Testimony of

David G. Kittle

November 19, 2008

Statement of

David G. Kittle, CMB

Chairman, Mortgage Bankers Association Before the

Committee on the Judiciary United States Senate

November 19,2008

Hearing on

"Helping Families Save Their Homes: The Role of Bankruptcy

Law"

Mr. Chairman, Ranking Member Specter and members of the Committee, I am David G. Kittle, CMB, Executive Vice President of Vision Mortgage Capitol in Louisville, Kentucky and Chairman of the Mortgage Bankers Association (MBA).1 I appreciate the opportunity to appear before you today to testify on behalf of MBA and the mortgage industry concerning the situation in today's housing market, efforts to help families save their homes and to identify the proper role for bankruptcy law.

Many families are facing hard economic times and all reasonable options should be explored to help them save their homes. The mortgage industry has been very active in promoting home retention alternatives to foreclosure for decades. The current crisis, however, has been unprecedented and has required extraordinary resources and new initiatives to help stem the rate of foreclosure. Congress has passed several critical pieces of legislation that have provided the industry with a number of new tools to assist in helping troubled borrowers. From July 2007 to September 2008, the mortgage industry has helped an estimated 2.47 million borrowers avoid foreclosure through repayment plans and loan modifications.2

Although these efforts are bold, we agree that additional work needs to be done to stimulate the economy and help those borrowers who are in trouble. MBA is working diligently with its members to look for new ways to overcome some of the obstacles that servicers currently face. We are examining various options, including FDIC Chairman Sheila Bair's proposal, which MBA believes has significant potential to assist more consumers.

At the same time, Congress and the Administration should move cautiously to ensure that any action is fully researched and vetted as to its potential consequences to consumers, financial institutions, the credit markets and the national economy. One of the greatest potential destabilizing initiatives is the topic of discussion today - allowing bankruptcy "cramdown,,3 for home mortgages.

MBA appreciates the opportunity to explain our concerns with legislative proposals to reform the bankruptcy code and to suggest other alternatives.

While my testimony goes into great detail with a number of concerns, I will focus the first half of my testimony on the following areas:

? The impact of cramdown on mortgage stability,

? Bankruptcy's impact on consumers,

? Cramdown treatment of second homes and vacation properties,

? Impact on inner cities, rural areas and new subdivisions,

?Efforts of the mortgage industry and the government to assist homeowners avoid foreclosure,

?Alternatives to bankruptcy cramdown that can curb foreclosures without damaging the credit market.

Market Stability

Clearly, one of Congress's key objectives is to determine how to unfreeze the credit markets, which has had a tremendous trickle-down effect to both consumers and businesses. Substantial discussion has occurred about the need to relieve the pressure on banks and other financial entities of their bad debt holdings and to stimulate additional lending at favorable terms and rates. Bankruptcy cramdown will not have this effect.

Among the most common bankruptcy reform provisions under consideration are the following:

?Removal of anti-modification protections for home loans, including permitting lien stripping (reduction of the mortgage to the fair market value of the property). Some bills, including S. 2136, limit lien stripping to "subprime" and "non-traditional products" and/or impose an income test. S. 2133 requires creditor approval;

?Allowing home loans to be repaid beyond the term of the Chapter 13 plan, which today cannot exceed three to five years;

?Eliminating the requirement to obtain credit counseling before the debtor can file for bankruptcy when the lender has notified the debtor that it may foreclose the loan; and

?Requiring that fees and charges, accruing during the bankruptcy proceeding be filed with the court, among other limitations.

We understand the well intentioned goal of such legislation is to provide a back stop against the large numbers of foreclosures. However, 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.

In recent weeks we have seen investors flee the GSE paper market. In the past, investors bought these securities because they had the "implicit backing" of the U.S. government. Investors are moving away from these investments due to the uncertain value of those assets. While proponents of cramdown continue to argue against our assertions that the lending community will increase costs due to added risk, investors are astute to the various factors of risk, and prefer predictable investments. Giving bankruptcy judges the ability to cram down mortgage debt does nothing to reassure investors as to the value of their investments.

