

COMMONWEALTH OF MASSACHUSETTS
APPEALS COURT

COMMONWEALTH OF
MASSACHUSETTS,

Plaintiff,

v.

FREMONT INVESTMENT & LOAN, and
FREMONT GENERAL CORPORATION,

Defendant.

Appeals Court
No.

(Suffolk County
Superior Court,
Business Litigation
Section
Civil Action
No. 07-4373-BLS1)

**BRIEF OF THE SECURITIES INDUSTRY AND
FINANCIAL MARKETS ASSOCIATION AND THE AMERICAN
SECURITIZATION FORUM AS *AMICI CURIAE* IN
SUPPORT OF INTERLOCUTORY RELIEF**

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Dated: March 25, 2008

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The Securities Industry and Financial Markets Association ("SIFMA") and the American Securitization Forum ("ASF")¹ submit this *amici curiae* brief to inform the Court of the negative impact that the Superior Court's injunction will have on non-party financial services companies, the financial markets and the public interest.

Historically, the Commonwealth of Massachusetts has sought to promote lending to facilitate homeownership. *Amici* are concerned, however, that the Superior Court's decision, by impeding the foreclosure process, will undermine lender and investor confidence in the real estate market of the Commonwealth. The Superior Court's ruling already has had a deleterious effect in the larger mortgage industry, creating uncertainty that is a disincentive to lending. Curtailing foreclosure, especially where loans at origination were made fairly and properly, diminishes

¹ SIFMA, which represents securities firms, banks, and asset managers, works 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. ASF, which includes numerous active participants in the U.S. securitization market, seeks to build consensus, advocate, and deliver education on behalf of the securitization markets and its participants.

the value of the loans affected and undermines the expectations and contractual rights of lenders and secondary market investors. Based upon similar experiences in other states, it will likely cause lenders to flee the Commonwealth rather than extend credit to present and prospective homebuyers.

Amici do not excuse certain egregious abuses that have occurred in the mortgage industry, or refute their possible effects on the current market. Rather, they seek to defend the interests of lenders and secondary market participants whose legitimate practices comported with existing law. Lenders and investors participate in the subprime market in reliance on the certainty that their contractual rights will be respected by the courts. Certainty facilitates lending and creates a brisk, competitive lending environment, benefiting borrowers with lower interest rates and more favorable terms. The Court's ruling, however, in creating new rules after the loans were originated, creates uncertainty which transcends the instant litigation, jeopardizes the flow of credit to Massachusetts borrowers and impedes recovery of the secondary market. Absent such certainty, secondary market participants will shy away from investment,

leaving lenders less willing to extend credit to those with less than prime credit histories. This will harm borrowers, lenders and secondary market investors.

I. THE MORTGAGE-BACKED SECURITIES MARKET HAS MADE HOMEOWNERSHIP ACCESSIBLE TO A MULTITUDE OF MASSACHUSETTS BORROWERS

A. *The Mortgage-Backed Securities Market*

Prior to the mid-1980s,² mortgage lenders relied almost exclusively on customers' deposits as the source of funding for mortgage loans. As such, deposit volume largely dictated the availability of mortgage credit. Not surprisingly, the availability of credit to borrowers with limited or impaired credit histories was extremely limited.³

The secondary mortgage market provides capital to fund the opening of credit to borrowers with limited

² Enactment of the Secondary Mortgage Market Enhancement Act ("SMMEA") in 1984 sparked a mortgage-backed securities market by authorizing federally regulated depository institutions to invest in securities that met certain conditions. Michael S. Talefiero, *Secondary Market, Mortgage Banking* (May 1, 1991), available at <http://www.allbusiness.com/personal-finance/real-estate-mortgage-loans/160837-1.html>.

