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November 14, 2000

The Honorable Elizabeth McCaul
Superintendent of Banks
State of New York
Banking Department
Two Rector Street
New York, New York 10006

Dear Superintendent McCaul:

The Bond Market Association (the "Association")[1] is responding on behalf of its members to the revised proposal of the New York State Banking Department (the "Department"), encouraging the adoption by underwriters of recommended Due Diligence Best Practices (the "Proposals") in order to combat abusive practices in the subprime market place. We appreciate that the November 3rd revised draft of the Proposals reflects several changes from an earlier circulated draft, responding in part to our letter dated August 1, 2000. Most importantly, we are pleased that the new draft states that the Department's recommendations "...are not designed to establish or alter the legal standards for disclosure or the nature or scope of the due diligence defense...." Nevertheless, there remain important concerns that render the Association unable to endorse the Proposals in their current form. We attempt to highlight those open issues below, and have attached as Exhibit A more detailed comments. We would like to meet in person to discuss our concerns and determine whether it may be possible quickly to produce another version that the Association could support.

I. SUMMARY

As a preliminary matter, the Association reiterates its strong support for the Department's policy goal of eliminating abusive and predatory subprime lending practices. Indeed, we are prepared to support the general recommendation contained in the revised Proposals that underwriters should make commercially reasonable efforts to satisfy themselves that the underlying pooled residential mortgage loans backing a securitization comply with applicable laws and regulations. Our members continue to believe, however, that (i) they are unwilling to adopt and dictate to their clients the Department's prescribed credit review standards, desiring instead to retain the flexibility to use alternative standards to evaluate credit risk, (ii) they should be able to control the manner in which they conduct, and the scope of, any such review, (iii) they should not be required to undertake extensive legal analysis and reach complex legal conclusions relating to individual loan originations as part of a due diligence process, (iv) they are not able to perform detailed evaluations of third party originators from whom issuers buy loans to securitize with underwriters, (v) the wording of the Proposals should be clarified to provide that individual underwriters that conduct a due diligence review do not assume a legal duty to disclose or act upon any findings that they may reach as a consequence of the Proposals,

other than that prescribed by applicable securities laws and (vi) the basic purpose of due diligence in the context of a securities offering is to provide the underwriter with a reasonable basis to believe in the accuracy of the offering documents, not to serve as a consumer protection device. Nevertheless, with the suggestions we provide herein and in Exhibit A, we believe it may be possible for the Association to endorse a revised proposal that balances the Department's public policy objectives and our members' business needs.

II. SPECIFIC CONCERNS

A. Prescribed Credit Review Standards

The preamble of the revised draft contains a number of adjectives, such as abusive, predatory, improper and unreasonable, to describe lending practices that are intended to be eliminated by the adoption of the Proposals. It appears that the practices to be prohibited do not necessarily violate applicable law, but instead represent the Department's view of what it believes to be unsound lending practices. The Department recommends that the review conducted by underwriters verify that such practices were not used in the origination of the individual pooled loans.

The Association's members are willing to conduct credit reviews to test for compliance with their own or a lender's prescribed standards, or those promulgated by the rating agencies; however, they are unwilling and unable to adopt verbatim the Department's credit review standards. Increasingly, lenders are relying on property valuations instead of appraisals, credit scores instead of debt-to-income and residual income ratios, and alternative forms of debt verification instead of credit reports. In other words, the tools that responsible lenders use to determine a borrower's creditworthiness are constantly changing due to innovation in the industry. The Association's members need to retain flexibility to use whatever creditworthiness tests they and their issuer clients believe are appropriate for their businesses, without having to worry that their good faith judgments will be suspect because they are not based upon a single prescribed methodology. As we noted in our prior letter, we do not believe that the credit review standards advocated by the Department should be described as "best practices," as they are neither required by law nor the object of unanimous acceptance among responsible lenders who share the Department's concern that borrowers under securitized subprime loans should be able to afford to repay the loans they obtain.

B. Nature and Scope of Review

In our prior letter, we outlined in detail the factors that due diligence by underwriters may encompass and the variables that may influence the actual nature and scope of the due diligence that an underwriter may perform. Our members generally already perform legal compliance tests to determine the presence and accuracy of required disclosures and primary credit documents. Whether they perform such an analysis on every pool or every transaction is a matter of business judgment. Our members also generally already perform an analysis of the issuer, including reviewing policies and procedures, governmental audits and investigations and litigation logs, analyzing performance data

and interviewing employees; they tend not to contact community and housing groups or third party data bases because of the unverified nature of the information available from these sources. Our members are also willing to use commercially reasonable efforts to conduct loan level and issuer reviews based on the factors and variables outlined in our prior letter, but believe that it is unreasonable and unnecessary for the Department to dictate the specifics of these reviews. Moreover, any determination of what is commercially reasonable must include a consideration of costs. We continue to believe that the significant cost of compliance with many of the specific "best practice" procedures would be passed through to consumers in the form of higher interest rates and would result in a material contraction in the amount of available credit from responsible lenders.

