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Helping Homeowners: Modification of Mortgages in Bankruptcy

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The United States is in the midst of the most serious home foreclosure crisis since the Great Depression, when Franklin Delano Roosevelt spoke of “one-third of a nation ill-housed, ill-clad, ill-nourished.”¹ Over a million homes entered foreclosure in 2007² and another 1.2 million foreclosures were started in the first half of 2008.³ By the end of 2012, around 8.1 million homes, or 16% of all residential borrowers may go through foreclosure.⁴ Millions of Americans have become trapped in unaffordable mortgages due to interest rate resets and declining home values that make refinancing impossible.

Foreclosures create enormous deadweight economic loss. Lenders lose a large percentage of their loan value, families lose their homes, and negative externalities abound. Neighbors see their home values fall; local tax bases are eroded, requiring either higher taxes or reduced services; foreclosed properties become eyesores and loci of crime and fire; and communities’ social bonds are ripped apart as families have to relocate.

Yet despite its inefficiency and social harm, there seems to be no sign of foreclosures abating. Voluntary private market solutions to stem foreclosures have failed to keep pace with new foreclosures, and official government programs, based on private market cooperation, have been abject failures. The FHASecure program, created to allow homeowners with non-FHA adjustable rate mortgages to refinance into FHA fixed-rate mortgages, has only helped a few thousand delinquent homeowners,⁵ not the 240,000

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¹ Franklin D. Roosevelt, Second Inaugural Address (Jan. 20, 1937).

² RealtyTrac, Press Release, *U.S. Foreclosure Activity Increases 75 Percent In 2007*, Jan. 29, 2008, at <http://www.realtytrac.com/ContentManagement/pressrelease.aspx?ChannelID=9&ItemID=3988&acct=64847>.

³ Chris Mayer et al., *The Rise in Mortgage Defaults*, 23 J. ECON. PERSPECTIVES – (2009) (forthcoming).

⁴ Credit Suisse Fixed Income Research, *Foreclosure Update: over 8 million foreclosures expected*, Dec. 4, 2008, available at <http://www.chapa.org/pdf/ForeclosureUpdateCreditSuisse.pdf>.

⁵ Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, WALL ST. J.,

predicted.⁶ Likewise, the HOPE for Homeowners program, established by Congress in July 2008 to permit FHA insurance of refinanced distressed mortgages, and predicted to help 400,000 homeowners, had as of mid-December 2008 attracted only 312 applications,⁷ and not actually refinanced any mortgages,⁸ in part because of its reliance on private market cooperation.⁹

At first blush, the private market's failure to resolve the foreclosure crisis is puzzling. When a single lender owns a loan, it will modify the loan in order to keep it performing as long as the modified loan minus transaction costs performs at a level above what would be realized in net in foreclosure. If lenders lose 50% in foreclosure, why aren't they reducing interest rates and writing down principal balances and stretching out amortizations to make the loan perform at 51% of current net present value?

The major factor behind the private market's failure to address the foreclosure crisis is that for most mortgages, there are no longer "lenders" of which to speak. Most mortgage loans are no longer owned by a single entity; instead they are securitized, so that thousands of investors have a fractional interest in a pool of loans. The vast majority (over 80%) of residential mortgages are securitized.

Securitization creates a variety of obstacles to efficient and socially constructive loan modifications instead of foreclosure. Unless the problems created by securitization are addressed, foreclosures are unlikely to subside until millions of Americans lose their homes. And as long as housing prices continue to slide because of market saturation and foreclosure sale externalities on neighboring properties, financial markets are unlikely to stabilize. This brief article argues that permitting modification of mortgages in bankruptcy is the only certain and realistic way to address the impediments to loan modification created by securitization.¹⁰ Bankruptcy modification is an immediately

Dec. 31, 2008.

⁶ See, e.g., Press Release, US Dep't of Housing and Urban Development, Bush Administration to Help Nearly One-Quarter of a Million Homeowners Refinance, Keep Their Homes; FHA to implement new "FHASecure" refinancing product (Aug. 31, 2007), available at <http://www.hud.gov/news/release.cfm?content=pr07-123.cfm>; Press Release, US Dep't of Housing and Urban Development, FHA Helps 400,000 Families Find Mortgage Relief; Refinancing on pace to help half-million homeowners by year's end (Oct. 24, 2008), available at <http://www.hud.gov/news/release.cfm?content=pr08-167.cfm>.

