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To the U.S. House Judiciary Committee
Subcommittee on Commercial and Administrative Law

"Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress – Part 2"

<u>October 30, 2007</u>

Chairman Sánchez, Ranking Member Cannon, and members of the Subcommittee, thank you for holding this second hearing on how we can protect homeownership and provide relief to consumers in financial distress. I appreciate the opportunity to provide this statement.

In the short month since Part 1 of this hearing, the problems in the subprime market have become more evident and have grown even worse. However, one hopeful sign is that we now have an active bipartisan effort to address this situation. I commend Representatives Miller, Sánchez and others for their current bankruptcy proposal, and I also want to commend Representative Chabot for his leadership in recognizing bankruptcy reform as a necessary tool for addressing the massive home losses families are experiencing today. A collaborative approach to this problem is essential, and it is heartening to see consensus on the need for action.

I. An Update on the Situation

The epidemic of subprime foreclosures keeps growing, and the ripple effects continue to extend wider. For example, First American CoreLogic (CoreLogic), a private firm with expertise in risk management, has highlighted how quickly risks are escalating in the mortgage market.[1] During the past month alone, roughly 150,000 households have experienced interest rate resets on subprime exploding adjustable rate mortgages (ARMs), meaning that these families are facing monthly payment increases ranging from 20% to 40%.[2] According to CoreLogic, up to 75,000 of these families will lose their homes to foreclosure. In fact, every week that passes without Congressional action to tweak to the bankruptcy code, some 18,000 families will lose their homes to foreclosure. And every subsequent day, the neighbors of each of these families will pay the price in the form of reduced property values, vacant houses nearby and a substantially reduced quality of life.

Homeowners aren't the only ones hurting; problems are still accelerating for lending institutions and financial markets. In the past month we've seen many companies with a stake in subprime lending report higher losses and layoffs. Countrywide Financial Corp. posted a $1.2 billion loss in the third quarter and has seen its stock lose 60% of its value and 12,000 of its employees lose their jobs so far this year. Last week, Merrill Lynch announced it lost $8.4 billion in the 3rd quarter—its worst loss in 93 years—with $7.9

billion of these losses on subprime and CDO assets. Citigroup reported at the beginning of this month that it was writing down $1.3 billion in subprime assets and paying $2.6 billion to cover credit losses and increased reserves. UBS AG reported its first quarterly loss in five years, and predicted that banks and securities firms will see more than **$30 billion** in bad loans and trading losses during the July-through-September period.[3]

Mortgage investors continue to suffer as well. ABX indices hit new lows last week, as the trusts that hold the loans backing subprime bonds in the ABX showed an "increase in 30- and 60-plus day delinquencies [that] was both alarming and surprising on deals that are yet approaching reset." In one alarming example, Barclays reported that the rate of 60-plus day delinquencies on loans from the second half of 2006 now stands at 29**%**. As a result of these reports, Moody's announced last Friday that it was downgrading or placing on review for downgrade a slew of CDO tranches. While the ratings firm did not immediately specify the amount of CDOs affected by the ratings action, an initial count by Dow Jones Newswires put the total at more than $4 billion.[4]

With such widespread repercussions from subprime foreclosures, it's no surprise that consumers have ranked the subprime crisis above global warming and the federal deficit among their most pressing concerns, according to a recent survey by TNS North America.[5] It is notable that subprime lenders—who should have known better in the first place—have yet to act on the widespread public understanding that recent lending is excessively risky. As Friedman Billings Ramsey reports in a recent study: "We find scant evidence that the risk characteristics of subprime loans originated in 2007 differ significantly from those of subprime loans originated in 2006 and 2005. Therefore, we cannot conclude that lenders have reversed the liberal underwriting criteria of 2007, limited exceptions to these criteria, and strengthened quality control procedures for newly originated subprime loans."[6]

Since the hearing last month, a number of prominent, independent housing economists have recognized the massive scale of the foreclosure crisis, the fact that current efforts to address this crisis are wholly insufficient, and that allowing judicial modification under chapter 13 is an essential part of the solution. Three preeminent professors that I spoke with who specialize in real estate economics and finance support the proposal: William Apgar, Senior Scholar at Harvard's Joint Center for Housing Studies, a former FHA Commissioner; Karl E. Case, a highly respected Professor of Economics at Wellesley College; and Roberto Quercia, Director of the Center for Community Capital at UNC-Chapel Hill. In addition, this Subcommittee has received a letter to this effect from Robert Shiller, Professor of Economics and Professor of Finance at Yale University and a principal in creating the Standard & Poor's Case-Shiller® Home Price Index, which is, according to S&P, "the leading indicator on the overall health of the U.S. housing market." Finally, Mark Zandi, Chief Economist and co-founder of Moody's Economy. com, is testifying in support today.

