



December 4, 2007

The Honorable Patrick Leahy
Chairman
Committee on the Judiciary
U.S. Senate
224 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Arlen Specter
Ranking Member
Committee on the Judiciary
U.S. Senate
152 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Leahy and Ranking Member Specter:

On behalf of the Mortgage Bankers Association (MBA), I write regarding the forthcoming U.S. Senate Judiciary Committee hearing, "The Looming Foreclosure Crisis: How To Help Families Save Their Homes." During the hearing, the committee will explore ways to assist families at risk of losing their homes. Specifically, the committee will look to legislative proposals, such as S. 2136, which would amend the nation's bankruptcy code, allowing judges to modify the terms of the mortgage contract and reduce the amount owed on mortgages. At a time when the mortgage market is already experiencing a serious credit crunch, proposals embodied in S. 2133 would further destabilize the mortgage market and result in injury to the overall economy. Specifically, mortgage bankers will no longer be sure that the money they lend is secured by real assets. This uncertainty will require higher interest rates and larger downpayments to offset the new risk and will push many lenders out of making certain mortgages.

MBA urges policymakers to take a more cautious and deliberate approach. Additional research is warranted given the complex nature of the issue and the known, unknown and unintended consequences of reopening the bankruptcy code.

Allowing bankruptcy judges to modify the terms of a mortgage – interest rate, repayment period, and other key provisions – effectively gives the courts free rein to rewrite these contracts without statutory or economic restraint. One of the most concerning parts of the legislation is the requirement that judges strip down or "cram down" the lien to the fair market value of the property at the time of the bankruptcy. Although these provisions are described as being targeted to remedying abusive subprime loans, they effectively cover all mortgages and home equity loans, thereby resulting in negative consequences for all future borrowers.

Current market conditions suggest that the risk premium lenders would charge could be as much as two full percentage points on a mortgage. In other words, if the interest rate

for a prime mortgage today is 6%, mortgage interest rates could go up to 8%, without any changes in market conditions, borrower credit or any other factor. As an example, at today's interest rates, a prime borrower with a 30-year fixed loan of \$300,000 at 6% interest would pay \$1,799 per month in principal and interest. If judges are allowed to alter the terms of a mortgage, we estimate that the rate for the same loan could go as high as 8%, leading to a monthly payment of \$2,201 -- a monthly increase of over \$400, an annual increase of \$4,824 and more than \$144,000 over the life of the loan. Alternatively, borrowers could see significantly larger downpayments of 20 to 30% on all loans.

We believe that rates and downpayments will be impacted significantly because lien stripping in bankruptcy renders ineffective certain portions of government mortgage insurance and other forms of credit enhancement that currently protect lenders against credit losses. The most obvious examples are with FHA and VA loans. Today, FHA insurance and VA guarantees protect the servicer against principal loss due to foreclosure. FHA and VA, however, cannot pay a claim for amounts stripped down in bankruptcy. Authorizing statutes for these programs simply never contemplated such risk. If lien strips were permitted, servicers that merely administer Ginnie Mae securities on behalf of passive investors will have to absorb principal losses they currently do not do today. Conversely, if the loan went to foreclosure, the servicer would *not* bear this risk. Without statutory changes, servicers will have to reduce their risk of loss by offsetting with higher rates or requiring greater downpayments. It is unclear what the impact would be on private mortgage insurance contracts, GSE trust indentures, and private label MBS contracts.

In addition to voiding various credit enhancements, the bankruptcy bill has the potential to void portions of mortgage companies' interests in hazard insurance claims. As a result, areas prone to natural disasters may simply not get funding because the loans can be crammed down to zero or close to zero and eradicate the creditor's hazard insurance claims along with it. This leaves lenders, servicers and investors at significant risk of principal loss.

If legislation such as S. 2136 were enacted, we anticipate a substantial surge in Chapter 13 filings because of the factors mentioned above and because the controls that currently limit lien stripping on *all other secured credit* will be removed solely for home loan creditors. Today, loans modified in bankruptcy must be entirely repaid within the maximum of three or five years. S. 2136 removes these restrictions and allows the modified debt to be paid over 30 years or the remaining term of the loan, thus ensuring bankruptcy filings will soar. Finally, we believe a surge of Chapter 13 filings will occur because the borrower can reap a windfall profit by stripping down the loan based on a temporary decline in what is historically an appreciating asset. Given this increased risk, it is clear that secondary market investors will have a difficult time pricing the risk associated with this bill and will price accordingly for the risk or switch to other types of investments that do not pose this risk.

Again, MBA respectfully urges members of the Judiciary Committee to take a more cautious and deliberate approach on this issue. Reopening the bankruptcy code would only further exacerbate the credit crisis, increase the costs of borrowing and ultimately hurt consumers.

Thank you for the opportunity to weigh in on this critically important issue. If you or your staff has any questions, please do not hesitate to contact me or Erick Gustafson, MBA's Vice President for Government Affairs, at (202) 557-2913.

Sincerely,

A handwritten signature in cursive script that reads "Kurt Pfothenauer". The signature is written in black ink and is positioned above the typed name.

Kurt Pfothenauer
Senior Vice President
Government Affairs and Public Policy