Testimony of

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Chairman Gutierrez, Ranking Member Hensarling, and members of the Subcommittee, thank you for the privilege of testifying here today on behalf of the Securities Industry and Financial Markets Association (SIFMA) and the American Securitization Forum (ASF) regarding reform of mortgage finance and in particular certain mortgage origination practices that contributed to the housing crisis affecting the nation today. We were pleased to have worked on this issue constructively with the Committee as it moved toward November 2007 passage of H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 3915" ("H.R. 3915" or the "bill"). We appreciate the opportunity to highlight the key considerations that guided the involvement of SIFMA in the earlier legislative initiative and that remain important to SIFMA/ASF today.

At the outset, let me state the obvious. The market is very different today than it was in the fall of 2007. We believe the House at that time wisely sought to limit the majority of the bill's provisions to subprime loans by focusing on the core practices that it believed contributed to the subprime crisis. The underlying premise was that every segment of the market – from borrower and broker - through to the investor – bore some responsibility for the breakdown, but that loans to subprime borrowers could be made in a responsible way, and that there was a desire to see industry continue to support this segment of the mortgage market. As such, the Committee worked to make the new requirements relatively understandable and the penalties for violations maintained a sense of proportionality.

Since then, of course, the availability of subprime credit has evaporated. This market has not returned. The conforming prime market is functioning but fragile. Congress and the Administration have made several attempts to address the current foreclosure and housing crisis. When the Federal Reserve Board (the "Board") adopted its final regulations to the Home Ownership Equity Protection Act in July 2008, it sought to address certain of the major underwriting concerns that H.R. 3915 covered. As a result, it appears that any new legislative initiative will be largely in anticipation of the eventual return of a private lending and securitization market. One of the key questions going forward is the extent to which policymakers wish to encourage the return of private investment in housing finance, particularly for borrowers who may not meet agency standards.

During its deliberations of the proposed bill, the House sought to balance the legitimate interests of borrowers, lenders and assignees in addressing five basic issues: (i) who should be subject to the law's requirements, (ii) what types of residential mortgage loans should be subject to the law's requirements, (iii) what does the law require, (iv) what are the remedies for violations of the laws, and (v) what is the relationship of the new federal law with state laws addressing similar issues. We believed then, and we still believe today, that there are certain principles that guide the willingness of the industry to participate in the primary and secondary mortgage markets. First, lenders, assignees and securitizers need legal certainty before being subjected to potential legal liability. Second, borrowers and market participants are looking primarily for a system that works: one that protects both the legitimate interests of innocent consumers from inappropriate lending products and provides incentives for investors to invest the funds needed to help get that borrower a home. Although we had some concerns, we felt that many of the provisions of H.R. 3915 provided a fair balance, and we hope that any newly proposed legislation will do the same.

I. BACKGROUND ON H.R. 3915

A. Substantive Requirements

H.R. 3915 essentially would have imposed four substantive obligations, two on mortgage lenders (defined as "creditors") and on two on mortgage brokers (defined as "mortgage originators"). First, it would have prohibited a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that at the time the loan is consummated, the consumer has a reasonable ability to repay the loan according to its terms (or to make the combined payments on all loans on the same dwelling about which the creditor knows or has reason to know), and all applicable taxes, insurance, and assessments. Second, H.R. 3915 would have provided that no creditor may extend credit in connection with any residential mortgage loan that involves a refinancing of a prior existing residential mortgage loan unless the creditor reasonably and in good faith determines, at the time the loan is consummated and on the basis of information known by or obtained in good faith by the creditor, that the refinanced loan will provide a net tangible benefit to the consumer. While H.R. 3915's ability to repay and net tangible benefits standards technically applied to all "residential mortgage loans," it established presumptions that would have resulted in the standard essentially applying only to subprime mortgage loans based on a quantitative test of the cost of the loan; loans that qualified for the presumptions were referred to as "safe harbor" mortgages .

