MEMORANDUM

TO: Drafting Committee Members, Advisors and Observers,
Proposed Home Foreclosure Procedures Act

FROM: Bill Breetz, Chair

DATE: November 7, 2014

RE: November 14-15, 2014 Drafting Committee meeting
Palmer House Hilton, 17 E. Monroe Street, Chicago, IL 20036
(312) 726-7500

Contents

I. INTRODUCTION Greetings to all. As you know, the Drafting Committee on the proposed Home Foreclosure Procedures Act will meet on Friday, November 14 and Saturday, November 15, 2014, at the Palmer House Hilton in Chicago. Meeting hours will be 9:00 a.m. to 5:00 p.m; we will not have a Sunday meeting. Our meeting room will be posted at the hotel.

If you have any questions concerning the meeting, please call Rachel Hewitt or Joleen Dimond from the Chicago office; they can be reached at (312) 450-6600.

Shuttle transportation to the hotel is available from both Midway and O'Hare Airports through Go Airport Express located in the baggage claim areas or by calling (800) 654-7371. A one-way shuttle rate from Midway is $22, and $27 from O'Hare. A one-way taxi ride from Midway Airport or O'Hare Airport to the hotel is approximately $45-50.

The Blue Line from O'Hare takes about 45 minutes. Get off at Monroe and walk a block and a half East just past State St. The hotel entrance will be on the right.

The Orange Line from Midway takes a little over 30 minutes. Get off at Harold Washington Library, the first stop in the Loop, walk north on State St. for three blocks to Monroe and turn right. The hotel entrance will be on the right.

An agenda for the meeting is attached as **Appendix A** to this memorandum.

APPENDIX A: AGENDA

HOME FORECLOSURE PROCEDURES ACT DRAFTING COMMITTEE MEETING

FRIDAY, NOVEMBER 14 and SATURDAY, NOVEMBER 15, 2014

AGENDA

Note – By request, we will defer consideration of Section 706 (Holder In Due Course) and other UCC-related matters until Saturday morning.

The Chair welcomes suggested amendments, comments regarding obvious omissions and special requests

Friday, November 14, 2014

9:00 am - 9:15	Welcome and Introductions of old and new attendees
9:15 - 9:30	Brief discussion of recent developments at the Federal level
9:30 - 9:45	Brief discussion of the proposed Electronic Note and Mortgage Registry
9:45 - 10:15	Consideration of Article 3 (Early Resolution), model rules
10:15 - 12:00 pm	Begin Line-by-Line Consideration of the Act
12:00 - 1:15	Lunch break [on own]
1:15 - 5:00	Further Line-by-Line Consideration of the Act

Saturday, November 15, 2014

9:00 am - 12:00 pm	Consideration of UCC-related matters: ○ Article 4 – Who can enforce; Lost Notes ○ Section 706 – Holder in Due Course
12:00 - 1:15	Lunch break [on own]
1:15 – 5:00	Further Line-by-Line Consideration of the Act

II COMMENTS ON THIS DRAFT

You should have already received both a redlined and clean draft of the most recent version of the Home Foreclosure Procedures Act from the Chicago office for consideration at our Chicago meeting. With that same email, you should also have received an extensive letter from Mark Greenlee of the Federal Reserve Bank of Cleveland.

Once again, that draft represents the work of our two excellent co-Reporters - James Charles Smith of the University of Georgia Law School and Alan White of CUNY Law School in New York City - and several conference calls between the Co-Reporters, American Bar Association Advisor Barry Nekritz and me. I continue to be most grateful for Jim, Alan and Barry's scholarship, drafting efforts and pragmatic approach to the drafting challenges we face in what remains a highly important subject.

The current draft is based on the draft considered at the annual meeting of the ULC this past July. All the amendments to that draft – as shown in the redlined version that you have – come from three sources.

First, they reflect the comments and debate which the Committee received at the annual meeting.

Second, a considerable number of amendments were generated from the several discussions of the draft among the co-Reporters, Barry Nekritz and me.

Third, we received substantial proposed amendments from the Style Committee developed at its September meeting, and which were discussed in a day-long meeting with Judge Yeakel (Chair of the Style Committee), the co-Reporters, the ABA Advisor and me. All of us who met with Judge Yeakel appreciate the work of the Style Committee; their efforts have substantially enhanced the readability and clarity of the draft

As always, the draft reflects substantial policy issues and I touch on those issues below. However, this draft contains many fewer policy differences compared to earlier drafts, as we have resolved many of them (at least for the moment) in earlier meetings.

ARTICLE 1 – GENERAL PROVISIONS

Sec. 102 (3) - definition of 'Creditor': As drafted, this definition includes all servicers, which is also a defined term. Dale Whitman, a member of the JEB on Uniform Real Property Acts ('JEBURPA'), thinks the definition is 'elegant' because it focuses on the PETE (Sec. 401) which he concludes is entirely appropriate. On the other hand, there may be situations where we intend different outcomes for a creditor than for a servicer.

The following comment appears in the full Act and reflects my own views, which the Committee may or may not find persuasive:

> 2. The Chair (and perhaps he alone) has struggled with the definition of 'creditor'. However elegant the current definition may be, it is ultimately circular – in that it includes the very servicers to whom the creditor may delegate duties under Section 107.
>
> Further, the definition does not describe the creditor's relationship to the borrower or the debt, but simply characterizes the 'creditor' as any PETE under 401(b); this is, again, a reference that clearly includes entities that are not traditional creditors but are, indeed, persons who may owe a duty to the traditional creditor once the foreclosure process is complete and the proceeds of sale are in hand.
>
> Finally, Section 401(b)(2) provides that 'only the person designated as the owner or holder of the obligation by the registry may commence a foreclosure'. While the [act] does not define what 'owner of the obligation' means, it surely does not mean a servicer who is under contract with that owner to commence the foreclosure.
>
> Reporter White suggests that an alternative approach might be to define the creditor as "a person entitled to receive payment or performance under an obligation". Section 107 – describing the relationship between servicer and holder – would then completely address the situation where the servicer is the PETE. This alternative definition would also be entirely consistent with the current definition of 'mortgage registry' which refers to 'the owner of an obligation'.

Additionally, this section includes bracketed language regarding a potential exemption for small lenders; the Drafting Committee should discuss this outcome.

Sec. 102 (4) - definition of 'Early Resolution": We continue our quest for a consensus term for what, in Connecticut, is called a 'Foreclosure Mediation Program'; ***see*** § 49 CGS 31m. The Committee must finally determine the name of this process.

There are three clusters of potential names, each based on a dominant word or combination of two of the dominant words: (i) foreclosure; (ii) mediation; and (iii) resolution. The clusters seem to include:

Foreclosure Mediation	**Foreclosure** Conciliation
Foreclosure Resolution	**Foreclosure** Diversion
Pre-**Foreclosure [etc.]**	

Dispute **Resolution** Early **Resolution**
Mediation [alone]

In our final conference call preparing for the November 14-15 meeting, the co-Reporters, the ABA Advisor and the Chair reached a consensus – clearly not binding on the Drafting Committee – that they would prefer to use the term "Foreclosure Mediation" throughout the act, and couple it with a Drafters' Note – already there - making clear that the rules under the Uniform Mediation Act and other state mediation statutes do not apply to the unique procedure detailed in this act.

Sec. 102 (9) - definitions of 'Homeowner' and 'Obligor': The former definition of "Homeowner' excluded a 'leasehold' interest; the new definition addresses that subject.

Further, we define and, throughout the act, we use – both the term 'homeowner' and the term 'obligor.' The two terms will define the same individual in the vast majority of cases, However, the distinguishing characteristics are that: (i) an individual may be a 'homeowner' but not be liable on the note (the paradigm being the spouse who marries and owns an interest in the home, but never signed the note) while (ii) an 'obligor' may be someone who signed the note – or a guarantee of the note – but does not own the home (the paradigm here is the divorced spouse who have up her one-half interest in the home but is still liable on the note).

The current draft continues to use both terms in ways that are confusing to a degree. Your drafters conclude that both terms are needed, and we have inserted comments that we hope are helpful to explain why both terms are needed. We welcome further suggestions.

Sec. 102 (15) - definition of 'Mortgaged Property': [appearing in this Draft as an amendment to 'Residential property':

1. Co-Reporter Smith convinced your Drafters that we could usefully combine the definitions of 'Mortgaged property' and 'Residential property' and this draft accomplishes that. Assuming the Drafting Committee agrees, the revised definition will appear in its proper order in the next draft; however, in order to best highlight the needed editing, the revised definition appears as amendments to definition (25) [residential property] rather than as definition (15) [mortgaged property].