⁷ Dina ElBoghdady, *HUD Chief Calls Aid on Mortgages a Failure*, WASH. POST. Dec. 17, 2008, at A1.

⁸ Tamara Keith, *Despite Program, No Hope for Homeowners*, Nat'l Pub. Radio, Dec. 17, 2008, at <http://www.npr.org/templates/story/story.php?storyId=98409330>.

⁹ Adam J. Levitin, *Flaws in the FHA Housing Bill*, WALL ST. J., July 11, 2008.

¹⁰ The obstacles to loan modification created by securitization could also be removed by federal government seizure of mortgages. Because this would be a governmental taking of private property, the federal government would have to pay just compensation to the mortgagees, as determined by a jury on an individual basis. Engaging in such a large-scale taking is likely to be politically unacceptable. Moreover, the potential cost of a federal taking program of this scale would likely be in the trillions, and the jury trial requirement would add to its delay and cost. See generally, Lauren E. Willis, *Stabilize*

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available form of foreclosure relief that has no cost to taxpayers, does not create moral hazard, can address both unaffordable and underwater mortgages, and provides an important future defense against systemic financial system risk.

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Understanding securitization is key to understanding why the private market has been unable to solve the foreclosure crisis and what the best policy response would be. Although securitization transactions are very technical, complex deals, the core of the transaction is fairly simple. A financial institution owns a pool of loans that it either made itself or purchased. Rather than hold these loans (and the credit risk) on its books, it sells the pool of loans to a specially created entity, typically a trust. The trust pays for the loans by issuing bonds. Because the bonds are collateralized (backed) by the pool of loans held by the trust, they are called mortgage-backed securities (MBS).

The securitization trust is just a shell to hold the loans and put them beyond the reach of the financial institution's creditors. Therefore, a third-party called a servicer must be brought in to manage the loans. The servicer is supposed to manage the loans for the benefit of the MBS holders. (There is also a trustee, but its duties are expressly limited to ministerial functions, so the servicer is largely unsupervised.) The trust's contract with the servicer is part of the indenture that creates the MBS, so under the Trust Indenture Act of 1939,¹¹ to alter the contract requires at least a majority of the MBS holders,¹² and if the alteration affects the MBS investors' cashflow, 100% consent is needed.¹³

Securitization is a very effective method of funding lending operations, especially for real estate. It allows the originator of the loans to escape the key problems of real estate lending—lack of liquidity caused by asset-liability maturity mismatch for lenders who fund their lending through bank deposits and other short-term credit and lack of geographic diversification among its mortgages. Securitization also permits lenders to shift the credit risk of the loans' performance to capital market investors and pocket cash and fees now.

In this way, securitization was *the* driving force behind the growth of subprime lending. Absent securitization there would not have been a subprime mortgage crisis.¹⁴ Without the ability to shift risk to third party investors who have very limited information

Home Mortgage Borrowers, and the Financial System Will Follow (Loyola-LA Legal Studies Paper No. 2008-28), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1273268; Howell E. Jackson, *Build a better bailout*, CHRISTIAN SCI. MONITOR, Sept. 25, 2008, available at <http://www.csmonitor.com/2008/0925/p09s02-coop.html>.

¹¹ 15 U.S.C. § 77aaa *et seq.* (2000).

¹² 15 U.S.C. § 77ppp(a)(1) (2000).

¹³ 15 U.S.C. § 77ppp(b) (2000).

¹⁴ As deeply implicated as Alan Greenspan is in the current financial crisis, he correctly identifies securitization as the main driver of the subprime loan debacle. See *The Financial Crisis and the Role of Federal Regulators: Hearing Before the H. Comm. of Gov. Oversight and Reform*, 110th Cong. 2 (2008) (testimony of Alan Greenspan) available at <http://oversight.house.gov/documents/20081023100438.pdf>.

about the loans, there would have been only the most limited subprime lending for the simple reason that it is too risky.¹⁵

¹⁵ Securitization need not always produce morally hazardous lending. Mortgage securitization existed for decades before the current crisis without encouraging reckless lending. The key distinction between the decades of beneficial securitization and the securitization that created the current crisis is that historically securitization was done under a watchful regulatory and political eye, whereas the problematic securitization of recent years was entirely a product of the private market.

