

House Committee on the Judiciary  
Subcommittee on Commercial and Administrative Law  
Washington, D.C.

“Home Foreclosures: Will Voluntary Mortgage Modification Help Families  
Save Their Homes?  
Part II”

Friday, December 11, 2009

11:00 a.m.

Testimony of

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and

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National Association of Chapter 13 Trustees

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Mr. Chairman, members of the Sub-Committee, and distinguished witnesses, I am pleased to have the opportunity to meet with you today to deal with the question raised by the Committee, “Will Voluntary Mortgage Modification Help Families Save Their Homes?” As a Chapter 13 trustee for the past 27 years, as chairman of the Legislative & Legal Affairs Committee of the National Association of Chapter Thirteen Trustees, and having direct involvement in administering 14,000 active Chapter 13 cases, I regret to tell you that the answer to your question is “no.”

I appear today as a representative of the National Association of Chapter Thirteen Trustees (NACTT), a national organization of consumer bankruptcy professionals, created to further the education of bankruptcy practitioners, trustees, and others involved in consumer bankruptcy, and to provide assistance and support to policy makers and the courts. The NACTT is an organization committed to imparting the highest professional standards to all of our members. The NACTT and its members have been fully committed to assisting debtors as they work to save their homes, while protecting the appropriate contractual interests of creditors, using whatever tools they are provided.

Chapter 13 has long provided the avenue where a homeowner, in arrears on a home mortgage, can save the home by curing the existing default and maintaining the ongoing contractual mortgage payments. For years, this has been an adequate bankruptcy remedy to save

hundreds of thousands of homes, preserving home ownership for thousands of families in communities across the country.

However, the structure of home mortgages has changed since the early days of the Bankruptcy Code, and the tools that Chapter 13 once provided are no longer adequate to help the families in distress keep their homes. The exotic mortgages created by the mortgage industry enticed expanded home ownership but did not conform with the traditional and prudent model of mortgages. Consequently, Chapter 13 no longer works as well to save homes from foreclosure. This committee has previously considered this same question.

The NACTT made suggestions to this Committee and members of Congress in reference to your consideration of H.R. 200 (S 61). As this Committee noted in its report on H.R. 200, submitted in February 2009, “Our Nation is currently experiencing a mortgage foreclosure crisis unprecedented since the Great Depression. It is severely harming neighborhoods, communities and the United States economy as a whole. Our economic recovery depends upon stabilizing the housing sector; and this requires more effective measures to stem the flood of foreclosures.”<sup>1</sup> The financial hits on homeowners that led to House passage of H.R. 200 have not improved. If anything, the conditions have deteriorated where mortgage defaults continue to climb, foreclosures increase, and family displacements escalate. Some 7.5 million foreclosure sales will have taken place between 2006 and 2011. Mark Sandy, economist for Moody’s, has predicted that 4.8 million foreclosures are expected between 2009 and 2011.<sup>2</sup> The third quarter delinquency rate in home mortgages is the highest since the Mortgage Bankers Association began keeping records in 1972. The combined percentage of those in foreclosure as well as

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<sup>1</sup> H.R. REP. NO. 111-19, at 4 (2009).

<sup>2</sup> See Ray Clancy, *U.S. Property Market Facing Further Pressure in 2010, According to Leading Economists*, U.S. PROP. NEWS, Dec. 7, 2009.

delinquent homeowners is 14.41 percent, or about 1 in 7 mortgage holders.<sup>3</sup> “The outlook is that delinquency rates and foreclosure rates will continue to worsen before they improve.”<sup>4</sup> The percentage of loans on which foreclosure actions were commenced reached a record at 1.42 percent.<sup>5</sup>

When the Senate rejected S. 61, the companion bill to H.R. 200, supporters of the remedies it had promised still held hope that the Making Homes Affordable program would encourage voluntary modification of mortgages by lenders that would give individual borrowers in distress the ability to keep their homes through modified mortgage payments.

The benefits of ongoing home ownership are clear. Continued home occupancy and payments, even when modified, provide a home for multiple family members, a performing loan for the mortgage creditor, the prevention of neighborhood decay and blight that can poison a community as foreclosed homes sit abandoned and the continuation of property tax revenues to cover the essential services such as schools, police and fire protection. The obviously economic benefits of making it possible for individuals to keep their homes and make their mortgage payments lead to the unavoidable conclusion that voluntary mortgage modifications are a good idea for all.

