		
Mr. Poe	X		
Mr. Chaffetz	X		
Mr. Rooney			
Mr. Harper	X		
Total	15	20	

3. An amendment by Mr. Forbes: (1) deleting the exception to the mandatory pre-filing credit counseling requirement in the Amendment in the Nature of a Substitute; and (2) requiring the court to find, as a condition of confirmation, that the debtor did not obtain the extension, renewal, or refinancing of credit that gives rise to a modified claim by misrepresentation, false pretenses, or actual fraud. Defeated 12 to 20.

ROLLCALL NO. 3

	Ayes	Nays	Present
Mr. Conyers, Jr., Chairman		X	
Mr. Berman		X	
Mr. Boucher			
Mr. Nadler		X	
Mr. Scott		X	
Mr. Watt			
Ms. Lofgren		X	
Ms. Jackson Lee		X	
Ms. Waters			
Mr. Delahunt		X	
Mr. Wexler		X	
Mr. Cohen		X	
Mr. Johnson		X	
Mr. Pierluisi		X	

ROLLCALL NO. 3—Continued

	Ayes	Nays	Present
Mr. Gutierrez		X	
Mr. Sherman		X	
Ms. Baldwin		X	
Mr. Gonzalez		X	
Mr. Weiner		X	
Mr. Schiff		X	
Ms. Sánchez		X	
Ms. Wasserman Schultz		X	
Mr. Maffei		X	
[Vacant].			
Mr. Smith, Ranking Member	X		
Mr. Goodlatte	X		
Mr. Sensenbrenner, Jr.			
Mr. Coble			
Mr. Gallegly	X		
Mr. Lungren	X		
Mr. Issa	X		
Mr. Forbes	X		
Mr. King	X		
Mr. Franks			
Mr. Gohmert	X		
Mr. Jordan	X		
Mr. Poe	X		
Mr. Chaffetz	X		
Mr. Rooney			
Mr. Harper	X		
Total	12	20	

4. An amendment by Mr. King requiring the court to find, as a condition of confirmation, that the debtor did not obtain the extension, renewal, or refinancing of credit that gives rise to a modified claim by the debtor's material misrepresentation, false pretenses, or actual fraud. Approved 21 to 3.

ROLLCALL NO. 4

	Ayes	Nays	Present
Mr. Conyers, Jr., Chairman	X		
Mr. Berman		X	
Mr. Boucher			
Mr. Nadler			
Mr. Scott	X		
Mr. Watt			
Ms. Lofgren		X	
Ms. Jackson Lee			
Ms. Waters			
Mr. Delahunt		X	
Mr. Wexler	X		
Mr. Cohen	X		
Mr. Johnson	X		
Mr. Pierluisi	X		
Mr. Gutierrez			
Mr. Sherman			
Ms. Baldwin	X		
Mr. Gonzalez	X		
Mr. Weiner	X		
Mr. Schiff	X		
Ms. Sánchez			
Ms. Wasserman Schultz	X		
Mr. Maffei	X		
[Vacant].			

ROLLCALL NO. 4—Continued

	Ayes	Nays	Present
Mr. Smith, Ranking Member	X		
Mr. Goodlatte	X		
Mr. Sensenbrenner, Jr.			
Mr. Coble			
Mr. Gallegly			
Mr. Lungren			
Mr. Issa			
Mr. Forbes	X		
Mr. King	X		
Mr. Franks			
Mr. Gohmert			
Mr. Jordan	X		
Mr. Poe	X		
Mr. Chaffetz	X		
Mr. Rooney	X		
Mr. Harper	X		
Total	21	3	

5. An amendment by Mr. Jordan revising the legislation to apply to nontraditional and subprime mortgages, as defined in the amendment. Defeated 14 to 20.

ROLLCALL NO. 5

	Ayes	Nays	Present
Mr. Conyers, Jr., Chairman		X	
Mr. Berman		X	
Mr. Boucher			
Mr. Nadler			
Mr. Scott		X	
Mr. Watt			
Ms. Lofgren		X	
Ms. Jackson Lee		X	
Ms. Waters		X	
Mr. Delahunt		X	
Mr. Wexler		X	
Mr. Cohen		X	
Mr. Johnson		X	
Mr. Pierluisi		X	
Mr. Gutierrez		X	
Mr. Sherman		X	
Ms. Baldwin		X	
Mr. Gonzalez		X	
Mr. Weiner		X	
Mr. Schiff		X	
Ms. Sánchez		X	
Ms. Wasserman Schultz		X	
Mr. Maffei		X	
[Vacant].			
Mr. Smith, Ranking Member	X		
Mr. Goodlatte	X		
Mr. Sensenbrenner, Jr.	X		
Mr. Coble			
Mr. Gallegly	X		
Mr. Lungren	X		
Mr. Issa			
Mr. Forbes	X		
Mr. King	X		
Mr. Franks	X		
Mr. Gohmert	X		
Mr. Jordan	X		
Mr. Poe	X		

ROLLCALL NO. 5—Continued

	Ayes	Nays	Present
Mr. Chaffetz	X		
Mr. Rooney	X		
Mr. Harper	X		
Total	14	20	

6. Motion to report H.R. 200 favorably, as amended. Passed 21 to 15.

ROLLCALL NO. 6

	Ayes	Nays	Present
Mr. Conyers, Jr., Chairman	X		
Mr. Berman	X		
Mr. Boucher			
Mr. Nadler			
Mr. Scott	X		
Mr. Watt	X		
Ms. Lofgren	X		
Ms. Jackson Lee	X		
Ms. Waters	X		
Mr. Delahunt	X		
Mr. Wexler	X		
Mr. Cohen	X		
Mr. Johnson	X		
Mr. Pierluisi	X		
Mr. Gutierrez	X		
Mr. Sherman	X		
Ms. Baldwin	X		
Mr. Gonzalez	X		
Mr. Weiner	X		
Mr. Schiff	X		
Ms. Sánchez	X		
Ms. Wasserman Schultz	X		
Mr. Maffei	X		
[Vacant].			
Mr. Smith, Ranking Member		X	
Mr. Goodlatte		X	
Mr. Sensenbrenner, Jr.		X	
Mr. Coble			
Mr. Gallegly		X	
Mr. Lungren		X	
Mr. Issa		X	
Mr. Forbes		X	
Mr. King		X	
Mr. Franks		X	
Mr. Gohmert		X	
Mr. Jordan		X	
Mr. Poe		X	
Mr. Chaffetz		X	
Mr. Rooney		X	
Mr. Harper		X	
Total	21	15	

COMMITTEE OVERSIGHT FINDINGS

In compliance with clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the Committee advises that the findings and recommendations of the Committee, based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Rep-

resentatives, are incorporated in the descriptive portions of this report.

NEW BUDGET AUTHORITY AND TAX EXPENDITURES

Clause 3(c)(2) of rule XIII of the Rules of the House of Representatives is inapplicable because this legislation does not provide new budgetary authority or increased tax expenditures.

CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

In compliance with clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the Committee sets forth, with respect to the bill, H.R. 200, the following estimate and comparison prepared by the Director of the Congressional Budget Office under section 402 of the Congressional Budget Act of 1974. The Committee notes that one statement in the CBO letter might be misconstrued. Its statement that "H.R. 200 would not apply to debtors with loans guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, or the Department of Agriculture" incorrectly describes the rule of construction in section 8 of the bill. As explained in the section-by-section analysis in this report, the rule of construction merely provides that the obligations of the FHA, the VA, and USDA under their mortgage loan guarantee programs are unaffected by the bill. All types of mortgage loans that otherwise meet the terms of the bill, including those backed by the aforementioned guarantee or insurance programs, are covered by the bill. The Statement in the CBO letter should be read consistent with the Committee's intent, as reflected in the section-by-section analysis and this paragraph.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, February 23, 2009.

Hon. JOHN CONYERS, Jr., *Chairman,*
Committee on the Judiciary,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 200, the Helping Families Save Their Homes in Bankruptcy Act of 2009.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Leigh Angres.

Sincerely,

DOUGLAS W. ELMENDORF,
DIRECTOR.

Enclosure.

H.R. 200—Helping Families Save Their Homes in Bankruptcy Act of 2009.

Summary: H.R. 200 would authorize bankruptcy courts to modify the terms of some mortgages on principal residences during Chapter 13 bankruptcy proceedings. CBO estimates that enacting H.R. 200 would reduce direct spending (in the form of increased offsetting receipts) by $31 million over the 2009–2019 period and increase revenues by $23 million over the same time period, thus reducing future budget deficits over this period by a total of $54 mil-

lion. Based on information provided by the Administrative Office of the United States Courts (AOUSC), CBO estimates that any additional discretionary costs to adjudicate more bankruptcy cases would not be significant; such costs would be subject to the availability of appropriated funds. The judiciary currently spends about $900 million a year for all bankruptcy activities.

The effects on direct spending over the 2009–2013 and 2009–2018 periods are relevant for enforcing the House's pay-as-you-go rule under the current budget resolution. CBO estimates that enacting H.R. 200 would reduce direct spending by $26 million over the 2009–2013 period and by $31 million over the 2009–2018 period. Enacting H.R 200 would increase revenues by $18 million over the 2009–2013 period and $23 million over the 2009–2018 period.

H.R. 200 would impose intergovernmental and private-sector mandates, as defined in the Unfunded Mandates Reform Act (UMRA), on certain creditors, including state and local pension funds and housing agencies. Because of uncertainty about the number of bankruptcy plans that would be modified as a result of this legislation and how those changes would affect holders of secured claims, CBO cannot determine whether the aggregate cost of complying with the mandates would exceed the annual thresholds for intergovernmental or private-sector mandates ($69 million in 2009 and $139 million in 2009, respectively, adjusted annually for inflation).

Estimated cost to the Federal Government: The costs of this legislation fall within budget function 750 (administration of justice.)

