

§ 9:2—The Mortgage Reform and Anti-Predatory Lending Act of 2007

Full explanation of the most recent legislation and its impact.

HR 3915, the Mortgage Reform and Anti-Predatory lending Act of 2007, was introduced in the House Financial Services Committee by Chairman Frank along with Representatives Mel Watt (D – North Carolina) and Brad Miller (D – North Carolina). It faced strong initial opposition from industry as well as many Republicans but then a compromise was struck with Ranking Member Spencer Bachus (R – Alabama). The compromise measure was voted out of committee and then passed overwhelmingly by the full House in November 2007. Among the main provisions of the bill, there are the following requirements:

- * Registration of all mortgage loan originators, either through the states or Housing and Urban Development;
- * Suitability standards for loan originators that ensure that consumers have a reasonable ability to repay ARM's and that they will receive a "net tangible benefit" from any refinancing;
- * A national standard of assignee and securitizer liability which includes liability for unsuitable loans. A safe harbor allows securitizers to demonstrate that they conducted sufficient due diligence to escape liability. States are not allowed to enact different measures regarding securitizer liability and safe harbors but are free to impose higher standards in other areas;
- * Protection for consumers from high cost loans by lowering points, fees, and interest rate triggers that increase the likelihood of foreclosure.

The Center for Responsible Lending as well as other consumer groups supported passage of the bill and issued the following statement:

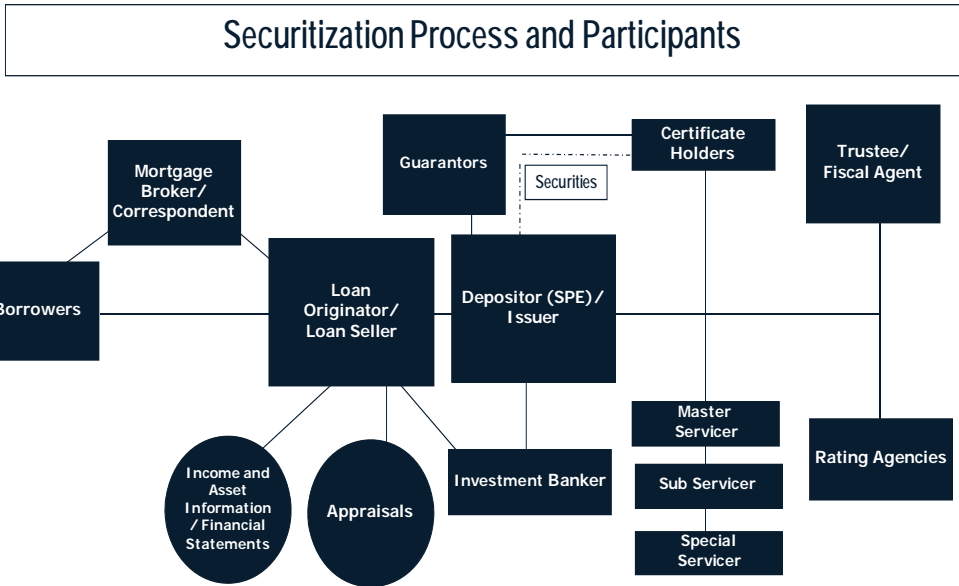
"The proposed legislation addresses many abusive lending practices that contributed to today's foreclosure crisis, including reckless underwriting practices, subprime prepayment penalties, and yield-spread premiums. However, it is critical that the details of remedy and enforcement provisions are strengthened in order to ensure protections are meaningful and that industry participants, including the secondary market, take their responsibility to police the

§ 1:3—The Participants

In spite of the myriad of changes and innovations we have witnessed during the past several decades, at its core, the market for financial assets still begins with a borrower requesting funds and a lender extending a loan. The lending relationship between the loan originator and the borrower represents the first necessary step in both the conventional lending and the asset-backed securitization process. As the chart below demonstrates, the change that the securitization model has introduced is that the borrowers' previous bilateral relationship with a lender is replaced by (a) the pooling of many borrowers' loans and (b) the ultimate funding of a loan coming from multiple investors rather than a single lender.

Commentary by experts in the field.

Graphical depictions of complex concepts give readers valuable information at a glance.



