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Legislative Notice

No. 10

April 30, 2009

**The Dodd-Shelby Substitute to S. 896—Helping Families
Save Their Homes Act of 2009**

Calendar No. 52

S. 896 was read twice and placed on the Senate Legislative Calendar on April 27, 2009.

Noteworthy

- Senators Dodd and Shelby have offered a substitute amendment to S. 896. This legislative notice summarizes the text of the Dodd-Shelby substitute.
- No Senate committee action occurred on S. 896 or H.R. 1106 and no corresponding report has been issued.
- The House of Representatives passed H.R. 1106, legislation similar to the Dodd-Shelby substitute to S. 896, on March 5, 2009, by a vote of 234 to 191. The fundamental difference between the two bills is the absence of provisions in the Dodd-Shelby substitute that would impose cramdown for primary residences.
- During the 110th Congress, Senator Durbin's amendment pertaining to cramdown for primary residences was tabled by a vote of 58-36.
- The Obama Administration's housing proposal includes cramdown in certain circumstances and mortgage servicer financial incentives.

Highlights

1. Mortgage Servicer Safe Harbor – The substitute removes certain legal liability for mortgage servicers that conduct loan modifications, even if the modifications may be in violation of contracts between servicers and mortgage holders.
2. Hope for Homeowners (H4H) – Since the applicant rate has been relatively low and the number of actual mortgages refinanced has been even lower, the intent is to expand the program's reach and increase eligibility by removing a number of limitations and enacting other changes.

3. FDIC – The substitute increases the borrowing authority of the Federal Deposit Insurance Corporation (FDIC) from \$30 billion to \$100 billion, provides temporary authority to exceed the \$100 billion threshold (up to \$500 billion) for necessary circumstances, and makes permanent the increase in federal guarantee for bank accounts from \$100,000 to \$250,000 per account.

Background

Mortgage Servicers

Mortgage servicers perform various functions for mortgage holders. This work includes collecting monthly mortgage payments, forwarding principal and interest payments to holders, maintaining escrow accounts, paying taxes and insurance premiums, taking steps to collect overdue payments, handling paperwork, foreclosing, and selling foreclosed properties. In practice, the original lender may sell the mortgage servicing rights to one company and sell the mortgage to another company. Alternatively, mortgages may be purchased by an entity and the servicing functions may be subsequently contracted out to a mortgage servicer. As mortgages are sold to other lenders and third parties, particularly through the securitization process, mortgage servicers often serve as the sole point of contact for homeowners.

As the number of homeowners facing financial difficulties has increased, the pressure on mortgage servicers to adjust mortgage payments in order to make them more affordable has increased as well. Notwithstanding the willingness of some mortgage servicers to be more accommodating, two distinct problems have developed.

First, many mortgage servicers are prevented from existing Pooling and Servicing Agreements (PSAs), which are the contractual relationship between a servicer and the mortgage holder that governs the servicing process, from conducting mortgage loan modifications. This is most applicable for mortgages that have been securitized and/or sold to third parties. Restrictions can be in the form of direct prohibitions or contractual limitations on the range of permissible modifications. It is important to note that many servicers are corporate affiliates of large mortgage originators and holders (i.e., banks), and thus there can be competing interests within a large financial institution over whether to allow servicers to modify mortgages in violation of the PSAs.

Second, the way mortgage servicers get compensated can favor foreclosure over modifying mortgages. In particular, a servicer can get paid for costs involving a foreclosure but gets nothing for the time and effort of conducting a loan modification. Instead, successful loan modifications may lead to greater headaches and legal exposure, as stated above, from mortgage holders. This issue has been muted to some degree by provisions within the Obama Administration's housing proposal that provide financial incentives to servicers conducting loan modifications. Specifically, on March 12, 2009, the administration named the first six companies (Chase Home Finance, Wells Fargo & Co., GMAC Mortgage Inc., Citigroup Inc.'s CitiMortgage unit, Select Portfolio Servicing, and Saxon Mortgage Services Inc.) that would receive \$9.9 billion of the total \$75 billion housing proposal to be used for financial incentives for mortgage holders and servicers, including payments to servicers that conduct successful loan

modifications. To date, twelve companies have been provided funding under this program for this purpose.

