SIFMA
Securities Industry and Financial Markets Association

American Securitization Forum

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United States House of Representatives

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Thank you and good morning. I am pleased to be here representing the American Securitization Forum (ASF)[1] and the Securities Industry and Financial Markets Association (SIFMA)[2] on issues related to the subprime mortgage market. We commend you, Chairman Frank, for calling this hearing and we are grateful for the opportunity to present our views.

Summary

Home ownership is one of the most widely shared values in America and an iconic symbol of personal achievement. Federal law reflects the importance of home ownership in American culture by encouraging and assisting families to buy homes. Policies such as the home mortgage interest deduction, the exemption from capital gains on home sales, the Federal Housing Administration mortgage insurance program and the creation of Ginnie Mae, Fannie Mae, Freddie Mac and the Federal Home Loan Banks, among numerous others, have helped millions of Americans buy homes who otherwise would have been excluded from the "American dream." The capital markets have also contributed substantially to expanding the availability and reducing the cost of mortgage credit by linking investors and home buying families through mortgage securitization.

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[1] 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. Additional information about the ASF, its members and activities is available at www.americansecuritization.com. ASF is an adjunct forum of SIFMA.

[2] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Market Association, is based in Hong Kong. More information about SIFMA is available on its website at www.sifma.org.

Mortgage securitization is the process of converting homeowners' monthly principal and interest payments from pools of home mortgages into mortgage-backed securities (MBS) which are sold to investors much like stocks, government and corporate bonds and other financial instruments. Securitization serves several purposes that all contribute to making mortgage loans more available and affordable to American families:

- Securitization provides a way for mortgage companies and other lenders to sell the loans they originate to generate capital for new loans. Mortgage companies, thrifts and others do not need to retain mortgages on their books for the entire terms of the loans.

- Securitization draws varied sources of capital to the mortgage lending market. Investors such as pension funds, insurance companies and mutual funds both inside and outside the U.S. generally do not want to hold individual mortgage loans in their investment portfolios. They are, however, active buyers of MBS, making their funds available to American families buying homes.

- Securitization distributes and reduces the risk of investing in mortgages. Participants in the MBS market have developed innovative ways of segmenting the risks associated with investing in mortgages and creating securities that allow investors to assume as much or as little risk as they desire.

Securitization helps provide capital for both "prime" mortgages—loans to homebuyers with relatively good credit—and "subprime" mortgages—loans to homebuyers with relatively weaker credit. In fact, securitization has been a driving factor in making mortgage loans available to subprime borrowers who otherwise may not have been able to purchase their own homes.

With the recent rise in delinquencies among subprime borrowers, policy-makers at the federal, state and local levels have been exploring changes in law and regulation designed to help protect homebuyers from "predatory" lenders. However, these well-intentioned efforts, if not appropriately conceived, can have the unintended effect of stifling the availability of mortgage loans for deserving subprime borrowers. Indeed, such efforts by policy-makers in some states and cities have resulted in complete shut-downs of all subprime lending activity and have been followed by hasty changes in law in order to restore the market.

Both the lending and investment markets have responded briskly to the rise in delinquencies among subprime borrowers. Dozens of subprime lenders have exited the market altogether. Those lenders who remain have tightened their lending standards. Investors are much more cautious about what securities they buy. Prices for certain securities backed by subprime loans have fallen, reflecting the heightened risk associated with the increase in delinquencies. Perhaps most important, mortgage servicers—those firms responsible for receiving monthly mortgage payments from borrowers and passing them through to MBS investors—have been working with borrowers who are in arrears on their loans to help avoid foreclosures. Servicers, who often have flexibility under their servicing contracts to help borrowers avoid default, have taken steps such as modifying loan terms and extending deadlines for payments to help families in trouble avoid losing their homes.

Poorly crafted policies designed to further regulate subprime lending or provide relief to borrowers could have the consequence of causing MBS investors to shun the market altogether and cut off mortgage credit for worthy subprime borrowers. There are several key areas where federal policy-makers should exercise caution:

- Mandatory forbearance. Legally mandated forbearance for borrowers delinquent on their loans—as opposed to forbearance contractually permitted in loan and servicing agreements—would violate legally protected contracts, harm investors, and cause many investors to exit the MBS market, drying up funds for home buyers.

- Assignee liability. Poorly crafted assignee liability provisions, imposing unquantifiable liability on investors or secondary market participants, would drive investors from the market and eliminate mortgage funding for many families.

