

Statement for the Record

Hearing on Bankruptcy Cram Down Legislation

Before the Committee on the Judiciary United States House of Representatives

January 22, 2009

The undersigned organizations respectfully submit the following statement for the record for the January 22, 2008 hearing by the House Judiciary Committee on H.R. 200 and H.R. 225 ("Cram down legislation"). We have and continue to strongly oppose broad cram down legislation.

Such cram down legislation would give bankruptcy judges the broad power to reduce unilaterally the remaining balance on a mortgage and modify or change the interest rate or term of the loan. Cram down would be available for all mortgage and other loans secured by a primary residence. There are no limitations on the types of mortgages, including prime mortgages, which would be subject to the cram down. Cram down would introduce substantial new risk and uncertainty into first mortgage and home equity lending and further undermine the stability of mortgage backed securities.

According to a recent study by Columbia University, cram down legislation would result in higher interest rates and reduce the availability of mortgages for many borrowers at a time when consumers and the nation are already suffering through a severe economic downturn.¹ Moreover, cram down would encourage many people to file for bankruptcy first and would undermine other efforts to work-out or modify troubled loans. Bankruptcy is an ad hoc process that will overload the courts with millions of new cases that the system could not handle quickly or effectively and the increased costs will be borne by taxpayers.

The housing market is already contracting and enactment of cram down legislation would make things even worse by injecting even more risk into the mortgage market, making it harder and more costly for people to buy and sell homes. Importantly, cram down legislation would disrupt Federal Housing Administration (FHA) and Veterans Administration (VA) loan programs that account for nearly a third of all new mortgages and are now the major source of affordable mortgage credit. FHA/VA programs make affordable, low-down payment loans possible by insuring lenders against the risk of non-payment. Cram down would make these loans more risky since the cram down amount is not covered by FHA/VA insurance. This will drive lenders away from the program and will be bad for veterans, moderate income borrowers, housing recovery, and the economy as a whole.

¹ "A New Proposal for Loan Modifications" by Christopher Mayer, Edward Morrison and Tomasz Piskowski, Columbia University (1/6/09). See link below. <http://www4.gsb.columbia.edu/realestate/research/housingcrisis/mortgagemarket?&>

Cram down would be costly to Fannie Mae and Freddie Mac (the "GSEs"), the federal government and taxpayers. For instance, 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 need to 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" ("TARP") and recent actions by the Federal Reserve, it was private sector parties owning mortgage backed securities (MBS) that would bear any losses resulting from cram downs. However, under TARP the federal government can buy troubled loans and MBS. The government has also guaranteed losses from some large financial institutions. Cram down of this debt and MBS would trigger massive losses for the federal government and taxpayers.

Cram down could also seriously impair the federal government's commitment to affordable home ownership. Under current law, the federal government cannot insure or guarantee the amount that has been crammed down in a FHA or VA loan. This transfers the loss to servicers, which is not the correct result since the servicer is not the owner of the loan. Therefore, private companies that service mortgages would have a strong incentive to refuse to service FHA and VA mortgages. This would mean that the government would bear the costs and burdens of servicing FHA and VA loans. As the FHA noted in its January 13, 2009, letter to Representative Neugebauer, if private servicers abandon the market and the federal government is required to service FHA loans, the federal government and taxpayers would then be required to absorb the losses associated with cram down.

Better alternatives than bankruptcy have been put in place and these can be expanded to enable lenders and borrowers to work together to modify mortgages to make them more affordable and avoid foreclosures. In particular, we believe that the FDIC's program on mortgage loan modifications could be an effective tool if implemented on a nationwide basis and if money from the Troubled Assets Relief Program (TARP) could be used to support the program's broader availability. There are also other loan modification proposals that have been put forward that have merit and that could be effective if adequate funding is provided. The House Financial Services Committee has recognized that more money is needed for these programs and has made it clear in legislation pending on the House floor (H.R. 384) that at least \$40 and up to \$100 billion of any further money provided by Congress for the TARP program should be used by the Obama Administration for programs designed to avert foreclosures.

In addition, the Federal Housing Administration, which created the FHA Secure program last year, has helped nearly 410,000 borrowers refinance into more affordable mortgages. The HOPE NOW Alliance, which includes over 30 market participants, is helping at-risk homeowners avoid foreclosure through more than 200,000 workouts and loan modifications each month. On December 15, 2008, the housing GSEs, Fannie Mae and Freddie Mac, working with their regulator and industry partners, implemented a

streamlined loan modification program similar to the FDIC's program for Indy Mac loans.² In July 2008, Congress passed the Housing Economic Recovery Act, which included the Hope for Homeowners program. This legislation established a new FHA program (Hope for Homeowners) with an additional \$300 billion in FHA insurance authority. This program became effective October 1, and is just now starting to be implemented. Hope for Homeowners is being expanded and made more flexible to assist more homeowners by legislation sponsored by House Financial Services Committee Chairman Frank (H.R. 384; "TARP II").

We look forward to continuing to work with the 111th Congress, the Obama Administration, and the regulatory agencies on these and other programs designed to help prevent foreclosures. In the meantime, we strongly urge you give these programs time to work and to not put in place broad bankruptcy cram down provisions that would make it harder for consumers to buy and sell homes.

American Bankers Association
American Financial Services Association
American Securitization Forum
Consumer Bankers Association
Independent Community Bankers of America
Mortgage Bankers Association
Securities Industry and Financial Markets Association
The Financial Services Roundtable
The Housing Policy Council
U.S. Chamber of Commerce

² Under the terms of the program, borrowers receive a loan modification with a maximum 38% down to 31% housing-to-income ratio through the use of interest rate reduction, amortization term extension, and in some cases, principal deferment. See explanation of this program at the FDIC's web site:
<http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html>