Borrowers would see the costs of obtaining a mortgage increase. Not only would interest rates and other fees increase, lenders will require higher down payments. The only true way for a lender to protect itself from cramdown risk would be to require a down payment large enough to ensure the home value does not fall below the loan amount during a period of home depreciation. Would a 10 percent down payment be enough for lenders and investors to feel protected from cramdown? Given that the average U.S. home price in 2007 was $313,600,4 borrowers would be required to come up with $31,000 for their down payment or more. Significantly, many borrowers could be required to put 20

percent down to protect from risk, leaving them in search of more than $62,000 for a down payment. These requirements would hit first-time homebuyers and low- to middle-income individuals the hardest.

Today, a number of borrowers use credit enhancements such as FHA insurance, VA guarantees and private mortgage insurance (PMI) to reduce down payments and lower rates. Proponents of cramdown fail to recognize that lien stripping will render useless these insurance protections for the amount of the cramdown, thus taking away the protections that allowed for lower rates and down payments. In this already fragile market, FHA and VA have become the only affordable, low¬down-payment option for the very individuals that these proposals intend to help. (I have included a more detailed analysis of some of these concerns later in my testimony.)

Bankruptcy Is Not a Consumer Friendly Process

In addition to the impact on credit availability, prices and terms, proponents of bankruptcy reform fail to acknowledge the very real and severe consequences for individual consumers who declare bankruptcy. A declaration of bankruptcy stays on a consumer's credit report for 7 to 10 years, making it extremely difficult to acquire future credit, especially in the tighter credit environment. Bankruptcy makes it more difficult for borrowers to get credit cards, finance a home or car, or purchase insurance, and in some cases, even obtain employment. Bankruptcy costs consumers about $3,000 to $5,000 in attorney fees and court costs. Moreover, there is no guarantee that a filing will be granted by the judge. Nevertheless, just by filing, it will immediately be reported on the borrower's credit profile. In addition, student loans, child support and certain tax payments will not be reduced, and various options to make the mortgage payment more affordable through loss mitigation are immediately taken out of the hands of a servicer upon filing for bankruptcy. Professor Lynn M. LoPucki detailed the realities of bankruptcies (http://www.bankruptcyvisuals.com/viewcharts.html). Despite the negative effects of bankruptcy, the considerable financial gain mortgage cramdown proposals offer makes bankruptcy almost irresistible. We fear that borrowers would give up their good credit scores in order to eliminate substantial amounts of principal. It is difficult to understand why Congress would rather encourage people to seek bankruptcy than promote other effective and less burdensome ways to help consumers.

If cramdown were truly for the benefit of helping borrowers stay in their homes, why do current proposals remove or postpone the counseling requirement? Congress enacted the pre-filing counseling requirement to assure that debtors in financial difficulty had the benefit of two independent sources of information ¬approved non-profit counselors and bankruptcy attorneys. This is an essential step to protect borrowers from the automatic black mark on their credit profile and gives them an opportunity to meet with a trained financial counselor to review their finances and explain the consequences of filing for bankruptcy.

Proposals Remove Critical Mortgage Creditor Protection: The Myth of the SecondNacation Home Cram down.

During this entire debate over whether to change the bankruptcy laws, advocates for cramdown have engaged in misleading dialogue on the treatment of vacation/second homes and investor properties during a Chapter 13 bankruptcy proceeding. To advance their agenda, they would like everyone to believe that the current Bankruptcy Code allows loans secured by vacation homes and investor properties to be crammed down without consequence. This is a fundamental misrepresentation of the facts.

In truth, the current Bankruptcy Code generally allows secured debts5 other than those secured by a principal residence to be crammed down. However, if they are crammed down, the debtor is required to payoff the entire amount of the secured claim within the three-to-five year duration of the Chapter 13 plan.6 The debtor does not have 30 years to payoff a modified mortgage as the original loan term may provide. For example, under current law, if a mortgage contract of $120,000 gets stripped down to $100,000, the debtor must pay the entire $100,000 within three to five years in equal monthly installments.

So while the consumer bankruptcy attorneys and other groups would like Congress to believe that individuals with vacation homes or investment properties are given major advantages under the current Bankruptcy Code, in fact, they are required to pay the entire amount of the secured mortgage by the end of their payment plan. Moreover, since these assets are often deemed nonessential to the reorganization of the debtor, they are usually surrendered to the creditor to liquidate through foreclosure without cramdown.

