

Legal analysis to guide the mortgage industry and protect its interests.

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Legislation that Could Alter the Mortgage Landscape Senator Durbin and Representative Conyers' cramdown proposals by Kerry P. McNerney and Jaime Cowley Erdberg

When it comes to mortgage industry news, there has been one constant among the rapid fire headlines: Cram-down. Sure, the story lines change — Will the cramdown legislation pass? Who will introduce a bill, and what will it say? Who is in favor, and who is opposed? — but this legal and political hot potato persists. Adding substance to this steady stream of speculation is the bankruptcy “cramdown” bill recently introduced by Senator Durbin. Much will be reported about this bill in the days to come, so stay tuned. Meanwhile, here is a concise summary of the proposed legislation.

On Jan. 6, 2009, Senator Richard Durbin [D-IL] introduced Bill S.61 to the U.S. Senate: “Helping Families Save Their Homes in Bankruptcy Act of 2009.” A companion bill was introduced in the House of Representatives on Jan. 6, 2009, by Rep. Conyers [D-MI]. The bill was read twice and referred to the Committee on the Judiciary. Similar legislation was first introduced in Fall 2007, and the most recent version died in the Senate in April 2008. Senator Durbin has introduced essentially the same bill this year, and the senator is also working to include the bill's language in the upcoming economic stimulus package.

The bill applies to residential real estate loans in which the foreclosure process has commenced. For these loans, the bill proposes several changes designed to give bankruptcy courts broader leeway in altering the original terms and provisions of defaulted mortgages loans.

The bill proposes to alter the eligibility for relief requirements under 11 U.S.C. § 109(e) and the mandatory credit counseling requirements found in subsection (h). The current Bankruptcy Code allows debtors with up to \$1 million in secured and unsecured debt to seek relief under Chapter 13. Durbin's bill provides an exception to these limits, allowing the debtor to exclude the debtor's residence from the calculation of debts if (1) the current value of the residence is less than the secured debt limit; or (2) if the residence was sold in the foreclosure or surrendered by the debtor, and the current value is less than the secured limit. The proposed alteration to subsection (h) would also waive the Chapter 13 debtor's mandatory credit counseling requirement when the foreclosure process has commenced.

The proposed bill also would amend 11 U.S.C. § 1322(b) to allow bankruptcy judges to modify mortgages on a chapter 13 debtor's principal residence when the foreclosure process has commenced on the residence. The proposal sets out the following modifications: (1) providing for payment of the amount of the allowed secured claim as determined under section 506(a)(1); (2) prohibiting, reducing or delaying adjustable interest rates which are applicable on and after the date the plan is filed; (3) extending the repayment period of the mortgage for up to 40 years (reduced by the period for which the mortgage has been outstanding) or the remaining term of the mortgage beginning on the filing date of the case; and (4) applying a fixed annual percentage rate to interest payments after the date of the order of relief equal to the most recently published annual yield on conventional mortgage, as published by the Board of Governors of the Federal Reserve System, plus a reasonable premium for risk.

Further, the bill proposes certain requirements for creditors collecting fees during the pendency of a Chapter 13 case in language which would alter 11 U.S.C. § 1322(c). In order to collect a fee during the pendency of a Chapter 13 case, the creditor would be required to do as follows: (1) file an annual notice of the fee (or a more frequent periodicity as the court determines) within one year after it is incurred or 60 days before the closing of the case; (2) submit only lawful reasonable fees provided for in the security agreement; and (3) ensure that the value of the debtor's principal residence is greater than the amount of the claim, including such fee, cost or charge. If the creditor failed to give the required notice, the creditor would waive any claim to such fees, costs or charges. What is more, any attempt to collect such fees, costs or charges violates the Bankruptcy Code's discharge injunction under section 524(a)(2) or the automatic stay under section 362(a). The provision also states that a Chapter 13 plan may provide for the waiver of any prepayment penalty on a claim secured by the debtor's principal residence.

The Act also proposes some safeguards to creditors whose rights are modified by the proposed legislation. In the proposed amendment to 11 U.S.C. § 1325(a), a creditor whose rights are modified under new section 1322(b)(11) will retain its lien as a condition of confirmation until the later of when the claim (as modified) is paid or when the debtor obtains a discharge. The court must also find that the modification is in good faith. Under amendments to 11 U.S.C. § 1328(a), a claim that is modified under § 1322(b)(11) is not discharged to the extent of the unpaid allowed secured portion of the claim.

Will the bill pass, in either the form introduced by Senator Durbin or Representative Conyers? Will it be enacted in time to be included in President Obama's economic stimulus package? Will the mortgage industry as a whole support or oppose the bill? These and other stories will no doubt play across the headlines of mortgage industry news in the coming days and weeks, and only time will tell. In the meantime, we will continue to keep you advised of the continuing evolution of this bill and its impact on the mortgage industry.