Conforming amendments have been made throughout the act to replace any references to 'residential property.'

2. The revised definition deletes what had been bracketed language in the old definition of Mortgaged property that at least implies that personal property other than fixtures may be included in a real estate mortgage.

Section 104 - Good Faith: The Drafting Committee should consider how to address the bracketed language in the last sentence of subsection (a).

Section 108 - No Waiver: The Drafting Committee should consider whether the Act should permit waiver, either generally or after default?

Section 109 - Notice and Knowledge: Two questions have been raised: first, whether the section is needed at all and, second, whether the language with regard to when an organization has knowledge is correct when it refers to the 'person conducting the foreclosure?' Is there a more felicitous way to describe the role of a person within an organization – say, a creditor or servicer – when the organization rather than the person is actually 'conducting' the foreclosure?

Your Drafters believe the current language could lead to unintended judicial interpretations – does the language mean, for example, that the notice must be sent to the sheriff or auctioneer conducting the sale? We therefore recommend deletion of this section.

Section 110 - Supplemental Principles of Law: Style believes this section is archaic, perhaps obsolete, and in any case vestigial – and proposes deletion.

ARTICLE 2 – NOTICES; RIGHT TO CURE

Section 201- Notice of Default: The Note suggests that the Reporters will draft a 'Safe Harbor' form of notice. Your Drafters conclude that this is not necessary; does the Committee concur?

Section 204 – Unknown Homeowner or Obligor: We have added a reference to Sections 404 (e) and 405, which both require the creditor to send a copy of the foreclosure advertisement and or the notice of sale to the homeowner and obligor – and therefore suffer from the same potential difficulty which this section solves.

ARTICLE 3 – EARLY RESOLUTION

Section 302 - Notice of Early Resolution: The earlier version of subsection (a) required the creditor to send a notice of the right to the Early Resolution process not later than 30 days after the creditor (i) sends the Sec 201 notice of default or (ii) files a foreclosure [complaint]. This raised several questions which your Drafters have chosen to remedy by amending the language of the Act as shown. We believe the resulting new language in Section 302 is now consistent with Section 201, which prohibits any effort to 'initiate foreclosure' for at least 30 days after the 201 notice is sent, with the language in Section 302(c) requiring that notice be sent before the creditor may proceed to finalize the foreclosure, and with Section 305(a), which also provides that the creditor cannot commence foreclosure until the Sec. 302 notice has been sent.

Section 303 - Eligibility for Participation in Early Resolution:

1. Your drafters discussed various scenarios under Section 303 which might arise if the homeowner and obligor are different people. As examples, suppose:

a. They disagree regarding a proposed solution?
b. One of them elects to participate, but the other does not?
c. One of them fails to comply with an agency rule or order?

We also asked whether the creditor would still have to 'notify' a non-participating obligor or homeowner under Sec. 304?

The consensus seemed to be that in some circumstances, a disagreement might make 'early resolution' impossible, but that would not be a common problem and in any event, there was no obvious solution to that possibility, any more than there would be if a married couple owning the property as joint tenants with right of survivorship disagreed as to a possible resolution.

2. The Drafting Committee needs to decide about the bracketed language regarding whether occupancy by an 'immediate family member' qualifies for the 'owner-occupancy' policy justifying a mandatory mediation process.

3. Should the Act include a timeframe within which the agency must make its 'owner-occupancy' decision, and what basis could the agency have for determining that the obligor's/homeowner's 'affirmation' that the property is 'owner-occupied' is not accurate? Is a hearing on that issue required? Currently, the Act does not address those issues.

Section 304 - Participation In Early Resolution: May a servicer to whom the creditor has delegated the duty of participating in an early resolution process adopt a policy of refusing to offer any loss mitigation option, regardless of whether the creditor for whom the servicer acts has adopted such a policy, so long as that refusal does not directly contradict the creditor's instructions?

Appendix to Article 3: The Drafting Committee has not spent any time reviewing the Appendix. Further, subject to further guidance from the Style and Drafting Committees, your Drafters moved the text of the Appendix to the end of the Act.

ARTICLE 4 – RIGHT TO FORECLOSE; PUBLIC SALE PROCEDURE

Section 401 [A] and [B] – Right to Foreclose – Judicial and Non-Judicial:

Does the Drafting Committee find the division of the section into two parts useful?

Section 402 – Assignment of Mortgage Unnecessary:

The current draft amends former language stating that a PETE has no duty to record a mortgage assignment from 'the initial holder' of the mortgage; the amendment now refers to 'any prior holder' of that mortgage.

Section 403 – Lost, Destroyed or Stolen Negotiable Instrument

The current language tracks the 2002 amendments to UCC 3-309 on this subject, which have only been adopted in a few states. Since this language would therefore be inconsistent with the law in the large majority of states, your drafters have amended the Legislative Note pointing out this inconsistency and recommending that the State adopt a consistent policy in this regard.

Section 407 – Confirmation of Public Sale

Your Drafters point out again that, as we understand the Drafting Committee's intention, this optional section is limited to seeking judicial confirmation of sales pursuant to a court order. We ask once again what the policy is that would deny the creditor the opportunity to seek such a confirmation in a non-judicial sale.

ARTICLE 5 – NEGOTIATED TRANSFER

Pursuant to the Style Committee's suggestion, the former Article 5, entitled 'Accelerated Dispositions' has been broken into its two constituent parts – one on Negotiated Transfers, the other on Abandoned Property.

Section 501- Negotiated Transfer of Mortgaged Property Subsection (a) does not by its terms require a non-owner obligor (who is therefore not a homeowner as defined in the Act) to agree to a proposed negotiated transfer. As the Drafters' Notes now point out, the obligor is not prejudiced by this outcome, since a consequence of the negotiated transfer under Section 504 is that the entire obligation is discharged.

ARTICLE 6 – ABANDONED PROPERTY

Section 606- Maintenance of Abandoned Property: The Drafting Committee should consider the bracketed language in subsection (h) (3) which would empower a 'community development corporation serving the area' to 'enforce the obligations created by this section.'

ARTICLE 7 – REMEDIES

Because the Style Committee divided former Article 5 into two Articles, the former Article 6 has become Article 7. The primary effect of the change is in the recasting of Section 606 on Holder In Due Course as Section 706.

Section 701- Effect of Violation:

Subsection (a) – the reference to ‘servicer’ here may be unnecessary; your Drafter conclude that the word may still be appropriate for the purpose of emphasizing that a servicer’s behavior may affect the outcome of a foreclosure procedure.

Subsection (g) – The Drafting Committee may wish to discuss the possible effect of this statute of limitations on causes of action arising under other law of the state, e.g., unfair trade practice statutes. To highlight the issue, your Drafters placed brackets around the one year statute; that short statute is consistent with causes of arising arising under various federal statutes.

Section 706- Effect of the Holder In Due Course Rule The only substantive changes to this section compared to the annual meeting draft are, first, to delete any reference to alternative sections and, second, to increase the limitation period from three years to six years.

ARTICLE 8 - MISCELLANEOUS PROVISIONS The Style Committee has proposed significant amendments to the organization and text of this Article, which the Drafting Committee should review. They ask: “How does this [a standard ULC ‘Repealer’ section] affect the Overlay concept? Repealer might be inconsistent with that concept.”

III ADDITIONAL OBSERVATIONS REGARDING HOLDER IN DUE COURSE

A. Introduction This subject continues to draw more attention than the rest of the Act combined.

The subject was debated at length at the ULC July, 2014 annual meeting in Seattle. The sense of the Floor debate was that the Drafting Committee should present a single proposal on HDC in the draft to be considered in 2015, and that the draft should be based on what was Alternative A in the annual meeting draft – that is, essentially this draft.

B. Position statements of various Interests

1. SIFMA At the annual meeting, at my request, the Executive Committee granted 'privileges of the floor' to Larry Platt of K&L Gates, counsel to SIFMA (Securities Industry and Financial Markets Association) and to Mark Greenlee, Deputy General Counsel to the Federal Reserve Bank of Cleveland. Both privately and on the Floor, Platt made clear that SIFMA and its members (all the large banks) would oppose <u>any</u> erosion of the HDC doctrine – obviously, a major threat to enactability. However, no lender groups have suggested there are any circumstances where they would support the Act, so perhaps more fervent opposition simply represents dropping more bombs on the rubble of the Act. Indeed, none of the Lender observers have made any substantive suggestions regarding amendments to Section 706.