Another mechanism that has been proposed to address these issues is to provide servicers with a legislative safe harbor from litigation generated by mortgage holders that have not authorized loan modifications above and beyond the PSA agreements. Under this construction, mortgage holders would be prohibited from enforcing provisions contained in the PSAs against servicers to the extent that the loan modification meets certain criteria.

Legislative efforts to enact a safe harbor have been advocated in separate efforts by Senators Martinez and Dodd and Senator Ensign during the economic stimulus legislation, and those provisions contained within S. 896. Concerns have been raised, however, that such efforts would ultimately result in the abrogation of private party contracts, and thus lead to significant losses for holders of securitized mortgages, such as junior tranche holders (those holding more risky portion of securitized loans that pay higher yields). Another option would be for the federal government to compensate mortgage holders for any financial losses in conducting loan modifications.

Hope for Homeowners

The Hope for Homeowners Program (H4H) – a program created by the Housing and Economic Recovery Act of 2008 (P.L. 110-289) – is a voluntary partnership between willing lenders, homeowners, and the federal government. The purpose of the program, which expires on September 30, 2011, is to refinance existing mortgages for homeowners experiencing financial difficulties into Federal Housing Administration-insured 30-year fixed mortgages. Under the program, participating lenders agree to write-down the total mortgage principal owed to no more than 96.5% of the current appraised value of the home. Borrowers are required to pay closing costs for the new mortgage, pay an upfront mortgage insurance payment of 3%, pay a 1.5% annual mortgage insurance premium on the outstanding mortgage balance that is rolled into the monthly premium, and share with the federal government any equity gained initially from the program and any further appreciation in home value. Borrowers must also meet the following criteria:

- Their mortgage must have originated on or before January 1, 2008;
- They cannot afford their current loan;
- They must have made a minimum of six full payments on their existing first mortgage and did not intentionally miss mortgage payments;
- They do not own a second home;
- Their mortgage debt-to-income must be at least 31%;
- They did not knowingly or willfully provide false information to obtain the existing mortgage, and they have not been convicted of fraud in the last 10 years; and
- They must fully document income and employment.

The existing program, which has been provided \$300 billion of federal government funding, has neither captured a wide number of homeowners nor had a wide impact on reducing foreclosure rates. The Congressional Budget Office originally estimated that the program, once fully

implemented, would assist approximately 400,000 homeowners, which HUD estimates would have been 40,000 by this time. Instead, as of January 2009, only 22 loans have closed and none have completed the insurance endorsement process.¹

FDIC Borrowing Authority

The Deposit Insurance Fund (DIF) was created in 2006 through the passage of the Federal Deposit Insurance Reform Act of 2005. It combined the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). DIF is funded through assessments imposed on FDIC-insured institutions, and insures individual depositor funds (subject to limits) in case of a bank failure.

The recent spate of bank failures (25 FDIC-insured institutions with assets of approximately \$372 billion failed in 2008 and 29 banks have failed so far in 2009) has reduced the amount retained in the DIF to less than \$40 billion (approximately \$19 billion left in reserves with another \$22 billion set aside to address anticipated failures). The FDIC is anticipating further failures in the coming years and is “estimating a range of the cost of estimates over the 2009-2013 period with \$65 billion considered the most likely outcome².” As of December 2008, the DIF reserve ratio, the percentage of reserves on hand compared to total FDIC-insured deposits, stood at 0.40%.



Figure 1: FDIC Quarterly, Volume 3, Number 1, Page 16

By law, the FDIC is required to establish a plan to restore the DIF reserve ratio to at least 1.15% within five years. Accordingly, the FDIC implemented a restoration plan in October 2008 to boost the DIF reserve ratio. On February 27, 2009, the FDIC’s Board of Directors voted to

¹ Hope for Homeowners Program, Monthly Report to Congress, January 2009, page 4.