	By Fiscal Year, in Millions of Dollars—												
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2009–2014	2009–2019
CHANGES IN DIRECT SPENDING													
Estimated Budget Authority	–4	–9	–6	–4	–3	–1	–1	–1	–1	–1	*	–27	–31
Estimated Outlays	–4	–9	–6	–4	–3	–1	–1	–1	–1	–1	*	–27	–31
CHANGES IN REVENUES													
Estimated Revenues	3	6	4	3	2	1	1	1	1	1	*	19	23

Note: * = less than $500,000.

Basis of estimate: For this estimate, CBO assumes that H.R. 200 will be enacted near the middle of fiscal year 2009.

H.R. 200 would allow bankruptcy courts to modify the terms of some mortgages for a primary residence during Chapter 13 bankruptcy proceedings. (This type of bankruptcy, often referred to as "reorganization," involves a repayment plan that sets forth how debts will be settled.) Under current law, Chapter 13 halts mortgage foreclosure proceedings, thus giving homeowners an opportunity to restructure their financial arrangements. Bankruptcy courts can establish a payment plan for overdue mortgage payments on primary residences but cannot change the amount, timing, or interest rate terms of mortgage payments. In 2008, about 354,000 cases were filed for Chapter 13 bankruptcy, a 14 percent increase over the number filed in 2007.

H.R. 200 would apply to Chapter 13 cases filed before, on, or after the date of enactment, but would limit which debtors would

qualify for a loan modification under the bill. First, the debtor's mortgage would have to be initiated prior to the effective date of the bill and subject to a notice of foreclosure. Second, H.R. 200 would not apply to debtors with loans guaranteed by the Federal Housing Administration, the Department of Veterans Affairs, or the Department of Agriculture.

Finally, the bill would require debtors to inquire about loan modifications with their mortgage servicer. Specifically, after the 15-day period beginning on the date of enactment, a mortgage modification may be proposed under Chapter 13 only if the debtor attempted to contact the mortgage servicer regarding a loan modification at least 15 days before filing for bankruptcy relief (this rule would not apply in cases where a foreclosure sale is scheduled to occur within 30 days of the date of the bankruptcy filing). For pending Chapter 13 cases, the debtor would have to certify that the debtor attempted to contact the mortgage holder about a loan modification. The bill would expand Chapter 13 eligibility by excluding home mortgage debt when determining if the debtor qualifies to file for Chapter 13, under certain circumstances.

The bill also would constrain the debtor's profit from a home sale in certain cases. H.R. 200 would require a debtor to share the net proceeds of a home sale with the lender, if the sale occurs within the first 4 years of the debtor completing a Chapter 13 plan. The amount the lender would receive would be 80 percent of the net profit in the first year, and then decline to 20 percent by the fourth year.

Impact on Bankruptcy Filings. Bankruptcy filings fluctuate over time and are dependent on economic trends and personal financial conditions. Between 1987 and 2008, Chapter 13 filings have ranged from a low of 140,000 in 1987 to a high of 470,000 in 2003. The primary reason that individuals file for Chapter 13 is to forestall foreclosure on their home—over 96 percent of Chapter 13 filers are homeowners and 70 percent of filers propose a plan to repay overdue mortgage payments. Because of the high number of foreclosures expected over the next several years (several million, based on information provided by the Center for Responsible Lending), CBO expects that bankruptcy filings will substantially increase in the near term—without enactment of H.R. 200. Under current law, based on information provided by the AOUSC, CBO estimates that Chapter 13 filings are likely to increase to almost 400,000 in 2009, a 13 percent increase over the number in 2008.

Economists and bankruptcy experts have found that the greater the financial benefit gained from filing for bankruptcy, the greater the likelihood a household will file. CBO expects that the financial benefit to filing under the bill would be greater than under current law. Based on an analysis of similar proposals to allow loan modification in Chapter 13, CBO estimates that over one million households would benefit financially from filing for Chapter 13 bankruptcy under the bill.

Studies analyzing household's decision to file for bankruptcy indicate that of those households that could realize a financial benefit from filing for bankruptcy, only a fraction actually make the decision to file. Of the over one million households that could benefit from filing for bankruptcy under the legislation in the next few years, we estimate that about 350,000 additional households would

file for bankruptcy over the 2009–2019 period, with about two-thirds of those filings occurring within the first 3 years after enactment.

The number of additional bankruptcy filings that would occur under the bill is, however, very uncertain. Some bankruptcy experts believe that filings would not increase substantially under H.R. 200 because the current fees and legal costs associated with filing for bankruptcy are high; the Government Accountability Office (GAO) reports that the median cost for filing Chapter 13 bankruptcy is $3,000. In the short term, new filings also might be limited by the supply of experienced bankruptcy lawyers who can handle additional filings. Further, some industry specialists maintain that the bill would encourage voluntary modification of mortgages outside of bankruptcy because many mortgage holders would prefer to work out their own arrangements rather than be subject to those imposed by a bankruptcy court. Other experts, however, contend that Chapter 13 filings would increase significantly as legal, tax, accounting, and payment concerns would deter voluntary modifications. Accordingly, debtors might view Chapter 13 modification as the best option for retaining their homes. Finally, whether significant numbers of debtors would be driven to seek bankruptcy protection by the prospect of mortgage relief might ultimately depend on how bankruptcy courts responded to the new authority that would be provided by H.R. 200.

Budgetary Impact of Additional Bankruptcy Filings. Additional filings would increase collections of bankruptcy fees. Those fees ($235 per Chapter 13 filing) are distributed among several government entities. About half of the amount collected is used to cover the judiciary's and U.S. Trustees' added costs and thus has no net effect on Federal spending. A portion of those filing fees, however, is recorded as an offsetting receipt (a credit against direct spending) in the Federal budget and deposited into a special fund in the Treasury; those amounts are not available for spending unless provided in an appropriation act. CBO estimates that enacting the legislation would increase such offsetting receipts by $31 million over the 2009–2019 period.

Revenues. Another portion of Chapter 13 filing fees is deposited into the general fund of the Treasury and recorded as increased revenues. CBO estimates that enacting H.R. 200 would increase such revenues from additional Chapter 13 filing fees by $23 million over the 2009–2019 period.

Potential Budgetary Impact on the Government-Sponsored Enterprises for Housing. Enacting H.R. 200 could affect the value of the financial instruments (mortgages and mortgage-backed securities) held or guaranteed by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)). These government-sponsored enterprises (GSEs) were placed in conservatorship in 2008 and are under the direct control of the Federal Government. CBO considers the GSEs' operations to be part of the Federal budget. Enacting H.R. 200 could change the value of those financial instruments and thus affect the Federal budget. It is unclear, however, whether enactment of the legislation would increase or decrease future costs for the GSEs.

Losses resulting from mortgages held by the GSEs are shouldered by those entities. Modifying loans in bankruptcy might be

more or less costly compared to foreclosure and would depend on future house prices, the length of time needed to sell foreclosed properties, the terms of potential mortgage modifications, the likelihood of re-default for modified loans, and the amount mortgage payments might be reduced in the bankruptcy process. Similar uncertainty exists for the impact of H.R. 200 on the value of mortgage-backed securities guaranteed and held by the GSEs.

Intergovernmental and private-sector impact: H.R. 200 would impose intergovernmental and private-sector mandates, as defined in UMRA, on certain creditors, including state and local pension funds and housing agencies. The bill would allow bankruptcy judges to modify the rights of holders of certain claims on mortgage debt by making changes to the terms of home mortgage agreements during bankruptcy proceedings. Under current law, bankruptcy judges are prohibited from changing the terms of loans for primary residences. The bill also would require such claimholders to file timely notice with the court before adding fees, costs, or charges while a bankruptcy case is pending.

The costs of those mandates would depend on the number of mortgage agreements that judges would choose to modify and how those changes would affect the value of secured claims. The amount recovered by a claimholder through a bankruptcy proceeding relative to the amount that could be recovered through foreclosure would vary depending on market conditions. In some cases, claimholders might not incur any additional costs. Because of those uncertainties, CBO cannot determine whether the aggregate cost of complying with the mandates in the bill would exceed the annual thresholds for intergovernmental or private-sector mandates ($69 million in 2009 and $139 million in 2009, respectively, adjusted annually for inflation).

Estimate prepared by: Federal Costs: Leigh Angres; Impact on state, local, and tribal governments: Melissa Merrell; Impact on the private sector: Paige Piper/Bach.

Estimate approved by: Theresa Gullo, Deputy Assistant Director for Budget Analysis.

PERFORMANCE GOALS AND OBJECTIVES

The Committee states that pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, H.R. 200 will authorize judicial modification of a mortgage secured only by a homeowner's principle residence in a chapter 13 bankruptcy case, under certain circumstances, so that such mortgage will be more affordable for an eligible homeowner.

CONSTITUTIONAL AUTHORITY STATEMENT

Pursuant to clause 3(d)(1) of rule XIII of the Rules of the House of Representatives, the Committee finds the authority for this legislation in article I, section 8, clause 4 of the Constitution.

ADVISORY ON EARMARKS

In accordance with clause 9 of rule XXI of the Rules of the House of Representatives, H.R. 200 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9(d), 9(e), or 9(f) of Rule XXI.

SECTION-BY-SECTION ANALYSIS

The following discussion describes the bill as reported by the Committee.

Sec. 1. Short Title. Section 1 sets forth the short title of the bill as the "Helping Families Save Their Homes in Bankruptcy Act of 2009."

Sec. 2. Eligibility for Relief. Bankruptcy Code section 109(e) sets forth secured and unsecured debt limits to establish a debtor's eligibility for relief under chapter 13. Section 2 of the bill amends section 109(e) to provide that the computation of debts does not include the secured or unsecured portions of debts secured by the debtor's principal residence, under two alternative circumstances. The first is if the current value of the debtor's principal residence is less than the secured debt limit specified in section 109(e). The second is if the debtor's principal residence was sold in foreclosure or the debtor surrendered it and its current value is less than the secured debt limit specified in section 109(e).