³ See Kristopher Gerardi et al., *Do Households Benefit From Financial Deregulation and Innovation? The Case of the Mortgage Market*, 3 (Federal Reserve Bank of Boston Public Policy Discussion Paper No. 06-6, 2007), <http://www.bos.frb.org/economic/ppdp/2006/ppdp066.pdf>.

or impaired credit histories. Through securitization, mortgage loans are pooled together and transformed into a mortgage-backed security that investors can buy and sell like any other asset. This process distributes the credit risk widely and provides the originating lender with funding to offer credit to others. This powerful mechanism for linking individual borrowers to investors has grown, and by 2005, nearly 80 percent of loans to persons with limited or impaired credit were funded through securitization.⁴

B. *Subprime Lending Has Expanded Homeownership*

In the last twenty years, the secondary mortgage market has yielded a marked increase in home ownership in the U.S., an estimated 12 million additional borrowers, particularly among historically disadvantaged groups.⁵

⁴ See ASF, *Assignee Liability in the Secondary Mortgage Market: Position Paper of the American Securitization Forum* (June 5, 2007) (citing Inside MBS and ABS, January 12, 2007; Standard & Poor's, *The Subprime Market 7* (June 17, 2005)), available at http://www.americansecuritization.com/uploadedFiles/Assignee%20Liability%20Final%20Version_060507.pdf.

⁵ Mark Doms & Meryl Motika, *The Rise in Homeownership*, Fed. Reserve Bank of San Francisco Economic Letter 2006-30, at 1 (Nov. 3, 2006), available at <http://www.frbsf.org/publications/>

A significant factor in homeownership growth is the increased availability of credit for subprime borrowers who traditionally had difficulty obtaining credit because of impaired or limited credit histories, a high debt load, or difficult-to-document income.⁶ From 1994 to 2005, loans to subprime borrowers quadrupled as a percentage of total originations, from 5 to 20 percent,⁷ providing these low- and moderate-income borrowers with the primary vehicle for wealth accumulation.⁸ And, in 2005, minority homeownership reached a record level of 51.6%.⁹

economics/letter/2006/el2006-30.html; Homeownership Rates for the U.S. and Regions: 1965 to Present, <http://www.census.gov/hhes/www/housing/hvs/historic/hist14.html>.

⁶ *Id.* at 2-3.

⁷ See Robert B. Avery et al., *Higher-Priced Home Lending and the 2005 HMDA Data*, Fed. Res. Bulletin, last updated Sept. 25, 2006, available at <http://www.federalreserve.gov/pubs/bulletin/2006/hmda/default.htm#fn9>.

⁸ See Thomas P. Boehm & Alan Schlottmann, *Wealth Accumulation & Homeownership: Evidence for Low-Income Households*, 33 (Washington, D.C.: Office of Policy Dev. & Research, Dep't of Hous. & Urban Dev., Dec. 2004), available at <http://www.huduser.org/publications/pdf/wealthaccumulationandhomeownership.pdf>.

⁹ See <http://www.hud.gov/news/release.cfm?content=pr05-057.cfm>.

Absent a secondary market, and the \$6.5 trillion in capital that it has made available, this would not have been possible.¹⁰ The mortgage-backed securities market has been a powerful ally in Massachusetts' efforts to facilitate lending to low-income persons.¹¹

II. THE COURT'S RULING ABROGATES LENDERS' AND INVESTORS' CONTRACTUAL RIGHTS AND WILL UNDERMINE THEIR CONFIDENCE IN MASSACHUSETTS LOANS AND MORTGAGE PRODUCTS

The mortgage industry requires a consistent application of the law in order to freely lend money to borrowers, particularly those with limited or impaired credit. In that vein, the loans at issue, which were highly regulated¹² and diligenced by

¹⁰ Statement of David Sherr before the Senate Banking Subcomm. on Sec., Ins. and Inv. on Apr. 17, 2007, available at http://banking.senate.gov/_files/sherr.pdf.

¹¹ For example, the Legislature formed the Massachusetts Housing Finance Agency in 1966, which has since invested more than \$9.9 billion "to provide home ownership and rental housing opportunities for Massachusetts residents with low and moderate incomes who are under-served by conventional housing markets." https://www.masshousing.com/portal/server.pt?open=512&objID=221&&PageID=266&mode=2&in_hi_userid=2&cached=true.

