American Securitization Forum | Mortgage Bankers Association | HPC | SIFMA Securities Industry and Financial Markets Association

The Financial Services Roundtable

June 27, 2007

The Honorable Christopher J. Dodd
Chairman
Banking, Housing and Urban Affairs
U.S. Senate
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510-6075

The Honorable Richard C. Shelby
Ranking Member
Banking, Housing and Urban Affairs
U.S. Senate
SD-534 Dirksen Senate Office Building
Washington, D.C. 20510-6075

Dear Chairman Dodd and Ranking Member Shelby:

As you continue your examination into issues related to subprime mortgage financing, market participants, including the undersigned organizations, have also been exploring appropriate market and regulatory responses. Our organizations have been actively engaged in developing solutions that market participants can apply to address many of the subprime mortgage financing issues that have emerged. This letter outlines our collective review of how the market is responding, initiatives being undertaken by our organizations and our current thoughts on potential policy options that Congress and regulators may be considering.

Over the last five years subprime mortgage lending contributed to expanding home ownership to millions of families who otherwise would not have had that opportunity. The Securities Industry and Financial Markets Association (SIFMA) estimates that nearly 2.2 million families bought their first homes using subprime financing over the period 2002-2006. While most benefited, some did not. In some sectors of the market the housing boom led to a relaxation of credit standards that placed some borrowers at greater risk. Now, as a result of a weakened housing market, challenging economic conditions in certain areas of the country and higher interest rates, some families who recently purchased or refinanced their homes are suffering through financial hardship and, in some cases, foreclosure.

The financial markets have responded swiftly to the deteriorating credit performance of subprime mortgages, and market pressures have imposed penalties on many subprime lenders and secondary market participants. Over 40 subprime lenders have gone out of business since subprime loan delinquencies and defaults began to rise. Investors in many mortgage-backed securities (MBS) that are backed by subprime loans have experienced losses and have seen the value of their holdings decline. Market participants have responded by tightening lending, credit, pricing and loan purchase standards.

The economic interests of mortgage market participants are aligned with those of borrowers themselves: to make sure that loans are made only to qualified borrowers, and to work with borrowers to avoid a default and foreclosure if they experience difficulties. No legitimate parties engaged in the mortgage financing system—originators, wholesalers, underwriters or investors—benefit from a rise in the rates of default and foreclosure on subprime loans. Foreclosures generally result in significant losses for investors, especially in softening real estate markets.

We believe appropriate policy responses should be based on an evaluation of corrections already taking place in the market and should seek to enhance consumer protections while assuring the availability of mortgage credit to qualified borrowers. Legislative or regulatory proposals that would arbitrarily restrict the availability of mortgage credit are not an appropriate response to current market conditions. What follows is our view on several proactive industry actions and potential policy alternatives and recommendations.

Consumer Disclosure

Disclosures currently mandated for mortgage lending include sufficient information for borrowers to understand their loan obligations and determine whether a particular loan is appropriate. However, the form and number of those disclosures are generally such that borrowers have difficulty finding or understanding relevant information either due to the sheer volume of documentation, or the complicated language of the disclosure itself. We believe consumers would benefit from a streamlined disclosure process based on the principles of clarity, simplicity, and utility. Straight-forward and plain language disclosures during the appropriate time in the loan shopping process would equip borrowers to understand loan products and enable them to make more informed decisions. The streamlined disclosure process should also protect originators from frivolous or unwarranted litigation.

Education and Counseling

Our associations strongly support consumer financial education programs and the availability of meaningful counseling by qualified counselors. No responsible mortgage market participant wants a homeowner to default on his or her loan and force a foreclosure proceeding. One important resource now available for homeowners who may be facing foreclosure is a toll-free hotline, 888-995-HOPE, where homeowners in all 50 states can receive free, independent HUD-certified counseling, available any time of the day. Several financial institutions have partnered with NeighborWorks® America, the Homeownership Preservation Foundation, Freddie Mac, Fannie Mae, the Housing Policy Council and the Mortgage Bankers Association in this national effort that is helping homeowners who find themselves in danger of defaulting on their loans. The hotline is available 24 hours a day, 7 days a week; homeowners can also receive in-person counseling at NeighborWorks® affiliates. None of the counselors are beholden to the lenders; their only interest is the best outcome for the homeowners. As such, they advise homeowners on how best to work with their lenders to resolve their problems in ways beneficial to all. Through this innovative program, as well as through others, lenders are taking proactive measures to help any homeowner who is experiencing a financial crisis and potential foreclosure. The hotline is being promoted in a national Ad Council campaign which was launched on June 25, 2007. We support additional efforts to make financial education and counseling readily available for current and prospective borrowers.

Broker Regulation

While brokers play an important role in the mortgage finance system, they are infrequently, if at all, subject to the same level of laws, regulations, and oversight as lenders. We support strong uniform regulation of mortgage brokers including a national database of approved brokers. A clear, national regulatory standard for mortgage brokers is an important step to create a seamless mortgage lending infrastructure for borrowers. At a minimum, brokers should be required to state their relationship to the borrower and disclose how they will be compensated for originating the mortgage transaction.

Prudent Credit Underwriting Standards

We believe that prudent underwriting is essential to the safety, soundness and efficient operation of the mortgage finance market. We support strong underwriting standards that require a lender to evaluate a borrower's ability to repay a loan. Mortgage underwriting, however, is a dynamic and multifaceted process requiring an evaluation of objective data as well as the application of subjective judgments. It is therefore essential to preserve the ability of mortgage lenders to employ their expert judgments in making credit decisions rather than requiring strict adherence to any specific set of underwriting criteria.