§ 1:4—The Participants - Loan Originator/ Loan Seller

The securitization process benefits from significant economies of scale, with successful securitizations often composed of \$500 Million to \$1 Billion or more of assets. As a result, a particular loan originator, that is, the entity that interfaces with the consumer and lends him/her money, often cannot generate sufficient loan volume through its direct branches and personnel. To supplement its own loan production, an originator often purchases loans from, or indirectly originates loans through, a network of mortgage brokers or correspondent lenders. In this fashion, Originators both initiate loans through their own efforts and aggregate loans initially generated by third parties. Traditionally dominated by the commercial banks and savings and loans, the loan origination process has grown to include many non-insured financial institutions. Although federally-insured financial institutions continue to generate the largest volume of

INDUSTRY BACKGROUND

loan originations, non-bank financial institutions today make up a much larger share of the loan origination market.¹

To initiate the lending process, the Originator collects from the borrower the required personal financial and asset valuation information necessary to underwrite the loan. This information varies by loan type but will typically address the borrower's ability to make the required monthly payments of principal and interest as well as an assessment of the value of the asset that will serve as collateral for the loan. Until the residential mortgage industry upheaval of 2007, the amount of information and documentation required by many loan programs had been eased significantly. Terms such as "no or limited doc[ument]" and "stated income" loan programs became commonplace. Now, such programs have largely been eliminated, especially for loans intended for securitization, and the underwriting process has become more conventional.

Once the loan underwriting process is complete and the loan has been approved, the borrower will execute a note and either a mortgage or deed of trust, depending upon the jurisdiction in which the collateral is located. In the residential mortgage situation the originator will then fund the loan with the proceeds being directed by the borrower to the purchase of a residence, retirement of prior debt or cash out to the borrower. Typically, the source of funds for the originator will predominantly be a loan from what is known as a "warehouse lender", together with a small amount of the originator's own funds. Warehouse lenders often advance

¹ Christopher Downing and Nancy E. Wallace, *Commercial Mortgage Backed Securities: How Much Subordination is Enough?*, January 4, 2005, at 1, at http://gemini.econ.umd.edu/cgi-bin/conference/download.cgi?db_name=CE2005&paper_id=37 ("The commercial mortgage-backed security (CMBS) market has experienced rapid growth in recent years, registering an average annual growth rate of about 18 percent since 1997. CMBS now surpass life insurance companies, and stand second only to commercial banks, as a primary channel of credit provision to the commercial real estate sector. Indeed, by the end of the third quarter of 2004, outstanding CMBS funded \$322 billion, commercial banks \$809 billion, and insurance companies \$210 billion of the total \$1.6 trillion of outstanding commercial mortgages."); Eric Higgins and Joseph Mason, *Deriving Credit Portfolio Diversification Properties from Large Asset-backed Security Pools*, Dec. 19, 2005 at 1, at <http://fic.wharton.upenn.edu/fic/papers/05/0543.pdf> (last visited March 20, 2006) ("Securitized loan markets are large and growing fast. Outstanding securitizations of non-mortgage consumer debt grew at a 50% annualized rate across the past two decades, while securitizations of consumer mortgage debt grew at a 15% annualized rate (compare those to overall debt sector annualized growth of 10%). As of fourth quarter 2004, roughly 68% of total U.S. consumer mortgage debt and 69% of other U.S. consumer debt (Credit Cards, Auto Loans, Student Loans, Home Equity Loans, Manufactured Housing loans, and Other) was securitized, amounting to 68% of all U.S. consumer credit outstanding. In levels, as of fourth quarter 2004 there was almost \$1.5 trillion of non-mortgage consumer debt asset-backed securities (ABS), \$2 trillion of private mortgage-backed securities (MBS), and \$3.5 trillion of agency (FNMA, GNMA, FHLMC) MBS outstanding, representing a total market of \$7 trillion, or just under 80% of total on balance sheet bank debt. (Federal Reserve Statistical Release Z1, pp. 58-59; Bond Market Association).").

Full citations of authorities give readers further resources to consult.