For years mortgages were securitized without problem by government-sponsored entities (GSEs)—the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac)—privately-owned, federally-chartered corporations, subject to direct federal regulation and oversight. Fannie and Freddie required that all loans they purchased conform to detailed underwriting standards and kept and ruthlessly pursued recourse against originators for any loans that turned out to be non-conforming. While the GSE underwriting standards were not statutory, they were subject to federal regulatory oversight and significant political pressure that indirectly ensured that securitization did not produce reckless lending. Because the GSEs often took on the credit risk on the loans they securitized, they served as gatekeepers for the mortgage market and did not purchase “subprime” or “exotic” loans.

Starting in the 1990s, however, a private-label mortgage securitization market developed that did not adhere to Fannie/Freddie underwriting guidelines and was not subject to federal regulatory oversight or political pressure. This private-label market securitized almost entirely loans that did not conform to Fannie/Freddie standards. Because non-conforming mortgages were riskier, they offered higher yields, which attracted investors. These transactions lacked the recourse element that existed in Fannie/Freddie deals because the securitization trusts and their investors lacked the resources to examine individual loans they purchased for conformance with the pool’s requirements, much less to pursue legal recourse. As a result, the originators of the loans for private-label securitizations did not retain any credit risk on them, either as a de jure or a de facto matter. Therefore, because they received flat rate payments for all the loans they originated, they were strongly incentivized to originate as many loans as possible. As a result, underwriting standards plummeted. Moreover, mortgage broker incentives often encouraged them to steer consumers to higher cost, non-conforming products. Howell E. Jackson & Laurie Burlingame, *Kickbacks or Compensation: The Case of Yield Spread Premiums*, 12 STAN. J.L. BUS. & FIN. 289, 296 (2007); Les Christie, *Yield spread premiums can bite you*, CNNMONEY.COM, July 5 2007, http://money.cnn.com/2007/07/02/real_estate/yield_spread_premium_demystified/index.htm; CENTER FOR RESPONSIBLE LENDING, CRL ISSUE BRIEF: BANS ON YIELD-SPREAD PREMIUMS AND STEERING: PROTECTING HOMEOWNERS AND STRENGTHENING THE MORTGAGE MARKET (2007), <http://www.responsiblelending.org/pdfs/ib-ysp-110507-final.pdf>.

As the private-label market’s share grew, Fannie Mae and Freddie Mac lost market share. Fannie and Freddie’s private shareholders placed tremendous pressure on the companies to compete for market share, but Fannie and Freddie could only do this by loosening their own underwriting standards. While the public agency aspect of the GSEs had helped keep the mortgage market clean and stable, the pressures placed on the GSEs

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An unfortunate consequence of securitization is that it severely complicates loan workouts—the restructuring of defaulted and distressed loans to make them affordable for borrowers. The institutional and contractual infrastructure of securitization that created the problems in the mortgage market by encouraging irresponsible and unsustainable lending is also a major impediment to resolving them.

The problems created by securitization are numerous and often highly technical, but may be reduced to three broad categories: contractual, practical, and economic.¹⁶ First, there are contractual limitations on servicers' ability to modify loans. Sometimes the modification is forbidden outright, sometimes only certain types of modifications are permitted, and sometimes the total number of loans that can be modified is capped. Additionally, servicers are frequently required to purchase any loans they modify at the face value outstanding.

Second, there are a range of practical difficulties. For example, servicers lack sufficient personnel to handle a large volume of customer contacts and the trained loan officers necessary to handle the volume of requested modifications.

Third, there are a number of economic disincentives for servicers to engage in loan modifications. Servicers are sometimes reluctant to engage in modifications for fear of suit by MBS holders who believe that modifications hurt their investments and favor other classes of MBS investors (“tranche warfare”).¹⁷ And in many cases, foreclosure is often more profitable to servicers than loan modification. Servicers receive fixed-rate compensation for a limited duration when a loan is modified, but get unmonitored cost-plus compensation in foreclosure. Therefore servicers are incentivized to foreclose rather than modify loans, even if modification is in the best interest of the MBS holders and the homeowners.¹⁸

Two possible general approaches emerge for dealing with the impediments securitization raises toward efficient loan workouts: carrots and sticks. The carrot approach is to offer lenders and/or servicers an incentive to engage in more modifications and more meaningful modifications than they otherwise would.

