Statement of Larry Platt
Kirkpatrick & Lockhart Preston Gates Ellis LLP

On behalf of
Securities Industry and Financial Markets Association

Before the
Committee on Financial Services
United States House of Representatives

December 6, 2007

Chairman Frank and Ranking Member Bachus thank you for the privilege of testifying here today on behalf of the Securities Industry and Financial Markets Association (SIFMA[1]) on a proposal that would allow regulators to impose significant monetary penalties on creditors and assignees that exhibit a pattern and practice of certain violations of H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act of 2007." While we appreciate the efforts of the Committee to strive to find ways to protect borrowers who are victims of unlawful lending practices, we oppose this measure as offered during floor consideration of H.R. 3915. We believe it will have the unintended effect of prohibiting residential mortgage loans that do not qualify for the safe harbors provided in Title II of H.R. 3915, much like HOEPA effectively outlaws "high cost mortgages." We believe the remedies provided in Title II should be given a chance to work before declaring them to be ineffective.

At the outset, we believe 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 all need to know what reasonably is expected of them before being subjected to the risk of significant penalties for errors in judgment made in good faith. Second, lenders, assignees and securitizers all desire carefully crafted laws that provide a reasonable balance between the legitimate interests of consumers and industry participants. Third, lender, assignees and creditors should not be subject to penalties that bear no rational economic relationship to actual harm, and impose the potential for "bet your company" liability. We are concerned that this proposal would upset the balance of the base legislation and cause parties to leave the market.

---

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers locally and globally through offices in New York, Washington D.C., and London. Its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong. SIFMA's mission is to champion policies and practices that benefit investors and issuers, expand and perfect global capital markets, and foster the development of new products and services. Fundamental to achieving this mission is earning, inspiring and upholding the public's trust in the industry and the markets. (More information about SIFMA is available at http://www.sifma.org.)

Washington ▪ New York ▪ London ▪ Hong Kong
1101 New York Avenue NW, 8th Floor ▪ Washington DC 20005-4629 ▪ P:202.962.7300 ▪ F:202.962.7305 ▪ www.SIFMA.org

BACKGROUND

As you know, Title II of H.R. 3915 obligates a creditor to make a reasonable and good faith determination of (i) a consumer's ability to repay a residential mortgage loan and (ii) the provision of a net tangible benefit to the consumer of a refinancing residential mortgage loan (the "Law"). Generally speaking, a consumer has a right to obtain a rescission of a loan that is made in violation of this provision although creditors and assignees may cure the violation in lieu of rescission. The proposed amendment also would impose civil money penalties of $1 million plus not less than $25,000 per loan on any creditor, assignee or securitizer that engaged in a pattern or practice of originating, assigning or securitizing residential mortgage loans in violation of the Law (the "Proposal").

The Proposal would apply only to residential mortgage loans that are not "qualified mortgages, "qualified safe harbor mortgages" or "high cost mortgages." The first two types of loans are presumed to satisfy the Law and thus could not raise the possibility of pattern and practice violations. The third type of loan, high cost mortgages, are subject to a separate set of statutory requirements; the mortgage finance industry generally does not make, finance, buy, sell, or securitize these loans because of the draconian remedies that may be asserted against assignees.

The remaining residential mortgage loans to which the Proposal would apply truly are caught between two worlds. On the one hand, they do not benefit from a presumption of compliance. On the other hand, they are not illegal, and remedies for violations do not include enhanced damages and assignees are not subject to any and all claims that consumers could assert under other laws as HOEPA now permits. Of course, the risk of rescission awaits a creditor or, in some cases, an assignee or securitizer who makes or buys a loan that violates the Law. But presumably a lender can price the risk of uncertainty and not withdraw entirely from this segment of the market for fear of immeasurable liability.

Underlying this amendment is the belief that enabling a borrower to get out of a loan that should not have been made is not enough. While it may make the individual borrower "whole," the limited remedy is perceived to be insufficient to discourage creditors, assignees and securitizers from routinely taking the risk to violate the Law. Imposing the risk of multi-million dollar liability, without regard to the actual harm suffered by individual borrowers whose loans were rescinded or cured, is thought to motivate the market to comply with the Law. We disagree and believe that the remedy of rescission should be given the chance to succeed.

ANALYSIS

Any evaluation of the merits of the Proposal must begin with a straight forward question—namely, should residential mortgage loans falling outside of the safe harbor be encouraged or discouraged? As a preliminary matter, by reducing the financial triggers that cause a residential mortgage loan to become a "high cost mortgage," the House already has sought to remove from the marketplace a large segment of loans to which the new Law otherwise would apply. For the remaining residential mortgage loans that do not qualify for the presumption of compliance, the amendment will effectively do the same thing.

H.R. 3915 does not conclusively define how a creditor determines a consumer's ability to repay a loan or a loan's net tangible benefit to a consumer. This means that the proposal would impose a minimum

penalty of $1 million on a creditor for engaging in a pattern or practice of violating a law that is inherently subjective in nature. H.R. 3915 also does not impose any substantive legal obligation on assignees or securitizers to make independent determinations of either a borrower's ability to repay a loan or a loan's net tangible benefit to a borrower or the correctness of the creditor's determination. And, even if it did impose a direct obligation, it does not precisely define what is illegal. This means that the Proposal would impose a minimum penalty of $1 million on an assignee for engaging in a pattern or practice of an act that is itself not illegal—the simple act of purchasing loans. Either way, the practical application of the Proposal is to impose substantial economic penalties on parties to discourage behavior that is ambiguous at best.

In the face of the inherent ambiguity of the law, what should a creditor do? A lender that reasonably and in good faith believes it has developed an alternative underwriting tool to predict default would be at material risk to use it. If it implements the widespread usage of the tool—shall we say a pattern and practice of usage—it could subject itself to multi-million dollar claims. Moreover, the underwriting tool that gave rise to the pattern and practice claim most likely would be the subject of class action litigation against creditors. Indeed, the available remedies presumably will provide a rich incentive to assert class action claims. And the absence of any meaningful definitions of what constitutes compliance with the Law means that long drawn out court battles will ensue with a judge or jury ultimately having to decide the meaning of phrases that Congress chose not to define. Continuing efforts to develop flexible underwriting tools for underserved borrowers, for example, would be undermined.

Assignees and securitizers acting in good faith are further challenged. They will have to evaluate the reasonableness of a creditor's determination of legal compliance and will be unable to diligence compliance in advance in a definitive way. As noted before, the simple act of repeatedly buying loans made by others creates a pattern and practice that could result in multi-million dollar liability. This Proposal would go beyond making assignees liable for the legal violations of creditors, and would seek to impose direct liability on the assignees and securitizer, thereby setting themselves up for piggy back claims under other laws.

As evident from market reaction to HOEPA and certain state experience in extending HOEPA-like liability to other sectors of the mortgage market, we know that excessive penalties that bear no rational relationship to actual harm will cause the mortgage finance industry to withdraw from the market. We believe the remedies in Title II are more than sufficient to discourage the behavior this Proposal seeks to curtail.

We appreciate the opportunity to testify, and would be happy to answer any questions.