Chapter 13 trustees were encouraged by these efforts of Treasury to promote voluntary mortgage modifications through the Homes Affordable Modification Program (HAMP). The sad truth, however, is that HAMP is complex, difficult for servicers to administer, confusing to unsophisticated borrowers facing financial problems, and provides neither adequate nor timely relief they so desperately need to restructure their mortgages.

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<sup>3</sup> David Streitfeld, *U.S. Mortgage Delinquencies Reach a Record High*, N.Y. TIMES, Nov. 19, 2009, at nytimes.com.

<sup>4</sup> Renae Merle, *Foreclosure Delinquency Rates Spike Amid Growing Unemployment*, WASH. POST, Nov. 19, 2009, at washingtonpost.com.

<sup>5</sup> Kathleen Howley, *FHA, Prime Mortgage Defaults at Records on Job Losses*, Nov. 19, 2009, at Bloomberg.com.

To be sure, many borrowers cannot afford their homes and the modifications contemplated under the HAMP program do little to cure the underlying problem: the debtor's income is inadequate to cover the mortgage payments even as modified.

Many homeowners, however, might well profit from a restructuring of the mortgage under HAMP, provided such modifications were offered as a part of the existing Chapter 13 bankruptcy infrastructure.

In today's mortgage environment, where exotic mortgages adjust interest rates, modify payments and escalate mortgage obligations, Chapter 13 no longer helps desperate debtors trying to keep their homes. Under current laws, ongoing mortgage obligations on a debtor's principal residence must be paid as provided in the original contract.<sup>6</sup> Chapter 13 debtors, seeking to preserve their homes, are powerless to restructure mortgages with a fixed and fair interest rate or a re-amortization of their mortgage debt. Servicers, however, advised by the HAMP directives that mortgage modifications are only optional for debtors in bankruptcy, have shied away from borrowers in bankruptcy, particularly Chapter 13. As trustees, we understand that debtors with the commitment to dedicate future income to the payment of creditors are willing to subject themselves to the scrutiny of a trustee and a bankruptcy court, and have experienced attorneys to assist them, are prime candidates for a mortgage modification. We are disappointed that voluntary mortgage modifications are not routine for Chapter 13 debtors.

This is not to imply that the individuals at the Department of the Treasury and individual servicers have not worked diligently in an effort to make HAMP modifications available to more debtors in Chapter 13 cases. The unfortunate truth, however, is that very few, if any, of the mortgage modifications proposed by Chapter 13 debtors have been accepted.

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<sup>6</sup> 11 U.S.C. §§1322(b)(5) and 1322(b)(2). It is somewhat ironic to note that the Bankruptcy Code permits a modification of a mortgage on investment property or a vacation home. Only a debtor's home mortgage is isolated from modification.

Trustee after trustee has indicated that the only consistent scenario they've seen from HAMP in Chapter 13 cases is failure, frustration and silence. Servicers fail to respond to inquiries by debtors and their attorneys. Debtors fail to understand the requirements imposed on them by HAMP. Debtors' counsel are not included in communications by servicers to borrowers, and thus are excluded from facilitating the very remedies they seek which can make a difference for their clients.<sup>7</sup>

We now know from the media that many of the modifications under the HAMP are not "working." This is no surprise, largely because of a systemic myopia in the program. HAMP looks primarily at the mortgage payments and does not examine the entire financial structure of a borrower, as occurs in a Chapter 13 case. It is time to awaken to the benefits of using Chapter 13 to facilitate the mortgage modification process.

Trustees know that HAMP modifications are not being made available to most debtors in Chapter 13. This view is supported by information we've received from debtors' attorneys.

An attorney in northern California indicates that for 20 requested HAMP modifications for Chapter 13 cases filed from July 1, 2009 through September 30, 2009, none of the debtors have received a permanent HAMP modification, none of the debtors received a temporary plan that had not been subsequently revoked, 85 percent (17 out of 20) of the servicers did not respond at all to the request for a HAMP modification, and 65 percent of the mortgage lenders actually objected to the confirmation of a Chapter 13 plan that simply requested a HAMP modification.

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<sup>7</sup> This is not to say that some servicers are not actively responding to modification requests. SPS, Countrywide and Wells Fargo appear to be more active than others in attempting to reach out to Chapter 13 debtors.

