

March 9, 2011

The Honorable Patrick Leahy  
Chairman, Committee on the Judiciary  
United States Senate  
224 Dirksen Senate Office Building  
Washington, D.C. 20510

The Honorable Chuck Grassley  
Ranking Member, Committee on the Judiciary  
United States Senate  
152 Dirksen Senate Office Building  
Washington, D.C. 20510

Dear Chairman Leahy and Senator Grassley:

The organizations listed below respectfully oppose S.222, the Limiting Investor and Homeowner Loss in Foreclosure Act, which the Committee is scheduled to mark-up on March 10, 2011. S. 222 would make it harder and more risky for banks to extend future mortgage loans, while undermining efforts aimed at stabilizing the housing market. It would harm consumers, all participants in the housing market, and our national economic recovery.

S. 222 would authorize individual bankruptcy courts to establish a “Loss Mitigation Program” (LMP), with wide variations in rules and procedures. Such LMPs will erect substantial procedural hurdles that effectively place a moratorium on foreclosures unless and until lenders agree to cram down the principle balance and make other significant changes. This is because LMPs are not true mediation as that term is generally understood, and because lender participation will be involuntary.

Under the LMP programs in existence now in New York and Rhode Island, judges may impose sanctions if lenders or servicers do not agree to loan modifications and the borrower and the judge subjectively believe that the servicer has not acted in “good faith.” This subjective standard imposes a punishment for declining to modify a delinquent loan, even if the modification would be expressly prohibited by Fannie Mae and Freddie Mac guidelines. We believe that these existing LMP programs go beyond the power granted to bankruptcy courts to hold status conferences. In fact, the legality of such LMP programs is currently being litigated in Rhode Island, and the clear intent of S. 222 is to influence that litigation through Congressional intervention and the provision of explicit authorization.

Although LMPs do not technically require creditors to surrender bargained for contractual rights, enactment of S. 222 would bring new pressures to bear in bankruptcy court proceedings to do exactly that. For instance, creditors may well be pressured to agree to concessions to satisfy local bankruptcy courts if a borrower/debtor subjectively believes a creditor has not negotiated in “good faith,” even when such concessions are not in the best interests of creditors and could not be otherwise obtained.

In fact, in its written statement in support of LMPs at a prior Senate hearing, the National Consumer Law Center (NCLC) specifically lauded this virtually certain pressure as a reason for putting LMPs in place. In other legal filings, NCLC has indicated its belief that court-ordered LMPs override the

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Chapter 13 prohibition against cramdown of loans secured solely by a principal residence. We would expect many bankruptcy judges to adopt that position if legislation authorizing LMPs is enacted. In short, the legislation would amount to back door repeal of that prohibition – even though, in the 111<sup>th</sup> Congress, a majority of the Senate voted against a floor amendment that would have directly eliminated the long-standing Bankruptcy Code provision that prohibits judicial modification of loans secured solely by a principal residence.

Further, the LMP program envisioned by S. 222 would undermine existing voluntary loan modification efforts, as well as state and local mediation programs. If S. 222 were to be enacted, bankruptcy courts would become the venue of final resort, in which some borrowers would “shop around” for a forced loan modification or a mortgage cramdown. This would incent a major new wave of bankruptcy filings that the courts are ill-prepared to deal with.

Finally, to the extent that S. 222 acts as a de facto foreclosure moratorium, it would be a serious threat to our economic recovery. An important component of a sustained economic recovery is a rebound in the housing market. Many thoughtful commentators contend that delaying foreclosures will further exacerbate weakness in the housing market and therefore delay a more general economic recovery. For instance, Third Way, a centrist Democratic think tank, recently issued a report opposing efforts to create a foreclosure moratorium on the grounds that delaying foreclosures will push housing prices lower and harm economic prospects. Third Way argues persuasively that a general policy slowing all foreclosures would “only prolong” our economic crisis.<sup>1</sup> The LMPs adopted by various bankruptcy courts are in reality a thinly disguised foreclosure moratorium and, as such, suffer from the defects identified by Third Way.

In conclusion, enactment of S. 222 would undermine continued economic recovery, potentially force mortgage cramdowns, and constitute an open-ended judicial foreclosure moratorium pursuant to a patchwork quilt of local judicial rules. S.222 would create a one-sided program to force creditors to surrender their contractual and statutory rights. A bankruptcy court is a court of equity in which a debtor is seeking extraordinary, equitable relief. It is therefore highly inappropriate and inconsistent with time-honored principles of equity for the federal judiciary or Congress to approve a dispute resolution process that allows debtors to unfairly pressure creditors. A court of equity should not condone the use of inequitable methods by a party seeking equitable relief.

We therefore urge you and the Members of the Committee to oppose S. 222.

Sincerely,

American Bankers Association  
The Financial Services Roundtable  
Housing Policy Council  
Independent Community Bankers of America  
Mortgage Bankers of America

Cc: Members of the Senate Judiciary Committee

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<sup>1</sup>See “The Case Against a Foreclosure Moratorium,” <http://thirdway.org/publications/342>.