II. Suggested Modifications to the Miller-Sánchez Bill

While discussing this matter with independent experts, I also spoke with a number of industry representatives who raised objections to the change in the bankruptcy code that we support. Some of the points raised, in my view, were good ones, and thus I would suggest modifying the Miller-Sánchez bill in the following ways:

A. Eligibility

Objection: Families with sufficient income to pay their mortgage should not benefit from the provision. People should not file for a chapter 13 modification if their property has lost value but they are able to continue paying their underwater mortgage; they should only use the bankruptcy option if their only alternative is foreclosure. Otherwise, they will be obtaining a windfall; bankruptcy should be the last option, not the first.

Solution: Impose a strict means test to ensure that only people who otherwise face foreclosure are eligible for a loan modification on their principal residence under chapter 13. To qualify for relief under the proposed bankruptcy tweak, a debtor must satisfy a rigid means test, and must live within strict budget limits.[7] In addition, the good faith requirement already applies, so someone who meets the means test but can still afford mortgage, somehow, could be excluded by lender objection. Finally, the existing $1 million loan limit for secured debt still applies as well.

B. Loan Term

Objection: Since there is no limitation on loan term, a borrower could have already been in a loan for 15 years, and a judge could extend the term out for another 30 years, making the total term 45 years. This would be unfair to lenders. Also, the bill does not provide enough guidance to judges.

Solution: Clarify that the modified loan term can only be up to 30 years less the period of time that the loan has been outstanding. Given that most loans are 30 years, this means that the loan term will generally be unchanged. However, if the original loan term was 40 years, the remaining term should be unchanged.

C. Credit counseling

Objection: A borrower should receive the benefit of credit counseling before filing for bankruptcy whenever possible, since, by receiving good advice, he or she may still be able to avoid filing. Since the lender files a foreclosure petition well before the foreclosure sale occurs, there is plenty of time to obtain counseling even after this event.

Solution: Allow a waiver of credit counseling only after the foreclosure sale has been scheduled. By this time, when the borrower is facing the imminent sale of his or her house and eviction, it is much too late for counseling to be able to prevent the debtor from filing for bankruptcy since that is potentially the only way to save the home.

D. Guidance to bankruptcy judges

Objection: The bill does not provide bankruptcy judges enough guidance on how to modify loan terms, which are threefold: remaining term in years, interest rate, and principal balance. The judge could therefore add 30 years to a loan that has already been outstanding for 15 years, reduce interest rates to 1% or 2% to make the loan maximally affordable, and cram down the principal to a 50% loan-to-value ratio. Such terms would be unfair to lenders, and the uncertainty created by lack of guidance will have a chilling effect on the market.

Solution: Provide guidance to bankruptcy judges on loan term to essentially leave it the same (see above) and establish that the benchmark interest rate will be market rate: the prevailing 30-year fixed rate plus a risk premium. Such a rule is consistent with holding in the Till case to use a customary index and require the judge to add a risk premium; the prime rate used in Till is customary for car loans but is not used to set the interest rate on first mortgages. In addition, the principal can only be crammed down to the fair market value of houseThe amount over value would become unsecured debt paid to extent family is able during 3 to 5 years of the plan. If a family fails in completing the chapter 13 plan, the loan returns to its original terms and cramdown is undone.

III. Arguments that Don't Hold Up Under Scrutiny

A. A Realistic Look at Market-Based Arguments

In addition to the concerns discussed above, the two most common points raised opposing the bankruptcy changes are: (1) market corrections will be adequate and therefore the bankruptcy solution is not necessary, and (2) allowing judicial modification would destroy the market. Let me explain why neither is valid.

1. The market through voluntary modifications is not correcting the problem.

Some industry representatives say lenders are modifying loans in such great numbers that the government does not need to do anything about it. On August 31, President Bush announced a White House initiative to help homeowners facing foreclosure. In his press conference, the President said, "I strongly urge lenders to work with homeowners to adjust their mortgages. I believe lenders have a responsibility to help these good people to renegotiate so they can stay in their home." Regulators have urged the same actions for banks they regulate.[8]

While there has been increased activity and a number of initiatives have been announced, the scope of the problem still dwarfs the response. As I mentioned in my previous testimony, Moody's Investor Servicers surveyed 80% of the servicing market through July of this year, and found that most lenders were modifying only 1% of subprime loans experiencing rate reset.[9] As a result, Moody's expected to continue downgrading mortgage-backed securities (MBS) because of rising defaults.