In addition, section 2 of the bill amends Bankruptcy Code section 109(h) to waive the mandatory requirement that a debtor have received credit counseling prior to filing for bankruptcy relief, under certain circumstances. The waiver applies in a chapter 13 case where the debtor certifies to the court as to having received notice that the holder of a claim secured by the debtor's principal residence may commence (or has commenced) a foreclosure proceeding against such residence.

Sec. 3. Prohibiting Claims Arising from Violations of the Truth in Lending Act. Under the Truth in Lending Act, a mortgage borrower has a right of rescission with respect to a mortgage secured by his or her residence, under certain circumstances.[148] Bankruptcy Code section 502(b) enumerates various claims of creditors that are not entitled to payment in a bankruptcy case, subject to certain exceptions. Section 3 of the bill amends Bankruptcy Code section 502(b) to provide that a claim secured by an interest in the debtor's principal residence is not entitled to payment in a bankruptcy case to the extent that such claim is subject to a remedy for rescission under the Truth in Lending Act, notwithstanding the prior entry of a foreclosure judgment. In addition, section 3 of the bill specifies that it shall not be construed to modify, impair, or supersede any other right of the debtor.

Sec. 4. Authority to Modify Certain Mortgages. Under Bankruptcy Code section 1322(b)(2), a chapter 13 plan may not modify the terms of a mortgage secured solely by real property that is the debtor's principal residence. Section 4 amends Bankruptcy Code section 1322(b) to create a limited exception to this prohibition. The exception only applies to a mortgage that: (1) originated before the effective date of this Act; and (2) is the subject of a notice that a foreclosure may be (or has been) commenced with respect to such mortgage.

In addition, the debtor must certify pursuant to new section 1322(h) that he or she attempted—not less than 15 days before filing for bankruptcy relief—to contact the mortgage lender (or the entity collecting payments on the lender's behalf) regarding modification of the mortgage. This requirement does not apply if the

[148] 15 U.S.C. § 1635 (2008).

foreclosure sale is scheduled to occur within 30 days of the date on which the debtor files for bankruptcy relief. If the chapter 13 case is pending at the time the new section 1322(h) becomes effective, then the debtor must certify that he or she attempted to contact the mortgage lender or entity collecting payments on its behalf regarding modification of the mortgage before either: (1) filing a plan under Bankruptcy Code section 1321 that contains a modification pursuant to new section 1322(b)(11); or (2) modifying a plan under Bankruptcy Code section 1323 or section 1329 to contain a modification pursuant to new section 1322(b)(11).

Under new section 1322(b)(11), the debtor may propose a plan modifying the rights of the mortgage lender (and the rights of the holder of any claim secured by a subordinate security interest in the residence) in several respects. It is important to note that the intent of new section 1322(b)(11) is permissive. Accordingly, a chapter 13 debtor may propose a plan that includes any or all types of modification authorized under section 1322(b)(11).

First, the plan may provide for payment of the amount of the allowed secured claim as determined under Bankruptcy Code section 506(a)(1). Second, the plan may prohibit, reduce, or delay any adjustable interest rate applicable on and after the date of the filing of the plan. Third, it may extend the repayment period of the mortgage for up to 40 years (reduced by the period for which the mortgage has been outstanding), or the remaining term of the mortgage beginning on the date of the order for relief under chapter 13, whichever is longer.

Fourth, the plan may provide for the payment of interest at a fixed annual rate equal to the currently applicable average prime offer rate as of the date of the order for relief under chapter 13, as determined pursuant to specified criteria. The rate must correspond to the repayment term determined under new section 1322(b)(11)(C)(I) as published by the Federal Financial Institutions Examination Council in its table entitled, "Average Prime Offer Rates—Fixed." In addition, the rate must include a reasonable premium for risk.

Fifth, the plan may provide for payments of such modified mortgage directly to the mortgage lender. The reference in new section 1322(b)(11)(D) to "holder of the claim" is intended to include a servicer of such mortgage for such holder.

New section 1322(g) provides that a mortgage may be reduced under new section 1322(b)(11)(A) only on the condition that if the debtor sells the principal residence securing the claim before the debtor receives a discharge under chapter 13, the debtor agrees to pay from the net proceeds of such sale a portion of those proceeds to the mortgage lender. If the residence is sold in the first year following the effective date of the chapter 13 plan, the lender is to receive 80 percent of the amount of the difference between the sales price and the amount of the lender's claim (plus costs of sale and improvements); this amount cannot exceed, however, the amount of the allowed secured claim determined as if it had not been reduced under the new section 1322(b)(11)(A). If the residence is sold in the second year following the effective date of the chapter 13 plan, then the applicable percentage is 60 percent. If the residence is sold in the third year following the effective date of the chapter 13 plan, then the applicable percentage is 40 percent. And if the residence

is sold in the fourth year following the effective date of the chapter 13 plan, then the applicable percentage is 20 percent. It is the intent of the Committee that if the unsecured portion of the mortgagee's claim is partially paid under this provision, it should be reconsidered under Bankruptcy Code section 502(j) and reduced accordingly.

Sec. 5. Combating Excessive Fees. Section 5 of the bill amends Bankruptcy Code section 1322(c) to provide that the debtor, the debtor's property, and property of the bankruptcy estate are not liable for any fee, cost, or charge incurred while the chapter 13 case is pending and that arises from a claim for debt secured by the debtor's principal residence, unless the holder of the claim complies with certain requirements. It is the Committee's intent that the reference in this provision to a fee, cost, or charge include an increase in any applicable rate of interest for such claim, as well as to a change in escrow account payments.

The requirements with which the holder of the claim must comply are the following: First, the claimant must file with the court an annual notice of the fee, cost, or charge (or on a more frequent basis as the court determines), within 1 year after the fee, cost, or charge was incurred or 60 days before the case is closed, whichever is earlier. Failure to give the required notice is deemed to be a waiver by the holder of any claim for the fees, costs, or charges, for all purposes. Then any attempt to collect them constitutes a violation of the Bankruptcy Code's discharge injunction under section 524(a)(2) and the automatic stay under section 362(a), whichever is applicable.

Second, the fee, cost, or charge must be lawful under applicable nonbankruptcy law, reasonable, and provided for in the applicable security agreement. Third, the value of the debtor's principal residence must be greater than the amount of the claim, including the fee, cost, or charge.

Section 5 of the bill further provides that a chapter 13 plan may waive any prepayment penalty on a claim secured by the debtor's principal residence.

Sec. 6. Confirmation of Plan. Bankruptcy Code section 1325(a) sets forth the mandatory criteria for confirmation of a chapter 13 plan. Section 6 of the bill amends section 1325(a) to provide certain protections for a creditor whose rights are modified under new section 1322(b)(11).

Section 6 imposes three new conditions for confirmation where the plan modifies a claim under new section 1322(b)(11). First, the plan must require that the creditor retain its lien until the later of when the claim (as modified) is paid or the debtor obtains a discharge. Second, the court must find that the modification under section 1322(b)(11) is in good faith. Third, the court must find that the debtor did not obtain the extension, renewal, or refinancing of credit that gives rise to a modified claim by the debtor's material misrepresentation, false pretenses, or actual fraud.

Sec. 7. Discharge. Bankruptcy Code section 1328 sets forth the requirements by which a chapter 13 debtor may obtain a discharge, and the scope of such discharge. Section 7 of the bill amends section 1328(a) to clarify that the unpaid portion of an allowed secured claim modified under new section 1322(b)(11) is not discharged.

Sec. 8. Rule of Construction. Section 8 provides that nothing in the Act or the amendments made by it may be construed to modify any obligation of the Federal Housing Administration, the Veterans Administration, or the Department of Agriculture under a contract that guarantees or insures the payment of any part of a loan secured by an interest in a principal residence.

Sec. 9. Effective Date; Application of Amendments. Section 9(a) provides that the Act and the amendments made by it, except as provided in subsection (b), take effect on the Act's date of enactment. Section 9(b) provides that the amendments made by the Act apply only to cases commenced under title 11 of the United States Code before, on, or after the Act's date of enactment.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italics, existing law in which no change is proposed is shown in roman):

TITLE 11, UNITED STATES CODE

* * * * * * *

CHAPTER 1—GENERAL PROVISIONS

* * * * * * *

§ 109. Who may be a debtor

(a) * * *

* * * * * * *

(e) Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000, or an individual with regular income and such individual's spouse, except a stockbroker or a commodity broker, that owe, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts that aggregate less than $250,000 and noncontingent, liquidated, secured debts of less than $750,000 may be a debtor under chapter 13 of this title. *For purposes of this subsection, the computation of debts shall not include the secured or unsecured portions of—*

(1) debts secured by the debtor's principal residence if the current value of such residence is less than the secured debt limit; or

(2) debts secured or formerly secured by real property that was the debtor's principal residence that was sold in foreclosure or that the debtor surrendered to the creditor if the current value of such real property is less than the secured debt limit.

* * * * * * *

(h)(1) * * *

* * * * * * *

(5) The requirements of paragraph (1) shall not apply in a case under chapter 13 with respect to a debtor who submits to the court a certification that the debtor has received notice that the holder of a claim secured by the debtor's principal residence may commence a foreclosure on the debtor's principal residence.