C. Complex Legal Conclusions

The determination of compliance with legal requirements applicable to mortgage loan origination may require the sophisticated application of complex and detailed legal principles to a vast array of facts. Both the duty and ability to perform this type of analysis appropriately rests with lenders and originators, rather than with underwriters of securities. Such is the case with the recommended analysis of the existence of credit discrimination against protected classes of borrowers or of redlining or reverse redlining. One cannot determine the existence of discrimination from an analysis of the face of a loan file or from reviewing an originator's lending policies. Generally speaking, one must undertake a costly, time consuming statistical regression analysis, controlling or grouping for variables that may or may not be evidenced in the loan files to begin to make meaningful conclusions; this would require a detailed coding of loan files to facilitate statistical analyses and conversations with representatives of the issuer. Moreover, the law is unsettled as to what constitutes discrimination, and underwriters simply are incapable of making such legal conclusions, given their specialized capital markets role and expertise. In this context, is unrealistic to expect underwriters to look for "pattern and practice" discrimination.

D. Third Party Originators

It is important to remember that issuers of mortgage-backed securities often acquire loans literally from hundreds of third party originators. The revised draft makes many references to a review of the originators and lenders. Our members generally conduct due diligence only of the actual issuer of the mortgage backed securities and/or any affiliated lenders; if the issuer has no lending affiliates and does not itself make loans, the due diligence is limited to the issuer as the purchaser of loans. Securities underwriters may review performance data of third party originators and the general approval criteria used by the issuer in selecting such originators, but they do not, and likely would not, conduct comprehensive reviews of third party originators because of time, resource and cost constraints.

E. Use of Findings

The implicit and unanswered question permeating the Proposals is exactly what an underwriter is supposed to do with any findings that it may reach. Presently, underwriters may elect not to do business with an issuer, may exclude certain loans from a pool to be securitized, change the subordination or credit enhancement levels for a transaction, seek additional certifications, representations and warranties from issuers, or they may price the risks they uncover. All of these are discrete business judgments not governed by law. The revised draft references the "vital public purpose" served by the Proposals and articulates the Department's belief that "...abusive and improper lending practices can be discovered and dealt with if the underwriters conduct due diligence through the sampling approach outlined below." This could be improperly construed to suggest that, in addition to their obligations under applicable securities laws, underwriters have some form of recognizable duty of care to the Department, borrowers or security holders that would be breached if they either failed to follow the recommendations issued by the Department or failed to disclose their findings to the Department or other parties. We do not believe that there exists any such duty of care, and it is important to us that that such a duty be explicitly disclaimed or negated in the final version of the Proposals. As we have repeatedly stressed, our members are unwilling to endorse recommendations that may be interpreted to impose a direct or indirect duty on underwriters.

F. Purpose of Due Diligence

As we noted previously in our August 1st letter, the basic purpose of due diligence in the context of a securities offering is to enable an underwriter generally to familiarize itself with the characteristics of the loans to be included in the pool and the business and activities of an issuer, to identify issues or problems with the issuer that may materially affect either the performance of the securities or the validity of the securities offering and, ultimately, to provide the underwriter with a reasonable basis for concluding that a registration statement or offering document is complete and accurate in all material respects. Such due diligence is performed with a view toward ensuring full and fair disclosure to the investors in the securities being offered, promoting efficiency and transparency of the markets in which the securities will be traded, preserving the underwriter's business reputation and customer relationships and shielding it from potential securities law liability.

It is important to reiterate that the purpose of due diligence is not to protect the underlying borrowers, or to enforce or ensure compliance with applicable federal, state and local consumer credit laws or regulations by the issuer and the third party originators from which an issuer may acquire loans. These are all desirable policy goals, and our members agree that a positive "spill over" effect from the public debate over predatory lending has been a heightened awareness among underwriters regarding the role, scope and value of due diligence that they conduct. Our members, however, are not conducting due diligence in order to serve a "vital public purpose" of combating predatory lending by loan originators.

III. CONCLUSION

Once again, we appreciate the opportunity to comment on the revised draft of the Proposals. As stated above, we believe this revision is significantly improved from the earlier draft and meets many of the concerns that we previously articulated. We are prepared to endorse a more general call to use commercially reasonable efforts to conduct due diligence, with the appropriate disclaimers regarding legal obligation or duty of care. We remain willing to work with the Department on this important issue. Our members, however, are unwilling and unable to support a more in-depth prescription of "best practices" that seeks to impose on underwriters a predetermined way to conduct due diligence, thereby impairing their flexibility to make individual business judgments.

