

New Mortgage Lienstripping Bill Ready for Possible Early Enactment

This month's Update includes the full text of the bill and statement of introduction by Sen. Dick Durbin (D-Ill.) on the new mortgage modification legislation (S. 61), introduced on Jan. 6, 2009. The bill's proponents, in coordination with the Obama administration, hope to attach the legislation to the economic stimulus package as one of the first items of business in the 111th Congress.

Mr. President, as the 111th Congress begins, the most important item on our agenda is to help end the worst economic crisis America has faced since the Great Depression.

I look forward to working with my colleagues in the Senate to develop and approve an economic turnaround package as quickly as possible.

But even if Congress authorizes as much as \$1 trillion in new Government spending over the next 2 years to stimulate the economy, if we don't address the origins of this crisis, I fear the impact of any recovery package will be dampened.

This economic crisis began with the bubble that burst in the housing market. So we have to address that, first and foremost. Families need to be able to stay in their homes, and communities need to be stabilized before the economy can start to grow again.

That's why, as my first bill in the new Congress, I am reintroducing the Helping Families Save Their Homes in Bankruptcy Act.

When I first began working on this bill almost two years ago, the Center for Responsible Lending, Credit Suisse, and others estimated that 2 million homes were at risk of foreclosure.

The Mortgage Bankers Association and the rest of the mortgage industry scoffed at such a number.

Last month, Credit Suisse estimated that 8.1 million homes are likely to be lost to foreclosure by 2012. If the economy continues to worsen, they believe foreclosures will exceed 10 million homes.

If over 8 million families—representing 16 percent of all mortgages—are losing their homes, our economy is not going to recover.

I first introduced this bill in September of 2007. I have chaired three hearings on the subject and tried three times to pass this legislation last year.

A large coalition supports this bill—including the AARP, the Consumer Federation of America, the Leadership Conference on Civil Rights, the AFLCIO, the Center for Responsible Lending, the National Association of Consumer Bankruptcy Attorneys, and many others. But the Mortgage Bankers Association and the rest of the mortgage industry have successfully opposed it so far.

Three things have fundamentally changed, and I am back, pressing even harder that we make this bill law.

First, the banks that brought us the reckless lending, dense securitization, and risky investing practices that created the boom and bust in the housing market

Only families living in the home would qualify—no speculators are allowed.

The bill would allow judges to cut through all of the constraints that have doomed foreclosure prevention plans from being successful for even the most proactive and well-intentioned mortgage servicers.

There are very real constraints on some of the current efforts to prevent foreclosure today because most mortgages are sliced and sold to different investors, servicers sometimes have a hard time locating all of the owners of the mortgages to get their consent for modifications.

Servicers that modify mortgages without the consent of all the investors fear that they could be sued.

Some investors refuse to approve sensible restructurings, because there is little incentive for the owner of a second mortgage to approve a modification of

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have now happily accepted a \$700 billion handout from the American taxpayers... even as most of them refuse to help the homeowners who are suffering most acutely from their irresponsible business practices. Frankly, I think that the credibility of the opposition to my bill has slipped just a bit.

Second, it is painfully clear that foreclosure mitigation efforts to date have failed. Professor Alan White of the Valparaiso School of Law analyzed a large sample of the mortgage modifications made voluntarily by the industry-led Hope Now Alliance. He found that almost half of these so-called foreclosure prevention plans actually increased the monthly payments of homeowners. How does that help families save their homes?

Third, America soon will have a President who understands the enormity of this problem and supports this change to the bankruptcy code.

So what does this bill do? This bill would allow mortgages on primary residences to be modified in bankruptcy just like other debts—including vacation homes, family farms, and yachts.

a first mortgage that will see the second mortgage wiped out.

Mortgage modifications that ignore the other pile of debt a household is facing is a set-up for failure. That's a leading reason why we see so many redefaults on newly modified mortgages through the current programs.

Finally, servicers who are on the front lines answering the phone calls from homeowners and processing the paperwork often are compensated more for foreclosures than modifications.

My proposal would allow judges to cut through these complicating factors to rework the underlying loans.

The mortgages that are modified in bankruptcy will provide far more value to the lenders and the investors than foreclosure.

The bill would provide borrowers who are frustrated with their mortgage servicers some desperately needed leverage to get their banker's full attention. It provides an incentive for banks to modify loans before the judges in bankruptcy do it for them.

Best of all, this program would cost the taxpayers nothing. Given the

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Dicta: Judicial Evaluations Can Be a Valuable Assessment Tool

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used by bankruptcy judges.⁸ To this author's knowledge, the Federal Judicial Center performance survey is never used

⁷ The Federal Judicial Center, at the request of the Judicial Conference Committee on the Administration of the Bankruptcy System, has drafted an extensive and detailed sample judicial performance survey and guide. The sample includes 39 statements that are rated on a five-point scale: never, sometimes, usually, always and total. The following samples are illustrative of the statements to be rated concerning intellectual integrity and impartiality: The judge—rendered rulings without regard to popular sentiment, media attention, or prospects of criticism; was open minded to arguments of counsel and facts of the proceeding; or rulings were influenced by the identity of lawyers or law firms involved. The following samples are illustrative of the statements to be rated concerning legal ability: The judge—demonstrated an understanding of the Federal Rules of Bankruptcy

by U.S. district court judges⁸ or other federal trial court judges.