It is not clear, however, whether any positive incentives offered to servicers will be sufficient to change their behavior, in part because we do not know how servicers gauge factors like litigation risk. Moreover, when servicers are contractually forbidden

by their private-ownership side, coupled with a lack of stronger regulatory guidance, ultimately reduced their effectiveness in this role.

¹⁶ An additional problem, not specific to securitization is the proliferation of second mortgages, typically held by different parties. Multiple mortgages on properties mean that multiple loan workouts are necessary to prevent a single foreclosure, and if the second mortgage is “underwater,” its holder has a strong incentive to hold-out for a pay-off.

¹⁷ See Kurt Eggert, *Comment on Michael A. Stegman et al.’s “Preventive Servicing is Good for Business and Affordable Homeownership Policy”*: What Prevents Loan Modifications?, 18 HOUSING POLICY DEBATE 279, 290–91 (2007).

¹⁸ *Helping Families Save Their Homes: The Role of Bankruptcy Law: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 17 (2008) (testimony of Adam J. Levitin, Associate Professor, Georgetown University Law Center), available at http://www.judiciary.senate.gov/hearings/testimony.cfm?id=3598&wit_id=7542.

from loan modification, no positive incentives, short of complete government indemnification, will change their behavior. While a carrots approach might be economically justifiable to overcome collective action problems, it has serious political and moral downsides. It would use taxpayer dollars to benefit (1) a limited subgroup of citizens—defaulted homeowners, some of whom borrowed irresponsibly or even fraudulently, (2) another limited subgroup of citizens—investors who stand to lose more in foreclosure than in a workable loan modification, and (3) loan servicers, who as a fiduciary matter should be doing the modifications anyhow in many cases. It also creates a poor precedent that could encourage moral hazard, if lenders and homeowners alike believe that government will bail them out of the consequences of irresponsible contracts. A carrots approach rewards three groups which do not deserve assistance and does so at taxpayer expense.

On the other hand, the consequences of not offering incentives to encourage loan modifications, regardless of how distasteful the distributional consequences are and any moral hazard it might create, are potentially catastrophic.

Accordingly, it is necessary to also consider a stick approach to motivate loan modifications, as well as methods for simply removing servicers from the loan modification process. The most effective tool for doing so would be to amend the Bankruptcy Code¹⁹ to permit consumers to modify all mortgage debt in bankruptcy.

Chapter 13 of the Bankruptcy Code permits qualified debtors to propose a 3- or 5-year repayment plan, during which time all collection actions against the debtor are stayed.²⁰ Secured debts and priority must be paid in full,²¹ and the debtor's entire statutorily defined disposable income must go to paying unsecured creditors.²² Upon successful completion of the plan, the consumer's remaining pre-bankruptcy debts are discharged.²³

Within these parameters, however, the debtor has significant leeway to restructure or modify almost any type of debt. Interest rates can be reduced, amortization schedules changed, loan tenors increased, and negative equity erased. A consumer debtor can modify car loans, credit card debt, student loans, yacht loans, jet-ski loans, snowmobile loans, airplane loans, computer loans, jewelry loans, and appliance loans, as well as investment property mortgages and vacation home mortgages. A consumer debtor can also modify a principal residence mortgage if it is a multifamily property. This means that a consumer who rents out the basement or the attic can modify the mortgage on her house in bankruptcy. The only type of debt that a consumer cannot modify in bankruptcy is debt on a single-family principal residence.²⁴ Currently, single-family principal residence mortgages must be repaid according to their original terms or the bankruptcy

¹⁹ 11 U.S.C. §§ 101 *et seq.* (2005).

²⁰ 11 U.S.C. §§ 1301-1328 (Chapter 13 provisions generally); 11 U.S.C. § 109(e) (Chapter 13 eligibility requirements); 11 U.S.C. § 362 (2005) (stay).

²¹ 11 U.S.C. §§ 1325(a)(5) (secured creditors must receive present value of their collateral or the collateral itself under a plan); 1322(a)(2) (priority creditors must receive deferred cash payments for their full claim).