2. Proposals from the Permanent Editorial Board on the UCC In mid-October, I met with the PEB in New York, and various members made various observations and suggestions on this subject.

a. Ed Smith and others proposed that the draft make clear that signing a note secured by a mortgage on residential property as we have defined it is a 'Consumer Transaction' within the meaning of recent amendments to the Uniform Commercial Code, specifically UCC Section 3-305 (f). For purposes of our discussion, I have attached the most current version of UCC 3-305; ***see*** attached **Exhibit 1**; the UCC definition of a "Consumer Transaction" is attached as **Exhibit 2.** By doing so, they suggest, we could delete the language that introduces § 706: "Notwithstanding UCC 3-305…."

b. There was much discussion suggesting that we require a higher 'standard of proof' – the suggestion was 'Clear and Convincing' – and require 'Particularity' in pleading, at least in any defense alleging fraud. The theory behind the argument seemed to be an attempt to avoid any delay in resolving a foreclosure action by permitting 'frivolous claims' of fraud designed to delay the entry of judgment.

c. Ed Smith suggested that by inserting this language into law, a 'choice of law' problem may arise in the following scenario:

Borrower lives in State A in the residential property which is collateral for the Note, so the collateral is also located in State A. The Note, however, provides that enforcement of the Note is governed by the law of State B, the state where the original Lender X is incorporated. Lender X then sells the note to Y. (I understand this scenario probably would not work with the Uniform Instrument, but….) State A has adopted the Home Foreclosure Procedures Act, while State B has not.

Following Borrower's default, Y, which is the PETE, decides not to foreclose on its collateral, but decides instead to sue on the note. A seeks to raise the defense of fraud, but Y claims that defense is not available to A because of the Choice of Law provision in the note. Which law governs: the law of State A or the law of State B?

d. Stephanie Heller discussed the language in Section 706 allowing borrower to pursue a declaratory judgment when there has been no default and therefore no foreclosure. She asked whether, since our original Committee charge from the Executive Committee was limited to addressing issues arising out of foreclosure, this proposal violates our 'scope' limitations.

e. Fred Miller and others asked whether this provision should be limited to non-Qualified Mortgages, which would be a considerable limitation on the number of affected borrowers who might, in an appropriate case, take advantage of it.

3. Proposals of Mark Greenlee (Deputy GC, Federal Reserve Bank of Cleveland) Attorney Greenlee suggested on the Floor at the annual meeting, and suggests in his recent letter (distributed to you as a separate Exhibit due to its length)**,** that the Act does not go far enough in certain respects. In his letter he suggests the following, beginning at page 7:

a. Remove the 'statute of limitations or other preclusion' exception in § 706 (b).

b. Clarify that the one-year extension of the 6 year statute of limitation applicable to interest rate adjustments runs subsequent to the 6 year period. Also, clarify that the rate adjustment is for a 'substantial' adjustment – that is, an aggregate adjustment of one percent or more.

c. Extend the three year statute of limitations in § 706 (d) to six years [as the current draft does].

d. Clarify that the one-year extension of the statute of limitations for rate adjustment § 706 (d) is only for a single extension and does not apply every time an adjustable rate mortgage adjusts.

e. Consider expanding the list of actionable defenses without entirely abolishing the doctrine. [His letter does not provide draft language.]

f. Finally, he proposes a ‘springing’ provision – by which I believe he means that the HDC provisions would only apply after a certain number of states have adopted it, to avoid the possibility of lender discrimination against the early adopting states.

IV DEVELOPMENTS IN THE FIELD SINCE OUR LAST MEETING

Your Chair remains a curious bystander as titans continue to clash across the nation over mortgage underwriting standards, risk retention requirements and lender/servicer behavior (or misbehavior) in addressing the plight of borrowers unable to repay their mortgages. The outcomes of those policy debates are likely to dramatically affect the lending and servicing environments; the subject matter of our Act remains at least relevant to those environments - and perhaps essential, depending on whose opinion for the future is most accurate.

For that reason, I continue to monitor various publications to try and at least superficially understand some of the developments that form the background for our work.

Since our last meeting, three significant trends appear significant:

First, a considerable easing in federal regulation of loan originators; and

Second, a shift of the servicing business from bank-related servicers to non-bank servicers; and

Third, continuing 'bad acting' on the part of both bank and non-bank servicers.

Easing of Federal Regulation: A November 3, 2014 headline in **National Mortgage News** conveys the major news story of the day:

"FHFA Concessions Show Mortgage Lenders Have Regained Sway In D.C."

"The banks are back in charge," said Bruce Marks, the CEO of Neighborhood Assistance Corp. of America, a nonprofit consumer advocate.[1]

Whether or not the banks are 'in charge", at the federal level, there have been fundamental changes in the anticipated characteristics of so-called 'Qualified Mortgages', in the risk retention or 'skin in the game' rules that would have required loan originators to retain a portion of the risk on loans that they sell, and on the GSEs' (primarily Fannie and Freddie) ability to require originators to repurchase loans sold to the GSEs when those loans fail to meet the representations and warranties that the originators made when they sold the loans.

All of these and other rules – the progeny of the widely touted 2010 Dodd-Frank Act - were anticipated to cause lenders to be more careful in their lending practices, to provide a greater level of protection to the taxpayers who at one point had advanced roughly $180 billion to Fannie and Freddie to cover their lending losses, and to make certain that credit was not extended to those who could not afford it.

[1] Quoted in **Exhibit 3**, FHFA Concessions Show Mortgage Lenders Have Regained Sway In D.C.

I attach several articles and opinion pieces on this subject that seemed most helpful to me in understanding how the federal regulatory landscape has changed.

Exhibit 3 consists of excerpts from the article entitled "FHFA Concessions Show Mortgage Lenders Have Regained Sway In D.C." It notes the considerable difference in tone set by Director Watt compared to his predecessor:

> In the last few months FHFA Director Mel Watt has struck a conciliatory tone with mortgage lenders, seeking input on housing policy and changing loan buy-back rules to be more favorable to the industry. Watt's actions stand is stark contrast to those of former acting FHFA director Ed Demarco….

The article goes on to detail what the FHFA changes entail:

- Changes to the GSEs' so-called representation and warranty framework will require that any inaccuracy in a loan file would have to be 'significant' to trigger a repurchase.

- The FHFA is developing an independent dispute-resolution process to give mortgage lenders in conflicts with Fannie or Freddie a hearing from an independent third party.

- Lenders will also have the opportunity to cure minor loan defects.

- Fannie and Freddie will create programs allowing lower down payments of just 3% to 5% for some homebuyers.

- FHFA had previously gave lenders a three-year sunset period that relieved lenders of some repurchase risk on loans, including a waiver of repurchase where borrowers had two 30-day delinquencies in 36 months.

In addition, as detailed in **Exhibit 5,** the Consumer Financial Protection Bureau and other agencies have dramatically reduced the 'risk retention' or 'skin in the game' and other rules:

- There are no restrictions on Loan-to-Value ratios;

- All risk retention requirements have been abandoned for Qualified Mortgages;

- FHFA will low allow borrowers to spend as much as 43% of their income on debt service, compared to considerably lower standards in prior years.

For good or ill, these collective changes represent a significant pulling back of the protections intended to benefit both consumers and taxpayers once trumpeted as a primary benefit flowing from Dodd Frank.

The response from the lending community, home builders and realtors to these collective rule changes has been enormously positive; all those industries perceive the earlier versions of these proposed rules as increasing their risk of doing business and undermining their profitability,

Liberal groups such as the Center for American Progress are generally supportive of the eased regulations. CAP's housing director, Julia Gordon, said:

> "We shouldn't obsess about down payments… Research confirms that low-down-payment loans to lower-wealth borrowers perform very well if the mortgages are well-underwritten, safe and sustainable."[2]

CAP's views seem typical of many consumer advocacy organizations - who fear that the proposed rules implementing Dodd-Frank would deprive lower-income residents from becoming homeowners – politicians (including especially the White House, who seek to encourage a more robust housing market) - and lenders and servicers

However, the issue is not without controversy. In the eyes of investor advocates and others, these rules potentially set the stage for the next housing crisis. They share the reported views of now retired Congressman Barney Frank, who is reputed to have said, that "it was a great mistake to push lower-income people into housing they couldn't afford and couldn't really handle once they had it."[3]

Attached are three different opinions critical of the regulatory changes:

In **Exhibit 4**, entitled "Don't Buy a House You Can't Afford " the author speaks to the potential damage to consumers and to the economy as a whole:

> A low-down-payment loan made to …someone with terrible credit and a lot of debt…has a higher default risk than a mortgage made to a similar borrower with an adequate down payment, because when you start out with little equity, you're apt to find yourself in foreclosure if you get into financial trouble.
>
> There is simply no way to make low down payment lending stable in any environment than in a rising house price environment," …[I]t only works in that environment and it creates this cycle of a boom as house prices are rising, and then once they stop rising everybody crashes. You get this epidemic of foreclosures. It destabilizes the entire market."