² Testimony of Arthur Murton, Director for the FDIC Division of Insurance and Research, before the Senate Banking Committee, March 19, 2009, page 2.

amend the DIF restoration plan to extend its length from five years to seven in recognition of the current significant strains on banks and the financial system, implement certain changes to the risk-based assessment system, and set rates for the second quarter of 2009. In addition, the Board also voted on an interim rule to impose a special assessment on insured institutions of 20 basis points to be collected September 30, and additional authority to impose an emergency special assessment after June 30, 2009, of up to 10 basis points, if necessary.

Notwithstanding the dramatic increase in the size of the banking industry, the FDIC's borrowing authority from the U.S. Treasury, which stands at \$30 billion, has not been changed since 1991. FDIC Chairwoman Sheila Bair recently wrote Banking Committee Chairman Dodd that an increase in this authority is necessary to make clear that the FDIC has "immediate access to necessary resources to resolve failing banks and provide timely protection to insured depositors³." As a consequence of increasing the borrowing authority, the FDIC anticipates that it would be able to lower its recent special assessment on the banking industry. In other words, increasing the FDIC's borrowing authority would reduce or eliminate the immediate need for the special assessment on banks, especially small banks. Overall, the borrowing authority being sought is temporary and requires heightened approval by applicable regulators before being used (e.g., broad support by the FDIC and Fed Reserve).

Administration's Housing Proposal

Over the last few months, U.S. Treasury Secretary Timothy Geithner has released details on the Obama Administration's Housing Affordability and Stability Plan, which was originally announced on February 18, 2009. The Dodd-Shelby substitute to S. 896 does not track the Obama Administration's housing proposal. For instance, the administration has not advanced official views on whether or how best to change the FDIC borrowing authority or mortgage service liability provisions.

The main tenants of the administration's plan, named Making Home Affordable, are:

- A home refinance program for current homeowners who have equity between 80% and 105% based on the current value of their home.
- A \$75 billion loan modification program (\$50 billion in TARP funding; \$25 billion from Fannie Mae/Freddie Mac) that includes:
 - Reductions in monthly mortgage payments, with a certain portion to be paid by federal government;
 - Financial incentives to servicers and borrowers to entice loan modifications;
 - Uniform guidelines for loan modifications;
 - Forced participation by TARP participants;
 - Modifications of home mortgages during bankruptcy;
 - Cramdown for primary residences for homeowners that seek a loan modification but do not qualify; and
 - Automatic reductions in second lien payments according to a pre-set protocol or the elimination of second liens in return for a lump sum payment under a pre-set formula.

³ *Congressional Record*, March 5, 2009, page H3022.

- Further funding and other actions for Fannie Mae and Freddie Mac (\$200 billion of non-TARP funding).

In order to incorporate the Hope for Homeowners Program into its Making Home Affordable Program, the administration announced changes on April 28, 2009. Specifically, the changes will require that mortgage servicers determine eligibility for Hope for Homeowners refinancing and offer this option to any applicant to the Making Home Affordable program. In addition, the administration plans to provide similar financial incentives to mortgage servicers and lenders participating in Hope for Homeowners as provided to the Making Home Affordable program participants. The administration also indicated support for additional statutory changes to the Hope for Homeowners program.

Not all homeowners will qualify for the Making Home Affordable loan modification program. Subject to guidelines released on March 4, 2009, and additional rules to be completed by the Treasury Department, those homeowners who actively pursue a loan modification with their lender but are rejected would be permitted to enter bankruptcy court protection with added benefits. In other words, as a last resort for homeowners, authority would be provided to the corresponding bankruptcy judges to utilize cramdown as a means to restructure mortgage principal for primary residences. The administration concedes that this proposal requires congressional action to change current law.

Legislative History

111th Congress

S. 895 and S. 896 were introduced on April 24, 2009 and placed on the Senate Legislative Calendar pursuant to Senate Rule XIV on April 27, 2009.