- Prohibiting certain mortgage products. Prohibiting lenders from offering certain mortgage products would restrict the ability of some borrowers to obtain loans that could mean the difference between qualifying or not qualifying for home ownership.

To address current issues in the subprime mortgage market, policy-makers should focus on:

- Full and aggressive enforcement of existing laws and regulations governing loan origination.

- Educating borrowers on the risks and benefits of mortgage products they are considering and ensuring that borrowers have all the clear, concise information they need to make intelligent decisions.

- Encouraging lenders and servicers to make use of the flexibility permitted in loan and servicing contracts to help borrowers in default avoid foreclosure.

Introduction

Home mortgage credit is more widely available today and at a lower cost because of securitization and secondary mortgage market activity than ever before. The secondary mortgage market[3] efficiently links 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—the process of transforming pools of mortgage loans into securities which can be bought by investors—and the secondary market have expanded access to credit for all borrowers, but especially to so-called non-prime or sub-prime borrowers[4], or borrowers with less than perfect credit.

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[3] In conformity with market usage, the term secondary market, as used in this paper, generally means the investor and securitization market whereby mortgages are indirectly financed through the capital markets' purchasing mortgages and mortgage related securities from lenders who directly make loans to consumers.

[4] As used in this paper, the term "non-prime" refers to the category of loans identified and defined in Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, *Interagency Guidance on Subprime Lending*, Mar. 1, 1999 and *Expanded Guidance for Subprime Lending Programs*, Jan. 31, 2001 as well as Office of the Comptroller of the

The ASF and SIFMA share concerns expressed by members of Congress, regulators, consumer groups and others about abusive lending practices, particularly those directed at non-prime borrowers. However, we would caution policymakers to take measured and appropriately targeted actions to address perceived problems in the subprime mortgage finance market. An overly broad legislative response to the current headline issues involving non-prime loans, borrowers and lenders could have deleterious, unintended consequences that would reduce the availability and increase the costs of mortgage credit for deserving borrowers. Worsening the current market's significant tightening of credit standards could greatly increase recent home purchasers' stress as refinancing options dwindle just as many subprime borrowers may try to refinance in order to avoid the potentially higher payments resulting from mortgage rate resets for loans originated in 2005 and 2006.

The Secondary Mortgage Market

The secondary market for nonprime residential mortgages loans and the securitization of mortgage loans in particular has allowed millions of Americans to achieve the dream of home ownership while at the same time providing systemic benefits by diversifying regional mortgage risk.

Mortgage-backed securities (MBS) are securities sold to investors much like stocks, government and corporate bonds, and other financial instruments. MBS are created when originators or financial intermediaries pool large volumes of individual mortgage loans and sell securities backed by the monthly payments made by borrowers on the underlying mortgage loans.

When a homeowner whose loan has been committed to a MBS pool makes his or her monthly mortgage payment, that payment, combined with payments from other loans in the pool, forms the basis of the cash flows to investors who bought the MBS. Often, MBS are structured to address particular investor risk preferences. Investors may choose their position in the priority of payments from that pool of loans in case of defaults—either at front of the line, in a AAA-rated tranche, or in a more risky position such as a subordinate tranche that may absorb the first losses experienced in the pool but that offers a higher return. Bonds may also be structured as tranches that receive only interest collected on the underlying mortgage obligations, called interest only tranches or IOs, and tranches that receive payments only from the principal payments of the underlying mortgages, called principal only tranches, or POs.

The U.S. government has supported and encouraged the development of the MBS market by creating Fannie Mae, Freddie Mac and Ginnie Mae (generally referred to as the "Agencies" or the "GSEs") and by enacting other laws designed to facilitate a secondary market for residential mortgages. These include the Secondary Mortgage Market Enhancement Act of 1984 and the Real Estate Mortgage Investment Conduit (REMIC) provisions of the Tax Reform Act of 1986, among others. The policy goal of these initiatives has been to expand the availability of credit to home-buying families and reduce the cost of that credit. MBS issued by these government-sponsored enterprises are known as "Agency MBS."

Currency, Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision and National Credit Union Administration, *Proposed Statement on Subprime Mortgage Lending*, Mar. 8, 2007.