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[2] Quoted in **Exhibit 4**: "Don't Buy A House You Can't Afford"

[3] Quoted in **Exhibit 6:** "Underwriting the Next Housing Crisis"

> Is there a good public-policy reason to encourage people to make a heavily leveraged bet on continued upward movement in home prices? Presumably, the argument is that many homeowners have done very well out of this over the past 50 years; rising home values sowed the seeds of many a college education and retirement fund.
>
> But there are huge drawbacks to housing, too. Leveraged bets are great when they pay off; when they don't, they leave you dead broke…. Put a homeowner into one of these gambles at the age of 35, send the local housing and job markets south a few years later, and the end result is a broke middle-age person with trashed credit in desperate need of a good rental unit.
>
> You also end up with a much more unstable housing market. When a huge segment of the market has negative equity or has equity too low to cover the substantial costs of a sale, then in any economic downturn, you are going to end up with a lot of foreclosures. Those foreclosures will, in turn, depress both the housing market and the broader local economy. Which we should all know, because we just went through this very process. So why are we so eager to return to this situation?

Exhibit 5, entitled "5 Things You Need To Know about Risk Retention" speaks to these rules from the perspective of the investor in RMBS bonds.

> [If] there is no restriction on LTV, that is not a low-risk mortgage," said Mark Adelson, a veteran bond market executive and researcher known for his early warnings about mortgage securitization risks.

Further, the qualified-mortgage rule's maximum 43% debt-to-income ratio, coupled with the exemption from risk retention, means that borrower leverage may get even higher, and that limits protection for investors from this risk.

> "The scope of the risk retention is going to be very narrow," said Adelson, who would favor a maximum DTI for exemption closer to 36%, more comparable to the conservative industry norms in the 1970s.

The article concludes:

> Credit concerns are being held at bay more by the skepticism of investors burned during the downturn than any regulatory restrictions, Adelson said. But investors will change their minds if other mortgage bonds become too scarce, he said.

Exhibit 6, entitled "Underwriting the Next Housing Crisis" appeared as an Op Ed piece in the New York Times on Halloween; the author is a senior fellow at the American Enterprise Institute. He writes:

> SEVEN years after the housing bubble burst, federal regulators backed away this month from the tougher mortgage-underwriting standards that the Dodd-Frank Act of 2010 had directed them to develop. New standards were supposed to raise the quality of the "prime" mortgages that get packaged and sold to investors; instead, they will have the opposite effect.
> ****
> The regulators believe that lower underwriting standards promote homeownership and make mortgages and homes more affordable. The facts, however, show that the opposite is true.
> ****
> Republicans generally favor eliminating the government's role in housing finance, while Democrats worry that without government support, mortgages would be too expensive for low- and moderate-income families. Although it runs counter to the current Washington view, good underwriting standards can satisfy the objectives of both parties.
>
> It's clear that today's policies create winners and losers. The winners include real estate agents and home builders, who want to increase borrowing and sell ever-larger and more expensive homes. The losers, as we saw in the financial crisis, are borrowers of modest means who are lured into financing arrangements they can't afford. When the result is foreclosure and eviction, one of the central goals of homeownership — building equity — is undone.

Apparently, FHFA has been sensitive to the criticism of these reduced lending standards. In a speech this week, Director Watt was quoted as saying that additional guidelines will be required of low-down payment loans:

> …the guidelines will require that borrowers have compensating factors — such as housing counseling, stronger credit histories, or lower debt-to-income ratios — in order to make the mortgage eligible for purchase by Fannie Mae or Freddie Mac," Watt said Friday in a speech to the National Association of Realtors annual convention in New Orleans.[4]

The article continues:

> Watt said that loans with low down payments are not inherently risky and that reforms put in place since the housing crisis will prevent abusive lending practices. However, tight credit conditions have locked many potential homebuyers out of the housing market and from benefiting from those mortgage reforms.
>
> "There are creditworthy borrowers in today's market who have the income to afford monthly mortgage payments but do not have the money to make

[4] Quoted in **Exhibit 7** – "GSEs' Low-Down-Payment Loans Must Have Compensating Factors: Watt"

a large down payment and pay closing costs. Purchase guidelines that allow for 3% down payments will provide an opportunity for access to credit for some of these borrowers," Watt said.

Analysts said Watt's comments were an attempt to rebut criticism that lower down payments were a return to the lending practices that caused the housing collapse.

Continued Servicer Problems Separately, it appears that loan servicers continue to experience regulatory challenges and a loss of profitability. Several of the exhibits detail the continued failure of servicers to meet their legal obligations, while at least one non-bank servicer – Ocwen – is accused of intentionally backdating thousands of notices to borrowers in order to avoid the need to offer them loan modifications to which they would otherwise be entitled.

Exhibit 8 is entitled "Consumer Bureau Finds Homeowners Harmed by Loan Firms; it is dated October 29, 2014" and reads in part:

> The three-year-old U.S. consumer protection agency said it discovered that the largest mortgage servicers have been mishandling loan modifications and harming borrowers since new rules came into effect in January.
>
> Consumer Financial Protection Bureau supervisors have made spot checks to examine the books and practices of bank and nonbank servicers, the agency said in a report yesterday, without naming the firms. Supervisors found "substantial delays" in modifying loans that resulted in "negative consequences," such as higher mortgage payments and unjustified blemishes on borrowers' credit reports, the report said.
> ****
> "The CFPB had tread lightly, relatively speaking, in mortgage servicing enforcement thus far as the rules went effective in January," Isaac Boltansky, an analyst with Compass Point LLC in Washington, said in an email. The report suggests that the agency is "re-emphasizing mortgage servicer compliance which means that the regulatory environment is unlikely to improve in the near-term."
> ****
> Today, the business of collecting mortgage payments is undergoing a transformation as large banks retreat from the $9.4 trillion market, selling servicing rights to nonbanks such as Ocwen and Nationstar Mortgage Holdings Inc. Ocwen has more than tripled the number of loans it services in the last two years to $426 billion, or 4.3% of the market.

Exhibit 9 is one of many recent newspaper articles regarding the servicing behavior of Ocwen Financial Corporation. Entitled "Ocwen Mortgage Backdating Started In 2010", the article's lead paragraph reads:

> Benjamin Lawsky's New York Department of Financial Services sent a letter to Ocwen on Tuesday accusing it of backdating thousands of loan modification denial notices starting in 2012, likely causing "significant harm" to borrowers by depriving them of enough time to appeal. The backdated letter scandal that has rocked Ocwen Financial is about to become an even bigger headache for the mortgage servicing giant.

A hint of the magnitude of the potential damages caused by Ocwen's activities is the company's announcement that it has set aside a loss reserve of $100 million, and, according to its CEO, this is just an estimate; the company is not certain of the magnitude of its potential liability.

I include this article because Ocwen has become one of the largest non-bank players in the servicing field; it has a pending proposal to acquire enormous servicing rights from Wells Fargo, which is apparently one of the banks seeking to exit this line of business.

Ocwen's experience and the results of the CFPB report suggest that the challenges facing the servicing industry will not subside in the near future.

This concludes my report for the November meeting.

LIST OF EXHIBITS

EXHIBIT 1 – Current 'Official' text of UCC § 3-305

§ 3-305. DEFENSES AND CLAIMS IN RECOUPMENT.

(a) Except as otherwise provided in this section, the right to enforce the obligation of a party to pay an instrument is subject to the following:

(1) a defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity, or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(2) a defense of the obligor stated in another section of this Article or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(3) a claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(b) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (a)(1), but is not subject to defenses of the obligor stated in subsection (a)(2) or claims in recoupment stated in subsection (a)(3) against a person other than the holder.

(c) Except as stated in subsection (d), in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (Section 3-306) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(d) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (a) that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy, and lack of legal capacity.

(e) In a consumer transaction, if law other than this article requires that an instrument include a statement to the effect that the rights of a holder or transferee are subject to a claim or defense that the issuer could assert against the original payee, and the instrument does not include such a statement: (1) the instrument has the same effect as if the instrument included such a statement; (2) the issuer may assert against the holder or transferee all claims and defenses that would have been available if the instrument included such a statement; and (3) the extent to which claims may be asserted against the holder or transferee is determined as if the instrument included such a statement.

(f) This section is subject to law other than this article that establishes a different rule for consumer transactions.