* * * * * * *

CHAPTER 5—CREDITORS, THE DEBTOR, AND THE ESTATE

* * * * * * *

SUBCHAPTER I—CREDITORS AND CLAIMS

* * * * * * *

§ 502. Allowance of claims or interests

(a) * * *

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that—

(1) * * *

* * * * * * *

(8) such claim results from a reduction, due to late payment, in the amount of an otherwise applicable credit available to the debtor in connection with an employment tax on wages, salaries, or commissions earned from the debtor; **[**or**]**

(9) proof of such claim is not timely filed, except to the extent tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a) of this title or under the Federal Rules of Bankruptcy Procedure, except that a claim of a governmental unit shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide, and except that in a case under chapter 13, a claim of a governmental unit for a tax with respect to a return filed under section 1308 shall be timely if the claim is filed on or before the date that is 60 days after the date on which such return was filed as required**[**.**]***; or*

(10) the claim for a loan secured by a security interest in the debtor's principal residence is subject to a remedy for rescission under the Truth in Lending Act notwithstanding the prior entry of a foreclosure judgment, except that nothing in this paragraph shall be construed to modify, impair, or supersede any other right of the debtor.

* * * * * * *

CHAPTER 13—ADJUSTMENT OF DEBTS OF AN INDIVIDUAL WITH REGULAR INCOME

* * * * * * *

SUBCHAPTER II—THE PLAN

* * * * * * *

§ 1322. Contents of plan

(a) * * *

(b) Subject to subsections (a) and (c) of this section, the plan may—

(1) * * *

* * * * * * *

(10) provide for the payment of interest accruing after the date of the filing of the petition on unsecured claims that are nondischargeable under section 1328(a), except that such interest may be paid only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims; **[**and**]**

(11) notwithstanding paragraph (2) and otherwise applicable nonbankruptcy law, with respect to a claim for a loan originated before the effective date of this paragraph and secured by a security interest in the debtor's principal residence that is the subject of a notice that a foreclosure may be commenced with respect to such loan, modify the rights of the holder of such claim (and the rights of the holder of any claim secured by a subordinate security interest in such residence)—

(A) by providing for payment of the amount of the allowed secured claim as determined under section 506(a)(1);

(B) if any applicable rate of interest is adjustable under the terms of such security interest by prohibiting, reducing, or delaying adjustments to such rate of interest applicable on and after the date of filing of the plan;

(C) by modifying the terms and conditions of such loan—

(i) to extend the repayment period for a period that is no longer than the longer of 40 years (reduced by the period for which such loan has been outstanding) or the remaining term of such loan, beginning on the date of the order for relief under this chapter; and

(ii) to provide for the payment of interest accruing after the date of the order for relief under this chapter at a fixed annual rate equal to the currently applicable average prime offer rate as of the date of the order for relief under this chapter, corresponding to the repayment term determined under the preceding paragraph, as published by the Federal Financial Institutions Examination Council in its table entitled "Average Prime Offer Rates—Fixed", plus a reasonable premium for risk; and

(D) by providing for payments of such modified loan directly to the holder of the claim; and

[(11)**]** *(12)* include any other appropriate provision not inconsistent with this title.

(c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—

(1) a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph

(3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law; **[**and**]**

(2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title**[**.**]***;*

(3) the debtor, the debtor's property, and property of the estate are not liable for a fee, cost, or charge that is incurred while the case is pending and arises from a debt that is secured by the debtor's principal residence except to the extent that—

(A) the holder of the claim for such debt files with the court (annually or, in order to permit filing consistent with clause (ii), at such more frequent periodicity as the court determines necessary) notice of such fee, cost, or charge before the earlier of—

(i) 1 year after such fee, cost, or charge is incurred; or

(ii) 60 days before the closing of the case; and

(B) such fee, cost, or charge—

(i) is lawful under applicable nonbankruptcy law, reasonable, and provided for in the applicable security agreement; and

(ii) is secured by property the value of which is greater than the amount of such claim, including such fee, cost, or charge;

(4) the failure of a party to give notice described in paragraph (3) shall be deemed a waiver of any claim for fees, costs, or charges described in paragraph (3) for all purposes, and any attempt to collect such fees, costs, or charges shall constitute a violation of section 524(a)(2) or, if the violation occurs before the date of discharge, of section 362(a); and

(5) a plan may provide for the waiver of any prepayment penalty on a claim secured by the debtor's principal residence.

* * * * * * *

(g) A claim may be reduced under subsection (b)(11)(A) only on the condition that if the debtor sells the principal residence securing such claim, before receiving a discharge under this chapter and receives net proceeds from the sale of such residence, then the debtor agrees to pay to such holder—

(1) if such residence is sold in the 1st year occurring after the effective date of the plan, 80 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection;

(2) if such residence is sold in the 2d year occurring after the effective date of the plan, 60 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection;

(3) if such residence is sold in the 3d year occurring after the effective date of the plan, 40 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection; and

(4) if such residence is sold in the 4th year occurring after the effective date of the plan, 20 percent of the amount of the difference between the sales price and the amount of such claim (plus costs of sale and improvements), but not to exceed the amount of the allowed secured claim determined as if such claim had not been reduced under such subsection.

(h) With respect to a claim of the kind described in subsection (b)(11), the plan may not contain a modification under the authority of subsection (b)(11)—

(1) in a case commenced under this chapter after the expiration of the 15-day period beginning on the effective date of this subsection, unless—

(A) the debtor certifies that the debtor attempted, not less than 15 days before the commencement of the case, to contact the holder of such claim (or the entity collecting payments on behalf of such holder) regarding modification of the loan that is the subject of such claim; or

(B) a foreclosure sale is scheduled to occur on a date in the 30-day period beginning on the date the case is commenced; and

(2) in any other case pending under this chapter, unless the debtor certifies that the debtor attempted to contact the holder of such claim (or the entity collecting payments on behalf of such holder) regarding modification of the loan that is the subject of such claim, before—

(A) filing a plan under section 1321 that contains a modification under the authority of subsection (b)(11); or

(B) modifying a plan under section 1323 or 1329 to contain a modification under the authority of subsection (b)(11).

* * * * * * *

§ 1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(1) * * *

* * * * * * *

(8) the debtor has paid all amounts that are required to be paid under a domestic support obligation and that first become payable after the date of the filing of the petition if the debtor is required by a judicial or administrative order, or by statute, to pay such domestic support obligation; **[**and**]**

(9) the debtor has filed all applicable Federal, State, and local tax returns as required by section 1308**[**.**]***;*

(10) notwithstanding subclause (I) of paragraph (5)(B)(i), whenever the plan modifies a claim in accordance with section 1322(b)(11), the plan provides that the holder of such claim retain the lien until the later of—

(A) the payment of such holder's allowed secured claim; or

(B) discharge under section 1328; and

(11) whenever the plan modifies a claim in accordance with section 1322(b)(11), the court finds that such modification is in good faith and that the debtor did not obtain the extension, renewal, or refinancing of credit that gives rise to a modified claim by the debtor's material misrepresentation, false pretenses, or actual fraud.

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§ 1328. Discharge

(a) Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan, and in the case of a debtor who is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, after such debtor certifies that all amounts payable under such order or such statute that are due on or before the date of the certification (including amounts due before the petition was filed, but only to the extent provided for by the plan) have been paid *(other than payments to holders of claims whose rights are modified under section 1322(b)(11))*, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1322(b)(5) *or, to the extent of the unpaid portion of an allowed secured claim, provided for in section 1322(b)(11)*;

* * * * * * *

(c) A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1322(b)(5) *or, to the extent of the unpaid portion of an allowed secured claim, provided for in section 1322(b)(11)* of this title; or

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MINORITY VIEWS

INTRODUCTION

The ongoing crisis in the U.S. home mortgage market has roiled, not just the U.S. housing market, but the very frameworks of our national and international financial systems. Several solutions have been suggested to address the crisis. To date, these measures have not remedied enough troubled loans to restore order to the market. It is urgent that we find more effective solutions, and that we apply them promptly.

H.R. 200, however, is not one of the solutions that will solve the problem. H.R. 200 seeks to address the crisis by *suspending* the laws of economics—rather than by faithfully observing them, applying them, and thereby curing our ill economy. The bill fails to solve the problems in a host of ways. Rather than reduce risk to stimulate credit, it increases the risks associated with existing principal residence mortgages, exposing them for the first time to modification in bankruptcy. Once this dangerous precedent is set, it will be easier for Congress to allow for bankruptcy modification of principal residence mortgages in the future. What is more, lenders will be forced to increase the interest rates they charge in order to account for the potential risk that borrowers file for bankruptcy and loans are modified by the courts. With increased borrowing costs to account for risk, future housing affordability will be reduced, which could make homeownership more difficult in the future and push home prices even lower.

Making matters still worse, H.R. 200 seeks to stem the current wave of foreclosures, not by targeting the subprime and nontraditional loans driving the crisis, but by indiscriminately sweeping all types of mortgages into bankruptcy. This blunderbuss-approach inevitably will dilute the bill's effectiveness and inject moral hazard into consumer decisions regarding whether to seek voluntary loan modifications, enter bankruptcy, or attempt through other means to resolve their financial distress. What will be the result? Almost certainly, it will be an avalanche of unnecessary bankruptcy filings that will overwhelm the bankruptcy courts and needlessly drag millions upon millions of dollars in petitioners' *non-mortgage* debt into bankruptcy. And because bankruptcy will permanently damage the petitioner's credit for years to come, allowing bankruptcy filings in these cases may do more serious long-term injury to the finances of the borrowers who seek to take advantage of this provision than other potential solutions.

More ominous still, the bill threatens to prompt a new wave of capital-reserve hoarding by banks. As bankruptcy courts modify mortgages, banks will have to increase their capital reserves to account for the impact mortgage write-downs in bankruptcy have on the market values of mortgage-backed securities. Increased capital

reserves means decreased lending of all types. Thus, the bill threatens, not to solve the crisis, but merely to trigger a repeat of the near financial meltdown the country experienced in the fall of 2008—a financial earthquake that precipitated the expenditure of hundreds of billions of taxpayer dollars. We must not tempt a repeat of that experience.