Approximately $10.2 trillion of 1-4 family mortgage debt was outstanding at the end of 2006[5]. Approximately $2.51 trillion of mortgages were originated in 2006, according to the Mortgage Bankers Association, and they project that $2.28 trillion will be originated in 2007[6]. Originations to subprime borrowers totaled $35 billion in 1994; this increased to $665 billion in 2005[7].

The mortgage-backed securities market is the largest fixed income market. At the end of 2006, approximately $6.5 trillion of securitized mortgage-related debt was outstanding compared to $4.3 trillion of U.S. Treasury securities and $5.4 trillion of corporate debt[8]. Total issuance of mortgage-backed securities (MBS), including private-label, agency, and home equity loan backed deals has increased threefold so far this decade, from $738 billion in 2000 to $2.4 trillion in 2006[9].

Non-agency issuance, which captures the vast majority of securitized subprime loans but which also includes prime loans that do not conform to agency underwriting standards, has grown from $157 billion in 2000 to $1.2 trillion in 2006[10]. In 2006, non-agency issuance exceeded agency issuance for the first time, achieving a 50.2 percent share of issuance[11]. Approximately 38 percent of private-label MBS issuance in 2006 was backed by subprime loans. Overall issuance of MBS backed by subprime loans has grown from $95 billion in 2001 to $450 billion in 2006[12].

Home ownership is close to its highest level in history, almost 70 percent overall.[13] This figure reflects roughly five percent growth from 1989 to 2006.[14] Non-prime mortgage loans have accounted for much of this growth in ownership; from 1998 to 2006, non-prime mortgages as a share of total originations grew from 10 percent to approximately 20 percent.[15] Increased homeownership has enabled Americans across all demographics to build wealth in residential real estate. It has also increased the stake of these home buyers in their communities and local schools. The secondary market, securitization and the liquidity they provides underlie these positive developments.

Before securitization became prevalent, banks funded mortgage loans through their customers' deposits, and mortgage credit availability was dictated in part by the volume of bank deposits. Today, banks and other lenders have the option of retaining loans or selling them into

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[5] Board of Governors of the Federal Reserve System, *Flow of Funds Accounts of the United States*, March 8, 2007, page 86.

[6] Mortgage Bankers Association, "MBA Mortgage Finance Forecast," March 13, 2007.

[7] Credit Suisse, *Mortgage Liquidity Du Jour: Underestimated No More*, March 12, 2007, page 22.

[8] Securities Industry and Financial Markets Association, *Research Quarterly*, February 2007, page 1.

[9] *Ibid*., page 10. Non-Agency or "private label" MBS may be issued by a bank, finance company, or other non-government related institution.

[10] *Ibid*.

[11] *Ibid*.

[12] *Inside MBS and ABS*, January 12, 2007.

[13] Statement of Douglas G. Duncan, Mortgage Bankers Association, before the United States Senate, Committee on Banking Housing and Urban Affairs, hearing on "Preserving the American Dream: Predatory Lending Practices and Home Foreclosures," February 7, 2007, page 2.