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EXHIBIT 2 - UCC Definition of 'Consumer Transaction'

UCC §3-103 (Definitions)

(a) In this Article:

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(3) "**Consumer transaction**" means a transaction in which an individual incurs an obligation primarily for personal, family, or household purposes.

EXHIBIT 3 - Excerpts from:

FHFA CONCESSIONS SHOW MORTGAGE LENDERS HAVE REGAINED SWAY IN D.C.

By Kate Berry

Reprinted from National Mortgage News, Monday, November 3, 2014

In the last few months FHFA Director Mel Watt has struck a conciliatory tone with mortgage lenders, seeking input on housing policy and changing loan buy-back rules to be more favorable to the industry. Watt's actions stand is stark contrast to those of former acting FHFA director Ed Demarco….

Last week FHFA…proposed changes to the GSEs' so-called representation and warranty framework that were lobbied for heavily by mortgage lenders. The new guidelines require that any inaccuracy in a loan file would have to be 'significant' to trigger a repurchase.

The FHFA is also developing an independent dispute-resolution process to give mortgage lenders in conflicts with Fannie or Freddie a hearing from an independent third party. Lenders will also have the opportunity to cure minor loan defects.

And Fannie and Freddie will create programs allowing lower down payments of just 3% to 5% for some homebuyers. Those loans will require increased scrutiny, higher fees and a mortgage insurance premium to protect taxpayers from losses if the borrower defaults.

****

The proposed changes raise questions about whether the government has gone too far in weakening the legal protections that hold lenders accountable for home loans. Watt already gave lenders a three-year sunset period that relieved lenders of some repurchase risk on loans, even allowing borrowers up to two 30-day delinquencies in 36 months.

***

The proposed changes were designed to get banks and mortgage lenders to reduce credit score 'overlays', such as a minimum credit score of 680, which is far above GSE requirements. Yet not all consumer advocates are convinced the changes will make any difference.

"The banks are back in charge," said Bruce Marks, the CEO of Neighborhood Assistance Corp. of America, a nonprofit consumer advocate. "They're panicked at the White House because lenders aren't lending. But Fannie and Freddie are doing only high-end, perfect-credit score borrowers. You'll see no impact to low and moderate income, working people.

Lenders disagree. "The credit box has been shrunk due to the fact that there is a question with regard to whether that loan is going to come back to you in the future, and that's really the issue…. If the FICO score minimum is 720, let's make it 730. If maximum debt-to-income is 43%, let's make it 41%, just to be certain. If you have to have two years of employment in the same job, let's make it three years. I think the whole issue of reps and warrants has clearly skinnied down the credit box and has resulted in good loans not being made." (Quote from a bank President).

EXHIBIT 4

DON'T BUY A HOUSE YOU CAN'T AFFORD

THE HARTFORD COURANT, By: Megan McArdle, Tuesday, November 4, 2014, page A 13

America needs more low-down-payment loans.

That seems to be the opinion of our government, anyway. The government agencies that drive most of the housing market are pushing for lower down-payment standards on mortgages, easing the 20 percent requirement that has become standard for much of the market.

The Center for American Progress approves: "We shouldn't obsess about down payments," said Julia Gordon, director of housing policy. "Research confirms that low-down-payment loans to lower-wealth borrowers perform very well if the mortgages are well-underwritten, safe and sustainable."

This depends, of course, on what you think "perform very well" means. A low-down-payment loan made to someone with a good credit rating and a low debt-to-income ratio will perform better than a low-down-payment loan made to someone with terrible credit and a lot of debt. But it has a higher default risk than a mortgage made to a similar borrower with an adequate down payment, because when you start out with little equity, you're apt to find yourself in foreclosure if you get into financial trouble.

I'm with economics blogger Arnold Kling on this: "There is simply no way to make low down payment lending stable in any environment than in a rising house price environment," Kling writes. "(The Center for American Progress') study says it covers the last decade. If you made a low down payment loan in 2001, there was enough of a price increase after that you're probably fine. But it only works in that environment and it creates this cycle of a boom as house prices are rising, and then once they stop rising everybody crashes. You get this epidemic of foreclosures. It destabilizes the entire market."

Is there a good public-policy reason to encourage people to make a heavily leveraged bet on continued upward movement in home prices? Presumably, the argument is that many homeowners have done very well out of this over the past 50 years; rising home values sowed the seeds of many a college education and retirement fund.

But there are huge drawbacks to housing, too. Leveraged bets are great when they pay off; when they don't, they leave you dead broke. Especially a bet on a large, illiquid asset such as a house. Put a homeowner into one of these gambles at the age of 35, send the local housing and job markets south a few years later, and the end result is a broke middle-age person with trashed credit in desperate need of a good rental unit. Which legislators should know, because we seem to have a lot of them around right now.

You also end up with a much more unstable housing market. When a huge segment of the market

has negative equity or has equity too low to cover the substantial costs of a sale, then in any economic downturn, you are going to end up with a lot of foreclosures. Those foreclosures will, in turn, depress both the housing market and the broader local economy. Which again, we should all know, because we just went through this very process. So why are we so eager to return to this situation?

Because, I think, most of us still haven't managed to shed the idea that buying a house is a good way to get some unearned bonus wealth. Too many people managed to do just that for too many years. We think of 2008 as an aberration, rather than reversion to the mean. And that's a costly mental error.

The long, steep increase in American home prices from 1946 to 2008 was driven by a whole lot of trends that are hard to repeat: the invention of the 30-year, fixed-rate, self-amortizing mortgage, which allowed people to pay more for a house by lowering the monthly payments. The securitization revolution, which lowered mortgage risk by bundling the loans into large, diversified portfolios, thereby lowering rates. Rising inflation, which pushed up the price of houses. Falling inflation, which lowered interest rates and monthly payments still further and allowed people to pay even more for those houses. The credit-scoring revolution, which allowed banks to offer loans to more people, increasing demand for the existing housing stock. And in dense coastal areas, you also had the rise of NIMBY zoning laws, which made housing scarcer and therefore more expensive.

The problem is, these things have already happened. Most of them cannot happen again -- interest rates can't really go much lower. NIMBYism will go on, but the expectation of rising land values is already priced into the current value of the houses. If anything, it's overpriced; I have a lot of conversations with fellow Washingtonians who expect our housing market to follow a path like Brooklyn's did, despite the notable absence of hyper-wealthy financiers and international billionaires who want a pied-a-terre in our modest burg.

So I'm unimpressed by the argument that it's unfair to lock financially marginal buyers out of this wondrous investment product. It's unlikely that current homebuyers are going to experience the kind of windfall that their parents and grandparents did, if for no other reason than the fact that too many of them are still expecting that sort of windfall and factoring that expectation into what they're paying for a house.

Which is not to say I am against buying homes. I am very much for buying a home -- so much so that I went and bought one myself a few years ago. But buying a house is a good idea only if you meet the following conditions:

You can afford a sizable down payment to cushion you from the effects of local economic downturns or you have a super-stable job, such as working for the government or your father-in-law, that makes you unlikely to ever miss any payments.

You can afford the maintenance as well as the payments, insurance and property taxes.

You have good disability and/or mortgage insurance to make sure that you do not miss any payments even if you break your back and can't do your job anymore.

You are pretty sure you do not want to leave your area or move to a larger, more expensive home any time in the next five years.

Your payment is a reasonable percentage of your take-home pay (I shoot for under 25 percent; anything over 35 percent is far too risky).

You have a sizable emergency fund to deal with contingencies.

You can afford other forms of savings, rather than counting on your house as a piggy bank for future needs. In general, if declining home prices would send you into a hysterical panic about your financial situation, you are buying too much house.

If you do not meet these conditions, then buying a house is gambling -- not just on rising home prices, but also on the continued soundness of your roof, boiler and plumbing. If you wouldn't borrow the money to go to Vegas, then don't borrow it for a house, either.

When legislators and activists say that we need low-down-payment loans because most people couldn't possibly save up for a 20 percent down payment, what they're really saying is that people can't actually afford to buy a house. Helping them to go buy one anyway is not a great idea; it will work out well for some, to be sure, but it will have tragic consequences for others, and for the housing market as a whole if there's another downturn. We just spent six years learning, the very hard way, that you can't borrow yourself rich. That knowledge is too expensive to throw away so easily.

Bloomberg
Megan McArdle is a Bloomberg View columnist who writes on economics, business and public policy.

EXHIBIT 5

5 THINGS YOU NEED TO KNOW ABOUT RISK RETENTION

by Bonnie Sinnock, OCT 23, 2014

Reprinted From National Mortgage News

Many mortgage lenders and securitization sellers generally like the final risk-retention rule and think it will do them little harm in the short run. But others are concerned, especially about the long-term consequences.