These are but a few of the most prominent ways in which H.R. 200, by ignoring economic realities, will only make the mortgage crisis and the broader economic crisis facing the country deeper, wider and longer. In committee, Republicans promoted alternative measures that could have helped to stem foreclosures and close the gap in voluntary mortgage workouts in harmony with fundamental economic principles. At mark-up, Republicans offered amendments that would at least have substantially narrowed the focus of this bill, so that it would have made bankruptcy modification available only on the loans that provoked the crisis, and only in ways that would have minimized collateral damage to the economy. All of these proposals were rejected by the majority. Committee Republicans therefore cannot support this legislation.

EXPERT OPINIONS ON PRIMARY RESIDENCE MORTGAGES IN BANKRUPTCY

- **Department of Housing and Urban Development:** "The Department is concerned about the effects of legislative proposals, such as S.61 and H.R. 200, that would remove the special status for principal residences. . . . Having the option of cramdown would increase the attractiveness of Chapter 13 filings versus working directly with lenders to find an appropriate loss mitigation workout plan. . . . It is the Department's conclusion that S. 61 and H.R. 200 create a fundamental change in the quality and value of residential real estate as collateral for a mortgage loan. It is this uncertainty that will lead to higher mortgage costs for most borrowers."
- **Professor Christopher Mayer, Columbia Business School:** "But proposals to change the Bankruptcy Code are deeply problematic. . . . These proposals would raise future borrowing costs and could encourage solvent borrowers to miss payments (a form of moral hazard). The financial crisis would be much worse if fifty-two million borrowers, who are now current, attempt to invalidate their mortgages. Equally important, proposals to change the Code could dramatically increase bankruptcy-filing rates. . . . Thus, proposed reforms could push millions of borrowers into bankruptcy, delaying the resolution of the current crisis for years. Finally, bankruptcy reform is a blunt tool: it applies a one-size-fits-all approach to loan modification, and it would impact all mortgages, including the majority of outstanding loans now owned by Fannie Mae and Freddie Mac."
- **Professor Todd Zywicki, George Mason University School of Law:** "Amending the Bankruptcy Code to permit modification of home mortgages must appear especially tempting as a political matter because it doesn't appear to require further expenditure of public funds, thus it appears to be 'free' to Washington. Allowing mortgage modification will provide a windfall for some trou-

bled homeowners, but its costs will be borne by aspiring future homeowners and any American who uses credit of any kind, from car loans to credit cards. The ripple effects could deepen the troubles the currently roiling America's consumer credit markets. Finally, because of the federal takeover of Fannie Mae and Freddie Mac, the losses incurred in bankruptcy may eventually come back to the taxpayers anyway."

- **Professor Mark Scarberry, Pepperdine University School of Law:** "Changing the risk characteristics of home mortgages retroactively in this way not only would likely depress further the value of the existing home mortgages. Increased risk would mean increased interest rates to compensate for the risk, and denial of mortgage credit to some who presently would qualify under appropriate underwriting standards. There also would be a shadow cast on the trustworthiness of American mortgage-backed securities. The implications are disturbing given that such securities are held worldwide by investors who count on the protection of property and contract rights under American law."
- **Barclays Capital:** "Losses from bankruptcy cramdowns could be significantly larger than servicer-driven modifications. Moral hazard and the potential for high plan failure rates could further increase losses and charge-offs without stemming foreclosures or accelerating a housing recovery. Bankruptcy filings could double or more, increasing credit card charge-offs by 2-4pp. We fear a massive sell-off that would worsen valuations, threatening further balance sheet write-downs."
- **Julian Mann, First Pacific Advisors:** "A proposed change to bankruptcy law to allow judges to reduce homeowners' mortgages may boost the capital needs of banks and insurers by hundreds of billions of dollars. . . . The loss of mortgage-bond payments because of bankruptcy changes would require financial institutions to mark down more securities to market values. . . . [T]he proposed changes would raise the cost of loans and cause foreign investors to flee American debt creating doubt about U.S. contracts. . . . [M]any borrowers will end up defaulting on debt reworked by bankruptcy judges."
- **UBS Investment Research:** "[T]he proposal to allow primary residence cramdowns, if passed in its current form, would likely have dire consequences—resulting in a sizable wave of new bankruptcy filings. . . . The compilation of [impacts of the legislation] is likely to put further strain on the financial system, increase losses, decrease the availability of credit and increase risk premiums for mortgages and consumer debt."
- **Justice Stevens, *Nobelman v. American Savings Bank*:** "At first blush it seems somewhat strange that the Bankruptcy Code should provide less protection to an individual's interest in retaining possession of his or her home than of other assets. The anomaly is, however, explained by the legislative history indicating that favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market."

BACKGROUND

A. Primary Residence Exception

Section 1322(b)(2) of the Bankruptcy Code provides that a Chapter 13 bankruptcy plan may: "modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence.*" [1] This important exception means that home mortgages may not be modified in bankruptcy and that the original contract between the borrower and the lender must be maintained.

While this limitation may seem to be an unwarranted anomaly, Justice Stevens explained the importance of the exception in *Nobelman v. American Savings Bank*: [2]

> At first blush it seems somewhat strange that the Bankruptcy Code should provide less protection to an individual's interest in retaining possession of his or her home than of other assets. The anomaly is, however, explained by the legislative history indicating that favorable treatment of residential mortgagees *was intended to encourage the flow of capital into the home lending market.*[3]

The legislative history of the primary residence exception buttresses Justice Stevens' explanation in *Nobelman*. Under Chapter XIII of the Bankruptcy Act of 1898, the statutory predecessor of the current Chapter 13, an individual wage earner's reorganization plan could not "deal with" (i.e. modify or otherwise affect) the rights of a creditor holding a claim secured by real property.[4] In 1978, when Congress set about updating the Bankruptcy Act of 1898, it had the opportunity to eliminate that exception, but specifically chose not to do so.[5]

As originally proposed, the House version of section 1322 of the Bankruptcy Code entirely eliminated this rule. The Senate version, on the other hand, preserved the real estate protection afforded under the 1898 Act. Edward J. Kulick, who testified before the Senate Judiciary Committee's Subcommittee on Improvements in the Judicial Machinery, pointed out that reducing a mortgagee's secured claim to the actual present value of the real property would have a dramatically negative impact on the mortgage industry.[6] In discussing the residential mortgage market, he testified that the proposed House version of section 1322 (which would have allowed cram-down) would have a decidedly negative impact on the availability of home mortgage funds, especially when the financial resources of an individual home buyer were not particularly strong. He proposed the carved out anti-modification language that is presently in section 1322 of the Code.

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[1] 11 U.S.C. § 1322(b) (emphasis added); *accord* 11 U.S.C. § 1123(b)(5) (for Chapter 11 bankruptcies).

[2] *Nobelman v. American Savings Bank,* 508 U.S. 324 (1993).

[3] *Id.* at 332 (Stevens, J. concurring).

[4] Bankruptcy Act of 1898, Pub. Law No. 61, 30 Stat. 544-66 (repealed 1978), § 606(1)).

[5] *Grubbs v. Houston First American Savings Association,* 730 F.2d 236 (5th Cir. 1984), and *Matter of Clark,* 738 F.2d 869 (7th Cir. 1984), contain summaries of the legislative history of section 1322 of the Bankruptcy Code.

[6] *Bankruptcy Reform Act of 1978: Hearings Before the Subcommittee on Improvements to the Judicial Machinery, S. Comm. on the Judiciary,* 95th Cong. 702–14 (1977) (testimony of Edward J. Kulick).

Thus, the anti-modification (anti-cramdown) protection that is afforded to home mortgage lenders under section 1322 and *Nobelman* has its roots in the Bankruptcy Act of 1898. In 1978, a compromise was reached when the mortgage industry agreed to permit limited modification of the rights of home mortgage lenders under section 1325 of the Code. This compromise was reached because the home mortgage industry, which performed a valuable public service through the making of loans, needed special protection against modification.[7] The intent of section 1322(b)(2) of the Code was to preserve the availability of residential mortgage funding for individuals of modest means.

The protections afforded home mortgage lenders in Chapter 13 were, in 1994, extended to Chapter 11 cases as well. In 1994, 11 U.S.C. § 1123(b)(5) was amended so that it too states that secured claims can be modified "other than a claim secured only by a security interest in real property that is the debtor's principal residence."

B. Foreclosure Crisis

The problem now challenging financial markets and the economy stems from historically low interest rates that encouraged millions of Americans to refinance their fixed rate mortgages or to purchase new homes. The lower interest rates meant that buyers could afford larger mortgages. Effectively, a bidding war broke out that raised the price of homes; higher prices limited the number of potential buyers. In response, the mortgage industry developed new products that allowed otherwise unqualified individuals (by income, assets, and/or credit history) to receive loans to buy or refinance a house. These same products also allowed creditworthy households to buy more expensive houses or to refinance their current houses to obtain cash for other uses.

Many borrowers took out riskier mortgage instruments, referred to as "subprime" loans. In recent years, subprime loans have come to account for an ever larger share of the mortgage finance market. By 2005, they accounted for about 20 percent of all outstanding mortgages, up from just 5 percent in 1994. Among the several distinct types of subprime loans on the market, the one causing considerable concern is the subprime hybrid called "2/28" or "3/27," which allows borrowers a low monthly payment during the first two to three years, but then resets to a higher interest rate and payment for the remaining 28 or 27 years, respectively. As these interest rates reset, many borrowers have been unable to meet the higher payment. As a result, defaults and foreclosures are rising.

The foreclosure crisis is the result of borrowers, lenders, brokers and investors all getting caught up in the "irrational exuberance" of the rising market:

- Brokers eager to earn fees sought out previously underserved, less-qualified borrowers.
- Lenders competing for business relaxed underwriting standards, and shifted credit risk to Wall Street by selling pools of loans to issuers of mortgage-backed securities.

[7] *Grubbs,* 730 F.2d at 246.