H.R. 1106 was introduced in the House of Representatives on February 23, 2009. The bill was approved by the full House on March 5, 2009, by a vote of 234 to 191. Subsequently, H.R. 1106 was referred to the Senate Committee on Banking, Housing, and Urban Affairs.

Separately, S. 61 was introduced by Senator Durbin on February 6, 2009. The bill consists of provisions similar, but not identical, to provisions contained in title I of H.R. 1106, as passed by the House. To date, no action has been taken on this legislation.

110th Congress

The two related legislative vehicles that obtained the most consideration were H.R. 3609, the Emergency Home Ownership and Mortgage Equity Protection Act, and S. 2133, the Home Owners Mortgage and Equity Savings Act. H.R. 3609 was approved by the House Judiciary Committee on December 12, 2007, but no subsequent action was taken.

In the Senate, S. 2133 received no official action; however, variations of the bill were discussed as amendments to other bills. In particular, Senator Durbin offered Senate Amendment 4388

during Senate consideration of H.R. 3221. The Senate voted to table the amendment by a vote of 58-36 on April 3, 2008.

Bill Provisions

Section 101. Amends the existing loan program for rural housing to require participant mortgagees (i.e., lenders) that have guaranteed loans under the program to conduct loss mitigation plans for homeowners subject to default or imminent default, and perhaps, foreclosure. The section also allows the Agriculture Secretary to authorize mortgage modifications and partial claim payments to mortgagees under certain circumstances (i.e., similar to a second loan, a partial claim typically pays the mortgagee for any participant's mortgage in arrears in exchange for the homeowner repaying the claim at a later time). Criteria under this section includes:

- The amount of the partial claim be determined by the Secretary but cannot exceed 30% of the unpaid principal balance of the mortgages plus costs;
- The partial claim be first applied to any outstanding indebtedness owed to the mortgagee and then could go towards reducing principal;
- The homeowner agree to repay the partial claim to the Agriculture Secretary; (4) the homeowner cannot be charged expenses for the process;
- The mortgagee may be paid for lost income and any costs for a modification or partial claim;
- The Secretary is authorized to make incentive payments to mortgagees for successful mortgage modifications; and
- The Secretary may allow mortgage modifications to extend the length of a mortgage to 40 years.

The section also authorizes the Agriculture Secretary to establish a program to pay the unpaid principal on a mortgage to a participating mortgagee that conducts a loan modification in exchange for the assignment of all rights to the home. The provision only applies to mortgages in default, where the loan has been sufficiently modified to make it affordable to the homeowner, and if the Agriculture Secretary arranges for mortgage servicing for the loan. In addition, the Secretary is authorized to dispose of the mortgage after modification by reassigning the mortgage under this program to the mortgagee, pooling mortgages into a new Ginnie Mae security, or reselling such mortgages to other parties. Under this section, loan servicers may be required to continue servicing mortgages modified under this section on behalf of the Secretary.

Lastly, the section allows the Secretary to bypass traditional rulemaking procedures in order to expedite the issuance of implementation rules.

Section 102. Modifies the housing loan guarantee program of the Veterans Affairs Department by establishing the starting point for purposes of calculating the maturity date as the time of loan origination.

Section 103. Authorizes an additional \$10 million for each of FY 2010 and FY 2011 to be used by HUD for advertising the threat of mortgage fraud in the top 100 markets with highest rates of foreclosures (\$5 million for each year for advertisements to reach broad segments of the economy), \$50 million for each of FY 2010 and FY 2011 to be used for the HUD Housing Counseling Assistance Program in the top 100 markets with the highest rate of foreclosures, and \$5 million for each of FY 2010 and FY 2011 to be used by the Office of Fair and Equal Opportunity within HUD to hire additional staff in the top 100 markets with the highest rate of foreclosures.

Section 104. Requires quarterly reports to Congress by the Office of Comptroller of the Currency and the Office of Thrift Supervision on various details regarding loan modifications and redefaults.