Sellers — who preferred the final rule over previous, stricter drafts — still expect it to cut into their business over time. And investor-protection advocates wish it had been tougher.

The single-family market enjoys huge exemptions from risk-retention requirements because of its ties to the government-sponsored enterprises, but it eventually could suffer some ill effects — as, even sooner, could many commercial securitizations.

With those concerns in mind, here are five implications of risk retention that mortgage-market participants should prepare for in their business plans.

1. It Will Affect Most CMBS

The commercial and multifamily mortgage-backed securities market is not as big as the single-family one, but post-downturn CMBS that will be covered by the rule have been flourishing to a larger extent than private-label, single-family MBS that also must comply with it.

"If the risk-retention rule was applied retroactively, it would impact roughly about $600 billion of existing CMBS and about $100 billion current 2014, 2015 and 2016 issuance," said Martin Schuh, vice president of legislative and regulatory policy at the Commercial Real Estate Finance Council. "Luckily we have two years to ramp up and become fully compliant."

Up to two qualified b-piece investors will have to hold at least 5% of securitizations ineligible for the qualified-commercial-real-estate exemption for at least five years. Moreover, they must agree to sell them only to another qualified investor, Schuh said.

"The exemption was not entirely so generous for commercial," he said. "By no means were we meaning to exempt over 90% of the market as was the case for [residential]." The council estimates that less than 4% of loans issued since 1997 would qualify for qualified-commercial-real-estate treatment.

But the final rule is more viable for CMBS sellers than earlier versions, Schuh acknowledged.

"While we would have liked to have gotten more leeway from the regulators, we didn't get everything we asked for," he said. "The good news in the market will continue. The first iteration was looking dicey for CMBS, so we're pleased at the evolution that this rule went through."

2. It Will Add to CMBS Costs

Risk retention will likely increase the coupon on the CMBS loans by an estimated 30 to 40 basis points, according to Schuh.

3. Balance-Sheet Lending Could Grow

"Balance-sheet lenders weren't directly affected by the rule, although I would suspect they would probably have the benefit of an increased book of business because some of the hurdles in the rule drive businesses to a more inexpensive means of financing," Schuh said.

4. No-Equity, Single-Family Loans Could Be Exempt

Home price depreciation that demolished borrowers' equity stakes in homes was a big reason that private-label, single-family residential mortgage-backed securities drastically underperformed in the 2007-2008 downturn, and risk retention was designed to head off such concerns.

Originally the thought was that if regulators required issuers to have some stake in how the loan pool performed, they would be less likely to make bad loans. Restrictions on the loan-to-value ratios generally are the best protection against depreciation.

But the final risk-retention rule as currently written lacks such restrictions.

"There is no restriction on LTV. That is not a low-risk mortgage," said Mark Adelson, a veteran bond market executive and researcher known for his early

warnings about mortgage securitization risks. He is now chief strategy officer at BondFactor.

The Consumer Financial Protection Bureau's qualified-mortgage rule (QM) to protect borrowers, a conceptual cousin of the qualified-residential-mortgage exemption from risk retention (QRM), has no loan-to-value restrictions either. However, regulators have said they will periodically consider tighter rules in the future.

However, Adelson is concerned that historically regulators tend to be more reactive than proactive when it comes to credit concerns. So they may not tighten rules until something happens again to warrant it, and it is too late.

The down payment is a key borrower hurdle that government regulators would like to overcome to provide more affordable home loans to underserved borrowers. Adelson supports that aim, but he noted that the potential for high loan-to-value pools without risk retention is still a concern for investors.

Right now most of the securitized, single-family market does not have much to worry about immediately when it comes to risk retention because it is largely controlled by the Federal Housing Administration, Fannie Mae and Freddie Mac, which are exempt from both mortgage rules.

But credit-related exemption standards for single-family remain important because down the road that could change.

5. The Maximum Single-Family Exempt DTI is 43%

The qualified-mortgage rule's maximum 43% debt-to-income ratio for borrowers means an equivalent exemption from risk retention allows borrower leverage to get that high before any risk retention is required, and that limits protection for investors from this risk.

"The scope of the risk retention is going to be very narrow," said Adelson, who would favor a maximum DTI for exemption closer to 36%, more comparable to the conservative industry norms in the 1970s.

But he does not think this will lead immediately to any widespread credit concerns in the market.

"There will be other barriers to having subprime shops with no standards opening their stores on every street corner," he said.

Regulators have agreed only to make the QRM requirements no broader than QM for the time being, but could revisit and tighten them. Fannie and Freddie are slated to lose their QM exemption when they leave conservatorship or on Jan. 10, 2021, whichever comes first, according to a KBW report.

Even with a 43% DTI, KBW estimates that at least 15% of GSE production would not be QM/QRM eligible because of the restriction. And even most of the new single-family securitized market unprotected by government exemptions currently consists of exempt QM/QRM product, according to a KBW.

Jumbo interest-only loans are the exception, but banks are usually pretty eager to fund these so any restriction on securitization would shift more business to them, the report noted.

Credit concerns are being held at bay more by the skepticism of investors burned during the downturn than any regulatory restrictions, Adelson said. But investors will change their minds if other mortgage bonds become too scarce, he said.

When asked about this possibility, KBW researcher Bose George said it is hard to say whether a lack of investors or a lack of volume is the reason private-label, single-family securitization has failed to take off the way commercial securitization has.

"You need a very large investor base, and it isn't there," he said. "I feel like it's a 'chicken or the egg' issue because it's also about creating a large, liquid market where they start coming back."

Exhibit 6

Underwriting the Next Housing Crisis

NEW YORK TIMES OP ED PAGE, 10-31-2014

By PETER J. WALLISON OCT. 31, 2014

WASHINGTON — SEVEN years after the housing bubble burst, federal regulators backed away this month from the tougher mortgage-underwriting standards that the Dodd-Frank Act of 2010 had directed them to develop. New standards were supposed to raise the quality of the "prime" mortgages that get packaged and sold to investors; instead, they will have the opposite effect.

Responding to the law, federal regulators proposed tough new standards in 2011, but after bipartisan outcries from Congress and fierce lobbying by interested parties, including community activists, the Obama administration and the real estate and banking industries — all eager to increase home sales — the standards have been watered down. The regulators had wanted a down payment of 20 percent, a good credit record and a maximum debt-to-income ratio of 36 percent. But under pressure, they dropped the down payment and good-credit requirements and agreed to a debt-to-income limit as high as 43 percent.

The regulators believe that lower underwriting standards promote homeownership and make mortgages and homes more affordable. The facts, however, show that the opposite is true.

In the late '80s and early '90s, down payments were 10 to 20 percent. The homeownership rate was 64 percent — about where it is now — and nearly 90 percent of housing markets were considered affordable (that is, home prices were no more than three times family income). By 2011 only 50 percent were considered affordable, and by 2014, just 36 percent — even though down payments as low as 5 percent are now common.

How could this be? Consider this: If the required down payment for a mortgage is 10 percent, a potential home buyer with $10,000 can purchase a $100,000 home. But if the down payment is dropped to 5 percent, the same buyer can purchase a $200,000 home. The buyer is taking more risk by borrowing more, but can afford to bid more.

In other words, low underwriting standards — especially low down payments — drive housing prices up, making them less affordable for low- and moderate-income buyers, while also inducing would-be homeowners to take more risk.

That's why homes were more affordable before the 1990s than they are today. Back then, when traditional standards for "prime" mortgages prevailed, homes were smaller; they had fewer bathrooms, and the kitchens were not appointed by Martha Stewart. A family could buy and live in a "starter home" for several years before selling it and using the accumulated equity to buy a bigger or better appointed home.

In a competitive housing market not subsidized by lax standards, home builders would similarly adjust by reducing the size and amenities of new homes to meet the financial resources of home buyers entering the market. Home prices would stabilize and not rise faster than incomes. Low- and moderate-income families and millennials might have to wait to save for a first home, but they would be able to afford it.

(Higher down payments are not the only way to limit excessive borrowing. The "standard" 30-year mortgage is a subsidized, archaic result of our government's distorted housing policies; very few home buyers stay in a home for 30 years. A 15-year fixed-rate mortgage means higher monthly payments, but the homeowner starts to accumulate equity sooner, reducing the lender's risk.)

If the government got out of the way, would sound underwriting standards come back? History suggests yes. Although Fannie Mae and Freddie Mac were government-backed, they were shareholder-owned, profit-making firms. They adopted strong underwriting standards to avoid the credit risk of subprime and other high-risk mortgages. But after Congress enacted affordable-housing goals, administered by the Department of Housing and Urban Development, in 1992, underwriting standards declined.