- Borrowers exploited lax underwriting standards: many overstated their incomes, borrowing more than they could reasonably expect to repay and purchasing more expensive homes than they could truly afford. Many borrowers put down very small downpayments on the assumption that rising prices would build equity in their homes. Some even gambled on being able to buy and "flip" an investment property before introductory rates ended.
- Wall Street eagerly securitized millions of loans, unconcerned about loan quality as long as there were buyers for the securities, which increased the capital available to lenders to keep the cycle going.

Also contributing to the creation of the crisis and the encouragement of lax underwriting standards was the purchasing and insuring of non-traditional and subprime loans by Freddie Mac and Fannie Mae ("GSEs"). For example, in 1992, when Congress imposed an affordable housing mission on the GSEs, the Department of Housing and Urban Development issued regulations that required them to make affordable housing more plentiful. In order to meet HUD's requirements and to keep their support in Congress, the GSEs began purchasing and insuring more and more subprime and non-traditional loans. This ready-market for mortgages at the GSEs spurred on the easy lending and lax underwriting that led to the housing bubble.

When this housing bubble burst, the result was and has continued to be a foreclosure crisis. Currently, approximately four million homeowners are delinquent on their mortgages and another twelve to fifteen million are underwater on their loans, owing more on their mortgage than their house is worth. According to Case and Shiller/S&P, housing prices dropped about 18 percent last year. Declining housing prices and lax underwriting standards when loans were written led to 2.25 million foreclosures being started last year according to the Federal Reserve and projections for another 1.7 million foreclosure starts this year.

DISCUSSION

A. Proponents' Rationale

Those lawmakers and advocacy groups pushing for reforms to the Bankruptcy Code are doing so because they believe that other options will not be an adequate avenue to keeping borrowers in their homes. In general, a borrower in default on his loan may:

- repay the loan, curing the default;
- refinance the loan to a loan with a lower interest rate and thus a lower monthly payment;
- try to work with the lender to restructure the mortgage to bring his monthly obligations in line with his ability to pay;
- if the home's market value is greater than the loan balance, the borrower is likely to sell it himself; or
- if the loan balance is greater than the home's value, let the lender pursue foreclosure.

The two best two options, refinancing and loan modification, are, according to advocacy groups, often not available to subprime borrowers facing default. Refinancing at a lower interest rate is often not available because the borrower either cannot qualify or because the value of the house has dropped so that the house is currently mortgaged for more than its worth. Loan modification or loan workout is often not an option because: the borrower is unable to determine who the actual holder of the mortgage note is; mortgage servicers who are not the mortgage holders are scared that modifying a mortgage may make them legally liable to the mortgage holder; servicers are overwhelmed with requests for modification; or the borrower does not qualify for modification under the lender's policies.

Advocacy groups also assert that no one wins in a foreclosure and thus bankruptcy reform is the best option for everyone. They argue that a foreclosure can cost a lender from 20 to 40 percent of the loan balance, and that lenders should prefer to have a performing loan (albeit adjusted through bankruptcy) than have a vacant property in a slow market. Overall, advocacy groups' basic claim is that the proposed bankruptcy reform would be better than foreclosure in terms of cost to lenders, but at least with bankruptcy reform borrowers would get to stay in their homes. Moreover, supporters assert that houses around a home that is foreclosed lose value; thus avoiding foreclosure is a benefit to surrounding homes.

B. Consequences of Enacting H.R. 200

Proponents of H.R. 200 have sold the bill as the "costless" solution to the foreclosure crisis because it does not require any upfront government spending. In this regard, H.R. 200 appears to be particularly appealing legislation. However, this bill is far from costless. On the contrary, H.R. 200 is deeply flawed and will create costs for taxpayers and future borrowers. Moreover, it will send ripple effects through the credit markets, the housing market, and the bankruptcy system.

1. Cost to future borrowers

Some of the largest costs this bill will impose will be borne by future homeowners and current homeowners who seek to refinance in the future. Allowing home mortgages to be re-written in bankruptcy will significantly increase the risks associated with mortgage lending thus increasing the costs of lending. Those costs will be passed on to the borrower. In fact, the lending industry contends that this legislation would raise interest rates by as much as two full percentage points on a primary residence mortgage. Moreover, lenders would be forced to require higher down-payments or mortgage insurance for all primary residence mortgages—requirements that would most affect low- and middle-income families. As a result, instead of actually helping families affected by the subprime crisis, this legislation threatens to do no more than swap the victims.

Indeed, at today's interest rates, a prime borrower with a 30-year fixed rate loan of $300,000 at 6% interest would pay $1,799 per month in principal and interest. If mortgage bankruptcy legislation is enacted, the Mortgage Bankers Association estimates that hold-

ing the economy, interest rates, borrower's credit, etc. constant, the rate for the same loan could go up to as much as 8%, leading to a monthly payment of $2,201, an annual increase of $4,824 and more than $144,000 over the life of the loan.

One does not have to take the Mortgage Bankers Association's word on the effects of the bill. In testimony before this Committee, Christopher Mayer, Senior Vice Dean and Paul Milstein Professor of Real Estate at Columbia Business School, confirmed that costs will increase if this legislation is enacted. According to Professor Mayer, "empirical evidence suggests that if mortgages are subject to strip-down in bankruptcy, the cost of future credit will rise as lenders incorporate this new risk into their lending decisions."[8] Additionally, Professor Mayer testified that "[b]ankruptcy reform would increase borrowing costs further, resulting in even less borrowing and likely further reduce demand for housing."[9]

Proponents of the bill have argued that because the manager's amendment limits the bill to existing mortgages, this bill will not impose costs on future borrowers. This argument is inaccurate for several reasons. First, the costs of writing down a loan because of bankruptcy must be borne by someone. That cost cannot be passed on to current borrowers, because their loans have already been consummated. Thus, the costs of write-downs will have to be passed on to future borrowers. Second, once the precedent has been set, it will be much easier for Congress to allow for modification of principal residence mortgages in the future, as has been done in the past with Chapter 12 of the Bankruptcy Code, which started off as a temporary section and was eventually made permanent. The uncertainty over whether this new bankruptcy modification will be extended in the future or made permanent will become a factor that lenders will price into their loans. Finally, if mortgage-backed securities investors are hit with massive write-downs on top of the write-downs they are already taking, those investors will be less likely to put capital back into the market in the future or will seek higher premiums before they invest. Less capital or higher premiums will lead to higher borrowing costs.

2. Cost to taxpayers

The exposure to taxpayers from non-performing mortgages is very large. The outstanding debt and mortgage guarantees from Freddie Mac and Fannie Mae ("GSEs") are in excess of $5 trillion. Additionally, the Federal Housing Administration (FHA) has hundreds of billions of dollars in loans at risk and the Federal Deposit Insurance Corp. (FDIC) has billions more from loan guarantees through takeovers of Indy Mac, Washington Mutual, and other failed lenders. The government also has guarantees for debt from loans to AIG, Citigroup, and Bank of America. Moreover, the Federal Reserve has risks from former Bear Sterns securities and other securities it now holds as collateral. This exposure would be compounded if the federal government creates a "bad bank" to purchase and manage troubled assets.

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[8] *H.R. 200, "Helping Families Save Their Homes in Bankruptcy": Hearing Before the H. Comm. on the Judiciary,* 111th Cong. (2009) (testimony of Christopher J. Mayer, Senior Vice Dean, Columbia Business School).

[9] *Id.*

Because of this exposure, allowing bankruptcy modification of principal residence home mortgages would be costly to the federal government and the taxpayers. For example, when a mortgage that has been packaged into a mortgage-backed security guaranteed by the GSEs is modified in bankruptcy, the value of the mortgage is negatively affected. The GSEs would realize a loss on the guarantee, and those losses flow through to the federal government in its role as conservator of those institutions and thus to taxpayers. In addition, prior to the enactment of the "Emergency Economic Stabilization Act" (which created the Troubled Asset Relief Program, or "TARP") and recent actions by the Federal Reserve, it was private sector parties owning mortgage-backed securities that would bear any losses resulting from cram downs. However, under TARP the federal government can buy troubled loans and mortgage-backed securities. The government has also guaranteed against losses from some large financial institutions. Bankruptcy modification of this debt and mortgage-backed securities would trigger massive losses for the federal government and taxpayers.

3. FHA/VA lending programs

The FHA and the Department of Veterans Affairs (VA) have programs that make affordable, low down-payment loans possible, by providing lenders insurance against non-payment by borrowers. This insurance, however, does not cover losses due to bankruptcy cram-down. Moreover, FHA/VA servicers could endure losses on FHA/VA loans if they are required to advance principal and interest payments on the original, pre-bankruptcy modified loan balance, rather than on the reduced amount. Therefore, reducing the principal through bankruptcy cram-down would cause devastating financial losses to FHA/VA lenders. Without the protection of government insurance, lenders will be driven away from offering low down payment FHA/VA loans, especially at low interest rates. Instead lenders will either move to higher down payment loan programs which offer more protection against cram-down risk or exit FHA/VA lending altogether. In either case, cram-down will reduce the availability and increase the cost of low down payment loans. As an assistant deputy secretary of Housing and Urban Development recently testified, "any legislation in this area would likely create a powerful disincentive to doing business with FHA and [the Government National Mortgage Association.]" [10]

The outcome to which the HUD official testified is particularly bad considering that FHA/VA loans are not the problem. While foreclosure rates for other types of loans have skyrocketed over the past year, foreclosure rates for FHA/VA loans have remained low and stable. This stability is due in large part to robust FHA/VA foreclosure-prevention and loan-modification programs. In fact, FHA loans have less than one-third of the foreclosure rate of subprime loans and VA foreclosure rates are even lower.

The manager's amendment attempted, but failed, to deal with the FHA/VA insurance problem. The manager's amendment inserted a non-binding rule of construction designed to exempt FHA/

[10] *FHA Oversight of Loan Originators: Hearing Before the H. Comm. on Financial Services,* 111th Cong. (2009) (testimony of Philip Murray, Deputy Assistant Secretary for Single Family Housing, Department of Housing and Urban Development).