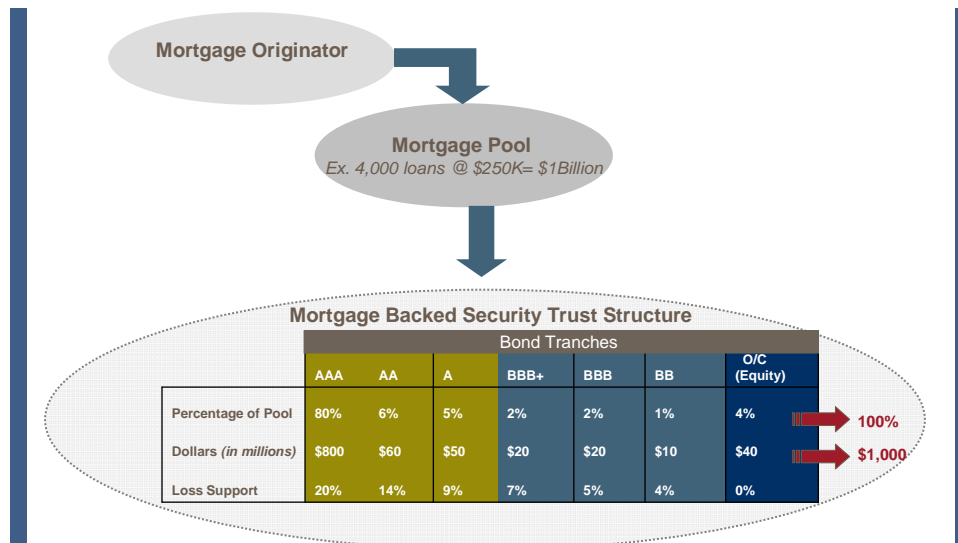
§ 1:6 The Participants—Certificate Holders

Investors who place funds in an MBS transaction receive a certificate evidencing their interest in a pool of mortgage loans. A mortgage certificate, also known as a pass-through certificate, conveys a particular interest in the cash flow from an entire pool of mortgage loans as opposed to specific loans in the pool. Thus, the investors in a MBS transaction are referred to as certificate holders. A pooling and servicing agreement and related documentation associated with these certificates instruct the trustee how to allocate the cash flows generated by the loans in order to assign the respective classes of investors (holding differing classes of certificates) particular attributes of the risks and benefits of ownership of the loans.

The loans owned by the trust provide the cash flow to make intended payments on the certificates which are sold to investors. The attributes of each type, or tranche, of certificates may vary greatly, but are often grouped generally into two broad categories: (i) more senior certificates or investment-grade rated securities, often generally referred to as “A” certificates and (ii) subordinate or more risky certificates, often rated below investment grade by the rating agencies, or not rated, and generally referred to as “B” certificates.

Ex. 1: Example of MBS Trust Structure

Charts give readers valuable information at a glance.



Because the loans that constitute the assets of the trust are not themselves investment grade, the “A” certificates typically command investment-grade ratings (BBB- or higher) from rating agencies because of pool diversity and/or some form of credit enhancement. The credit enhancement may result from an explicit guarantee or enhancement by a

Glossary of Common CMBS and RMBS Terms

Glossary of terms provides a quick reference at readers' fingertips.

Accretion ¹	The process of adding interest to principal owed to the investor instead of paying the interest as it becomes due. This technique allows the creation of zero coupon bonds, known as "Z bonds".
Additional Interest	Interest accrued after an Anticipated Repayment Date in respect of a ARD Loan that is in excess of the interest rate relating to such ARD Loan prior to such Anticipated Repayment Date.
Additional Trust Fund Expense	Certain expenses of the trust fund relating a securitization (other than master servicing fees and trustee fees) that may include certain special servicing fees (including fees relating to any work-outs or liquidations), indemnities under the pooling and servicing agreement, federal, state and local taxes, unrecovered advances and interest on such advances, and reimbursements to be made by the securitization to any other securitization for the servicing of a mortgage loan (<i>e.g.</i> , a whole loan composed of two notes: one in each securitization). Additional Trust Fund Expenses, however, generally do not include overhead expenses of servicer, trustees, certificate registrars, paying agents or similar agents, such as costs for office space, office equipment, supplies and related expenses, employee salaries and related expenses, and similar internal costs and expenses.
Adjustable Rate Mortgage Loan ¹	A mortgage loan in which payments are adjusted periodically based on a specific floating index rate.
Advance Interest ²	Interest accrued on advances made by the Master Servicer, Special Servicer or Trustee with respect to a mortgage loan and payable to the party that made the advance.
Advance Rate ²	The rate at which Advance Interest accrues, which is typically the Prime Rate.
Alternative A, or Alt-A Loan ¹	Mortgage loans that do not qualify for the best mortgage rate. Either the borrower has

¹ This term applies primarily to RMBS transactions.

² This term applies primarily to CMBS transactions.