Republicans generally favor eliminating the government's role in housing finance, while Democrats worry that without government support, mortgages would be too expensive for low- and moderate-income families. Although it runs counter to the current Washington view, good underwriting standards can satisfy the objectives of both parties.

It's clear that today's policies create winners and losers. The winners include real estate agents and home builders, who want to increase borrowing and sell ever-larger and more expensive homes. The losers, as we saw in the financial crisis, are

borrowers of modest means who are lured into financing arrangements they can't afford. When the result is foreclosure and eviction, one of the central goals of homeownership — building equity — is undone.

After the financial crisis, Representative Barney Frank — the Massachusetts Democrat who led the House Financial Services Committee during the crisis, and a champion of credit programs for low-income buyers — admitted, "It was a great mistake to push lower-income people into housing they couldn't afford and couldn't really handle once they had it." Policy makers who support homeownership would be wise to consider who is hurt and who is helped when we abandon traditional underwriting standards.

Peter J. Wallison, a senior fellow at the American Enterprise Institute, is the author of the forthcoming book "Hidden in Plain Sight: What Really Caused the World's Worst Financial Crisis and Why It Could Happen Again."

EXHIBIT 7

GSEs' Low-Down-Payment Loans Must Have Compensating Factors: Watt

by Brian Collins

National Mortgage News NOV 7, 2014

Fannie Mae and Freddie Mac are working on "sensible and responsible" guidelines to ensure borrowers who take out low-down-payment loans can afford to repay them, a top regulator said Friday.

Federal Housing Finance Agency Director Mel Watt said that the government-sponsored enterprises will soon be offering mortgages with loan-to-value ratios of 95% and 97%.

But he stressed that the new loan products will be "targeted in scope," and only available to creditworthy borrowers.

"As a result, the guidelines will require that borrowers have compensating factors — such as housing counseling, stronger credit histories, or lower debt-to-income ratios — in order to make the mortgage eligible for purchase by Fannie Mae or Freddie Mac," Watt said Friday in a speech to the National Association of Realtors annual convention in New Orleans.

Watt said that loans with low down payments are not inherently risky and that reforms put in place since the housing crisis will prevent abusive lending practices. However, tight credit conditions have locked many potential homebuyers out of the housing market and from benefiting from those mortgage reforms.

"There are creditworthy borrowers in today's market who have the income to afford monthly mortgage payments but do not have the money to make a large down payment and pay closing costs. Purchase guidelines that allow for 3% down payments will provide an opportunity for access to credit for some of these borrowers," Watt said.

Analysts said Watt's comments were an attempt to rebut criticism that lower down payments were a return to the lending practices that caused the housing collapse.

"It is clear that this speech was intended, at least in part, to blunt concerns in some corners that recent FHFA efforts to expand mortgage credit availability mark the

return of unsafe lending standards," said Isaac Boltansky, an analyst with Compass Point. "Our sense is that Director Watt is committed to expanding mortgage credit availability but he remains cognizant of the political dimensions of this issue and will therefore continue to move at a measured pace."

Housing industry representatives welcomed Watt's remarks.

"We were encouraged to hear Director Watt reiterate his position to make prudent, low-down-payment mortgage products available to consumers," said NAR President Steve Brown in a statement. NAR will continue to work with lenders to ensure these products are offered to qualified borrowers to demonstrate that well underwritten, low-down-payment loans can be made responsibly.

EXHIBIT 8

CONSUMER BUREAU FINDS HOMEOWNERS HARMED BY LOAN FIRMS

Reprinted from Mortgage Servicing News- 10/29/2014

Bloomberg News
OCT 29, 2014

The three-year-old U.S. consumer protection agency said it discovered that the largest mortgage servicers have been mishandling loan modifications and harming borrowers since new rules came into effect in January.

Consumer Financial Protection Bureau supervisors have made spot checks to examine the books and practices of bank and nonbank servicers, the agency said in a report yesterday, without naming the firms. Supervisors found "substantial delays" in modifying loans that resulted in "negative consequences," such as higher mortgage payments and unjustified blemishes on borrowers' credit reports, the report said.

"All borrowers should be treated fairly by loan servicers, and through our supervision program, we intend to hold them accountable," Richard Cordray, the CFPB director, said in a statement.

The consumer bureau, created by the Dodd-Frank law and empowered to rid the mortgage industry of abusive practices, rolled out regulations that took effect this year. The bureau is examining the compliance of the rapidly expanding servicing industry as a New York regulator bears down on its biggest nonbank participant, Ocwen Financial Corp., whose shares have plunged this year.

"The CFPB had tread lightly, relatively speaking, in mortgage servicing enforcement thus far as the rules went effective in January," Isaac Boltansky, an analyst with Compass Point LLC in Washington, said in an email. The report suggests that the agency is "re-emphasizing mortgage servicer compliance which means that the regulatory environment is unlikely to improve in the near-term."

Robert van Raaphorst, a spokesman for the Mortgage Bankers Association, declined to comment about the report.

The CFPB was created after Wall Street lobbied against it, warning that a new agency would impose regulations that would constrict the flow of credit to

consumers. Elizabeth Warren, now a Democratic senator from Massachusetts, helped set up the bureau, in part by arguing that the mortgage banking posed a threat to ordinary homeowners. During the housing boom between 2004 and 2007, lenders provided about $2 trillion in subprime loans, many to unqualified borrowers that later went bad.

Today, the business of collecting mortgage payments is undergoing a transformation as large banks retreat from the $9.4 trillion market, selling servicing rights to nonbanks such as Ocwen and Nationstar Mortgage Holdings Inc. Ocwen has more than tripled the number of loans it services in the last two years to $426 billion, or 4.3% of the market.

EXHIBIT 9

OCWEN MORTGAGE BACKDATING STARTED IN 2010

By Kevin Dugan, New York Post, October 25, 2014

Benjamin Lawsky's New York Department of Financial Services sent a letter to Ocwen on Tuesday accusing it of backdating thousands of loan modification denial notices starting in 2012, likely causing "significant harm" to borrowers by depriving them of enough time to appeal. The backdated letter scandal that has rocked Ocwen Financial is about to become an even bigger headache for the mortgage servicing giant.

Ocwen sent backdated letters denying homeowners a chance to rework their troubled loans as early as 2010 — two years before regulators said the problem started, The Post has learned.

The full extent of Ocwen's backdated letter problem is coming to light as Lawsky negotiates with the company to shake up its leadership and provide relief to consumers, a source close to the probe told The Post.

The DFS has evidence of backdated letters going back further that it hasn't made publicly available while the investigation is ongoing, the source said.

Eartha Smith, 75, a former fire department nurse who retired on disability, tried to get a modification on her $131,000 home loan in 2009, according to her lawyer, Peter Gleason. Gleason received a letter from Ocwen on either Jan. 18 or 19, 2010, demanding financial information, pay stubs, bank statements and tax forms in order to modify the terms of Smith's mortgage, he told The Post.

But the letter — which Ocwen said should be returned "as quickly as possible"— was dated Aug. 29, 2009, according to a copy of the letter provided to The Post. That's about five months before he received it, according to Gleason.

"They put us through hell," Eartha's daughter, Evette, told The Post. "She's a senior — she can't get a modification to own her own home."

Evette, who has power of attorney for her mother, took a leave of absence from school to help her mother fight Ocwen.

Ocwen sent thousands of letters to clients denying them a loan modification and giving them 30 days to appeal, Lawsky's office said. Those letters were backdated more than 30 days, making it impossible for homeowners to modify their mortgages and increasing the likelihood of default.

"Ocwen's indifference to such a serious matter demonstrates a troubling corporate culture that disregards the needs of struggling borrowers," Lawsky said.

EXHIBIT _

Investors Profit from Foreclosure Risk on Home Mortgages

By MATTHEW GOLDSTEIN
August 13, 2014

Rises in housing prices have been profitable to private equity firms and institutional investors that bought foreclosed homes to flip them or to rent them out. Now the recovery in housing is fueling a niche market for newly minted bonds that are backed by the most troubled mortgages of them all: those on homes on the verge of foreclosure.

And it is not just vulture hedge funds swooping in to try to profit from the last remnants of the housing crisis. The investors making money off these obscure bonds — none are rated by a major credit rating agency — include American mutual funds. And one of the biggest sellers of severely delinquent mortgages to investors is a United States government housing agency.

The demand for securitizations of nonperforming loans illustrates Wall Street's never-ending hunt for higher-yielding investment opportunities. The market also reflects in part an effort by regulators to close a chapter on the housing mess.