VA loans from cram-down. However, it is unclear how this rule would even work—the changes H.R. 200 makes to section 1322(b) do not exempt FHA/VA loans but the courts are directed to interpret the statute as if they are exempted. Such an approach to exempting FHA/VA loans is highly questionable, and thus the FHA/VA insurance problem remains despite the manager's amendment to H.R. 200.

4. Bank write-downs

Recent analysis of the proposals to allow bankruptcy courts to modify principal residence home mortgages concludes that the write-downs associated with allowing bankruptcy modification could require banks to increase their capital reserves by hundreds of billions of dollars. This is because there is language in the prospectuses of many mortgage-backed securities that would cause bankruptcy losses to be shared among all securities holders, even those that hold AAA rated bonds.[11] Indeed, according to Standard & Poor's, because bankruptcy carve-outs "were not initially sized for the change in law the proposed legislation contemplates,"[12] it can be expected that "increases in bankruptcy losses could, in short order, result in principal losses being allocated to the senior-most certificates."[13]

In instances where the loss is shared by AAA bonds, according to J.P. Morgan, "rating agencies may downgrade a significant amount of AAA securities to below investment grade."[14] More bank write-downs will result if securities are downgraded below AAA. According to Julian Mann of First Pacific Advisors, the "loss of mortgage-bond payments because of the bankruptcy changes would require financial firms to mark down more securities to market values."[15] As J.P. Morgan analysis of the situation explains,

> This means that assets will need to be marked-to-market, with losses hitting income. An even larger issue is around risk based capital weightings. For example, AAA securities have a 20% weighting, while BB has a 200% weighting. This means that banks and insurance companies could be required to hold 10 times more capital (or more if downgraded below BB), even though non-bankruptcy related loss scenarios show minimal risk of loss to the AAA.[16]

The Treasury Department, through the TARP, and the Federal Reserve have spent the past few months trying to infuse capital into banks. Write-downs related to this bankruptcy legislation would be counter-productive and could threaten to undo their ef-

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[11] According to Standard & Poor's *Ratings Direct,* "[w]hile losses resulting from loan modifications outside of bankruptcy are allocated according to the rules governing traditional credit losses, losses from bankruptcy principal write-downs and other judicial modifications to the secured lien may be allocated in certain transactions to all of the securities pro rata after the transaction reaches a minimum threshold of bankruptcy losses." Standard & Poor's, *The Potential Effect of Proposed Bankruptcy "Cram-Down" Legislation on U.S. RMBS , Ratings Direct,* January 30, 2009, at 4.

[12] *Id.* at 9.

[13] *Id.* at 4.

[14] J.P. Morgan, *Securitized Products Weekly,* January 23, 2009, at 11.

[15] Jody Shenn, *Bankruptcy Bill May Hurt Banks on Mortgage-Bond Quirk,* Bloomberg, Jan. 21, 2009, http://www.bloomberg.com/apps/news?pid=20601009&sid=abIxZqXis96s.

[16] J.P. Morgan, *supra* note 14, at 11.

forts or require them to infuse more capital into the banking system.

5. Increased bankruptcy filings will lead to delay, less oversight

Some experts believe that bankruptcy filings could double or triple as a result of this legislation. Currently, about 80,000 Americans file for bankruptcy each month—a rate that is just shy of the roughly 100,000 house per month foreclosure rate. Recent numbers indicate that some 4 million homeowners are currently delinquent on their mortgages and some 12-15 million homeowners are underwater on their mortgages. A surge in bankruptcy filings could result if even a fraction of these homeowners file for bankruptcy in order to reduce their interest rates or cram-down the principal owing on their homes.

It does not appear that the bankruptcy courts, the U.S. Trustees program, or Chapter 13 trustees could effectively handle an increased volume of cases over a short period of time. Thus, a dramatic surge in filings related to this bill could lead to delayed resolution of the crisis and less oversight of bankruptcy cases.

In terms of bankruptcy judges, enactment of H.R. 200 will increase the burden on court dockets. This increased burden will come in the form of the large number of new Chapter 13 filings and the adjudication of issues of first impression that H.R. 200 will create. For example, in section 4 of H.R. 200, the phrase "notice that a foreclosure may commence" raises legal and factual questions: does a call or letter from a lender stating that if the late mortgage payments are not made the bank may begin the foreclosure process suffice, or does the borrower actually have to receive notice that the bank has begun the foreclosure process. Additionally, most cases will raise disputes regarding the value of the home and the appropriate "reasonable premium for risk" to apply.

H.R. 200 will also place increased burdens on the United States Trustees. United States Trustees appoint and oversee private Chapter 13 trustees, enforce fraud and abuse provisions of the Bankruptcy Code, and litigate important legal issues arising in bankruptcy cases. It may not be possible for the U.S. Trustees to maintain their current level of oversight of the bankruptcy system with the increased Chapter 13 bankruptcies that will be filed if H.R. 200 is enacted.

Also affected by an increase in Chapter 13 filings would be the private Chapter 13 trustees, who are the backbone of the Chapter 13 system; they administer the Chapter 13 plan, assess the viability of the debtor's proposed repayment plan, collect funds from the debtor, and distribute proceeds to creditors. Allowing modification of principal residence home mortgages will necessarily increase the workload for Chapter 13 trustees. A steep increase in Chapter 13 filings may quickly overwhelm trustees who are not adequately staffed to process the increased caseload.

In sum, the increased filings after enactment of H.R. 200 will make it harder for the Chapter 13 system to function, leading to either a much slower process, decreased oversight of the system, or some combination thereof. The goal of foreclosure relief should be to resolve this crisis as quickly as possible. It does not appear, how-

ever, that the bankruptcy system is the route to a quick resolution of the crisis.

6. Failure rate in bankruptcy

Approximately two-thirds of all Chapter 13 bankruptcies terminate before being completed. These failures to complete the Chapter 13 plan leave the homeowners liable for their mortgage debt and creditors in a much worse position relative to having addressed the problem at the time of the bankruptcy filing. With the likelihood that a Chapter 13 plan will fail, allowing bankruptcy modifications may only delay a resolution of the foreclosure crisis. Some suggest that allowing modification will increase the success rate; however, any increase would have to be significant to make bankruptcy modification even moderately successful at addressing the foreclosure crisis. The 57 percent failure rate for Chapter 12 bankruptcies, in which cram-down is currently allowed, suggests that the failure rate for Chapter 13 bankruptcies will still be significant even if H.R. 200 is enacted.[17]

7. Moral hazard and bankruptcy abuse

H.R. 200 presents incentives to file for bankruptcy that could lead to borrowers opting for bankruptcy rather than loan modifications and could create moral hazard leading many borrowers to abuse the system. First, in terms of loan modifications, borrowers may have little incentive to accept non-bankruptcy loan modification programs when they can petition a bankruptcy court to have their mortgage crammed-down to the fair market value. Cram-down gives the borrower a permanent reduction in the outstanding mortgage debt. When housing prices rise, as they eventually will, the borrower enjoys the appreciation.[18] With this possibility out there, borrowers would have a strong incentive to reject a lender offered modification proposal and either hold out for a better deal or file for bankruptcy.

In addition to the problems this bill may create with regard to loan modifications, enactment of H.R. 200 could lead to the possibility that borrowers will abuse the bankruptcy system to take advantage of incentives to filing for bankruptcy created by the bill. These incentives have not existed in the past as "[t]raditionally, the ability to modify consumer debt was limited to depreciating assets like cars and boats, thus this temptation for strategic behavior was mitigated because borrowers had little prospect of profiting because the property was unlikely to increase in value in the future." [19]

Currently, approximately 50 million borrowers are paying their mortgages on time; however, roughly a third of these borrowers owe more on their mortgage than their house is worth. For these borrowers who are underwater on their mortgages, the otherwise unappealing prospect of filing for bankruptcy may become an at-

[17] A recent study by the Office of the Comptroller of the Currency found that more than 50 percent of borrowers that receive a loan modification missed at least one payment in the six months after the lender modified their loans.

[18] The manager's amendment put some limitations on this, allowing for some lender recapture if the house is sold within five years of completion of the Chapter 13 plan.

[19] *H.R. 200, "Helping Families Save Their Homes in Bankruptcy": Hearing Before the H. Comm. on the Judiciary,* 111th Cong. (2009) (written testimony of Todd J. Zywicki, Professor, George Mason University School of Law).

tractive option once cram-down of mortgage principal is made possible. As Professor Mayer has pointed out, "[w]hile many commentators have downplayed this argument as scare tactics, it is not hard to envision late night TV advertisements informing homeowners that they no longer need to make their mortgage payments and yet could still remain in their home."[20]

Proponents of H.R. 200 have asserted that the concern over negative impact on credit scores will prevent borrowers from abusing the system. However, the fact that many borrowers are walking away from underwater mortgages, allowing those homes to be foreclosed, when delinquency and foreclosure also negatively impact one's credit score, undercuts this argument. The chance to reduce principal by tens or even hundreds of thousands of dollars in some cases, to re-write the interest rate, and extend the maturity date of a mortgage may encourage many borrowers to go into bankruptcy despite the adverse impact on their credit score.

8. Nothing will stop future Congresses from applying cram-down more broadly

The manager's amendment to H.R. 200 limits the bill to existing mortgages; however, once the precedent has been set, it will be much easier for Congress to provide for modification of principal residence mortgages in the future. Indeed, if the past is a prologue, it should be expected that this is exactly what will happen. Chapter 12 of the Bankruptcy Code provides the perfect example. The Chapter 12 family farmer bankruptcy provisions were originally enacted in 1986 with a seven-year sunset. In 1993, that sunset was extended by five years and was subsequently extended multiple times, with only a brief lapse, until Chapter 12 was made permanent in 2005.