¹² On the federal level, mortgage lending is governed by, *inter alia*, the Truth-in-Lending Act, the Real Estate Settlement Procedures Act, the Home Ownership and Equity Protection Act of 1994, and the Home Mortgage Disclosure Act, Equal Credit Opportunity Act, and the Fair Housing Act. Massachusetts has also enacted a number of consumer protection statutes

investors prior to securitization, did not violate any law or regulation,¹³ and "were not generally recognized to be unfair" when originated and securitized.¹⁴ In the marketplace, therefore, the lenders who lent, the investment banks that bought, and the investors that invested in these loans fully expected to be able to foreclose, as a last resort, in order to recoup the monies lent in the event of a borrower's default.

The Superior Court effectively rewrote the rules and did so in a way that the market participants could not have foreseen at the time they performed their diligence. The Court's core reasoning is the hypothesis that the 2004 Legislature, in enacting the Predatory Home Loan Practices Act (the "Act") (which prohibits lenders from making "high cost mortgage loans"), would have deemed the loans at issue to be predatory, had it known what the Court now knows.¹⁵ The Court's decision is fundamentally flawed.

including the Licensing of Mortgage Lenders and Brokers Act.

¹³ Decision at 15.

¹⁴ *Id.* at 25. The Court also found that the lender did not misrepresent or conceal any loan terms. *Id.* at 12-13.

¹⁵ *Id.* at 21.

First, given the degree of federal and state regulation in the field and the interlocking complexities of the mortgage market, amendment of lending and enforcement practices is best left to the thoughtful consideration of the regulatory and legislative processes, where all interested and affected parties may participate.

Second, the Act was passed a mere three years before and the mortgage products of which the Court complains were very much in existence at the time the Legislature debated that law. In fact, subprime lending was being closely analyzed just prior to the Act's passage.¹⁶ Had the Legislature wanted to deem

¹⁶ See, e.g., Statement by Fed. Reserve Governor Edward M. Gramlich before the Fin. Serv. Roundtable Annual Hous. Policy Meeting in May 2004:

One of the key financial developments of the 1990s was the emergence and rapid growth of subprime mortgage lending. . . . The increased availability of subprime mortgage credit has created new opportunities for homeownership and has allowed previously credit-constrained homeowners to borrow against the equity in their homes to meet a variety of needs. At the same time, increased subprime lending has been associated with higher levels of delinquency, foreclosure, and, in some cases, abusive lending practices. On a social level, one question is whether the gains afforded by these new market developments outweigh the losses.

the subject loans structurally unfair loans, it could have. It did not.

Third, the Legislature has in the last several months taken up and passed amendments to the Act and did not see fit to amend the reach of the law as the Court below suggested it would.

Fourth, the Court's *ex post facto* determination of unfairness abrogates the contractual rights of lenders and countless investors who had relied on the Act when deciding to finance mortgage loans in the Commonwealth. They stand to see the value of their investments eroded if not nullified.

* * *

More specifically, with respect to the foregoing points three and four --

A. The Homeownership Act Is the Legislature's Response to Increased Subprime Defaults

In divining what it believes the Legislature would have done, the Superior Court has ignored what the Legislature has recently done. In reaction to the recent increase in Massachusetts foreclosures, including foreclosures of subprime mortgages, the Governor and the Legislature worked together to enact

available at <http://federalreserve.gov/boarddocs/speeches/2004/20040521/default.htm>.

Chapter 206 of the Acts of 2007, An Act Protecting and Preserving Homeownership, which was signed into law on November 29, 2007 (the "Homeownership Act")¹⁷ and takes a completely different approach to solving the problem of increased foreclosures than the Court seeks to ascribe to the Legislature.