In my home city of Nashville, a leading debtors' law firm requested HAMP modifications in 19 separate cases. None of these requests resulted in either a temporary or permanent modification. In nine of the cases, debtor's counsel received no response at all.

A Kansas attorney reports that after six months of attempting to work out a loan modification from Bank of America (f/k/a Countrywide Home Loans), a couple received a foreclosure lawsuit at the same time they were being told that they were being reviewed for a modification. A judgment in civil court was taken against them and their home was repeatedly placed on the auction docket every month and removed at the last minute while Bank of America considered the modification request. These debtors finally received an offer from Bank of America approving a modification. This offer was later withdrawn when they filed bankruptcy to deal with the rest of their debt problems.<sup>8</sup>

Even where submissions of HAMP requests have been simplified by use of a web site ([www.defaultmitigation.com](http://www.defaultmitigation.com)), only 33 percent of the submissions appear to have led to a HAMP offer. While this is better than it has been, it is far from what we had hoped.

Chapter 13 trustees, wishing to encourage the use of HAMP modifications, repeatedly inquire of debtors at Meetings of Creditors whether they had had any success in soliciting a HAMP modification. The response is always the same: as long as borrowers are in bankruptcy they are ineligible for a HAMP modification.

A trustee in Maryland reports that Chapter 13 debtors often complain about receiving inconsistent information related to mortgage modifications. Some debtors, being advised to make a modified payment amount, do so, only to discover that the bankruptcy department of their loan servicer has referred the matter for foreclosure precisely because the debtors paid the lower, trial period payment amount.

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<sup>8</sup>See *In re Devorsky*, Bk. No. 09-22087 (Bankr D. Kan.).

We are aware that HAMP has been disappointing in many ways.<sup>9</sup> In October, the Congressional Oversight Panel revealed that only about 1,700 permanent modifications under the HAMP program had been completed. This number is far less than anticipated and far too few to have any meaningful impact on our housing crisis.

What trustees and participants in the bankruptcy process have learned is that HAMP is a massive disappointment, across the board, failing to adjust mortgages, whether in or out of bankruptcy. The HAMP program, while a novel and commendable idea, has been marked only with a lack of success and overwhelming frustration by borrowers, their attorneys, and trustees. As more homes fall to foreclosure, as more homeowners fall delinquent on their mortgages, our opportunity to fix the problem diminishes. Chapter 13, formerly the best means by which a debtor could maintain possession of a home while repaying a mortgage as currently established, cannot solve the problems of today's mortgages in today's world. In April, the Senate rejected the House's proposal of judicial modification of home mortgages by federal courts. The NACTT supported H.R. 200 and encouraged its enactment. We saw the strengths of an impartial and fair judicial system, with substantial experience in valuing real property and restructuring secured debt, effecting modifications of exotic home mortgages in the context of a broad, comprehensive reorganization of an individual borrower's debt. When H.R. 200 failed to become law, the NACTT was hopeful that voluntary modifications would help. We now know: they did not.

### **Proposals to Effect a Meaningful Response**

The NACTT continues to believe that judicial modifications of home mortgages through our existing federal court structure is the best way to quickly, fairly and effectively restructure home mortgages facing foreclosure. We believe that the problems facing us do not arise from

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<sup>9</sup> See *Edward et al. v Aurora Loan Services, et al.*, civil action pending in the U.S. District Court for the District of Columbia, filed November 9, 2009.

local community banks and credit unions.<sup>10</sup> Similarly, revisiting judicial modification of mortgages, even if limited to interest rates, amortization and capitalization of advances, enforced by authority of a court order, can make modifications meaningful and can actually have a broad impact on helping to solve our growing foreclosure crisis. While we understand that there were some valid questions raised by H.R. 200 and S. 61<sup>11</sup>, the trustees supported the efforts of this Committee.