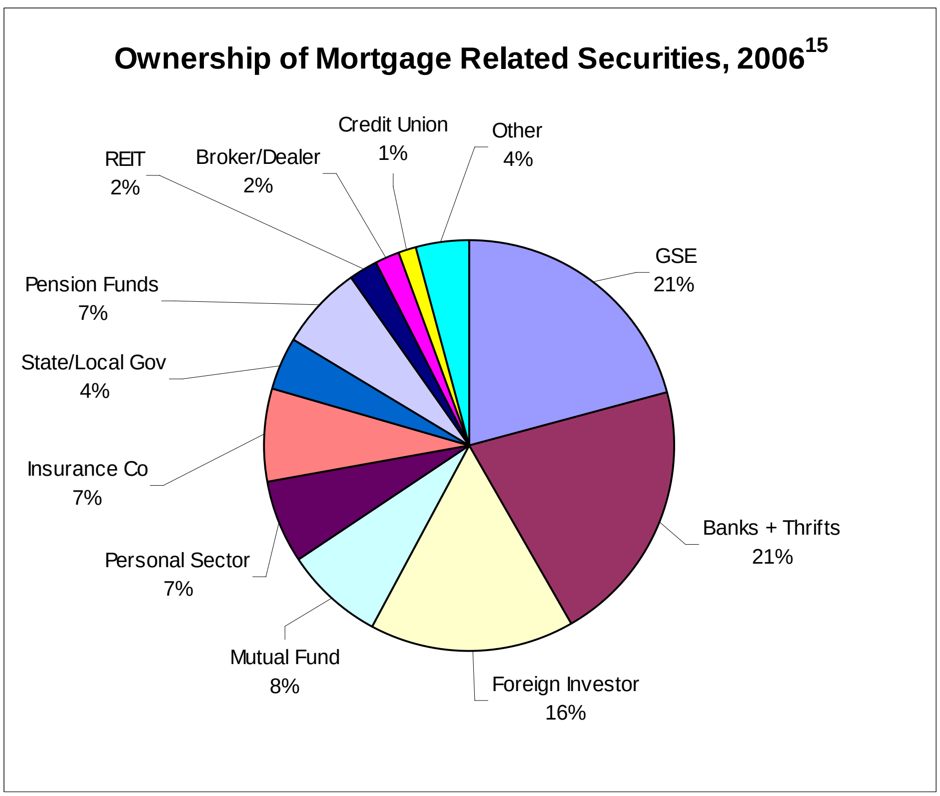
[14] *Ibid.*

[15] *Ibid.* See also "Subprime Mortgage Origination Indicators," *Inside B&C Lending*, November 10, 2006.

the secondary market. Many lenders issue their own mortgage-backed securities backed by the loans they originate or purchase. Others do not lend directly, but purchase pools of loans from a wide-range of originators. Originators can use these pools to back issues of bonds or retain them as investments. Purchasers of such securities include institutional investors, such as pension funds, investment funds, banks and insurance companies, both throughout the United States and increasingly throughout the world.

The ability of mortgage lenders to sell mortgages in the secondary market promptly and with substantial certainty increases funds available to lend and lowers borrowing costs. The liquidity provided in the secondary market enables portfolio managers to provide capital to U.S. mortgage lending that would not otherwise be available because of their ability to adjust their exposures easily within the secondary market as required and to hedge against changes in individual risk concentrations in their portfolios over time.

Finally, the widespread securitization of residential mortgage loans has decreased the systemic risk of regional mortgage holdings in local banks. The more efficient allocation of risk to both national and international investors reduces the concentration of risk that would otherwise be borne solely by local financial institutions due to fluctuations in local real estate markets. Holdings of mortgage related securities are dispersed across a broad spectrum of industries and regions, with more than 15 percent held overseas.



The Secondary Market and Legal Certainty

The twin benefits of widespread availability of credit for home buyers and the reduction in systemic risk in financing home purchases that are provided by a liquid secondary market depend on certain factors that make investment possible for those who cannot assess the details of every mortgage they help finance. In particular investors need to know that the risks they take at the time they make their investments will not be altered by changing the terms of the underlying contracts they finance. They also need to know that they will not have to bear liability based on the conduct of parties that they do not control or subjective determinations of whether loans were in the "best interest" of individual borrowers. The terms of most securitizations do provide, however, flexibility for servicers to accommodate particular cases of borrower distress. Risk is typically modeled at the time of purchase based on probabilities of default and severities of loss of the underlying mortgages based on historical data and loan terms remaining as they existed at the time of purchase. The analysis does not include change-of-law risk, which is unable to be effectively modeled but generally viewed as remote. Increasing change-of-law risk will inhibit the flow of funds as investors will not be able to quantify the risks they are accepting at the time of their purchase decision.

With the recent rise in delinquencies among subprime borrowers, many mortgage servicers have exercised this flexibility to help homeowners in trouble keep their homes. Some, for example, have begun using computer models to help predict which borrowers will fall behind in their payments and when, and then proactively contact those borrowers to help arrange alternatives to delinquency and default.[16] Some have added delinquent amounts to mortgage balances or arranged for borrowers to repay delinquent amounts over several months.[17] Some banks have funded programs operated by community organizations designed to provide attractive refinancing options for subprime borrowers facing difficulties with their loans.[18] In the case of most loans that back MBS, servicing agreements provide servicers with some latitude in modifying loan terms for borrowers in trouble.

However, investors cannot advance funds easily into a mortgage finance system characterized by a patchwork of different state and local laws which dictate different standards of conduct and liability. A liquid and efficient national mortgage market at its current scale in the U.S. depends to a significant degree on relative uniformity of risk and certainty that merely purchasing mortgage loans will not give rise to unmanageable liability or loss of investment.

