RSC Republican Study Committee

REP. TOM PRICE, M.D. (R-GA), CHAIRMAN
PAUL TELLER, EXECUTIVE DIRECTOR
424 CANNON HOUSE OFFICE BUILDING
WASHINGTON, DC 20515

rsc.price.house.gov
ph (202) 226-9717 / fax (202) 226-1633

Legislative Bulletin……………………………….………February 25, 2009

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H.R. 1106 - Helping Families Save Their Homes Act of 2009 *(Conyers, D-MI)*

Order of Business: H.R. 1106, the Helping Families Save Their Homes Act of 2009 is scheduled to be considered under a likely structured rule on Thursday, February 26, 2009. The RSC will summarize any amendments made in order in a separate document.

Background: In recent years, there has been a significant rise in home foreclosures and bankruptcies. This rise can be attributed to many factors including, but not limited to: the economic downturn; a crisis in the housing market caused by subprime loans (loans with more risks associated with them) given to unqualified individuals; and subprime loans that allow borrowers a low monthly payment for the first few years, but then raise the payments exponentially for the remaining years. As interest rates rise in this situation, borrowers are often unable to meet their mortgage payments. Furthermore, when government sponsored enterprises (GSEs) like Freddie Mac and Fannie Mae began securitizing more subprime and non-traditional loans, they relaxed their underwriting standards, creating more risk-prone loans.

On January 6, 2009, Chairman Conyers (D-MI) introduced H.R. 200, the Helping Families Save Their Homes in Bankruptcy Act of 2009, with the goal of allowing bankruptcy judges to modify mortgages before foreclosure becomes essential. The bill would allow judges to "cramdown" a loan – lowering the amount a borrower must pay a creditor on a loan. Cramdowns on principal residences are currently not allowed under Chapter 13 bankruptcy, which enables a debtor to develop a plan to repay the debt to the creditor.

H.R. 200 was reported out of the House Judiciary Committee on February 24, 2009 (See Committee Report: 119-19). H.R. 1106 contains a majority of provisions that were included in H.R. 200 (Title I), as well as provisions that fall under the jurisdiction of the Financial Services Committee (Title II).

Title I—Prevention of Mortgage Foreclosures

Title I would allow bankruptcy judges to restructure mortgage payments after an individual files Chapter 13 bankruptcy. Under current law, Chapter 13 bankruptcy allows a judge to "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*." In other words, home mortgages are not able to be restructured under Chapter 13 bankruptcy. This bill will alter that by giving judges the ability to adjust the rate and terms of a mortgage.

The major provisions of the title do the following:

- amends the means test to determine whether or not a debtor must file Chapter 13 bankruptcy (by including the primary residence as eligible for Chapter 13 bankruptcy court);
- requires a debtor who is eligible for a cramdown under Chapter 13, to pay the lender a percentage of the sale if the home is sold within four years and there are still outstanding payments on the loan;
- gives the authority to modify certain mortgages. This section allows for the modification, or "cramdown," of primary residence mortgages (only on mortgages initiated before enactment of this bill);
- prohibits fees, costs, or charges from being added to a debt while a Chapter 13 case is pending, unless the creditor gives notice of the fees; and
- provides that a primary residence mortgage lien shall be retained until the modified lien is fully paid.

Title II—Foreclosure Mitigation and Credit Availability

Service Safe Harbor for Mortgage Loan Modifications: The provision is intended to protect mortgage servicers from liability if the servicer makes mortgage loan modifications under conditions specified in the bill. The "safe harbor" under the legislation is available if default on a mortgage has occurred or is likely to occur, and the servicer reasonably believes that the anticipated recovery on the principal outstanding obligation of the mortgage under the modification plan will exceed money collected via foreclosure.

The legislation further requires that any servicer that engages in loan modifications or workout plans based on the safe harbor provided in the bill fulfill certain reporting requirements.

This provision would apply to all mortgage servers, even where a contract currently exists between the mortgage servicer and investors that explicitly prohibits loan modifications. The provision would apply for modifications, workouts, and other loss mitigation plans entered into before January 1, 2012.

Changes to Hope for Homeowners Program: The Hope for Homeowners Program was created by the Housing and Economic Recovery Act of 2008. The program authorizes $300 billion of FHA loan guarantees.