When considering this 1% figure, keep in mind that the chief researcher at First American CoreLogic concluded that up to half of the 450,000 families facing subprime resets in the next three months will lose their homes to foreclosure. Thus, even if industry modification efforts increase ten-fold—an extraordinary increase under any circumstances—that effort would still be far from enough.

Just this month, the California Reinvestment Coalition (CRC) surveyed 33 mortgage counseling agencies that offer assistance to financially strained borrowers, and found that "California's largest lenders are not helping borrowers, who struggle to make their mortgage payments, avoid foreclosure . . . . [M]ost borrowers are pushed to foreclosure or short sale, leaving them without the homes they worked so hard to own. Fifty-seven percent of counselors surveyed reported foreclosure, and 33 percent reported short sale, as the most common outcomes for borrowers who cannot afford to pay their mortgages. Both of these outcomes lead to more people losing their homes."[10]

Moreover, many of those few modifications that are being made do not comply with the objective of long-term sustainability. Indeed, most of Countrywide's foreclosure prevention activities consist of simply capitalizing arrearages, or taking the borrower's home before the foreclosure proceedings are completed.[11] Others simply delay the rate reset for six to 24 months, or worse, I've heard, add the unpaid interest between the teaser and fully adjusted rates to the loan's principal balance, thus delaying the problem and making it worse at the same time.

The fact is that there are several structural obstacles to modifications on a large scale that will prevent voluntary modifications from occurring in sufficient numbers without enacting the change to the bankruptcy code. Even those servicers and lenders who genuinely wish to help homeowners in distress, or who recognize that investors as a whole would fare better under a modification than through foreclosure, face significant obstacles to modifying loans. The following are four main reasons for failing to modify:

- Fear of Investor Lawsuits. The servicer has obligations to investors who have purchased mortgage-backed securities through pooling and servicing contracts. Modifying a loan typically impacts various tranches of a security differently, which raises the specter of investor lawsuits when one or more tranches lose income. For example, a modification that defers loss rather than immediately writing down principal will favor the residual holder if the excess yield account is released after a certain period of time, generally three years, but will hurt senior bondholders since the residual, or equity, will not be there to absorb losses anymore. In an uncertain situation of tranches with different interests, the least risky course for the servicer is to pursue foreclosure – even though this may be the least economically beneficial for investors as a whole.

The Consumer Mortgage Coalition made just this point in a letter to FDIC Chairman Sheila Bair, noting that servicers that modify too aggressively face investor lawsuits. The letter noted that private securitizations typically do not have an active manager to which the servicer can go for approvals.

> While this passive structure may appear to give the servicer more discretion, in fact, because of the lack of an active decision-maker from which the servicer could obtain waivers of the usual requirements, no entity exists with the authority to grant waivers. As a result, a servicer that violates the terms of the [pooling and servicing agreement] faces potential legal action from the securitization trustee and even from the securities holders themselves. When a servicer agrees with a customer to reduce a loan's interest rate or principal balance, the servicer is giving away the investors' money, not its own. As a result, investors limit the servicer's discretion to make significant modifications both through the servicing contract and related guidelines.[12]

- Dilemma of Piggyback Seconds. Somewhere between one-third to one-half of 2006 subprime borrowers took out piggyback second mortgages on their home at the same time as they took out their first mortgage.[13] When there is a second mortgage, the holder of the first mortgage has no incentive to provide modifications that would free up borrower resources to make payments on the second mortgage. At the same time, the holder of the second mortgage has no incentive to support an effective modification, which would likely cause it to face a 100% loss; rather, the holder of the second is better off waiting to see if a borrower can make a few payments before foreclosure. Beyond the inherent economic conflict, dealing with two servicers is a negotiating challenge that most borrowers cannot surmount.

- Servicers Overwhelmed by Demand. The magnitude of the crisis has simply been too much for many servicing operations to effectively respond. Hundreds of thousands of borrowers are asking for relief from organizations that have traditionally had a collections mentality, have been increasingly automated, and whose workers are simply not equipped to handle case-by-case negotiations. Many of these servicers are affiliated with lenders who are going bankrupt or facing severe financial stress, and therefore they are cutting back on staff just as the demands are increasing significantly. In addition, housing counselors and attorneys have observed that even when top management expresses a desire to make voluntary modifications, the word does not filter to the front-line staff.