Assignee Liability

Imposing unquantifiable assignee liability on the secondary market for abuses committed by brokers or others in the origination chain would severely affect investors' willingness to hold mortgage risk for which they might become liable through no fault of their own. This would create more rather than fewer innocent victims of predatory lending behavior and ultimately reduce the availability of capital to the mortgage market. Rather than making secondary market participants the "policemen" for the actions of originators, it would simply drive investors from the subprime market altogether, severely reducing capital available for subprime lending and

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[16] "Digging Out of Delinquency," *The Wall Street Journal*, April 11, 2007, page D1.
[17] *Ibid*.
[18] "Subprime Refinancings with B of A, Citi Funding," *American Banker*, April 12, 2007, page 3.

raising costs for families least able to afford home ownership. This harm has been amply demonstrated by the market's reaction to certain extreme state anti-predatory lending laws that have not worked as anticipated. Whereas proponents of assignee liability theorize about possible benefits, this harm we describe is neither theoretical nor unprecedented.[19]

For example, one of the most poorly crafted of the state anti-predatory lending laws is the Georgia Fair Lending Act[20] ("GAFLA"), which stands as a prime example of how good intentions can go awry. When GAFLA was first enacted on October 1, 2002, it became the most stringent—but also the most damaging to legitimate subprime borrowers—anti-predatory lending law on the books. GAFLA had a complicated three-tiered loan classification system; its various prohibitions applied to "home loans," "covered loans," and "high cost loans." The definition of "points and fees" was unique and difficult to apply in practice. Most significantly, like HOEPA, GAFLA provided that, notwithstanding any other provision of law, any person who purchased or was otherwise assigned a high-cost home loan was subject to all affirmative claims and any defenses with respect to the loan that the borrower could assert against the original creditor or creditors of the loan. This expansive assignee liability was not capped or limited to individual actions.

In response to the onerous statute and its unquantifiable risks, many lenders refused to purchase or otherwise finance any Georgia loans, which dramatically reduced the liquidity of the state's mortgage markets and the availability of loans for subprime borrowers. All three of the major ratings agencies—Standard & Poor's, Fitch Ratings and Moody's—announced that they could not rate any structured finance transactions containing *any* loans subject to GAFLA. As a result of the reaction of the secondary market and its implications for mortgage origination, Georgia was forced to amend GAFLA to remove several of its worst provisions.

This pattern has been repeated in numerous jurisdictions around the country that have overreached in their efforts to manipulate the secondary market. The most recent example is Providence, Rhode Island, which rescinded an anti-predatory lending ordinance with extremely broad potential application only weeks after it had been enacted. New Jersey promulgated a statute originally very similar to GAFLA that also had to be rewritten after numerous lenders and investors were forced to stop doing business in the state. In Ohio, new lending standards issued by the state Attorney General have had the unintended effect of reducing the origination of certain subprime loans that can benefit self-employed borrowers with seasonal or irregular income.

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[19] As an initial matter there is uncertainty and attendant risk due to fluid and imprecise definitions of "predatory lending" in most of the problematic statutes. This makes it difficult, if not impossible, to predict accurately when liability might attach. As a general matter, the "predatory lending" measures have tended to include the origination of loans or the maintenance of lending practices that have been deemed, as a matter of applicable law and regulation, to be unfair, inappropriate or unconscionable either on their face or for specific types of borrowers or specific types of borrowers in certain situations. Efforts to be more specific have focused on loan terms or lending practices such as points and fees or interest rates above a certain threshold or trigger, prepayment penalties, "packing" of fees in the amounts financed, mandatory arbitration clauses, balloon payments, negative amortization, the frequent refinancing of a loan without tangible net benefit to the borrower, and making loans to borrowers without regard to their ability to repay their loans. However, attempts to create more bright-line standards necessarily injected some measure of arbitrariness into the definition as policymakers attempted to meet conflicting goals of establishing specific triggers while preserving sufficient flexibility to address evolving circumstances and not harm deserving borrowers.

[20] Ga. Stat. Ann. § 7-6A-1 *et seq*.

