TESTIMONY OF
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BEFORE THE
COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

HEARING ENTITLED
"LEGISLATIVE PROPOSALS ON REFORMING MORTGAGE PRACTICES"

OCTOBER 24, 2007

Introduction

Mr. Chairman and members of the Committee:

My name is Marc Lackritz and I am President and CEO of the Securities Industry and Financial Markets Association ("SIFMA").[1] I am pleased to provide the views of both SIFMA and the American Securitization Forum ("ASF")[2] on H.R. 3915, the "Mortgage Reform and Anti-Predatory Lending Act."

We commend you and your staff for a fair and participatory process in the development of this legislation. The legislation seems true to the goals that you outlined when you began examining this subject earlier this year, and we appreciate the opportunity to provide additional comments. The Committee has tried to stay true to a simple principle – namely, that a borrower should not get a loan that he or she cannot afford and from which he or she does not benefit. Moreover, a borrower should be able

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[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.)

[2] The American Securitization Forum is a broadly-based professional forum through which participants in the U.S. securitization market express their common interests on important legal, regulatory and market practice issues. ASF's membership – over 350 organizations in all – includes securitization issuers, investors, servicers, financial intermediaries, trustees, rating agencies, legal and accounting firms, and other securitization market participants. ASF is an adjunct forum of SIFMA. (Additional information about the ASF, its members and activities is available at www.americansecuritization.com.)

to get out of any loan that breaches this simple standard. We support that framework as the system works best when we can keep families in their homes.

The beauty of our housing finance system has been its continued ability to innovate and develop new techniques to best reach and serve all market participants. Occasionally, some of these techniques do not work as well as they are intended. Importantly, we cannot overreact in crafting legislation to address the abuses that have occurred in a very small segment of the lending market. Indeed, the market has already adjusted to the rise in delinquencies with dozens of subprime lenders exiting the market altogether and others eliminating practices that did not work or tightening their lending standards. There are limits to the uncertainty and liability that an investor will accept without taking its money and investing elsewhere, especially when it involves increasingly global capital flows. We urge the Committee to bear that in mind when determining the final features of the bill.

Background

Despite the current troubles in the home mortgage market, the United States has a housing finance system that has been extremely successful in making the dream of home ownership available to millions of Americans. Home mortgage credit has been more widely available at a lower cost because of securitization and the secondary mortgage market.[3] The secondary market efficiently links mortgage borrowers to the capital markets and enables lenders to provide more credit at a lower price than they otherwise could. Over the past decade, securitization and the secondary market has expanded access to credit for all borrowers. Today, nearly 70 percent of American households own their own homes, a historically high figure.

In addition, Congress has consistently supported and promoted securitization by enacting laws to make the secondary mortgage market more efficient. Congress created Ginnie Mae, Fannie Mae and Freddie Mac to promote securitization as a means of expanding mortgage lending. Other laws such as the Secondary Mortgage Market Enhancement Act of 1984 and the REMIC provisions of the Tax Reform Act of 1986 specifically recognized the benefits of securitization in expanding home ownership and making the securitization process vastly more efficient.

Major Concerns

We are concerned that several provisions of the current legislation could significantly reduce funding from the secondary mortgage market and cut off mortgage credit for worthy subprime borrowers.

[3] In conformity with market usage, the "secondary mortgage market" generally means the process whereby home loans are indirectly financed by investors' purchasing mortgages and mortgage securities from lenders who directly make loans to homebuyers.

National Standards are Needed

The single biggest deficiency in the bill is the lack of federal preemption of state laws. Although we understand that you intend for Title II to be preemptive, we believe such a preemption should be explicitly stated. The bill requires a lender to determine both that the borrower has the ability to repay a loan and that the loan provides a net tangible benefit to the borrower before the loan is made. Reasonable people can differ on whether a borrower should have such a statutory right to require the lender to be responsible to protect the borrower from making bad choices. We acknowledge that the proposal at some levels tries to balance the interests of borrowers and lenders on this point. Nevertheless, we believe this should be a single, national standard, which is not subject to 50 variations flowing from state legislation. Without such preemption, this bill will only add to the patchwork of regulation which regulates mortgage lending, and will increase the costs of compliance which likely will be passed on to end borrowers.