Third, H.R. 3915 would have required that mortgage originators "diligently work to present the consumer with a range of residential mortgage loan products for which the consumer likely qualifies and which are appropriate to the consumer's existing circumstances." Furthermore, the duty would have mandated that originators make complete and timely disclosures to a borrower of the comparative costs and benefits of each product offered, the nature of the originator's relationship to the borrower, and any relevant conflicts of interest. This duty would have applied to both prime and subprime, consumer purpose, residential mortgage loans. Fourth, H.R. 3915 would have prohibited mortgage originators from receiving, and any person from paying, incentive compensation (such as yield spread premiums) that is based on, or varies with, the terms of the loan. It expressly excluded variations in compensation based on the amount of principal. This fourth restriction only would have applied to the same subprime loans to which the ability to repay and net tangible benefits would have applied.

B. Remedies for Violations

The remedies for violations of these provisions differed depending on the violations. The standard civil liability provisions of the Truth in Lending Act would have applied to violations of the H.R. 3915's provisions. H.R. 3915 would have increased the type and amount of monetary damages that would have been available for violations. Congress later doubled the statutory penalties applicable to closed end mortgages when it enacted The Housing and Economic Recovery Act of 2008.

TILA currently imposes liability primarily on lenders who fund loans in their name; it applies to "creditors," but not mortgage brokers. H.R. 3915 would have extended TILA civil liability to include mortgage originators. A mortgage originator that violated the duty of care and anti-steering provisions would have been liable for actual and statutory damages but not enhanced damages. However, those monetary damages would have been capped at three times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the mortgage loan, plus costs and attorney's fees.

H.R. 3915 also would have materially expanded rescission as an available remedy. Rescission, which extinguishes the loan and requires the creditor or assignee to return to the borrower all amounts he or she previously paid, is an extraordinary remedy under current law but limited in its application from a time standpoint. Under TILA currently, a borrower has a right to rescind a refinancing mortgage loan transaction for three days after closing or until the delivery of certain material disclosures, whichever is later. If the creditor fails to provide those disclosures altogether, or fails to provide accurate material disclosures, the right to rescind extends to three years. This three-year term is considered the "extended" right to rescind, compared to the "general" rescission right that is limited to three days following closing.

H.R. 3915 would have provided an extended right to rescind for certain of its new loan origination provisions. Rescission would have been available to consumers under the bill as a remedy for violations by creditors of the proposed underwriting requirements. However, mortgage originators that violated the duty of care and anti-steering requirements would not have been expressly subject to rescission claims. If the creditor could not have provided, or a consumer could not have obtained, rescission because the loan was held by somebody else, the liability would have to have been satisfied by providing the financial equivalent of a rescission, plus costs and reasonable attorney's fees. Further, a creditor would not have been liable for this new rescission remedy if the creditor had cured the violation within 90 days after the consumer notified the creditor of the violation. H.R. 3915 created an exemption from liability and rescission in the context of borrower fraud or deception.

H.R. 3915 would have imposed limited assignee liability for violations by creditors of the bill's underwriting requirements but not for violations by mortgage originators, although it did not define the term "assignee." Liability would have extended to assignees and "securitizers." A "securitizer" was defined as any person that assigns residential mortgage loans, to any securitization vehicle. The bill exempted "securitization vehicles" from assignee liability, which meant that trusts or other entities that issue securities backed by the loans and that also hold those loans, as well as the purchasers or repackagers of the securities, would not have been liable for violations. The consequence of this distinction was significant. Under the bill, a holder of an interest in a mortgage-backed security or collateralized debt obligation would have not borne the economic risk of loss for a violation of the loan origination requirements.

An assignee or securitizer that acted in good faith would have been liable in an individual action for rescission, costs and attorney's fees, but not for money damages. It could have avoided rescission as a remedy in two circumstances. First, it could have cured a violation within 90 days by modifying or refinancing the loan, at no cost, to provide terms that would have complied with TILA (as amended) at time of origination, plus refund costs and pay reasonable attorney's fees. Second, an assignee or securitizer would not have been subject to assignee liability under the House bill if the assignee or securitizer could satisfy a due diligence safe harbor, which is referred to as the "securitizer safe harbor." To qualify, the assignee would have to demonstrate that it:

1. established a policy against buying residential mortgage loans other than "qualified mortgages" or "qualified safe harbor mortgages";

2. required the seller to represent and warrant in the loan sale agreement that all of the loans are qualified mortgages or qualified safe harbor mortgages; and

3. in accordance with rules to be promulgated by federal banking agencies and the Securities and Exchange Commission exercised reasonable due diligence to adhere to its policy in purchasing mortgage loans, including through "adequate, thorough, and consistently applied sampling procedures."