We look forward to an opportunity to discuss our views and remaining concerns with you in person, in the hope that we can reach a mutually acceptable resolution in this matter. To arrange such a meeting, or if there is any additional information that the Association may be able to provide, please contact me directly at 212.440.9403.

Sincerely,

/s/

George P. Miller
Senior Vice President,
Deputy General Counsel

EXHIBIT A

Specific Comments on Draft Dated November 3, 2000 of Open Letter Urging Adoption of Due Diligence Best Practices in Connection with the Securitization of Residential Mortgage Loans (the "Proposals")

INTRODUCTION:

1. 2nd Paragraph, 2nd Sentence: Reference to "improved disclosure protocol" is misplaced, as the Proposals do not address disclosures in securitizations.

2. 3rd Paragraph, 3rd Sentence: Replace phrase "can be discovered and dealt with" with something like "may be reduced."

3. 4th Paragraph, Third Sentence: Add at end of sentence something like: "; moreover, these recommendations are not intended to establish a duty of care or other duty on the part of underwriters to mortgagors, the Department or securities holders."

RECOMMENDATIONS:

1. First Paragraph, First Sentence: Replace the phrase "sound underwriting and appraisal practices" with something like "established credit standards."

2. First Paragraph, First Sentence: Clarify the recommendation to provide that the compliance of the underlying loans with applicable standards is "in all material respects." Clarify that the use of "commercially reasonable efforts" by the underwriters includes, without limitation, "reasonable cost considerations and the purpose for which the due diligence is undertaken."

FEDERAL LAWS AND REGULATIONS:

1. Delete reference to Section 8 of RESPA.

NEW YORK STATE LAWS AND REGULATIONS

1. Delete reference to Section 296-1 of the Executive Law (fair lending)

DUE DILIGENCE/GENERAL:

1. First Paragraph, First Sentence: Delete references to "statistically relevant sample" and "adverse selection," and provide that appropriate sampling should be undertaken.

2. First Paragraph, Second Sentence: Clarify that the scope of the review should be designed in light of potential adverse pool performance, which may include the illustrative list set forth below; recommendations should not dictate specific steps to be followed.

DUE DILIGENCE/CREDIT REVIEW:

1. First Paragraph, Verification of Ability to Repay: Delete the detailed scope of review and replace with general covenant to verify ability and/or willingness to repay and/or stability of income based on criteria acceptable to the underwriter.

2. Second Paragraph, Credit History: Delete the specific reference to credit reporting agency and replace with general covenant to determine credit history based on criteria acceptable to the underwriter.

3. Third Paragraph, Appraisals and Loan to Value Ratio: Delete reference to appraisal with general covenant to determine valuations based on criteria acceptable to the underwriter.

DUE DILIGENCE/COMPLIANCE REVIEW:

1. First Paragraph, First Sentence: Qualify review by materiality standard.

2. Second Paragraph, Second Sentence: Qualify review by materiality standard.

3. Third Paragraph, First Sentence: Replace with general covenant to identify material inconsistencies between and among disclosure documents.

4. Third Paragraph, Second and Third Sentences: Delete.

5. Fourth Paragraph: Delete entire paragraph.

DUE DILIGENCE/QUALITY OF ORIGINATORS

1. THROUGHOUT: Revise reference to "originator(s)" throughout to "issuer or its affiliated seller."

2. FIRST PARAGRAPH, INTRODUCTORY PARAGRAPH: Clarify that the review of the issuer may not need to be for each securitization if the issuer goes to the capital markets more than once a year.

3. FIRST PARAGRAPH, BULLET POINTS: Clarify the first bullet point to provide that the underwriter should seek to determine if the issuer holds all of the material licenses that it needs. Delete the second, third, fifth, sixth and seventh bullet points. Delete reference to right of rescission in eighth bullet point. Replace "certification" with "contractual representations" in ninth bullet point.

FOOTNOTES

[1] The Association represents securities firms and banks that underwrite, distribute and trade debt securities, both domestically and internationally. Among other roles, the Association's members act as issuers, underwriters and dealers of mortgage and asset-backed securities, including securitization of subprime loans. The views expressed in this letter are based upon input received from a broad range of Association members who are active in these markets, including members of the Mortgage and Asset-Backed Securities Division, who are actively involved in the mortgage securitization markets. More information about the Association, its members and activities may be obtained from the Association's website at www.bondmarkets.com .