- Mismatched Incentives between Servicer and Investor. Foreclosures are costly – often costing 40% or more of the outstanding loan balance – but these costs are borne by investors, not servicers. In fact, servicers often charge fees by affiliates for appraisals, foreclosure trustee services and other foreclosure-related services, and so can have economic incentives to proceed to foreclosure since these fees are paid first after sale of the house following foreclosure, even where a loan modification would be better for investors.[14]

Since, for the various reasons listed above, servicers have not modified loans that are proceeding directly to foreclosure in significant numbers, Congressional action is needed to enable bankruptcy courts to order loan modifications. This will remove the threat of investor lawsuit and therefore lead to voluntary modifications on a much larger scale than has occurred to date. This legislation would be in the interest of borrowers and investors alike.

2. Tweaking the bankruptcy code would actually improve the market.

Some industry groups are asserting that judicial modifications will negatively impact the mortgage market.[15] There is irony to this claim given that the current credit squeeze is caused by the *lack* of adequate regulation. Absent such regulation, reckless lending practices flourished, causing lender bankruptcies and investor losses. Investors reacted abruptly (and belatedly) to stem further losses, causing a sudden, unplanned-for, and highly disruptive liquidity crisis.

Be that as it may, the prominent independent economists I mentioned earlier do not believe that the proposal will harm the market, and there is strong evidence that the proposed reform will not adversely affect the availability of credit and, in fact, will help stabilize the housing market. Such evidence includes the following:

- Experience shows that past modifications worked well without adversely affecting the availability of credit. For the fifteen years between the enactment of the 1978 Bankruptcy Code and the Supreme Court's 1993 *Nobleman* decision interpreting the Code to disallow modification of loans on primary residences, numerous bankruptcy courts did allow modifications of mortgages on primary residences by placing the portion above the market value of the house on par with other unsecured debts. There is no evidence that the cost or availability of credit for mortgages on primary residences was negatively impacted in these jurisdictions during this time, either compared to jurisdictions that did not allow modifications or compared to lending patterns after 1993.[16]

- Bankruptcy modifications work fine for other types of assets. The claim that allowing modifications of home mortgages will adversely impact the cost or availability of credit is similarly belied by decades of experience in which bankruptcy courts have been modifying mortgage loans on family farms in chapter 12,[17] commercial real estate in chapter 11,[18] vacation homes and investor properties in chapter 13,[19] with no ill effects on credit in those submarkets. Debt secured by all of these asset types, in addition to credit cards and car loans, are easily securitized even though they can be modified in bankruptcy.[20]

  In its position paper distributed on Capital Hill, "Oppose Proposals to Modify Mortgage Obligations During Bankruptcy Proceedings," the Securities Industry and

Financial Markets Association (SIFMA) argues that allowing bankruptcy judges to modify mortgages on primary residences, would cause "major disruption in the financial markets." It uses two main pieces of evidence to support this claim. First, it claims that loans on investment properties have higher interest rates and higher down payment requirements because they can be modified in bankruptcy. I must say, in over a decade dealing with housing finance, I have never heard this argument before. As Self-Help has recognized through our commercial lending operation and as the Wall Street Journal concludes, these loans are simply riskier than loans on owner occupied houses, since investors are much more likely to walk away than homeowners. Second, SIFMA asserts that because of judicial modification, loans on second homes and investment properties are more difficult to securitize. It then cites an article in the trade publication Inside MBS & ABS to assert that only 9% of mortgages on second homes are securitized. However, the reference cited for this statistic makes this point about *second liens, not second homes.*[21] Most second mortgages are in fact on primary residences, which are not subject to modification in bankruptcy. Since both of SIFMA's pieces of evidence do not withstand scrutiny, their claim of market impact must be viewed with extreme skepticism.

- Bankruptcy reform would impact only a fraction of all mortgages. We estimate that the proposed changes to the bankruptcy law would allow 600,000 families who are facing foreclosure to keep their homes.[22] While this number would significantly reduce the severity of the current foreclosure epidemic, it only represents 1.4% of all homeowner households with outstanding mortgages.