The Homeownership Act's numerous protections for homeowners include:

- A right to a notice of a default before lenders may accelerate the loan and foreclose on the property.
- A 90 day grace period to cure any defaults, during which the loan may not accelerate and certain fees cannot be added to the balance.
- A prohibition against lenders from making subprime adjustable rate mortgages to first time homebuyers unless they (1) opt into a subprime adjustable rate product, and (2) receive mortgage counseling.¹⁸

¹⁷ See November 30, 2007 press release from the Official Website of the Governor of Massachusetts, http://www.mass.gov/?pageID=pressreleases&agId=Agov3&prModName=gov3pressrelease&prFile=071130_foreclosure_prevention_legislation.xml. ("This legislation is the result of the coordinated efforts of the Patrick Administration, House and Senate leadership and members, Attorney General Martha Coakley and Boston Mayor Thomas Menino. It also draws upon the recommendations of the Mortgage Summit Group") The Mortgage Summit Working Group, led by the Commissioner of Banks, included representatives from the Division of Banks, the Attorney General's office and numerous industry and consumer groups.

¹⁸ St. 2007, c. 206. The Act also requires: (a) an allocation of \$3,000,000 to the Division of Banks

"With the provisions of this bill now law, Massachusetts has one of the most consumer protective mortgage lending statutes in the country."¹⁹

Clearly, therefore, the Legislature is actively thinking about and legislating on the very issues that concern the Court. Passage of the Homeownership Act belies the Superior Court's central assumption that the Legislature has never considered the type of subprime loans at issue here.

B. Investors and Lenders Face the Diminution of Their Investments If They Cannot Foreclose

Although it is a last resort, foreclosure allows lenders and investors to recoup some or all of their investment, which is the primary reason that residential mortgage rates are lower than other types of credit.²⁰

("DOB") to regulate the mortgage lending industry and maintain a foreclosure database; (b) the DOB to rate lenders on their practices and deny licenses to those which do not meet certain criteria; and (c) the DOB to use the fees from these licenses to provide an additional \$2,000,000 in grants to promote best lending practices, counsel first-time homebuyers, and fund 10 foreclosure prevention centers.

¹⁹ See *supra* note 17.

²⁰ For example, while the average charge-off rate for credit card loans in the fourth quarter of 2007 was approximately 4.15%, the average charge-off rate for residential real estate loans was just 0.44%. See Fed. Reserve Bd., Charge-Off Rates, All Banks, SA

The Court's decision jeopardizes investments made by many secondary market investors. These investors come from all segments of society, including the Massachusetts Pension Reserves Investment Management Board ("PRIM"), which administers a pension fund established to invest the assets of the Massachusetts State Teachers' and Employees' Retirement Systems, and the assets of various county, authority, district, and municipal retirement systems.²¹

Moreover, PRIM's investments reflect a goal of supporting financing for low and moderate-income individuals in Massachusetts. PRIM has heavily invested in the secondary mortgage market both through subprime mortgage-backed securities and economically targeted investments, which lend capital to geographic areas in need of financing.²² The Court's injunction is at odds with Massachusetts' policy in this regard.

(2008), available at <http://www.Federalreserve.Gov/releases/chargeoff/chgallsa.htm>. Since the charge-off rates for mortgages are lower than for other types of credit, mortgage lenders may charge lower interest rates.

²¹ <http://www.mapension.com/aboutus/PRIMPRIT.html>.

²² PRIM invested \$75 million in the Access Capital Fund, which invests in securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae, among others and is "targeted to support low and moderate-income individuals in Massachusetts for affordable housing

III. THE INJUNCTION WILL HARM MASSACHUSETTS BORROWERS BECAUSE OF ITS NEGATIVE IMPLICATIONS FOR BOTH THE PRIMARY AND SECONDARY MORTGAGE MARKETS

No business wants to operate in an environment where the judiciary can and will, without notice, alter contractual rights and the economic status quo. Where such rights are affected, parties and markets are left to wonder, what is next? Will the next court seek to prevent automobile lessors from repossessing vehicles or credit card companies from filing reports that affect a consumer's credit history? While the Court's decision may have sought to provide a reprieve to borrowers, the unintended but real consequence may well be a chill on mortgage lending, and perhaps, other forms of credit as well.