Every legislative proposal introduced to date would remove the requirement that crammed down mortgages be paid off during the term of a Chapter 13 plan. This creates an entirely different risk profile. With the compounded problem of lost mortgage insurance protections due to cramdown, lender losses will mount as will the cost of credit.

Today, the requirement that borrowers payoff crammed down debt within the period of the bankruptcy plan, controls unbridled runs on the bankruptcy court whenever property values or rates decline. This control, however, would be stripped from the rights of home loan creditors. Modified home mortgages would be allowed to survive bankruptcy discharge and be paid over 30 or even 40 years. These proposals encourage borrowers to seek Chapter 13 bankruptcy at the exclusion of all other remedies.

The Impact of Cramdowns on Inner Cities, Rural Areas & New Developments

Not only will cramdown shut the door to financing people with less than perfect credit and limit the options for first-time homebuyers; but inner cities, rural areas, and new subdivisions, where prices are historically more volatile, could be subject to overly cautious lending.

Certain geographic areas hard hit by job losses and population outflows, or that have a high risk of natural disasters, could also suffer. By reforming the bankruptcy law to give judges the unilateral authority to alter the terms of a mortgage contract, Congress will increase the cost of getting and keeping a mortgage in the very same areas it has sought to stabilize.

Going forward, underwriting standards will be drastically changed. Lenders will be forced to engage not only in credit valuation for the borrower, but projections of real estate values. Such predictions will never be accurate and lenders are likely to err on the side of caution. An appraisal representing current property value will no longer be sufficient to make a credit decision. Lenders will have to assume some level of market decline. If mortgage insurance is still available, it is likely to be curtailed for high loan-to-value loans, less creditworthy borrowers and volatile real estate markets.

Industry Efforts to Prevent Foreclosure

The industry has been engaged in historic efforts to assist distressed homeowners and we believe these have proven successful in stemming foreclosures. We agree more programs can be implemented to provide additional assistance, but it is worth noting what has transpired to date.

?Servicers have assisted a record number of borrowers through various loss mitigation efforts. From July 2007 to September 2008, an estimated 2.47 million repayment plans and modifications have been executed. Foreclosure sales for the same period were approximately 1 million, resulting in a 71 percent workout-to-foreclosure ratio.

?Last week, the Federal Housing Finance Agency and the HOPE NOW Alliance announced a major streamlined loan modification program for GSE and financial institutions' portfolio loans to get struggling homeowners affordable mortgage payments.

?Investors and mortgage insurers are introducing a greater number of helpful options including Fannie Mae's HomeSaver Advance, which allows the borrower to cure a delinquency by placing the arrearage in a subordinate loan that carries no interest or a low interest rate. Mortgage insurers and FHA also have similar programs.

?HOPE NOW in concert with NeighborWorks and the Homeownership Preservation Foundation have assisted in promoting the HOPETM Hotline, a national counseling network which is available 24 hours a day, 7 days a week, and 365 days a year. The Homeowner's HOPE ? Hotline receives an average of more than 6,000 calls a day. There is no cost to homeowners for contacting a nonprofit counselor.

?Servicers and many of their investor partners are paying for borrowers to have one-on-one counseling sessions with HUD-approved counselors.

?Servicers implemented the American Securitization Forum's (ASF) Streamlined Foreclosure and Loss Avoidance Framework for Securitized Adjustable Rate Mortgages which provides systematic criteria that servicers can use to streamline the evaluation of borrowers in subprime hybrid ARMs in private label mortgage backed securities facing interest rate resets. Approximately 111,000 subprime ARMs have been modified with over 73 percent of these modifications having duration of five years or longer.

?Participants in the HOPE NOW Alliance announced Project Lifeline, which is a targeted outreach to seriously delinquent homeowners (90 days or more late) who are currently facing the greatest risk of losing their home. Servicers under this program have agreed to "pause" foreclosure for 30 days while loan modification packages are evaluated.