In general, this section of the bill is intended to increase the number of loans refinanced through the Hoper for Homeowners program. Originally CBO projected that 400,000 Americans would take advantage of the program, but so far less than 25 loans have been closed. This section of the bill would:

- put the Secretary of Labor in charge of running the program, and give the program's board an advisory role;
- eliminate the requirement that an individual receiving assistance under this program verify their income by providing income tax return information—instead, the legislation allows the Secretary of Labor to create alternative procedures and standards;
- reduce the upfront fee for the program from 3% to 2%, and reduce the annual free from 1.5% to 1%;
- allow the Secretary to make payments of up to $1,000 for each loan made by the servicer; and
- require the Secretary ("if feasible"), with the concurrence of the board, to create an auction process to refinance eligible mortgages on a wholesale or bulk basis.

The bill prohibits anyone with a net worth of more than $1 million from participating in the program.

The legislation also reduces the $700 billion of TARP (Troubled Asset Relief Program—or "bailout") funding under the Emergency Economic Stabilization Act by $2.316 billion.

Requirements for FHA-Approved Mortgagees: The bill prohibits any person or entity that is not approved by the Secretary to serve as a mortgagee. In order to be approved by the Secretary, an applicant mortgagee must not have any officer, partner, director, principal, or employee who meets one of several conditions listed on pages 36-37 of the bill.

Permanent Increase to FDIC Cap: The bill permanently increases the limit on deposits insured by the Federal Deposit Insurance Corporation (FDIC) and the National Credit Union Administration (NCUA) to $250,000. The Emergency Economic Stabilization Act (H.R. 1424) increased the limit from $100,000 to $250,000 through December 31, 2009. However, under current law, the limit goes back down to $100,000 beginning in 2010.

In addition to the permanent increase to $250,000, H.R. 1106 provides for an inflation adjustment beginning in 2015 and each succeeding year. The legislation extends from five years to eight years the amount of time available to replenish their insurance funds. Finally, the bill increases the FDIC's borrowing authority from $30 billion to $100 billion and increases the NCUA's borrowing authority from $100 million to $6 billion.

According to the score for H.R. 786 (a bill containing this provision), this section of the bill would increase spending by $7.6 billion over five years but reduce spending by $14.9 billion over ten years. A similar provision was also included in H.R. 384, the TARP Reform and Accountability Act.

Possible Effects of This Legislation and Conservative Concerns:

- **Rising Interest Rates, Tightened Lending Requirements, and Higher Down Payments**. In order to protect themselves from a financial loss and the added risks that will result from this legislation, banks will likely be forced to raise interest rates, and mortgage lenders will likely have to require more of a down payment. Lenders will have to absorb debts that are relieved in bankruptcy court and protect themselves against the risk of having loans crammed down. Such increased costs will likely be passed on to the borrower.

- **Difficulty in Refinancing**. Lenders who were previously willing to offer high percentage loan-to-value financing will be hesitant to do so given a greater risk of a bankruptcy cramdown.

- **Encourages Bankruptcy Filings**. According to the House Judiciary minority views, there are currently an approximate 4 million homeowners that are delinquent in their mortgage payments. There are approximately 12-15 million more who are struggling with their mortgage payments. With the option of a cramdown of what an individual owes on his or her home, there is incentive for these struggling homeowners to file Chapter 13 bankruptcy.

- **Discharges other debt**. This bill could allow a borrower to discharge other debt (credit card, car loans, medical debt) by encouraging bankruptcy filings.

- **Rewards those who are living beyond their means**. This legislation does not differentiate between prime loans (given to borrowers with good credit) and subprime loans (given to borrowers with a heightened risk of default) when it comes to cramdowns. Essentially, it makes no distinction between those individuals who have fallen on hard times and are unable to make some payments, and those individuals who are living well beyond their means and cannot afford at all the home in which they live.

- **Federal Housing Authority (FHA), Veterans Affairs (VA), and the Rural Housing Service (RHS) loans will be put at risk.** The VA and FHA have programs that provide lenders insurance against borrowers who do not make their payments. This would not be the case with a cramdown. Cramdowns would create a huge loss for FHA and VA lenders for which they will have to make up with higher interest rates, higher down payment requirements, or by simply getting rid of the programs.