Imposition of liability on the secondary market for origination practices is an effort to turn the secondary market into the policeman of loan originators. That is not the proper role of the secondary market, and investors and other market participants are not suited to enforce laws that apply to originators. The law does not impose liability on purchasers of stock for corporate misconduct. It is literally impossible to ask that aggregators of loans in the secondary market be responsible for every telephone call, in person conversation or conveyance of written communication that mortgage brokers have with millions of borrowers. Similarly, it is unreasonable to impose a duty—with attendant liability—on secondary market participants to ensure that a mortgage loan meets subjective standards of appropriateness for an individual borrower, such as whether the loan confers a "net tangible benefit." The cost of policing compliance with numerous existing state anti-predatory laws in every detail cannot be shifted to the secondary market without significant and deleterious effects on the provision of capital. The secondary market is not involved in the face-to-face negotiation of credit and is not structurally an efficient arena in which to focus enforcement actions.[21]

The patchwork of inconsistent and poorly drafted state and local laws significantly increases compliance, inhibiting the purchase of mortgages on a uniform basis and artificially restricting the flow of capital. Mortgages in states with laws that impose unquantifiable assignee liability or vague standards that cannot be conclusively complied with will be excluded from purchase by secondary market participants or sold only at significant discounts, ultimately harming the very consumers these well-intentioned laws were designed to protect. If similar concepts were enacted on a national level there would be a significant contraction of mortgage credit generally and a proportionately large increase of unintended effects to deserving buyers.

The public policy challenge is to strike the balance between counteracting predatory mortgage lending practices and ensuring the flow of credit to borrowers who cannot obtain loans in the prime market. In large part that balance already has been struck. Laws already exist and impose stringent penalties on unscrupulous parties who engage in fraud and prey on the financially unsophisticated. Likewise, there are substantial civil and criminal sanctions against loan originators and loan brokers contained in the Home Ownership and Equity Protection Act of 1994. In addition, regulators recently have proposed significantly enhanced regulatory guidance designed to ensure appropriate lending standards are applied across the subprime market. Significantly, the market has also reacted swiftly to unanticipated losses and the proposed regulatory guidance. For example, according to the Federal Reserve's most recent survey of senior bank loan officers released in January, over 18 percent of domestic banks reported having tightened mortgage lending standards in the fourth quarter of 2006, the highest net fraction posted since the early 1990s.[22] In contrast, in the same survey reports released in April and July 2006, 10 percent of banks in each quarter reported easing mortgage lending standards. Moreover significant closure and bankruptcies of subprime originators attest to the sharp curtailment of credit to subprime borrowers. All of these legislative, regulatory and market forces represent significant available avenues to address the issues now visible in the subprime housing market

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[21] Creating liability for a downstream purchaser of a mortgage that was not directly involved in or in control of the circumstances surrounding the origination of that loan means the liability is neither manageable nor quantifiable. This again places an undue burden on secondary market participants that will almost certainly limit and disrupt the flow of legitimate credit, dramatically increase costs and potentially add a new layer of fees to deserving borrowers and historically underserved communities.

[22] Board of Governors of the Federal Reserve System, *The January 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices*, table 11.

without unduly constraining the flow of mortgages to buyers who can afford their mortgage payments if given the opportunity.

Governmentally Mandated Forbearance

Governmental mandates to modify the terms of mortgages after sale would also unfairly penalize innocent classes of investors who advanced money on the assumption that the contracts would be honored according to their original terms. Those terms reflect a negotiated and carefully balanced allocation of mortgage credit risk among transaction participants. Most nonprime securitization transactions include provisions that permit some flexibility to modify loans where a default has occurred or is reasonably foreseeable, and economic incentives are in place to ensure loan servicers use that flexibility. Altering reasonable expectations of investors regarding the operation of contracts associated with their investment would reduce dramatically the supply of capital to the mortgage market.

The various classes of investors in an MBS pool often are in a zero-sum relationship with one another in that what benefits one class will harm another. For example, the timing of principal payments, if accelerated, may be beneficial to certain principal-only classes and harmful to other interest-only classes. Investors who assumed that losses, if they occur, would be handled in one way may have hedge costs and even tax effects if those losses were handled another way. There are also potentially negative dynamic consequences to waiving defaults or altering standardized collection procedures. If servicers are unconditionally required to grant waivers of contract terms to mortgage holders, assuming they are free to do so under their particular securitization documents, it may provide incentives for others that are not in genuine distress to claim similar benefits. Individual review is also necessary to ensure that the proper course of forbearance is followed; one-size-fits-all mandates will not create the best outcome for a unique borrower. Imposing unforeseeable costs on the market would undermine the certainty required by investors and make future investments in mortgages both less available and more costly to obtain.