Government and Industry Efforts Moving Forward

We urge Congress to consider other alternatives to bankruptcy cramdown that will have positive results in stemming foreclosures without the substantial impact to the credit markets. MBA suggests the following:

?Allow GSE/HOPE NOW Initiatives To Work: As stated above, last week, the Federal Housing Finance Agency, Fannie Mae, Freddie Mac and the HOPE NOW Alliance announced a streamlined loan modification program to get struggling homeowners affordable mortgage payments. The program targets certain high-risk borrowers who have missed three payments or more, own and occupy their properties as their primary residences, and have not filed for bankruptcy (bankruptcy bars lenders from communicating directly with customers or attempting to collect the mortgage debt, including through loss mitigation). The real benefit of the program is the systematic and uniform approach that lenders will now apply to modifications. The involvement of Fannie Mae and Freddie Mac is a substantial new development.

By creating a fast-track method of getting troubled borrowers to an affordable first mortgage payment (including homeowners association/condo dues) of no more than 38 percent of the household's monthly

gross income, the program is expected to ultimately help thousands of borrowers. Affordability will be achieved through a mix of reducing the mortgage interest rate, extending the amortization of the loan and/or deferring payment on part of the principal. This is a bold attempt to define a nationwide program that can reach many troubled borrowers quickly, thereby stabilizing those families and the communities and neighborhoods in which they live. This program becomes effective December 15, 2008. Congress must allow time for these programs to work.

?Workable Refinance Program: To date, there are two government created refinance programs available to delinquent borrowers: FHASecure and Hope for Homeowners (HFH). While, unfortunately, these programs have substantial barriers to participation from the servicer, investor and borrower perspectives, a viable refinance program is desperately needed. We believe with certain changes these programs can become viable loss mitigation tools.

FHASecure is particularly attractive to lenders or servicers who want to cure distressed loans for long-term investment. There are several ways to enhance lender and borrower participation in this program. In particular, the program must include fixed rate loans, permit more borrowers with blemished payment histories to qualify, and expand underwriting requirements. Unfortunately, there is a significant risk that this program will be terminated at the end of 2008. To ensure the continued availability of this program, MBA recommends that Congress allow FHASecure (for delinquent borrowers and new subordinate financing only) to be funded through the pool of funds dedicated to Hope for Homeowners.

The Hope for Homeowners program was created this past summer by the Homeownership and Economic Recovery Act of 2008(HERA). The program was designed as a "rescue plan" to help distressed mortgage borrowers whose property values have declined below the outstanding amount of their mortgages. Participating lenders/investors generally will be limited to those who wish to divest themselves of the assets. FHA was given $300 billion in additional mortgage insurance authority for the purpose of refinancing eligible borrowers into new, affordable FHA-insured loans with lower fixed rates based on current property values. The program has numerous legal, financial and administrative impediments. Nonetheless, a refinance program that addresses all levels of borrower demand for refinance programs should be considered and we encourage Congress to revamp HFH to make it a workable product. MBA has already made recommendations on how to make the program more workable.

?FDIC-Insured Modification Plan: MBA also believes that the FDIC's guaranteed modification program has promise. Under this program, servicers offering modifications meeting the FDIC's criteria will receive a government guarantee covering a portion of the loan balance. MBA believes that this program will be favorable to borrowers in private label securities. While we would suggest some changes to the conditions of the plan, including a recognition that pooling and servicing agreements may not permit

portfolio-wide adoption of the plan, we believe it is a concept that should be explored and we look forward to more details.

Role of Bankruptcy Today and Efforts by the Mortgage Industry to Stem Foreclosures

MBA would assert that cramdown is not necessary today. Current Chapter 13 bankruptcy law already plays an important role in saving the borrower's home. Today, borrowers declare bankruptcy to eliminate or reduce their unsecured debt obligations, such as credit cards or medical debt. This in turn frees up income to keep essential assets such as the home. Once unsecured debts are reduced, borrowers generally have sufficient funds to afford their mortgage payments.

Unfortunately, most bankruptcy proposals do not recognize this fact. To date, few bankruptcy reform bills distinguish between under-secured mortgage debt and unsecured debt. While S. 2136 appears to limit judges' ability to cram down debt if the borrower can afford the regular mortgage payment plus the arrearage during the term of the plan, it is unclear whether such a mortgage affordability test is taken after reducing unsecured debt or whether such analysis is performed treating under-secured portions of mortgage debt and unsecured debt together. Failure to treat under-secured mortgage debt more favorably than unsecured debt would be contrary to the basic legal premise of priority interests of secured creditors. The end result would be that the borrower's income, which today is prioritized to pay for the borrower's home mortgage, would be freed up to pay more credit card and other unsecured debts. Bankruptcy is generally a zero sum proposition. If funds are deducted from one set of debts - the priority debts, such as a home mortgage - it makes more funds available for non-priority and unsecured debts. While it may not be this committee's intent to shift the bankruptcy process to the advantage of credit card and other unsecured lenders, this would be the result.