A number of other well-intentioned efforts to regulate the mortgage industry have likewise had unintended, negative consequences for borrowers. For example, on October 1, 2002, Georgia enacted the

mortgages, small business loans, and health care loans." See Lisa A. Hagerman et al, *Mass. Pension Reserves Inv. Mgmt. Bd.: urban investing through a transparent selection process*, Labor & Worklife Program Harv. L. School, at 21 (May 2006), available at http://www.community-wealth.org/_pdfs/articles-publications/state-local/paper-hagerman06.pdf

Georgia Fair Lending Act ("GAFLA"),²³ which when first enacted, was among the most stringent of the state anti-predatory lending laws. In response, a number of mortgage lenders and secondary market purchasers discontinued making and purchasing residential mortgage loans in Georgia,²⁴ and within four months of the law's taking effect, the major rating agencies refused to rate transactions that included loans subject to GAFLA.²⁵ Just five months later, the

²³ Ga. Stat. Ann. §§ 7-6A-1 et seq. Similarly (i) a statute similar to GAFLA passed in New Jersey, which was later amended after numerous lenders and investors stopped doing business in the state (N.J. Stat. Ann. §§ C:46:10B-22 et seq.); (ii) lending standards issued by Ohio's Attorney General had the unintended effect of throttling the origination of reduced documentation loans that benefited self-employed borrowers with seasonal or irregular income (Oh. Rev. Stat. §§ 1345.01 et seq.); and (iii) an anti-predatory lending pilot program in Illinois was suspended after concerns were raised about fair lending issues and creditors' ability to enforce mortgage obligations (Illinois House Bill 4050 (2005); Mary Umberger, *Home-buyer Counseling Challenged*, CHI. TRIB. (Nov. 2, 2006)).

²⁴ Lisa Keyfetz, *The Home Ownership and Equity Protection Act of 1994: Extending Liability for Predatory Subprime loans to Secondary Mortgage Market Participants*, 18 LOY. CONSUMER L. REV. 151, 171 (2005).

²⁵ See <http://www.mortgagebankers.org/NewsandMedia/PressCenter/32158.htm> (Fitch Inc.); <http://www.Buter.aandrews.com/legislative-updates/directory/new-developments/Moody-s%20GA%20statement.pdf> (Moody's Investors Service); <http://www.communityinvestmentnetwork.org/single-news-item-states/article/standard-and-poor-s-to-disallow-georgia-fair-lending-act-loans>

Georgia legislature retreated, amending GAFLA to reduce the statute's restrictions and attract market participants back into the state.

There is, therefore, a balance between protecting borrowers and permitting lenders to enforce bargained-for, legal loan terms. With the Court's decision, the pendulum has (unexpectedly) swung too far, seriously undermining lender and investor confidence in Massachusetts. If this decision is left undisturbed, it is ultimately borrowers who will suffer.

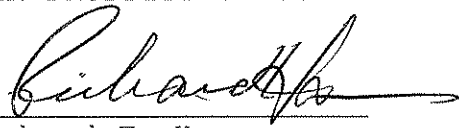
CONCLUSION

For the foregoing reasons, the Court's Order granting a preliminary injunction should be reversed.

Dated: New York, New York
March 25, 2008

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(Standard & Poor's).

CERTIFICATE OF SERVICE

I, Neil T. Bloomfield, hereby certify that on March 25, 2008, I caused a true copy of the foregoing proposed Brief of the Securities Industry and Financial Markets Association and the American Securitization Forum as *Amici Curiae* in Support of Interlocutory Relief to be served by Federal Express Standard Overnight upon (i) Christopher Barry-Smith and Jean M. Healey, Assistant Attorneys General, Consumer Protection Division, One Ashburton Place, Boston, MA 02108, and (ii) James R. Carroll, Skadden, Arps, Slate, Meagher & Flom LLP, One Beacon Street, Boston, MA 02108.

Dated: March 25, 2008

A handwritten signature in black ink, appearing to read "Neil T. Bloomfield", is written over a horizontal line.

Neil T. Bloomfield