We are concerned that imposing rigid requirements in the underwriting arena, or expanding the legal duties and responsibilities of lenders, would have the unintended result of restricting the availability of credit to deserving borrowers. Imposing rigid criteria such as suitability standards, net tangible benefits requirements or even fiduciary obligations on loan originators or others in the mortgage financing chain can and has yielded undesired results. States and localities that have imposed overly expansive liability or suitability measures have experienced a halt or severe curtailment in mortgage credit funding. It is nearly impossible for either lenders or secondary mortgage market participants to determine definitively whether a loan is the "best choice" for a particular borrower from the information generally available to them at the time of underwriting. In short, lenders should evaluate a borrower's ability to repay based on the application of prudent but flexible credit underwriting standards.

Restrictions on Loan Products

A hallmark of the U.S. mortgage lending system that has set us apart and has been fundamental to America's long-standing economic strength is product innovation and borrower choice. We oppose wholesale restrictions on loan products and loan features that limit borrower choice and that could have the unintended effect of raising costs for consumers. For example, loans with prepayment fees are designed to offer borrowers lower interest rates than loans without prepayment fees. Borrowers who are reasonably certain that they will retain their mortgages for the term that prepayment fees might apply should be better off with the loan that comes with a prepayment fee. The choice should be the consumer's. Disclosure, noting the availability or absence of these fees, should be clearly stated for the consumer, and consumers should be provided with a clear and easy to understand explanation of the benefits and risks of the options available to them. Prepayment fees should not extend beyond the end of any initial fixed rate period on hybrid ARMs. "Stated income" or "low doc" loans are appropriate for some borrowers, such as those on commission income or self-employed, but their availability should be conditioned on a lender's underwriting determination that there is a reasonable expectation that a borrower has the ability to repay the loan.

Loan Modifications

Loan servicers and secondary market participants have been working to clarify standards and promulgate recommendations and guidance on using existing flexibility to modify securitized subprime mortgage loans, collateral pools and trusts in appropriate circumstances. Mortgage servicers—the companies who collect payments from borrowers and pass them on for distribution to loan and securities holders—generally have latitude to modify the terms of the obligations of borrowers who are in default and facing foreclosure to help them keep their homes and mitigate loss for investors.

The extent to which servicers can modify defaulted loan terms is specified in contractual servicing and loan agreements and is influenced by REMIC and accounting rules. Consistent with their other legal and fiduciary obligations, servicers should use the latitude they have in servicing agreements to maximize recovery on loan assets, which can often help borrowers in trouble keep their homes. Through loss mitigation initiatives, servicers may have the ability to: 1) defer mortgage payments; 2) reduce interest rates; 3) add amounts past due to loan balances; 4) provide forbearance; and 5) pursue other actions.

The American Securitization Forum (ASF) has been especially active on this front proposing recommended industry guidance and principles designed to facilitate loan modifications in appropriate circumstances. This guidance was vetted and developed through a vigorous process with members and regulators alike. Attached, please find a copy of these principles for your review. The Mortgage Bankers Association (MBA) has issued a position paper on FAS 140 accounting issues. A copy of the position paper is also attached. Very importantly, the work of both ASF and MBA are intended to promote greater uniformity, clarity and certainty of application of loan modification provisions, and to facilitate the ability of servicers to initiate loan modifications when it is reasonably foreseeable that a loan may default, rather than waiting until an actual event of default occurs.

We strongly oppose mandated loan forbearance or other across-the-board approaches to loan modifications not supported by loan or servicing contracts. Mandatory forbearance may not help borrowers whose individual situations differ and require tailored solutions. Such forbearance would inappropriately impose losses on mortgage investors that could not have been anticipated under prevailing laws at the time of the initial transaction. Violating contractual agreements would cause investors to withdraw from the market and would constrict loan capital for subprime borrowers. No one can appropriately calculate the risk of the impact of potential changes in laws governing the contracts into which they enter.

Assignee Liability

Assignee liability generally refers to imposing legal liability on secondary mortgage market participants—loan purchasers or MBS investors—for the illegal actions of loan originators. We do not believe that secondary market participants should be held responsible for loan terms or originator actions they cannot identify or measure clearly. Holding subsequent buyers of loans responsible for the actions of brokers and originators could cause investors to shun mortgage securities as investments or demand a premium price for added uncertainty thereby reducing the supply of capital to mortgage borrowers and raising the cost. For these reasons, we oppose the imposition of secondary market liability. As dialogue continues on mortgage lending generally, we urge deliberate and careful consideration of any proposal that would impose assignee liability – and the consequences such imposition could bring. Legal certainty and predictability are necessary for the operation of orderly and cost efficient national markets; the current patchwork of inconsistent and conflicting federal and state laws will only serve to disrupt functional markets and raise the cost of lending to borrowers.

In sum, an appropriate policy response to current conditions in the subprime market requires balancing a variety of interests. Policy-makers must balance the need for personal accountability among borrowers with appropriate regulation of originators and lenders, and the need to protect consumers with a desire to ensure a free flow of reasonably priced capital to worthy borrowers and continued innovation in consumer lending products. If subprime lending becomes over-regulated—or, even worse, if regulations become exceedingly unclear or if liability associated with lending becomes unrestricted—market participants will simply withdraw from affected portions of the market. The result would be less capital availability at higher cost for worthy subprime borrowers.

As this important dialogue continues, we look forward to working with you and your colleagues and we offer our assistance in that effort.

Sincerely,

Steve Bartlett
President and CEO
The Financial Services Roundtable

George P. Miller
Executive Director
American Securitization Forum

John H. Dalton
President
Housing Policy Council

Jonathan L. Kempner
President and CEO
Mortgage Bankers Association

Marc E. Lackritz
CEO
Securities Industry and Financial Markets Association