Secondary Market Liability Must be Targeted

Although we do not think that liability for the secondary market for actions of brokers or originators is appropriate, we do recognize and appreciate that the bill limits the exposure of the secondary market investors and trusts. The bill also limits the damages that a securitizer (sponsor) of the trust has, should the worst-case scenario arise. We believe the bill should ensure that the cure remedy is made preferable to rescission. In that respect, the bill should clarify that the 90-day cure period starts from the time the securitizer or assignee receives the claim notice either directly from the borrower or indirectly through the servicer or other third party. The bill should affirmatively state that a consumer loses the right to a rescission if the consumer rejects a qualifying offer to cure. Moreover, a borrower should not have the right to rescind a loan that he or she procured through fraud or misrepresentation.

We remain concerned that the liability has been expanded beyond the "securitizer." We understand that the Committee may want to ensure that an investor who buys and holds loans rather than securitizes them is not insulated from liability. At the same time, however, the ability of a borrower to bring an action against any party that ever had an interest in the loan will create chaos in the marketplace. We recommend that the term "assignee" be narrowly defined to be "the entity, other than a Securitization Vehicle, that owns the residential mortgage loan at the time the consumer makes the claim." Section 131 of the Truth in Lending Act ("TILA") currently provides that a loan servicer that holds legal title to a loan to conduct the servicing function is not considered an assignee for purposes of TILA, and we believe that provision should apply here as well.

One of the elements of this safe harbor provides that the securitizer/assignee must exercise reasonable due diligence based on a sample of loans to make sure that the loans are qualified mortgages or qualified safe harbor mortgages. We are very concerned that finding one ineligible loan would cause the safe harbor to evaporate. Accordingly, we suggest that the bill clarify that the exercise of commercially reasonable due diligence based on a sample of loans is intended to prevent the assignee or securitizer from knowingly purchasing or taking assignment of a pool of mortgages as to which a *material* portion of such mortgages are not qualifying mortgages or qualifying safe harbor mortgages.

Defining Qualified Mortgages and Qualified Safe Harbor Mortgages

We are concerned about the scope of loan products which will fall into the safe harbor provisions in Section 203, that is, how many loans will be "qualified mortgages" and "qualified safe harbor mortgages." Typically, where broad unlimited assignee liability exists, such as under the Home Ownership and Equity Protection Act, ("HOEPA") for high-cost loans, the market simply dries up. Loans are rarely made and certainly not securitized. Given the current state of the mortgage-backed securities credit market, we are concerned that the combined effect of the limited rescission liability in Title II and HOEPA expansion in Title III will cause only those loans qualifying for the safe harbor to be made. Furthermore, if the safe harbor is constructed in a narrow manner, there may be little life in the subprime market, while regulators work out the details clarifying which loans are safe and what the process is going forward.

We understand that the theory underlying the bill is that the market will eventually price the non-safe harbor loans, but do not necessarily believe it to be a certainty. If it happens, we wonder how long it will take, how much costs will increase for borrowers, and what impact it will have on the economy.

The bill also enumerates certain objective tests for loans to qualify for the safe harbor. Although we support the general carve out for "prime" loans (i.e. qualified mortgages), we recommend the following adjustments to the criteria for "qualified safe harbor" mortgages:

- Make the debt-to-income ratio one of the alternative criteria rather than the mandatory criteria;

- Reduce the required length of fixed payments from seven years to five years;

- In lieu of restriction on margin for ARM loans, provide that the adjustable interest rate will not increase on any change date by more than three percentage points or during the life of the loan by more than seven percentage points.

Statute of Limitations

The scope of application in section 204 should be reduced. The language effectively allows a perpetual application, because it is the later of six years or foreclosure, acceleration, or the mere default by a borrower of 60 days or more. The bill allows those in a difficult financial situation to simply default on, and then try to rescind, their loans, even after years of paying them. The bill relies upon existing TILA law treatment as the foundation for the remainder of the rescission remedy. As such, for consistency sake, the statute of limitations for this section should be three years as under existing TILA section 125, with certain very limited exceptions following the initiation of foreclosure. A borrower should know within three years whether the tests are satisfied.

Other Concerns

We have an overarching concern with the lack of a role for the Federal Reserve in the rulemaking process. The Federal Reserve Board has important expertise with securitization and the secondary markets, as well as the administration of HOEPA. We believe the Fed should share rulemaking authority with the other regulators in the bill.

We also continue to believe that there should not be an outright prohibition on mandatory arbitration. Pre-dispute arbitration continues to be a far more efficient and cost-effective dispute resolution mechanism than traditional court-based litigation.

Thank you for the opportunity to raise these concerns with you. We look forward to working with the Committee to craft legislation that protects homeowners while ensuring a vigorous home finance market.