- Investors receive more from loan modifications than foreclosures. For the 600,000 families whom we expect this legislation to help, the alternative to a loan modification is foreclosure. This outcome is worse, not only for borrowers, but for lenders as well. Chapter 13 would guarantee at least the market value of the property that the lender took as collateral and would mandate that the borrower make regular payments over three to five years on the difference between market value and the loan balance. Conversely, under foreclosure, lenders receive only liquidation value, not fair market value, with any remaining balance written off altogether. In addition, there are significant expenses associated with foreclosure that would not arise under judicial modification: lenders face one to two year delays and incur high legal expenses, not to mention the costs related to the maintenance and sale of the property. Thus, subprime lenders or investors lose approximately 40% of the principal balance of a loan that defaults.[23] Finally, foreclosures have significant negative impacts on surrounding property values. Therefore, to the extent a lender holds liens on other properties in the area, loan modifications help protect the value of other collateral

- Preventing foreclosures will preserve home prices and assist the overall housing market. Foreclosures depress housing prices overall. Millions of families *not facing foreclosure*—those who have faithfully paid their mortgages on time—lose equity through property value declines every time there is a foreclosure in their neighborhood**.** Averting 600,000 foreclosures will save an additional $72.5 billion in wealth lost by American families *not* facing foreclosure.[24] This in turn will save local governments property tax revenues, as well as the significant costs of police and administrative support that foreclosures require.[25] According to the Joint Economic Committee, every new foreclosure can cost all stakeholders $80,000.[26]

- The cost of credit already reflects the risk that some loans will end in the loss of the home to foreclosure. Because the Miller- Sánchez bill revised to include a means test would provide for modifications only in those cases where without it the home will be lost to foreclosure, and because modification is economically preferable to the lender/investor than the cost and loss associated with foreclosure, it imposes no additional risk, and hence, no further cost. Bankruptcy in this situation does not cause default, it merely ameliorates it.

B. Misconceptions About the Proposal

I would like to address several other common misconceptions. One complaint about the bill is that it seeks to reopen the 2005 bankruptcy act, which has not been in place long enough to justify changing. However, the proposal goes back to the 1978 implementation of the current bankruptcy code, when judicial modification was instituted, bypassing the 2005 changes. In fact, the proposal can be looked at to complement the 2005 act, which moved more borrowers from a chapter 7 liquidation plan to a chapter 13 payment plan. However, when the mortgage on a principal residence is not affordable and is the cause of the family's financial distress, chapter 13 is ineffective; this proposal would enable the chapter 13 plan that the 2005 act encouraged to work. The only provision that even touches the 2005 act is the credit counseling provision. However, if modified to waive counseling only when foreclosure sale is scheduled, it can hardly be said to be a repeal of 2005, and the debt management counseling provided before discharge would still be required.

Some who oppose the proposal are attempting to frame it as legislation that would benefit speculators, investors and/or wealthy homeowners. In fact, the opposite is true: The bill will benefit ordinary homeowners only. It will not have any impact at all on speculators or investors; current law—not the proposal – allows mortgage loan modifications by speculators and investors. The bill would apply to ordinary homeowning families only, and would extend to these families the protections that have long existed for all other debtors and for all other debts. In fact, following a chapter 13 plan requires a family to abide by a budget with *severe limitations* on living expenses overseen by a judge for three to five years, hardly an option a wealthy family is likely to subject themselves to.

Another critique I have heard is that it is unreasonable or unfair to expect lenders to modify the interest rate or principal balance of outstanding loans. To the contrary, the proposal is designed so that lenders will recover *more* from the modification than from the lender's available alternative (foreclosure). Moreover, modifications, including reducing and fixing interest rates and reducing the principal balance, are called for both by Senator Dodd's May 2007 Homeownership Preservation Principles (endorsed by industry leaders), as well as all of the federal banking agencies and the Conference of State Banking Supervisors.[27]

In related argument, some in the industry say that lenders and servicers cannot modify troubled loans because of obstacles posed by securitization vehicles and the objections of those who hold second mortgages. First, this is true only some of the time; in most instances, where a borrower has defaulted or default is reasonably imminent, servicers have authority to modify these loans. But those servicers who do not have such authority, or who fear investor lawsuits, are exactly why the proposal is necessary: bankruptcy judges can order modifications where lenders and servicers cannot not make them voluntarily.

Similarly, opponents say that lenders should be given the opportunity to approve (or veto) any proposed cram-down. However, the reality is that this is sometimes not possible, given the legal obstacles that securitization can place on the servicer. Moreover, as noted above, even where lenders or servicers have the authority to approve these changes, many are reluctant to do so out of fear that any discretion they exercise will give investors a basis for suing them. Empowering bankruptcy judges to order these changes will provide lenders and servicers with the "cover" they need. Today we are seeing the results of lenders' inaction; leaving cram-downs to lender discretion would maintain the status quo and allow the foreclosure epidemic and all its negative effects to continue expanding unchecked.