²² 11 U.S.C. § 1325(b) (2005).

²³ 11 U.S.C. § 1328(a) (2005). There are certain exceptions to discharge. *Id.*

²⁴ 11 U.S.C. §§ 1123(b)(5); 1322(b)(2) (2005).

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stay will be lifted and the mortgagee permitted to foreclose.

The policy behind the special protection for single-family principal residences is that Congress believed in 1978 that if mortgage lenders were shielded from losses in bankruptcy, competition would ensure that lenders would pass on these gains to consumers in the form of lower mortgage costs, thereby encouraging homeownership.

Unfortunately, the economic assumption behind the special protection for single-family principal residence mortgages in bankruptcy is incorrect. Bankruptcy modification risk is not reflected in primary mortgage pricing, secondary mortgage market pricing, or, most crucially, in private mortgage insurance pricing,²⁵ and there is no discernible effect on homeownership rates from the protection. The markets' indifference to bankruptcy modification risk is because lenders face smaller losses from bankruptcy modification than from foreclosure. Therefore, they will not price against bankruptcy modification. Indeed, bankruptcy is designed to give lenders at least as much as they would recover in foreclosure,²⁶ so there is no reason the market would price against bankruptcy modification.

Any attempt to mitigate foreclosures faces the challenges of quickly deciding which homeowners to help, addressing the twin problems of negative equity and affordability, avoiding moral hazard, and determining who will bear the cost of loan modifications. Bankruptcy modification helps solve these very issues and can do so more effectively and cheaper than any other proposed solution. Bankruptcy modification is also the only way to bypass the contractual, legal, practical, and economic problems created by securitization.

Permitting mortgage modification in Chapter 13 would provide an immediate solution to much of the current home foreclosure crisis. Bankruptcy courts are capable of immediately handling a large volume of filings, and the bankruptcy automatic stay²⁷ would function like a foreclosure moratorium until cases could be sorted through.

Bankruptcy modification would not yield a windfall to housing speculators or second home purchasers and would only help homeowners who could ultimately afford a reasonable mortgage. A mortgage loan modification in bankruptcy can occur only as part of a repayment plan. The automatic stay would likely be lifted on an investment property (or second home) before a plan could be confirmed. Accordingly, speculators and homeowners intent on keeping their second homes are unlikely to file for bankruptcy to seek mortgage modification in the first place.

To qualify for Chapter 13 bankruptcy, in which a loan can be modified, a homeowner must have a regular income,²⁸ and Chapter 13 plans must be feasible given the debtor's means.²⁹ This does not mean that any modification is permissible; federal common law of bankruptcy requires that modified loans reflect a reasonable risk premium for the debtor,³⁰ and the Bankruptcy Code requires that a secured creditor

²⁵ Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WISC. L. REV. – (2009) (forthcoming).

²⁶ 11 U.S.C. § 1325(a)(5) (2005).

²⁷ 11 U.S.C. § 362 (2005).

²⁸ 11 U.S.C. § 109(e) (2005).

²⁹ 11 U.S.C. § 1325(a)(6) (2005).

³⁰ *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

receive at least the present value of its collateral.³¹ Only a debtor who can afford a loan modified within these limits will be able to keep her home. Permitting bankruptcy modification of primary home mortgages thus steers a true course between extending the right sort of relief and not extending it too broadly.

Nor would bankruptcy provide a windfall to homeowners in the event that property values appreciate in future years. While the homeowner would benefit from future appreciation, lenders have no reasonable expectation of this appreciation. Bankruptcy is supposed to, at the very least, give lenders what they would get in foreclosure, and when a home is sold in foreclosure, the lender gets cash for the value of the house, and does not receive any benefit from the property's future appreciation.

Bankruptcy modification would also provide a solution for both of the distinct mortgage crises—negative equity and payment shock. Bankruptcy modification would help negative equity homeowners by eliminating their negative equity position (“cramdown”), which would reduce their incentive to abandon the property.³² Likewise, homeowners who are unable to afford their mortgage because of a rate reset, due to the expiration of a teaser rate or to the resetting of an adjustable rate mortgage or to the reamortization of an option-ARM could modify their loans to make monthly payments fixed and affordable level.

