

Legislative Highlights

Mortgage Empire Strikes Back at Modification Bills

The housing industry has launched a full-scale assault on proposed legislation that would give bankruptcy judges the power to rewrite home mortgages in chapter 13, with the Mortgage Bankers Association (MBA), the National Association of Home Builders (NAHB) and the Financial Services Roundtable, among others, in a coalition to head off bills born out of the foreclosure crisis.

Congress has been chasing the home foreclosure wave for a while now. Hearings have been held in both the House Financial Services Committee on the systemic risk arising from high foreclosures, and the House Judiciary Committee on mortgage-stripping, specifically. In addition to emergency funding bills to raise the portfolio caps on Fannie Mae and Freddie Mac, there

are no fewer than four bills (two in the Senate and two in the House) introduced that would permit modification of home mortgages on a principal residence in chapter 13, allowing a strip-down of the mortgage lien to the fair market value of the home and permitting the repayment period to extend well beyond the normal term of a chapter 13 plan. MBA contends that these bills would give courts too much leeway to rewrite loans without legal or economic constraints, introducing major uncertainty in secondary markets and thus adversely affecting the flow of capital into home lending.

While some commentators have made the legal and policy argument for removing bankruptcy protection for subprime, “exploding ARM” and other exotic mortgages (*e.g.*, **Hank Hildebrand**’s Consumer Corner column in the

September *Journal*), the pending bills make no such distinction and could apply to any home mortgage irrespective of its terms. One House bill (H.R. 3609; Rep. Miller, D-N.C.) passed the Commercial and Administrative Law Subcommittee by just a 5-4 vote on Oct. 4. The next step for H.R. 3609 would be the full House Judiciary Committee—if the Democrat majority has the votes to move the bill. The other bills are S. 2136 (Sen. Durbin, D-Ill.), S. 2133 (Sen. Specter, R-Pa.) and H.R. 3778 (Rep. Chabot, R-Ohio). All four bills are summarized and contrasted in a chart on the home page of ABI World (www.abiworld.org), prepared by ABI Resident Scholar Prof. **Mark S. Scarberry**.

Arguments for mortgage modification point to the extreme nature of

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the current foreclosure crisis, the adverse impact of foreclosures on neighborhood values and the economic reality that lenders would recover at least as much from modification as it would from a foreclosure sale. Advocates point to the precedent of chapter 12 in the mid-80s, where the law in time helped stabilize falling farm land prices arising from foreclosures. However, chapter 12 was invoked by relatively few borrowers and was designed as a temporary measure with a five-year sunset (though Congress made it permanent in BAPCPA). None of the current mortgage modification bills—which proponents say could affect 600,000 borrowers today—has a sunset limit.

The Bush administration's new program for distressed borrowers is called "Hope Now" and it combines foreclosure prevention counseling by mortgage servicers and other market participants in an alliance to help homeowners facing default. Supported by the NAHB, it provides at-risk borrowers with information and resources to allow them to keep their homes by restructuring the terms of the mortgage. However, the program is voluntary.

House Financial Services Chair Barney Frank (D-Mass.) has his own remedy to spur market action: the threat of liability for those firms that purchase, repackage and sell mortgages "predatory" loans. He plans to in-

troduce legislation in late October that would establish a federal duty of care for all mortgage originators. No loans could be made to a consumer who has "no reasonable ability to repay the loan" based on their current circumstances; a refinanced loan could not be offered if it "lacks a net tangible benefit" to the consumer. Investment firms, appraisers and loan services could also find themselves liable under a new duty of care, according to an outline produced by the committee in October. Senate Banking Committee Chair Chris Dodd (D-Conn.), Frank's counterpart across the Capitol, is known to favor more of a regulatory approach by the Federal Reserve and banking regulators. ■



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