If judicial modification is not possible, then, at a minimum, HAMP should be modified to make clear that Chapter 13 debtors are not precluded from pursuing a HAMP modification while they are in bankruptcy. The documentation required under HAMP should be modified to recognize that debtors in bankruptcy are subjected to severe scrutiny by creditors, trustees, and the court. Thus, the documents provided to the trustee should be adequate to provide the documentation necessary for an evaluation as to whether the Chapter 13 debtor is eligible for a HAMP modification early in the bankruptcy process. The Bankruptcy Code itself, 11 U.S.C. § 521(a)(1), requires the submission of detailed documentation of a debtor's income, expenses, assets and liabilities. A debtor must submit tax returns to the trustee in their case. *See* 11 U.S.C. §521(f). Debtors must submit pay advices for review to verify the veracity of the debtor's stated income. The submission of these documents should be sufficient to satisfy the documentation requirements imposed under HAMP. We encourage Treasury to require servicers to accept bankruptcy documentation in lieu of the documentation currently requested as part of a HAMP modification.

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<sup>10</sup> Often such financial institutions retain an adequate interest in a mortgage to facilitate voluntary mortgage modifications without the institutional impediments that asset-backed security pools and their servicers face.

<sup>11</sup> The trustees are concerned over the limitations that the legislation would place upon the percentage fee that trustees would be permitted to assess in a case when they are administering a modified mortgage under the proposal.

### **Prompt Response Required or Defer to the Court**

For Chapter 13 debtors seeking to propose a restructure of their debts, it is essential that HAMP requests be dealt with promptly and efficiently. If a mortgage servicer fails to respond to a HAMP request, it only makes sense to permit the HAMP analysis to be done by the court to determine whether a Chapter 13 debtor is eligible for the HAMP modification. If a debtor appears to be eligible for a HAMP modification at the onset of a Chapter 13 bankruptcy case, the mortgage servicer should be required to demonstrate that it is not in the best interest of the mortgage holder to permit the HAMP-style modification requested by a debtor.<sup>12</sup>

### **Permit Courts to Apply the HAMP Tests**

Although this Committee endorsed the concept of broad judicial modification of home mortgages in a Chapter 13 bankruptcy plan in H.R. 200, the Senate rejected such a modification. Despite this rejection by the Senate, this Committee should revisit this issue and confer authority to a judicial officer -- the bankruptcy judge -- to impose HAMP-style modifications by (1) capitalizing late fees, advances, escrow shortages, etc.; (2) adjusting the interest rate in .125 increments; (3) re-amortizing the obligation up to 40 years; and/or (4) capitalizing the unpaid principal over the remaining life of the loan. While this does limit the effect of judicial modifications of home mortgages, it can encourage prompt and effective mortgage modifications for debtors in bankruptcy.

### **Encourage the Debtors' Attorneys to Become More Active in the Process**

The efforts of the Department of the Treasury and the HAMP program have been focused on compensating servicers for their consideration and work involved in working through a HAMP modification. Similarly, the Department of Treasury ought to encourage debtors'

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<sup>12</sup> This is the essence of the Net Present Value (NPV) test of HAMP. Where a court determines that a HAMP modification should be imposed, a mortgage lender should be required to demonstrate that the NPV test precludes a modification.

attorneys and borrowers' representatives to become more active in submitting the documentation necessary to obtain a HAMP modification, particularly where a borrower is in a Chapter 13 bankruptcy and the information is already in the possession of a debtor's attorney. This Committee should make clear that compensating a debtor's attorney, not with taxpayer funds, but with funds from the estate created in a Chapter 13 case, is appropriate for an attorney pursuing a modification pursuant to the relatively complex requirements of a HAMP modification.

### **Bring Chapter Thirteen Trustees into the System**

The Department of the Treasury has made a commendable effort to bring Chapter 13 trustees into this process to work with servicers and government officials in encouraging HAMP program implementation in the bankruptcy system. This should continue to be encouraged and Treasury should provide full information to Chapter 13 trustees through the Executive Office of the United States Trustee, educating trustees and their staffs in order to assist debtors and their attorneys in making HAMP modification requests.

The NACTT members are willing to assist the Department of the Treasury in reaching out to individual trustees, debtor's attorneys, borrower's advocates, and servicers, as they work through an ongoing effort to make HAMP modifications, whether voluntarily accepted as under the current program, or, through legislative change, imposed on lenders through a judicial process, such that participation can be meaningful and effective.

NACTT members strongly support this Committee's original proposal that home mortgages be modified through a fair, open and tested judicial process. We believe that the system within which we work is well equipped to promptly effectuate mortgage modifications

The Trustee members of the NACTT stand willing to provide the structure and the support to the bankruptcy community to insure that modifications are meaningful and effective.

The NACTT stands ready to answer any questions you may have.