Section 201. For mortgages originated prior to the date of enactment of the bill, authorizes (until December 31, 2012) a legal safe harbor for mortgage loan servicers who conduct qualified loss mitigation plans for residential mortgages under certain criteria. To qualify for the safe harbor, the loss mitigation plan must be consistent with the guidelines issued by the Treasury Department or cover a refinancing under the Hope for Homeowners Program. In addition, the provision requires: (1) the loan be in default, imminent threat of default, or default is reasonably foreseeable; (2) the property be occupied by the debtor as a primary residence; and (3) the servicer reasonably determined or had a good faith expectation that a qualified loss mitigation plan for a particular property will result in greater principal recovery than foreclosure of that property. The safe harbor would also cover any person (e.g., trustees, insurers, and loan originators) working in cooperation with the servicer.

Section 202. Makes a number of changes to the Hope for Homeowners Program (created by Title IV of the Housing and Economic Recovery Act of 2008 (P.L. 110-289) and amended further by Section 124 of the Emergency Economic Stabilization Act of 2008 (P.L. 110-343)). Specifically, the section:

- Provides the HUD Secretary preeminent authority to establish and implement the program and reduces the role of the Board created by the program to advisory status.
- Revises the certification process required of borrowers to: (1) lessen the burden from never intentionally defaulted on a mortgage or any other debt to not intentionally defaulted on a mortgage or other substantial debt in the last five years; and (2) remove a requirement that they acknowledge the penalties for false statements.
- Slightly modifies the requirement that borrowers have a debt to income ratio above 31%.
- Replaces the mandatory requirement with permissive authority that the Board issue standards and policies in which participants agree to pay second lien holders a portion of future home appreciation.
- Imposes less stringent standards for obtaining a second lien on the newly insured mortgage.
- Replaces the statutory requirement that mortgagors document and verify income of borrowers with a requirement that the process be subject to the HUD Secretary's rules

and procedures. In addition, it specifically removes a reference to a mortgage holder obtaining income tax return transcripts of borrowers' tax returns.

- Slightly lessens the prohibition on participation by those convicted of fraud in the last 10 years to allow compliance if a lender makes a good faith effort to determine such fact.
- Allows the HUD Secretary to waive the requirement that the home of an eligible homeowner be the sole primary residence. Specifically, an exception would be permissible if it is inherited property, or being sold or attempting to be sold as part of relocating to a new jurisdiction.
- Adds a new prohibition on millionaires (those with a net worth that exceeds \$1 million) from being eligible for the program.
- Adjusts the one-time insurance premium from 3% to not more than 3% and from 1.5% to not more than 1.5% for annual insurance payments. Requires the HUD Secretary to consider the overall financial integrity and intended purposes of the program when establishing these rates.
- Makes permissive rather than a requirement that the Secretary be provided 50% of any appreciation in value of a refinanced mortgage made under the program (capped at the appraised value of the original mortgage), and allows the Secretary to share any appreciation it obtains with the mortgage holder.
- Requires HUD to make any insurance documents, forms, and procedures required under the program consistent with those required under existing statute.
- Authorizes the HUD Secretary to pay originators and loan servicers for each loan insured under the program.
- Authorizes the HUD Secretary to conduct an auction to refinance eligible mortgages on a wholesale or bulk basis.
- Reduces the Troubled Asset Relief Program (TARP) funding by \$2.316 billion to offset the costs of changes in this section.

Section 203. Eliminates the Director of the Enforcement Center from the composition of the Mortgage Review Board; prohibits any local, state, or federal law from preventing the Mortgage Review Board from exercising its authority (e.g., reprimand or cease and desist orders) against a mortgagee; requires the Secretary of HUD to approve all originators of Federal Housing Administration-insured loans and specifically excludes applicants that are suspected or convicted of certain wrongdoings; requires approved FHA mortgage originators to use their official name in promotional materials and maintain copies of such materials; requires any approved mortgage originator to notify the Secretary of HUD of any negative actions taken that may change its status; and makes a number of technical changes to expand the applicability and scope of penalties for violations of FHA programs. In addition, it requires the HUD Secretary to expand its review process of new applicants for mortgage insurance programs and their potential risk to the Mutual Mortgage Insurance Fund and expand its review of applicants approved in the past year.