Finally, some argue that only low-income people should be able to take advantage of judicial modification. However, people with incomes higher than their state median income were deceived into taking an exploding ARM, and should therefore also receive the benefit of judicial modification. For an extra 0.65% over the teaser rate, recent exploding ARM borrowers could have received a fixed rate loan and avoided the rate reset.[28] Instead, half of such borrowers in 2006 paid even more -- an extra 1% or so -- to get a "stated income" loan, even though they had W-2s readily available. Also, 75% got their loans from a broker, and most paid a higher interest rate over what they qualified for and often a prepayment penalty to provide the broker with a yield-spread premium.

In addition, people who have higher-than-median incomes live in middle-class neighborhoods that will be devastated by foreclosures resulting from their neighbors' exploding ARMs. This will reduce everyone's property values, including those faithfully paying their mortgages, and reduce everyone's wealth.

IV. Conclusion

Much of my statement addresses arguments against bankruptcy reform, but let me end by reminding you of all the reasons in favor of opening existing protections to homeowners. The benefits and advantages are many:

- There would be no cost to the U.S. Treasury, and experience shows there would be no negative impact on home credit.

- This solution, particularly with the tweaks I have discussed today, narrowly targets families who would otherwise lose their homes.

- This solution also helps families who live in the vicinity of potential foreclosures by minimizing the amount of value lost in surrounding properties.

- And, finally, this solution not only helps homeowners, it is also better for investors as a whole. Chapter 13 loan modifications are less expensive for lenders and investors than the cost of foreclosures, and modifications would guarantee at least the value of the property that the lender took as collateral. Moreover, a loan modification ensures a continued stream of income—the borrower continues to pay—and, to the extent the lender is involved with other properties in the area, it prevents the further decline of overall property values.

By tweaking the bankruptcy code, Congress has an opportunity to help homeowners all over the country, and the ripple effects emanating from that action will have positive implications for families, local governments and the economy as a whole. I urge you to take this crucial step to help homeowners struggling with abusive subprime mortgages and thereby minimize the impact of the subprime crisis that ultimately will affect us all.

[1] *See, eg.*, Christopher L. Cagan, Mortgage Payment Reset: The Issue and the Impact, First American CoreLogic (March 19, 2007), available at http://www.facorelogic.com/uploadedFiles/Newsroom/Studies_and_Briefs/Studies/20070048MortgagePaymentResetStudy_FINAL.pdf; See also First American CoreLogic: Core Mortgage Risk Monitor Q4, 2007 (October, 2007), http://www.facorelogic.com/uploadedFiles/Newsroom/Innovations_Newsletter/Core_Mortgage_Risk_Monitor_Q3_2007.pdf; and First American CoreLogic: Core Mortgage Risk Monitor Q3, 2007 (Sept. 2007), http://www.facorelogic.com/uploadedFiles/Newsroom/Innovations_Newsletter/riskmonitor_Q4-07_3.pdf

[2] *See* Christopher Cagan, cited in Ivry, Bob, "Subprime Borrowers to Lose Homes at Record Pace as Rates Rise" (Sept. 19, 2007), Bloomberg, available at: http://www.bloomberg.com/apps/news?pid=email_en&refer=finance&sid=akOEPec30TR4.

[3] "UBS Says Subprime Contagion May Cause More Writedowns," (October 29, 2007), Bloomberg, available at http://www.bloomberg.com/apps/news?pid=20601085&sid=arFeWPc869rs.

[4] "ABX Index Hits Record Low Of 17.5 Cents Vs 18," Dow Jones Newswires (October 25, 2007), available at http://www.smartmoney.com/news/on/index.cfm?story=ON-20071026-000836-1526.

[5] "Public Perceptions," American Banker (October 11, 2007).

[6] "Changing Credit Performance of Subprime RMBS," FBR Capital Markets Structured Finance Insights, (Sept 27, 2007).

[7] The means test would exclude from relief any debtor whose monthly income exceeds the sum of: (a) monthly living expenses allowable under the chapter 13 means test that incorporates IRS living expense standards, plus (b) amount due on the mortgage. If a borrower has enough income left after living within the IRS's strict expense limitations to pay their mortgage, modification is not available. If there is not enough income left to do so, the family would otherwise lose their home in foreclosure, and relief is available. In addition, if the debtor does not have sufficient income even to pay a reasonable market-rate mortgage on a loan equal to the fair market value of the house, modification would not be available either. Note that the means test is generally met for families if foreclosure proceedings have been initiated already, since bankruptcy would be an alternative to the foreclosure.