Because of the history of Chapter 12 and of other sunsets that are later extended, once the principal residence exemption is lifted, even if for only existing mortgages, the risk exists that this limited opening will be broadened in the future. Lenders will price mortgages for this risk accordingly.

C. Republican Amendments

At the January 27, 2009, markup of H.R. 200, Republican members of the Committee offered five amendments. With the exception of an amendment offered by Mr. King, all Republican amendments were defeated on party-line votes.

Smith Amendment: Ranking Member Smith offered an amendment that would have required courts to apply a three-step process, modeled after that employed by the Federal Deposit Insurance Corporation (FDIC), when altering mortgages to keep monthly mortgage payments between 31 percent and 38 percent of a homeowner's current monthly income. Also similar to the FDIC approach, the Smith Amendment would have required debtors to agree to equity recapture for lenders if the debtor sells the house for a profit after an equity cramdown. Mr. Smith's amendment was defeated on a 14 to 20 party-line vote.

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[20] Mayer, *supra* note 8.

Franks Amendment: Mr. Franks offered an amendment that would have limited the bill to loans originated between January 1, 2004 and December 31, 2007, the time-frame during which many of the most problematic loans were made. Additionally, Mr. Franks' amendment would have limited the bill's provisions to bankruptcies filed within three years of the date of enactment. Mr. Franks' amendment was defeated on a 15 to 20 party-line vote.

Forbes Amendment: Mr. Forbes offered an amendment that would have maintained the requirement that those debtors that receive mortgage modifications go through credit counseling. The amendment also would have precluded debtors that made misrepresentations or committed actual fraud from modifying their mortgages in bankruptcy. Mr. Forbes' amendment was defeated on a 12 to 20 party-line vote.

King Amendment: Mr. King offered an amendment to prohibit debtors who obtained or refinanced their loans based on material misrepresentations, false pretenses, or actual fraud from being able to modify their mortgages in bankruptcy. Mr. King's amendment was agreed to on a 21 to 3 vote.

Jordan Amendment: Mr. Jordan offered an amendment to limit bankruptcy mortgage modification to subprime and non-traditional loans—the two types of loans at the heart of this crisis. Such a limitation was included in the version of the mortgage bankruptcy bill reported out of this Committee in the last Congress (H.R. 3609, 110th Cong.). Mr. Jordan's amendment was defeated on a 14 to 20 party-line vote.

D. Answers to Majority's Rationale for Rejecting Republican Amendments

As discussed above, at the markup Republicans offered five amendments aimed at narrowing the scope of the bill to those loans that are at the heart of the foreclosure crisis. In arguing against supporting Republican amendments, members of the majority made several arguments. These arguments are incorrect or miss the mark. Below are responses to the majority's principal arguments:

1. Vacation homes, second homes, and other secured debt in bankruptcy

Throughout the debate over mortgage bankruptcy legislation in this and the last Congress, the argument has been repeatedly made that this legislation is not extraordinary because the Bankruptcy Code already permits the modification of other forms of secured debt in bankruptcy. As attractive this argument may be, it is simply not the case.

Under the current provisions of Chapter 13, if a secured creditor's lien is crammed-down, the *entire amount* of the secured claim (after the cram-down) plus interest must be paid off during the three-to-five year duration of the Chapter 13 plan. For example, were a Chapter 13 debtor to submit a plan that proposed to cram-down a mortgage on a vacation home from $450,000 to $400,000, that plan would have to provide for the payment of the entire $400,000 in three-to-five years in equal monthly installments. Accordingly, as a practical matter, a debtor cannot cram-down a first

mortgage on a vacation home, because the payments needed to pay off even the crammed-down amount over three-to-five years will be too large. In the unlikely circumstance that a debtor could afford such large payments, that debtor would be undeserving of bankruptcy relief.

Under H.R. 200, however, a debtor could pay off a crammed-down home mortgage over a period that could be in excess of thirty years. Thus, H.R. 200 makes cram-down feasible for home mortgages—treating home mortgages much differently than mortgages on vacation homes and other investment property. Moreover, the interest rate to which the holder of the home mortgage would be entitled for the thirty-plus year period would be set by the court rather than by the mortgage contract.[21] Conversely, when other secured creditors' liens are crammed-down in Chapter 13, the liens are subject to a court-determined interest rate for no more than five years and cannot be required to wait longer to be paid.

Furthermore, since enactment of the 2005 amendments to the Bankruptcy Code, in many instances, limitations have been placed on the ability to cram-down the claims of secured creditors in Chapter 13. For instance, auto loans are only subject to cram-down if the loan was made more than 910 days (roughly two and half years) prior to filing for bankruptcy. Thus, H.R. 200 moves home mortgages from receiving special protection aimed at encouraging the flow of capital into the home mortgage market, to being treated less favorably than most other secured consumer debts, including debts for depreciating assets like automobiles.

2. Family farms in Chapter 12

Proponents of H.R. 200 have pointed to the family farmer provisions of Chapter 12, which allow for cram-down, in support of their argument that principal residence mortgage modifications should be allowed in Chapter 13. Reference to Chapter 12, however, does not support their argument.

First, analogizing Chapter 12 to allowing home mortgage modification in Chapter 13 is particularly inapt because, as a practical matter, Chapter 13 filings dwarf Chapter 12 filings. In the twelve-month period ending in June 2008 there were 344,421 Chapter 13 filings compared to only 314 Chapter 12 filings.

Second, during the Clinton administration the Department of Agriculture concluded that Chapter 12 "may have substantially increased costs for farm businesses."[22] According to that study,

> A conservative estimate of the incremental impact of Chapter 12 over Chapter 11 is that it raises indirect bankruptcy costs by about a fourth. To offset the costs Chapter 12 imposes on creditors, interest rates to farm borrowers will rise 0.25-1.0 percent on average. Much higher costs will be borne by financially weaker farm borrowers, either

[21] The bankruptcy judge could set the interest rate at "a fixed annual percentage rate, in an amount equal to the then most recently published annual yield on conventional mortgages . . . plus a reasonable premium for risk."

[22] U.S. Department of Agriculture, *Do Farmers Need a Separate Chapter in the Bankruptcy Code?,* at 3 (1997).

> in the form of increased interest or other charges, or in their inability to obtain loans at any price.[23]

Moreover, the study also found that,

> The major marginal effect of Chapter 12 is to encourage both inefficient farmers who would otherwise liquidate and efficient farmers who would otherwise continue their operations at greater expense to reorganize their businesses under the protection of bankruptcy. These provisions increase direct bankruptcy costs by encouraging bankruptcy filings by some farmers who would not otherwise have done so. They also increase indirect costs by increasing the number of farmers who choose to reorganize inefficient farms. This impact could be mitigated by allowing lenders the option of recapturing writedowns in secured debt if asset values recover. Such an option exists under Chapter 11.[24]

Thus, it is clear that the argument that "allowing cram-down in Chapter 12 has not had negative effects and therefore we should extend cram-down to mortgages on principal residences in Chapter 13" is incorrect. According to the Clinton Agriculture Department, Chapter 12 has increased borrowing costs especially for marginal borrowers and encouraged farmers that otherwise did not need to file for bankruptcy to file.

3. Subprime and non-traditional loans

In the last Congress, this Committee favorably reported H.R. 3609, a bill that provided for bankruptcy modification of principal residence mortgages, with a manager's amendment that limited the bill to subprime and non-traditional loans. Members of the majority rejected this limitation at the mark-up of H.R. 200 because they asserted that the crisis has now spread beyond subprime and non-traditional loans. The foreclosure numbers, however, do not bear this argument out.

According to the Mortgage Bankers Association, there are currently 52 million mortgage loans. Of these 52 million loans, approximately 34 million are prime fixed-rate mortgages, 7 million are prime adjustable-rate mortgages (ARMs), 3 million are subprime fixed-rate mortgages, 3 million are subprime ARMs, and 5 million are FHA/VA loans. Thus, the majority of these loans are prime-fixed rate mortgages and the vast majority of these loans are not subprime.

The Mortgage Bankers Association data on foreclosures started indicates for these loan types that foreclosures were started in the third quarter of 2008 for: 0.34% of prime fixed-rate mortgages, 1.77% of prime ARMs, 2.23% of subprime fixed-rate mortgages, 6.47% of subprime ARMs, and 0.95% of FHA/VA loans. Thus, the worst performing loans are subprime fixed-rate and subprime adjustable-rate mortgages. The 34 million prime-fixed rate mortgages, which account for 65 percent of all existing mortgages, are only seeing foreclosure starts at 0.34%. FHA/VA loans are also seeing foreclosure starts at less than 1%. Yet, both prime and FHA/VA

[23] *Id.*
[24] *Id.* at 5.

mortgages would be eligible for bankruptcy modification if H.R. 200 is enacted.

Given the relatively low percentage of foreclosure starts among prime and FHA/VA loans, it would seem that limiting this bill to subprime and non-traditional loans is a more than reasonable limitation. When one considers the above-discussed costs imposed by this bill and the moral hazard associated with it, there seems to be little reason not to limit the coverage to what are still the most problematic loans.

CONCLUSION

Allowing for modification of principal residence mortgages in bankruptcy comes with too many attendant costs and the failure rate of Chapter 13 bankruptcies is much too high for it to be considered a practical approach to stopping foreclosures. Proponents of H.R. 200 assert that everything else has been tried and that nothing has worked to put an end to the foreclosure crisis. They assert that allowing bankruptcy mortgage modification is the linchpin to effective foreclosure relief. However, there are many better alternatives that have yet to be tried—alternatives that do not present the parade of horribles and hundreds of billions of dollars of downside risk threatened by this cram-down bill. The Congress and the Executive Branch must try these alternatives before rushing to bankruptcy as the answer. And, if in the end bankruptcy relief must be an option, it must be crafted along the lines of the rejected Republican amendments from the mark-up of H.R. 200, so that it is narrowly targeted at the loans at the heart of the current crisis.

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