Recommendations

Many Americans have already obtained home purchase and home equity loans that would have been denied but for the capital provided by the secondary mortgage market. It is important to bear in mind that if a mortgage lender funds a mortgage loan to a subprime borrower and that loan defaults, this is not, absent fraud, “predatory lending.” In fact, there are broad incentives for secondary market participants to avoid foreclosure; indeed, foreclosure is expensive, cumbersome and time consuming. On a broader scale, loan defaults do not indicate that a systemic market problem exists for which a legislative response is needed.

Flexible and adaptable underwriting standards are essential to ensuring that the overwhelming majority of borrowers who never experience foreclosure are able to obtain mortgage loans that meet their particular economic needs and circumstances. A zero-loss standard would shut off access to credit for the most vulnerable homebuyers, including some minorities, entrepreneurs, artists, or those with volatile earnings or a history of credit problems. Arguably objective measures such as income tests and other rigid standards could very well expose lenders to claims of discrimination under established laws such as the Fair Housing Act and the Equal Credit Opportunity Act that are intended to protect minorities’ access to credit.

Imposing vague and subjective standards like a duty of "suitability" would make the participation of secondary market investors in the nonprime mortgage market almost impossible, to the extent that those downstream investors were held liable for post-hoc determinations that certain mortgage loans were "unsuitable" or "inappropriate" for particular borrowers.

Market incentives and mechanisms are already operating to tighten underwriting standards. Secondary market participants do have strong economic and commercial incentives to minimize foreclosures and losses. The secondary market recognizes that it has a responsibility to assist in developing solutions to abusive and predatory lending. To that end, we recommend several steps that should be taken and express concern over potential actions that should not be taken in order to improve the provision of credit to subprime borrowers and maintain the health of the market.

Consumer Education and Disclosure

Instead of onerous laws that impose unnecessary risks on secondary market participants, the better course is to provide robust opportunities for consumer education and credit counseling to allow borrowers to select the products they need. Consumer education should be supplemented by uniform and meaningful mortgage disclosures that effectively inform consumers of the risks that they assume when taking out a particular mortgage loan. Not only will consumer education and disclosure uniformity assist borrowers in making informed choices, they will also promote greater transparency for a liquid and flexible market that enables lenders and investors to meet the needs of homebuyers responsibly.

Robust Enforcement of Existing Law

Federal, state, and local agencies should vigorously oversee and enforce existing law and regulation at the point where mortgage fraud and abuse take place - the origination process. There is also a need for consistent and comprehensive enforcement of laws applicable to mortgage brokers, appraisers and others involved in loan origination. Also, better information sharing and centralized databases would help identify bad actors. Secondary market participants already utilize robust quality control procedures consistent with due diligence and risk management business practices to screen nonprime originators and loans. Consistent and reliable access to information would enable the secondary market to improve this diligence and control procedures and further discourage predatory lending practices.

In addition, existing and proposed regulatory principals continue to exert a significant and positive effect on new originations. On September 29, 2006, the federal banking regulators jointly issued final *Interagency Guidance on Nontraditional Mortgage Products* (the "*Guidance*").[23] On November 14, 2006, the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR"), in an effort to provide analogous model state guidance, followed the regulators' suit by issuing *Guidance on Nontraditional Mortgage Risk* (the "*State Guidance*").[24] More than half the states have adopted the *State Guidance* in its entirety. In addition, on March 8th federal bank regulators issued for comment a proposed *Statement on Subprime Mortgage Lending* (the "*Statement*") that addresses

[23] 71 Fed. Reg. 58,609 (Oct. 4, 2006).
[24] CSBS & AARMR, *Guidance on Nontraditional Mortgage Risks* (Nov. 14, 2006).

certain risks and issues relating to subprime mortgage lending practices, including adjustable-rate mortgages ("ARMs") such as 2/28 and 3/27 loans.[25] If adopted, the *Statement* will complement the *Guidance*, which does not specifically address amortizing ARM products.

SIMFA supports many of the principals contained in the *Guidance,* the *State Guidance* and *the Statement.* Collectively, they reflect regulators' responses to concerns that borrowers, particularly non-prime borrowers, may not fully appreciate the risks and consequences of obtaining nontraditional mortgages, including ARM products. Moreover, the collective guidance sets forth both recommended underwriting criteria and factors, including payment shock, that lenders should generally consider in making such loans and recommended marketing and borrower disclosure practices to which lenders should adhere. Many lenders have already taken substantial steps to comply with the *Guidance* and *State Guidance* and most likely will take similar steps to comply with the *Statement* once it is finalized and its details satisfactorily worked out in consultation with the industry.