Procedure; demonstrated an understanding of substantive bankruptcy law; or oral rulings were substantively sound. The following samples are illustrative of the statements to be rated concerning professionalism and work habits: The judge—helped ensure the steady progress of a case or proceeding; ruled promptly on matters; prepared adequately for hearings and trials; or exhibited too little patience toward attorneys and parties during proceedings.

⁸ There are some exceptions to this statement, notably judges **James Starzynski** of New Mexico Bankruptcy Court and **Colleen Brown** of the Vermont Bankruptcy Court, who have established judicial performance liaison officers (independent, nonjudicial academic or nonbankruptcy attorneys) to receive comments and complaints from attorneys, "scrub" them to insure anonymity, and then convey the information to the judge.

The federal judiciary prides itself on independence, transparency and judicial excellence. These are characteristics that have helped us maintain a reputation as the preeminent judicial system in the world. That standard can be best maintained if the judges in that system are, like others, subject to fair and reliable (and unvarnished) judicial performance evaluations. ■

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staggering amounts that taxpayers have been asked to give to the mortgage industry lately, the taxpayers are ready for a plan that doesn't cost them anything and that will actually work.

Since the Mortgage Bankers Association still opposes this plan, after taking all of that taxpayer money and after failing to do anything meaningful on their own to address this crisis, I want to address their primary remaining objection to this plan as clearly as possible so that everyone listening fully understands why the industry is wrong, once and for all.

A few weeks ago, the Chairman of the Mortgage Bankers Association testified in the Senate Judiciary Committee that my bill would create a tax of \$295, per month, for every homeowner in America, forever. I asked in the hearing, and my staff asked three times after the hearing, for some shred of evidence to support such a ridiculous claim. The response finally came just before the holidays, and it is laughable.

The Mortgage Bankers Association claims that changing the bankruptcy code will create new costs for lenders that must then be passed on to all borrowers. They have concocted a list of individual costs that add up to the full "tax," as they call it. But they don't provide a single shred of evidence to support any of these cost estimates. Not one. They just made them all up.

On the other hand, a study conducted by **Adam Levitin** of the Georgetown Law School uses actual statistical data to show that there is virtually no impact on mortgage interest rates just because

mortgages can be modified by judges in bankruptcy.

The main problem with the argument that my bill will increase future mortgage rates is this:

The choice for mortgage lenders and investors is not full payment of the original mortgage versus a lower payment from a judicially modified mortgage.

The choice is between a lower payment from a judicially modified mortgage and mortgage failure.

Valparaiso's Professor White reports that in his large study sample, mortgage servicers and their investors lost an average of 55 percent of the value of the mortgages that failed through foreclosure, or about \$145,000 per loan.

If those loans would have been modified in bankruptcy, the servicers and investors would have been given ownership of a sustainable mortgage worth at least the fair market value of the home plus an interest rate that included a premium for risk. These modified mortgages would on average have created far better results than the foreclosures that actually occurred.

Therefore, when the Mortgage Bankers Association claims with no evidence whatsoever that my bill would raise mortgage interest rates, we should all ask them this: Why would mortgage bankers charge future borrowers higher interest rates tomorrow because of a change in the law that helps the bankers reduce their losses today?

I urge the Senate to move swiftly to enact the economic recovery package that America desperately needs. And as

part of that effort I urge my colleagues to support the remedy to the foreclosure crisis that will provide the most help to the 8.1 million families across the country who are at risk of losing their homes.

If we don't address the core of the crisis, I fear that the stimulus may not work as well as it should. I look forward to working with Chairman Dodd, Senator Schumer, all of the other Senators who have supported this provision, and President-elect Obama to see that it is signed into law quickly.

There being no objection, the text of the bill was ordered to be printed in the Record as follows:

S.61

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

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 that 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 CONSUMER PROTECTION LAWS.

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 is subject to any remedy for damages or rescission due to failure to comply with any applicable requirement under the Truth in Lending Act, or any other provision of applicable State or Federal consumer protection law that was in force when the noncompliance took place, notwithstanding the prior entry of a foreclosure judgment.”

SEC. 4. AUTHORITY TO MODIFY CERTAIN MORTGAGES.

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

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

(2) in paragraph (10) by striking “and” at the end, and

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

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

“(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 an annual percentage rate calculated at a fixed annual percentage rate, in an amount equal to the then most recently published annual yield on conventional mortgages published by the Board of Governors of the Federal Reserve System, as of the applicable time set forth in the rules of the Board, plus a reasonable premium for risk; and

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

SEC. 5. COMBATING EXCESSIVE FEES.

Section 1322(c) of title 11, the 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, the 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), the plan provides that the holder of a claim whose rights are modified pursuant to section 1322(b)(11) 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) the plan modifies a claim in accordance with section 1322(b)(11), and the court finds that such modification is in good faith.”

SEC. 7. DISCHARGE.

Section 1328 of title 11, the 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” the 1st place it appears, 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. 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. ■