The section expands the existing authority for the HUD Secretary to pay insurance benefits to cover loss mitigation efforts for homeowners facing imminent threat of default. It also expands the loss mitigation requirements for mortgagees participating in FHA-insured mortgages to cover homeowners in imminent threat of default, not just those already in default. Lastly, the section expands the authority of the HUD Secretary to pay partial claims for homeowners and includes

requirements for FHA-insured mortgages similar to that provided in section 101 of the bill to the Agriculture Secretary.

Section 204. Temporarily extends (from December 31, 2009 until December 31, 2013) the increases in federal deposit insurance coverage from \$100,000 to \$250,000 and makes a corresponding extension for credit union accounts. The section extends the time allotted for the FDIC to complete its Deposit Insurance Fund restoration plan from five years to eight years and increases the borrowing authority from the U.S. Treasury of the FDIC from \$30 billion to \$100 billion and from \$100 million to \$6 billion for the National Credit Union Administration. The FDIC is also provided authority (until December 31, 2010) to exceed the \$100 billion borrowing authority threshold (up to \$500 billion) upon written recommendations of the Board of Directors (with approval required by vote of not less than 2/3 of the members of the board), Board of Governors of the Federal Reserve System (with approval required by vote of not less than 2/3 of members of the board), and the Secretary of the Treasury. Such authority may not be used to fund obligations to guarantee or purchase assets under TARP. Similarly, the NCUA is provided temporary authority to increase its borrowing authority from the U.S. Treasury to \$30 billion under the same conditions.

The section amends the process by which the FDIC would replenish its Deposit Insurance Fund to allow the imposition of special assessment obligations on depository institution holding companies, which are not covered today, and replaces the statutory process for determining assessments with one established by FDIC regulations. It also requires the National Credit Union Administration to prepare and implement a five-year plan to replenish its Share Insurance Fund whenever the equity ratio of its existing Fund is projected or actually falls below minimum set thresholds.

Lastly, the section creates a new seven-year Temporary Corporate Credit Union Stabilization Fund to operate in companion with similar statutory requirements and structure as the existing credit unions' Share Insurance Fund. The fund would be used for disposition (e.g., conservatorship or liquidation) of insured corporate credit unions.

Section 205. When providing assistance to mitigate a home foreclosure using TARP funds, the Secretary of the Treasury will be required to use the Government Sponsored Entities (GSE) conforming loan limits applicable for that home at the time of the assistance is made.

Section 206. Amends the process for insuring reverse mortgages for elderly homeowners to tie the lease term to the actuarial life expectancy of the mortgage borrower.

Section 207. Establishes a Sense of Congress that the Secretary of the Treasury should purchase mortgage revenue bonds for single-family housing issued by state and local entities.

Section 302. Establishes a Sense of Congress that the Department of Justice should create a mortgage fraud task force.

Section 401. Establishes a Sense of Congress that lenders and servicers should enact foreclosure moratoriums until foreclosure mitigation efforts, such as the revised Hope for Homeowners and

Obama Administration's housing program, are fully implemented and operational. It also clarifies that: (1) such a moratorium should not apply to loan modifications for FHA loans that are made before mitigation plans are finalized; (2) homeowners should maintain properties subject to any moratorium; and (3) homeowners should reply to inquiries made by mortgage lenders or servicers during any moratorium.

Cost

No official score is available for S. 896 or the Dodd-Shelby substitute. The Congressional Budget Office, however, estimated that H.R. 1106, as introduced, would increase direct spending by \$7.6 billion over fiscal years (FYs) 2009 to 2014 and decrease direct spending by \$14.9 billion over FYs 2009 to 2019. In addition, it would increase revenues from FYs 2009 to 2014 by \$19 million and by \$23 million from FYs 2009 to 2019. This is primarily due to the provisions contained in section 204 of the substitute, although the changes to Hope for Homeowners in section 202 would increase direct spending by \$579 million from FYs 2009 to 2014 and decrease revenues by the same amount.