[8] White House press release, August 31, 2007. *See also* the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, http://www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm

[9] Michael P. Drucker and William Fricke , Moody's Investors Service, Moody's Subprime Mortgage Servicer Survey on Loan Modifications, September 21, 2007 ("Based on the survey results, Moody's is concerned that the number of modifications that will be performed in the future by subprime servicers on loans facing reset may be lower than what will be needed to significantly mitigate losses in subprime pools backing rated securitizations.").

[10] http://www.calreinvest.org/news-room/2007-10-10; http://www.sfgate.com/cgi-bin/article.cgi?file=/c/a/2007/10/11/BUBTSL4IL.DTL&type=business. *See generally* "Modified Mortgages: Lenders Talking, Then Balking," San Francisco Chronicle, 9/13/07 ("Lenders are uniformly unwilling to make loan modifications for homeowners whose interest rates are resetting higher, said Rick Harper, director of housing at Consumer Credit Counseling Services of San Francisco, which talks to about 1,000 delinquent borrowers a month."); Jim Wasserman, "Foreclosures stack up: Frustrated borrowers who lenders to try to work things out say it's a fruitless ordeal," Sacramento Bee, 9/2/07; "Tangle of Loans Feeds Foreclosure Crisis," The Boston Globe, 7/3107 http://www.boston.com/business/personalfinance/articles/2007/07/31/tangle_of_loans_feeds_foreclosure_crisis/.

[11] Gretchen Morgenson, Can These Mortgages Be Saved?, The New York Times (Sept. 30, 2007), available at http://www.nytimes.com/2007/09/30/business/30country.html.

[12] "Group Warns on Large Scale Modifications: Consumer Mortgage Coalition Sends Letter to FDIC," MortgageDaily, December 9, 2007.

[13] Credit Suisse, Mortgage Liquidity du Jour: Underestimated No More, March 12, 2007, p. 5.

[14] Gretchen Morgenson, Can These Mortgages Be Saved?, The New York Times (Sept. 30, 2007), available at http://www.nytimes.com/2007/09/30/business/30country.html.

[15] Sloan, Steven."Bankruptcy Reform 2.0? Subprime Ills Raise Odds." American Banker, October 9, 2007. (http://qa.cujournal.com/$nocookies$/article.html?id=2007100590M4RK4L)

[16] CRL reviewed data on homeownership rates, for the years 1984 to 2000, from the United States Census Bureau, as well as data on mortgage interest rates for the same period, from the Federal Housing Finance Board's Monthly Interest Rate Survey, comparing both states that permitted modifications in bankruptcy and those that did not, as well as trends in "modification states" before and after the 1993 Nobleman decision. The data revealed no observable connection between the modification of home mortgages by bankruptcy courts and either homeownership rates or the cost of mortgage credit.

[17] *See, e.g.*, Hon. Greg Zerzan, Deputy Assistant Secretary for Financial Institutions Policy, Dep't of the Treasury, Congressional Testimony Before the House Committee on

Agriculture (June 2, 2004) ("There are many providers of credit to farmers and ranchers, including commercial banks, insurance companies, the Farm Credit System, and specialized agricultural credit providers. … Farmer Mac is providing a secondary market outlet for lenders to dispose of loans, much the same way that other financial institutions would purchase or participate in agricultural real estate mortgage loans from one another."); Peter J. Barry, Paul N. Ellinger and Bruce J. Sherrick, Valuation of Credit Risk in Agricultural Mortgages, American Journal of Agricultural Economics (Feb. 1, 2000) ("Agricultural mortgage markets in the United States are experiencing a major transition toward greater institutional lending, wider geographic dispersion, larger lending systems, increased standardization of financing arrangements, greater reliance on nondeposit funding, and expanded potential for securitized loan pools.").

[18] Stacey M. Berger, Does anyone (other than the borrowers) care about servicing quality?, Mortgage Banking (July 1, 2005) ("The commercial real estate finance industry has been reshaped by the strong influence of global capital markets. … A high proportion of fixed-rate loans are now securitized."); Kenneth P. Riggs, Jr., A new level of industry maturity: commercial real estate has earned its place in the pantheon of stable and attractive investment classes, Mortgage Banking (Jan. 1, 2005) http://www.encyclopedia.com/doc/1G1-127789084.html; Amos Smith, Lenders are renewing their interest in real estate, Los Angeles Business Journal (Oct. 16, 1995) ("Investors and developers are once again being courted by lenders and mortgage bankers seeking to finance commercial property. … Real estate lending is also providing attractive yields relative to other investments.")

