

March 31, 2008

To: Members of the U.S. Senate

Re: Oppose Legislation to Change the Treatment of Mortgages During Bankruptcy

We are writing to you to express our strong opposition to mortgage bankruptcy provisions that have been included in Title IV of the Foreclosure Prevention Act of 2008, the Substitute to H.R. 3221 that is likely to be considered by the Senate as early as Tuesday, April 1.

Title IV would allow bankruptcy judges to modify, after the fact, the terms of first mortgages in Chapter 13 proceedings. There is no doubt that this proposal would increase risk and uncertainty and would: (1) undermine the ability to provide new loans to those who legitimately cannot afford their existing loans; and (2) raise interest rates for millions of American homebuyers in the future. We strongly oppose the Substitute to H.R. 3221 unless Title IV is removed.

A March 3 editorial by the Washington Post noted that allowing bankruptcy judges to rewrite mortgages would cause lenders to price the risk of litigation into interest rates, making “it harder for everyone to afford a home.” Noted economist Robert J. Samuelson wrote in his March 5 Washington Post column that some measures being considered by Congress, such as overhauling the Federal Housing Administration (FHA), might help, but that other proposals, “particularly empowering bankruptcy judges to reduce mortgages unilaterally – would perversely hurt the housing market by raising the cost of mortgage credit. Lenders would increase interest rates or down payments to compensate for the risk that a court might modify or nullify their loans.”

Title IV is not the “narrow,” targeted approach to the problems in the mortgage market that proponents claim. Although an attempt was made to narrow the focus to “subprime” loans, the definition of subprime is very broad and would include many prime loans. Merely changing the focus from all mortgages to subprime mortgages is still too broad, since the vast majority of subprime mortgages are not in trouble or going to foreclosure. Further, although the revised version of Title IV purports to measure the ability of debtors to pay their mortgages, the standards are very broad and open to abuse.

Title IV would permit bankruptcy judges to reduce unilaterally (cram down) the balance owed on a mortgage. Proponents argue that this cram down should be allowed because bankruptcy law already allows it for vacation homes. What they fail to mention is the cram down applies to vacation homes only if the creditor consents and that the mortgage must then be paid off within the 5 year length of the Chapter 13 plan. The cram down is one major reason that interest rates for vacation home loans are higher than for first mortgages. Title IV would extend cram down to first mortgages without requiring the consent of the creditor and without any time limit other than the remaining term of the loan – which can also be extended by the bankruptcy judge.

In addition, Title IV includes several provisions that have nothing to do with the current housing situation. For instance, it would allow courts to override arbitration provisions and subject lenders to severe penalties for technical noncompliance with the Truth in Lending Act. The enactment of these provisions, which have never been the subject of committee hearings, would lead to protracted litigation and would exacerbate the current contraction in the credit markets.

Title IV encourages homeowners to file for bankruptcy without first trying to work things out with their lenders. This is not good for anyone – except debtors’ attorneys, who stand to make money on increased bankruptcy filings. It would undermine the effectiveness of Congressional and private-sector initiatives to help homeowners. Current efforts are starting to take hold. In addition to several initiatives that Congress has already acted on, there are promising new legislative proposals being worked on now. Further, the HOPE NOW alliance of counselors, lenders, and servicers reported in March that more than 1.1 million homeowners have been helped so far through repayment plans and workouts, and that the number of borrowers being helped is accelerating rapidly.

Title IV would also further restrict credit at a time when every effort possible is being made to stimulate the economy and avoid a recession. It would reduce mortgage originations by creating uncertainty about the value of collateral, and it would adversely affect the secondary market by introducing greater uncertainty about the value of the assets underlying mortgage-backed securities. This new concern about assets’ value would increase the turmoil in the mortgage market and pose a threat to the overall economy.

The bankruptcy code is incredibly complex. Trying to amend it on the Senate floor opens up all sorts of potential problems – drafting errors that could have severe consequences and substantive changes to the bankruptcy system that could have long-lasting and adverse consequences for our mortgage market and economy.

Financial services institutions across the country are working hard to help troubled borrowers, including refinancing subprime loans made by others. Title IV of the Substitute to H.R. 3221 would clearly undermine these efforts. Therefore, we strongly urge you to support efforts to remove Title IV from the bill and to oppose it unless Title IV is removed.

American Bankers Association  
American Financial Services Association  
American Insurance Association  
American Securitization Forum  
Consumer Bankers Association  
Consumer Mortgage Coalition  
Independent Community Bankers of America  
Manufactured Housing Institute  
Mortgage Bankers Association  
National Association of Home Builders  
Securities Industry and Financial Markets Association  
The Financial Services Roundtable  
The Housing Policy Council  
U.S. Chamber of Commerce