The language was silent on the required scope or method of due diligence, and on the consequence of adverse findings from the samplings, leaving those details to regulation.

H.R. 3915 expressly stated that these were the exclusive liabilities that could have been imposed on an assignee for violation of the proposed underwriting requirements. The bill provided a limited preemption of state laws that would have applied additional rules and penalties to secondary market participants with regard to the construct in H.R. 3915. The remedies described in the new liability provision would have constituted the sole remedies against an assignee, securitizer, or securitization vehicle for a violation of the ability to repay or net tangible benefit standard or any other state law addressing that specific subject matter. However, the bill expressly would not have preempted the applicability of state laws against creditors. The bill also would not have preempted the availability of state law remedies for fraud, misrepresentation, deception, false advertising, or civil rights laws against an assignee, securitizer, or securitization vehicle for its own conduct in connection with the making of a loan, or the sale or purchase of residential mortgage loans or securities.

C. Revisions to the High Cost Loan Requirements of HOEPA

While the bulk of H.R. 3915 was the creation of a new regulatory regime for higher cost, subprime loans that did not rise to the level of high cost loans under HOEPA, Title III of the bill also would have increased the universe of loans that would have been subject to HOEPA and the substantive restrictions that would have applied to such loans.

II. POSITIVE ELEMENTS OF H.R. 3915

The final version of H.R. 3915 had many provisions that we considered extremely helpful. It properly differentiated between the new legal responsibilities of mortgage brokers and mortgage lenders, recognizing the inherent differences in the roles of the two types of originators and the related expectations of consumers. It generally limited the applicability of its provisions to subprime loans, recognizing that the lending abuses that afflicted the subprime market were generally absent in the prime market. It qualified the responsibilities of creditors to lessen the likelihood of successful claims for errors in judgments made in good faith. While it increased the monetary damages that would have been available for violations, it limited the availability of "enhanced" or penalty damages to ensure some level of proportionality between the violation and the remedy. While it increased the availability of the extraordinary remedy of rescission, at least the bill offered a creditor the ability to avoid rescission by curing the violation. The bill also properly balanced its treatment of assignees, although the term remained undefined.

Underlying these positive measures was the belief that consumers with troubled credit histories may have required greater protections but deserved the opportunity to obtain home financing. The House understood at the time that there was (and still is) no functioning market for "high cost" loans under HOEPA, because the industry refuses to make, finance, buy, or securitize these loans in response to the "bet your company" liability that HOEPA imposes. While not all agreed, there was a sense that the balancing of interests noted above would comfort the industry to participate in the higher cost loans that would have been regulated under H.R. 3915.

III. LINGERING CONCERNS OVER H.R. 3915

Although SIFMA / ASF continue to have concerns about several issues from H.R. 3915, we appreciate the Committee's balanced approach and beginning the discussion with the final version of H.R. 3915.

Issues that we would like to continue to discuss include:

- The narrow scope of loan products that would have been eligible for the safe harbor. The bill envisioned a class of non-safe harbor mortgages that were not deemed high-cost loans. We felt the market would have difficulty in determining risk and pricing for these loans and they may become prohibitively expensive for many borrowers. Because of the significant penalties and expanded assignee liability provisions under HOEPA, high cost loans generally are not made, financed, purchased, sold, or securitized. The interaction between the lowered HOEPA triggers in H.R. 3915 coupled with other financing limitations in the bill will not have allowed a market to return for these non-safeharbor loans.

- Rationalizing the provisions permitting a consumer to assert claims following the expiration of the statute of limitations in the defense to foreclosure section. The bill could be interpreted as having provided a consumer with a perpetual right to obtain money damages against creditors and assignees following the expiration of the statute of limitations. The bill gave a consumer the right to assert a civil action against a creditor and assignee for violations of the ability to repay and net tangible benefit requirements for the greater of three years and one year after the initial reset or conversion of the loan, but no more than six years. That should be a sufficient time for a consumer to figure out whether they could afford the loan or have received a net tangible benefit from the loan.

Thank you very much for the opportunity to raise these issues. SIFMA/ASF looks forward to working with the Committee to craft legislation that protects homeowners while ensuring a vigorous home finance market. We pledge to continue to work constructively with you on these matters as the bill is developed.