[19] While interest rates are generally higher on investment properties than on primary residences, this is because "[e]xperts say such properties are higher foreclosure risks than homes lived in by their owners." "The United States of Subprime: Data Show Bad Loans Permeate the Nation; Pain Could Last Years" by Rick Brooks and Constance Mitchell Ford. Wall Street Journal, Page A1. October 11, 2007.

[20] *See* http://www.riskglossary.com/link/securitization.htm (All sorts of assets are securitized: auto loans, mortgages, credit card receivables); http://jobfunctions.bnet.com/whitepaper.aspx?docid=105734 ("credit card ABS market has become the primary vehicle by which the card industry funds unsecured loans to consumers").

[21] "Securitization Rate Slips in Second Quarter Despite Lag in Nonprime MBS Process," Inside MBS & ABS (September 7, 2007).

[22] *See* Appendix A, Testimony of Eric Stein, CRL, House Judiciary Subcommittee on Administrative and Commercial Law, "Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress,"September 25, 2007, http://www.responsiblelending.org/pdfs/stein-testimony-on-subprime.pdf.

[23] Fitch Smartview: 170 U.S. Subprime RMBS Transactions Placed Under Analylsis (Jul. 12, 2007), http://www.marketwatch.com/news/story/fitch-smartview-170-us-subprime/story.aspx?guid=%7b65699D03-9AFB-468F-86D5-D9272BFBEAE4%7d&print=true&dist=printTop -"First lien loan loss severity assumptions reflect the performance to-date, resulting in projected lifetime loss severity averaging approximately 40%, with a range of 30%-65% by transaction."

[24] Families lose 1.14% of their own house's value for every foreclosure that occurs on their block. Woodstock Institute, "There Goes the Neighborhood: The Effect of Single-Family Mortgage Foreclosures on Property Values," June 2005, http://www.woodstockinst.org/content/view/104/47/. Assuming the median house value equals $212,000 (National Association of REALTORS® Median Sales Price of Existing Single-Family Homes for Metropolitan Area, 2007 Q2, http://www.realtor.org/Research.nsf/files/MSAPRICESF.pdf/$FILE/MSAPRICESF.pdf, $212,000 value per home * 1.14% value lost per foreclosure* 50 homes per block = $121,000 value lost per foreclosure * 600,000 foreclosures avoided = $72.5 billion in home value saved.

[25] *See* Jim Rokakis, The Shadow of Debt – Slavic Village Is Fast Becoming a Ghost Town. It's Not Alone, (Sept. 30, 2007) http://www.washingtonpost.com/wp-dyn/content/article/2007/09/28/AR2007092801331.html?hpid=opinionsbox1; Noelle Knox, "Rising foreclosures reshaping communities," USA TODAY, 4/07, A1 http://www.usatoday.com/money/economy/housing/2007-04-12-foreclose-cover-usat_N.htm.

[26] http://www.jec.senate.gov/Documents/Reports/subprime11apr2007revised.pdf

[27] Homeownership Preservation Summit Statement of Principles (May 2, 2007), http://dodd.senate.gov/index.php?q=node/3870/print (The Principles were announced by Senator Dodd, and endorsed by the Mortgage Bankers Association, CitiGroup, Chase, Litton, HSBC, Countrywide, Wells, AFSA, Option One, Freddie Mac, and Fannie Mae); *also* the Interagency Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, http://www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm (Encouraging lenders to address subprime hybrid ARM resets by pursuing "appropriate loss mitigation strategies designed to preserve homeownership. . . . Appropriate loss mitigation strategies may include, for example, loan modifications, deferral of payments, or a reduction of principal.")

[28] Industry has acknowledged that borrowers placed in subprime hybrid ARMs could have received fixed-rate loans, with a rate difference that is "commonly in the 50 to 80 basis point range." January 25, 2007 letter from CFAL to Ben S. Bernanke, Sheila C. Bair, John C. Dugan, John M. Reich, JoAnn Johnson, and Neil Milner, at 3. A review of rate sheets from eight subprime lenders on file with CRL showed that the fixed rate premium in the spring of 2007 ranged from 40 basis points (available with a 3-year prepayment penalty) to 75 basis points.