Permitting bankruptcy modification would not create moral hazard for lenders or debtors. Lenders will lose loan value. While they will generally do better than in foreclosure, and the loss is not because of bankruptcy *per se*, there is still a high price for lenders that will discourage reckless lending. And for homeowners, Chapter 13 bankruptcy is not a “drive-by” process. In order to receive a discharge in Chapter 13, a debtor must live on a court-supervised, means-tested budget for 3 or 5 years,³³ and fully repay certain debts, including allowed secured claims, domestic support obligations, and tax liabilities.³⁴ There are also limitations on how often a debtor may receive a bankruptcy discharge.³⁵ Nor would bankruptcy modification give homeowners a windfall. At best, a homeowner with negative equity would end up with zero equity, not positive equity. Given the large transaction costs to a sale, debtors are unlikely to sell their properties for anything beyond a *de minimis* profit absent a remarkable recovery of the housing market.

Finally, one of the greatest advantages of bankruptcy modification is that it has no cost for taxpayers. In an age of near a trillion dollars in government bailouts, bankruptcy modification is a rare bargain. Bankruptcy courts are overstaffed relative to historic filing levels, and court fees cover the administrative costs of the process. Bankruptcy modification has no effect on the public fisc.

³¹ 11 U.S.C. § 1325(a)(5) (2005).

³² Chapter 13 “cramdown,” also known as “strip down” or “lien stripping” or “claim bifurcation,” is not to be confused with the unrelated but eponymous Chapter 11 “cramdown,” the confirmation of a plan of reorganization under 11 U.S.C. § 1129(b) (2005), over the objections of a dissenting class of creditors or interests.

³³ 11 U.S.C. § 1325(b) (2005).

³⁴ 11 U.S.C. §§ 1322(a); 1325(a)(5) (2005).

³⁵ 11 U.S.C. §§ 727(a)(7)-(9); 1328(f)(2) (2005).

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Beyond helping solve the current crisis, ensuring widely available bankruptcy relief will provide an important defense against systemic financial risk. Bankruptcy plays a crucial, but often overlooked role in preventing systemic financial risk. Systemic financial risk is a product of unpredictable (or more precisely, unpredicted) losses; predictable losses do not cause systemic risk.

Bankruptcy helps makes losses more predictable. It does so in two ways. First, it provides a loan modification mechanism that can preserve greater value for lenders than state law debt collection. By limiting losses, bankruptcy narrows the range of potential lender losses. Bankruptcy makes the peaks lower and the valleys higher. Restricting the volatility of consumer debt losses makes losses more predictable. Second, for consumer debt, bankruptcy allows for a constant (and reasonably predictable) trickle of losses, rather than a build-up and sudden explosion of defaults. In this sense, bankruptcy provides a safety valve for the consumer economic boiler.

Predictability is key to stable financial markets. The nature of systemic risk is that it stems from unpredictable issues. Therefore, reforms aimed at solving this crisis's problems, like changes to the securitization process or to mortgage finance in general, are no protection against future crises. It is, in the Rumsfeldian taxonomy, the "unknown unknowns" that present systemic risk. Bankruptcy provides an important protection against these unknown unknowns.

Bankruptcy is not just the social safety net that protects middle class consumers. It is also a stabilizer for the entire consumer economy. Ensuring widely available bankruptcy relief both in terms of consumers' eligibility and the range of debts that can be modified in bankruptcy is a key financial system safety reform regardless of private market improvements or specific regulatory reforms. Permitting all mortgages to be modified in bankruptcy is an important step in bolstering this bulwark against systemic risk from consumer debt.

As the foreclosure crisis deepens, bankruptcy modification presents the best and least invasive method of stabilizing the housing market. It could also be combined with a carrot approach for potentially greater effect. Permitting modification of all mortgages in bankruptcy would not have prevented the irresponsible lending leading to the foreclosure crisis. Nor is it a magic bullet solution, but it is a quick, fair, efficient, and administrable response that would help stabilize the housing market and prevent the deadweight social and economic losses of foreclosure. Unlike any other proposed response, bankruptcy modification offers immediate relief, solves the market problems created by securitization, addresses both problems of payment reset shock and negative equity, screens out speculators, spreads burdens between borrowers and lenders, and avoids both the costs and moral hazard of a government bailout. Bankruptcy modification should be at the top of the financial reform and economic stabilization agenda.

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