We believe examination scrutiny and investigation by the host of experienced and dedicated federal and state regulators regarding the underwriting and marketing of nontraditional and non-prime mortgage loans, and, when appropriate, federal and state law enforcement activity with respect to particular lenders' or lending activity will curb the vast majority of non-prime lending abuses and should ameliorate rising delinquency rates prospectively. State and federal regulators and law enforcement are responding vigorously to various issues regarding non-prime lenders that have made headlines recently to protect borrowers and address potential improper or unscrupulous activities.

Allow the Market's Response to Continue to Work

The industry reaction to losses has been swift and effective in curtailing many of the practices that led to the poor performance now visible in the originations of 2005 and 2006. Underwriting standards have been tightened and the effect can be seen in the high number of sub-prime mortgage brokers and originators that are exiting the business. Portfolios are being scrutinized heavily and professionally at even higher levels as the attributes of the loans that suffered early payment defaults are becoming well known. Tightening credit too much at this time runs the risk not only of denying future borrowers credit, but making it almost impossible for those borrowers who are about to suffer rate shock to obtain reasonable re-financings of their mortgages when their rates reset. Overly broad legislation could exacerbate the already significant stress in the subprime market.

Fair, Objective Standards

Imposing any subjective standards on the mortgage process will create tremendous problems for the mortgage and securitization industries, as well as for borrowers. Without intending to exclude, much less endorse, other vague or ambiguous criteria, we do express particular concern about the inherently subjective "suitability" duty that some have advocated. Lenders are likely to restrict the provision of credit under such a standard, and will struggle with how to reconcile it with existing fair lending laws that encourage them to make loans to members of protected classes who arguably are "unsuitable" for certain loan products. Lenders also will face the risk that, even when they act appropriately, borrowers in default or foreclosure will

[25] 72 Fed. Reg. 10,533 (Mar. 8, 2007).

claim their loan was "unsuitable." A suitability standard, thus, will breed uncertainty for lenders and, in turn, secondary market investors who are not present for the innumerable phone calls, meetings and distributions of loan materials that occur throughout the country as individuals decide on which mortgage option to pursue.

The ASF and SIFMA support the adoption of uniform national lending standards applicable to lenders and brokers that are clear and objective without imposing any undue restrictions on the secondary market. To achieve a net benefit for non-prime borrowers, such standards must be national in scope and include broad preemption of state and local laws in light of today's national mortgage and secondary mortgage markets. A uniform, national standard will promote competition and market efficiencies, and will reduce the cost of mortgages.

In drafting national standards, Congress should promote risk-based pricing, avoid excessive restrictions on mortgage products or financial vehicles, avoid any suitability standard, and enhance the regulation and oversight of mortgage brokers. National standards, moreover, must be clear and concise and not assign unquantifiable liability to the secondary market for originators' practices.

National legislation also should recognize the realities of consumer lending in open and competitive markets. Lending standards aimed solely at reducing the incidence of default and foreclosure would have much graver social consequences. Many deserving purchasers who today are granted mortgages routinely would be denied the credit they need to buy their homes. Originators must underwrite with a view to reasonable target loss ratios in order to maintain the product innovation and secondary market liquidity that, in turn, has provided so many non-prime borrowers with homes. Moreover, state and federal bank regulators are specifically charged with protecting the safety and soundness of financial institutions with respect to losses.

Conclusion

Any anti-predatory lending legislation should include a single, uniform national lending standard that contains robust consumer protections and prohibits abusive lending activities, but is mindful of the efficient market mechanisms at work and the intricacies of the secondary market. This law should preempt the confusing patchwork of state anti-predatory lending laws that increase the cost of credit for consumers and impose unnecessary risks on secondary market investors. Assignee liability should not be expanded because of its deleterious effect on the provision of credit from the secondary market to homebuyers. At the same time, federal and state regulators, along with consumer advocates and the mortgage lending industry, should work together to promote consumer education initiatives to prevent consumers from obtaining inappropriate mortgage products. Uniform and simplified disclosures should be issued at the federal and state levels to clearly inform consumers of both their rights and responsibilities. At the same time, the origination process should be more consistently and transparently regulated to allow the secondary market to enhance its already robust due diligence and quality control procedures. Taking these steps will help curtail abusive lending practices while preserving the free flow of capital that has enabled the growth of the mortgage market.