Additional Points Highlighting our Concerns with Bankruptcy Cramdown

Moral Hazard of Permitting Cramdowns

One of the most inequitable results of bankruptcy reform proposals is the fact that debtors in depressed real estate markets or with damaged or destroyed properties would reap a windfall profit at the expense of lenders, servicers, investors and borrowers who honor their debts. This windfall would occur if the borrower is permitted to reduce the debt to the depressed value of the property, retain the property and realize future appreciation when market conditions improve (or repairs get made with insurance and government aid), while having no obligation to pay the lender for the amount originally borrowed. Cramdowns based on a snapshot of value ensures borrowers will make significant profits when the property appreciates later in time. The case in point is illustrated by !n re: Enewally 368 F.3d

1165 (9th Cir., 2004).8 Despite the current market downturn, over the last 30 years home prices nationally have risen six percent per year on average.9 Home values will return.

The unfair result this reform would create does not occur today when the servicer is allowed to foreclose on the property. The creditor would have the right to mortgage and hazard insurance to offset losses or could hold on to the property and rent it out as is more commonplace today. Furthermore, in the case of foreclosures, the servicer could seek a deficiency judgment for the difference between the value of the property and the contractual obligation when permitted by state law. This remedy is extinguished under the proposed changes to Chapter 13 filings for home loans.

Cramdowns Render Useless Mortgage Insurance Protections

As I discussed earlier in my testimony, bankruptcy cramdown would render mortgage insurance protections useless for the amount of the cramdown. This section provides you with a full analysis of the numerous legal and financial implications that would soon follow enactment of proposed legislation.

Proponents of bankruptcy reform argue creditors will take the same losses if the loan is stripped down to the fair market value as they would if the loan is foreclosed. This is simply inaccurate and demonstrates a lack of understanding of the credit markets. It is critical to understand that lien stripping renders ineffective certain portions of mortgage insurance, which historically allows lenders to require smaller down payments and grant favorable rates.

FHA and VA Programs

Today, FHA insurance and VA guarantees protect the servicer against principal loss due to foreclosure. FHA and VA staff, however, indicate that the agencies are not statutorily permitted to pay a claim for amounts stripped down in bankruptcy. Consequently, if lien strips are permitted, servicers that merely administer Ginnie Mae securities on behalf of passive investors will have to absorb principal losses they never contemplated. The severity of losses to which servicers would now be exposed would be comparable to what FHA and VA lose with each foreclosure - more than $30,000 per property. Servicers are in no way capitalized to absorb these losses. This places Ginnie Mae at risk for increased servicer defaults and having to step into the shoes of the servicer to advance principal and interest payments to bond holders as guarantor.

Conversely, if those loans went to foreclosure sale, FHA insurance and VA guarantees (for which these agencies receive compensation through premium payments) would protect the servicer against principal loss. Without statutory changes to these programs, servicers who do not own the loans are being

required to step into the mortgage insurer's shoes, or worse, being asked to provide property value guarantees.

FHA and VA loans are not insulated from the havoc bankruptcy reform would wreak. Despite some legislative proposals to limit cramdown to "subprime" and "non-traditional" products, "subprime" is defined as a loan with an APR three points over comparable Treasury securities, which ensures a significant number of government loans (and prime loans) would be eligible for lien stripping. This is most likely for loans originated after the first quarter of 2008 where the spreads between Treasuries and Ginnie Mae securities have widened. We believe that bankruptcy cramdown would cover the vast majority of FHASecure and Hope for Homeowners loans because higher mortgage insurance premiums and unfavorable Ginnie Mae pricing pushes these loans above the three percent threshold. Given Congress's interest in kick-starting these programs, bankruptcy cramdown seems counterproductive.