- **Cramdowns will be costly to investors.** Many mortgages are packaged into mortgage-backed securities (MBSs) guaranteed by the federal government via Fannie Mae or Freddie Mac (GSEs). When these mortgages are crammed down, GSEs take a loss on the guarantee, which is then pushed off to the investor.

- **Increased capital reserves will lead to decreased lending**. The bill will cause banks to have to increase their capital reserves in order to account for the cramdowns in bankruptcy court. As stated in a recent letter to Secretary of the Treasury Timothy Geithner, from both the Ranking Members of the House Judiciary and Financial Services Committees, "…widespread cramdowns of mortgages in bankruptcy will force downgrades of senior-tranche mortgage-backed securities held by banks and insurance companies. These downgrades will force financial institutions holding the securities to boost their capital reserves significantly. For example, a bank holding a AAA-rated security that has been downgraded to a BB rating will have to increase its associated capital reserves tenfold."

- **The bill comes at a cost to future homebuyers.** Proponents of this bill argue that it is a costless solution to the foreclosure crisis. However, it will create a significant cost to future borrowers who have to make up for money lost to lenders due to cramdowns.

- **Attempted Expansion of Hope for Homeowners Program:** Many conservatives may oppose expansion of the Hope for Homeowners Program. For example, the Minority Views of the Committee Report for H.R. 787 (legislation also aimed at expanding the Hope for Homeowners program) states in part:

  "H.R. 787, as now estimated by CBO, would improve the efficacy of the HOPE for Homeowners program by serving 25,000 distressed households but at a cost of $670 million dollars, or $27,000 per assisted family. ***We believe that Congress should eliminate this program because it is ineffective, costly and does not maximize the taxpayer's investment in providing foreclosures mitigation to distressed homeowners. Instead, we believe that Congress should start anew with private and existing public initiatives that have a proven record and will not expose taxpayers to costly remedies while doing little to improve conditions in the housing market."***

Democrat Inconsistency Alert!

Democrats claim that they want to make it easier for more people to own homes, yet H.R. 1106 would create conditions under which mortgage lenders would likely decrease their lending.

What the Experts Are Saying About Cramdown:

As David Kittle, Chairman of the Mortgage Banks Association stated in his testimony in front of the U.S. Senate Committee on the Judiciary in November 2008:

> *…the unintended result would be large numbers of bankruptcies, higher losses to servicers, lenders and investors, and reduced ability by the financial industry to extend affordable credit. Such bankruptcy reform will have a negative impact on individual borrowers, a housing recovery and the economy as a whole.*

As stated in a recent letter to Secretary of the Treasury Timothy Geithner, from both the Ranking Members of the House Judiciary and Financial Services Committees, under the proposed bill:

> *Although allowing for this type of modification in bankruptcy may have the short-term effect of lowering bankruptcy petitioners' monthly payments, it is certain to yield negative long-term consequences for taxpayers and the federal government that will dwarf any benefit to the economy that cramdowns might create.*

Organizations Opposed to Bankruptcy Cramdown Legislation:

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, and the U.S. Chamber of Commerce

Citigroup Deal: Citigroup supported H.R. 200 (Title I of H.R. 1106) due to a compromise with the Democrats that included the following concessions: 1.) the bill will not apply to future mortgages; 2.) the bill will require homeowners to prove an attempt to contact lenders to change the terms of their loan before filing for bankruptcy; and 3.) the bill will only disallow claims for mortgages involving major Truth in Lending Act violations.

Committee Action: On February 23, 2009, the bill was referred to the Committees on Financial Services, Judiciary, and Veterans Affairs, none of which took subsequent public action.

Administration Position: No Statement of Administration Policy (SAP) was available at press time.

Cost to Taxpayers: No CBO score is available.

Does the Bill Expand the Size and Scope of the Federal Government?: Yes, by allowing the government to rewrite an additional class of private contracts as part of bankruptcy proceedings.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: No CBO score is available. However, among other things, the bill allows judges to cramdown an individual's loan on primary residences.

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: An earmark statement was not available at press time.

RSC Staff Contact: Natalie Farr, natalie.farr@mail.house.gov, 6-0718 (Title I) and Brad Watson, brad.watson@mail.house.gov, 6-9719 (Title II).