In this market environment, the FHA and VA programs have become the only sources of affordable, low down payment mortgage credit for a large number of home buyers. This is evidenced by the rise in Ginnie Mae issuances from 10 percent of total agency issuances in 2007 to more than 30 percent in 2008. In absolute terms, Ginnie Mae issuances have quadrupled from $20 billion in third quarter of 2007 to $80 billion in third quarter of 2008. Disrupting this vital source of mortgage credit will have dire consequences. FHA and VA serve low-income and first-time home buyers better than other programs.

Private Mortgage Insurance and GSE Lending

Private mortgage insurance operates similarly to FHANA insurance or guarantees. They are contracts to protect the creditor against first dollar losses associated with foreclosures. Similar to government insurance and guarantees, we believe private mortgage insurance will not be available to offset cramdown losses. As a result, private mortgage insurance contracts will be rendered useless in the event of a lien strip. Fannie Mae and Freddie Mac (and portfolio lenders) will, therefore, suffer greater losses in the event of a lien strip than in the event of a foreclosure. Both Fannie Mae and Freddie Mac are required by their charters to obtain credit enhancements on loans they originate with high loan to value ratios. Traditionally, this credit enhancement has been in the form of private mortgage insurance. If they are unable to file mortgage insurance claims, the losses these entities face will be significant. Given Fannie Mae's and Freddie Mac's conservatorships, these costs ultimately could be borne by the federal government and taxpayers.

Hazard Insurance Claims

Lien stripping will likely impact the availability of hazard insurance proceeds in the event of loss or partial loss of the property. Based on case law associated with other secured debts, mortgage creditors

will lose their secured interests in hazard insurance proceeds for the amount of the cramdown, with possibly no recourse to recover the value of the original debt. Bankruptcy reform would place lenders, servicers and investors in an inappropriate role of property insurers of last resort and/or guarantors of property values. Lenders and servicers did not price for the risk at origination, and would require cross¬subsidization from new originations to avoid massive losses. That cross¬subsidization would result in higher costs for new loans.

Borrowers should not be able to wipe out the security interests of creditors when their properties are destroyed by natural disasters, but unfortunately cramdown legislation would do just that. Imagine if properties damaged by Hurricanes Katrina and Rita were subject to cramdown. These properties could have their debt completely extinguished despite receiving Community Development Block Grant funds to rebuild their properties. Servicers should retain the full value of their insurance policies, but unfortunately this would not occur under the proposed bills. Mortgage creditors and investors may, therefore, reduce credit to geographic areas prone to natural disasters.

The Second Lien Market Will Be Harmed Without Corresponding

Reduction in Foreclosures

Several bankruptcy bills would allow cramdown of second liens. The second mortgage market has been particularly hard hit by current declining real estate values. Many borrowers are not paying their second mortgages because the fair market value of their properties has declined below the combined principal balance of the first and second mortgages. In most cases, the second lien holder is left with no other option but to allow the delinquency to continue but retain the lien. They are not foreclosing on the second mortgages and thus borrowers retain their homes. Eventually home values will rise and these borrowers will begin repaying their second liens.

These second liens serve as credit enhancements for many first mortgages in the subprime market and should not be extinguished indiscriminately. Proponents claiming that second lien holders are no worse off in bankruptcy than in foreclosure fail to recognize that second lien lenders are not seeking foreclosure, and are thus preserving their assets for the long term. Bankruptcy reform would strip lien holders of this crucial right, effectively taking the asset from them.

Impact on Investors and MBS Market

Securitization increases the availability of mortgage credit. Historically, banks and other lenders sell mortgage debt to investors or "securitize" it. This frees up capital and allows banks and mortgage companies to invest more into local economies and makes home mortgage credit more widely available.

As a result, homeownership has risen significantly since the mid-1990s. The share of Americans who owned homes rose from 64 percent in 1994 to 69 percent by 2005. This is the highest increase in homeownership since the surge that followed World War II.

Securitization of mortgages is based on the underlying value of those mortgage contracts. Due to the delinquency rate on loans serving as collateral for private label securities, private securitizations are frozen. Securitization must be revived regardless of whether such securitizations are through government or quasi¬government agencies or through the private sector. Without the ability to securitize, fewer loans can be originated.

Granting bankruptcy judges the authority to prospectively or retroactively modify a mortgage in Chapter 13 proceedings would have a materially adverse impact on the mortgage contract and would do nothing to reassure investors seeking to invest in the U.S. mortgage or credit markets. If, with a stroke of a pen, the U.S. government could eliminate the secured nature of these investments whenever there is a cyclical downturn, why would investors return to our mortgage markets? They would simply take their money to other, more secure and predictable investments or demand a much higher return for the added risks. Existing MBS values would also decline as more investors dump MBS collateralized by subprime and at-risk assets and as credit rating agencies further downgrade securities.

Servicer Losses

Even if lien stripping was limited to existing debt and certain product types, the risk of uninsured losses and repurchase risk created would cause existing servicing portfolios to decline in value, requiring accounting write downs of servicing assets. The velocity at which loans would enter bankruptcy could further exacerbate capital and liquidity problems for servicers. This disruption could also cause significant problems with voluntary mortgage workouts as bankruptcy cramdowns would consume the servicer's financial and personnel resources. The stated objective of encouraging more voluntary workouts would simply not materialize because (1) the reward in bankruptcy is far more lucrative to borrowers than what servicers could offer borrowers and (2) servicers may have to cut staff, including loss mitigation staff, to offset losses.

Bankruptcy Filings Will Overwhelm Courts

An attempt to solve the foreclosure crisis in bankruptcy courts will result in millions of new filings. The logistical problems are compounded by the fact that these filings will be concentrated in a few states such as California, Florida, Nevada and Arizona. The system will simply clog-up by the onslaught of new filings putting lenders and borrowers in limbo status and putting loss mitigation efforts on hold. Servicers will have to continue to advance principal and interest (P&I) payments to private label

investors despite borrowers not paying the mortgage. If backlogs continue for any extended period of time, servicers will be strained in their financial capacity to advance principal and interest payments.

Impact on Other Credit Segments

Losses will not be limited to the mortgage sector. As more consumers seek Chapter 13 to take advantage of the lien strip benefit, a lot of consumer debts will be wiped out as well, causing a fresh wave of losses to lenders, further impairing their ability to extend new credit. Large and geographically concentrated numbers of people in bankruptcy will depress local economies.

Interest Rate Reductions

Several legislative proposals combine principal reductions with interest rate reductions. I urge Congress to be cautious of the impact of modifying interest rates on loans serving as collateral for mortgage backed securities. In the case of FHA, VA, Freddie Mac and Fannie Mae (on older trusts) a modification of rate requires the issuer (Le., GSE or servicer) to repurchase the loan from the pool and place it on the balance sheet (GSE) or redeliver it subject to current market prices.

In the case of the GSEs, they will bear the cost of repurchasing these assets from MBS pools and placing them in portfolio.lO The result may be a diminished capacity to purchase new loans. In the case of FHA and VA loans, Ginnie Mae servicers will have to buy those loans at par (outstanding indebtedness) and face redelivery of the loan into a Ginnie Mae II possibly below par (depending on the note rate), meaning the servicer once again has to absorb significant losses. Independent mortgage companies currently borrow funds from commercial banks to repurchase loans from pools. Given that warehouse lines are constricting, it is possible that servicers will simply be unable to repurchase these loans, increasing the risk of servicer defaults.

Conclusion

MBA opposes amending the bankruptcy law because of the harm it would cause to the mortgage industry, the mortgage market, the economy and future borrowers who seek home mortgages. While well-intentioned, bankruptcy reform would limit the availability of credit, increase down payments and raise interest rates. Mortgage insurance that protects lenders and investors from loss in the event of foreclosure would be void for the amount of the lien strip. Noteholders' interests in hazard insurance claims would be at risk. With investor appetite for U.S. mortgages waning, it is ill-advised to pass legislation that would further disrupt the mortgage market. Bankruptcy cramdown brings with it a number of additional risk factors that investors will take into account.

We strongly urge Members of this committee and all of Congress to look deeper into the implications of bankruptcy reform before passing harmful legislation.

We urge Congress to consider other alternatives to bankruptcy cramdown that will help deserving homeowners avoid foreclosure and MBA looks forward to working with you through that process.

Thank you for this opportunity to share our concerns with this committee.