For mutual funds and other institutional investors, the appeal of these bonds is obvious. They have yields of about 4 percent and pay out quickly — often in just two years — if the foreclosure process on the loans in the portfolio goes smoothly. The yields look enticing compared with the current 2.42 percent yield on a 10-year Treasury note.

So far this year, there have been 28 deals backed by $7 billion worth of nonperforming loans sold to investors, according to Intex Solutions, a structured finance cash-flow modeling firm. Last year, Intex said, there were 72 deals backed by $11.6 billion worth of nonperforming loans.

Regulatory records show that over the last two years mutual funds either offered or advised by firms like JPMorgan Chase, SEI Investments, Weitz Investments and Edward Jones have been buying unrated bonds with names like Bayview Opportunity Master Fund IIa Trust NPL, Kondaur Mortgage Asset Trust and Stanwich Mortgage Loan Trust NPL.

The market for these bonds is still small when compared with the heyday of the mortgage-backed securities market before the financial crisis. But the demand is expected to grow as institutional investors search for yield, and analysts estimate that there are still some $660 billion worth of delinquent mortgages in the United States. The trade publication Asset Backed Alert recently said that bond deals worth $4 billion to $5 billion were in the works for the second-half of the year.

“These are very short-duration bonds, which really operate as liquidation trusts,” said Ken Shinoda, a mortgage backed securities portfolio manager with DoubleLine Capital, which has reviewed but not yet invested in unrated bonds of nonperforming loans.

Representatives for some of the mutual funds that have invested in these securities say so far these bonds have paid out as anticipated and the risk of loss is low because their funds’ relative exposures are small.

Carlene Benz, a JPMorgan spokeswoman, said in an emailed response that the bank’s portfolio managers were comfortable investing in these unrated bonds because they have a “short duration yet provide yields higher than many longer duration assets.”

John Boul, a spokesman for Edward Jones, said unrated investments accounted for a small percentage of the firm’s bond funds. He added that the firm’s bond fund was managed by outside advisers, including some at JPMorgan.

For the investment firms, hedge funds and private equity firms buying the distressed mortgages and packaging the bonds, securitization is way to finance their operations and cash in their investments.

The catalyst for the emergence of this unusual market was a decision by the Housing and Urban Development Department to begin selling some of the most severely delinquent mortgages guaranteed by the Federal Housing Administration to avoid losses to United States taxpayers. Since 2010, HUD has sold 101,290 soured home loans with a combined unpaid balance of $17.6 billion in more than a dozen auctions, and more distressed sales are planned.

Recently, Freddie Mac, the giant mortgage finance firm that operates under government control, also got into the act when it sold $659 million worth of troubled mortgages. Banks are also sellers of nonperforming mortgages.

Institutional investors are especially drawn to the Housing and Urban Development auctions because these nonperforming loans, which are spread across the United States, can be purchased for between 60 cents and 70 cents on the dollar of the unpaid principal. The list of investment firms buying HUD loans includes firms affiliated of the Blackstone Group, Oaktree Capital Management, Lone Star Funds, Angelo Gordon & Company, the Kondaur Capital Corporation and Pretium Partners.

The most recent auction in June attracted bids from 27 institutional investors, about double the number of bidders for a similar auction of soured mortgages a year ago. The HUD loan sales have gained favor with some institutional investors that were buying foreclosed homes because there are now fewer good-quality properties to be had after a rush of distressed home buying.

The government housing agency has set up its loan sale program to encourage the private buyers to rework the mortgages and make them more affordable so the borrowers can start making payments again. But given that most of the borrowers have not made a single mortgage payment in two years, the agency has assumed that most of the loans will end up in foreclosure. In many

cases, foreclosure proceedings were already well underway even before the mortgages were sold at auction.

The housing agency contends that even if a small percentage of the loans are reworked in a way that avoids a foreclosure or permits a borrower to gracefully exit a mortgage without being burdened with additional debt payments, it's a good outcome.

Biniam Gebre, a general deputy assistant secretary at HUD, said, "While the primary objective of the note sale program is to minimize losses to F.H.A.'s insurance fund, and ultimately to taxpayers," it was also providing "an opportunity for borrowers with no alternatives" to avoid foreclosure.

The agency, he added, has no problem with the private buyers finding ways "to securitize and bring private capital into the mortgage market" as long as it doesn't detract from the program's goals.

Before the end of the summer, the buyers of these HUD loans are supposed to file the first of several periodic reports outlining their ability to either rework the mortgages or foreclose on the properties. Representatives for several investment firms declined to discuss their performance figures before the reports are submitted to HUD.

Some firms that have sold bonds backed by nonperforming loans said they were also working on putting together securitizations of once-distressed loans that had been reworked or made to be "reperforming" in the parlance of Wall Street. Reperforming loans are ones in which the overall debt owed by the borrower has been reduced or the monthly payment cut to a level the homeowner can afford. Some of these reworked loans have been included in a number of the nonperforming loan deals as well.

But a review of some of the early pools of delinquent loans bought by the investment firms from HUD suggests that the percentage of reworked loans is likely to be small.

An analysis of 633 soured mortgages purchased by Kondaur Capital from HUD in June 2013 found that just over 20 percent were already in the foreclosure process at time of the sale. The analysis of local property records by RealtyTrac, a firm that monitors housing sales and foreclosures, also found that since the sale about 33 percent of the homes in that pool were subsequently sold, most likely either in a foreclosure, a short-sale or a deed in lieu of foreclosure — a transaction where a borrower essentially forfeits the rights to a property.

HUD's bidding rules bar buyers from bringing a foreclosure action for at least six months after the auction process is completed. An official with Kondaur Capital, a firm based in Orange, Calif., declined to comment.

Still, rating agencies, which are largely reluctant to get involved in reviewing nonperforming loan deals, are gearing up to review bonds that are backed by reperforming mortgages. The thinking is that as the economy and housing markets continue to improve, the ability of delinquent homeowners to start making payments on a more affordable mortgage will rise.

In anticipation of a new wave of securitizations, Fitch Ratings just this week published a proposal for its criteria for rating mortgage securities backed by reperforming loans. It has asked players in the market to provide feedback on its proposal by mid-September.

"The absence of a rating hasn't been an obstacle to these deals so far," said Michele Patterson, a senior director with Kroll Bond Rating Agency, which like Fitch has begun reviewing how it might rate reperforming mortgage deals. She said some "some issuers may be looking for a rating to diversify their investor base."

EXHIBIT _

With Some Lenders Hurting, Could Double-Pledging Fraud Resurface?

by Bonnie Sinnock [MORTGAGE TECHNOLOGY NEWS]
JUL 24, 2014 3:57pm ET

A lot of home lenders' bottom lines have been under pressure recently, and that makes it more tempting for mortgage companies to fraudulently double-pledge loans, potentially increasing warehouse lending risk.

There should be broader awareness today than there was during the last decade of this risk of a lender fraudulently pledging the same loans to different warehouse lenders multiple times. Double-pledging played a notorious role in the collapses of nonbank lender Taylor, Bean & Whitaker, and Colonial Bank, a financial institution that served as TBW's lead warehouse lender and that TBW later attempted to acquire. And even if industry participants have short memories, there's generally more scrutiny and regulation in today's market than during the go-go years.

The risk has certainly dropped compared to 2009, but it looks likely to have increased compared to about a year or so ago. Since then, profit from loan volume has become harder to come by due to a jump in rates from historic lows, and lender expenses have gone up due to major regulations that took effect early this year. Lenders have shown some signs of desperation for cash in the wake of these developments. Loan volumes have picked up a bit from earlier this year, but they are still below some estimates. And there is yet another sweeping and potentially costly regulatory change on the horizon requiring lenders to provide new disclosures to provide to borrowers in originations.

Instances of the same property being banked at multiple warehouse lenders have decreased compared to the TBW days, but are still

commonly detected, said Brian Fitzpatrick, president and chief executive of LoanLogics.

"What I've heard is that the warehouse lenders are probably seeing maybe one [instance of double-pledging] a quarter as of late. So it has significantly dropped off from what we've seen in the past," said Fitzpatrick, whose Trevose, Pa., company helps market participants mitigate risks. "However, we have reached a new low if you will in the industry relative to profits at mortgage lenders."

Mortgage Bankers Association statistics show only 54% of mortgage lenders made a profit in the six months between the fourth quarter of last year and the first quarter of this year.

"We're talking 46% of lenders are just not making money right now and that's the first time we've seen that in a very, very long time," Fitzpatrick said. "Now, when those types of things happen, obviously, you need to be more guarded against desperation or desperate acts."

At the same time, home lenders and the warehouse lenders that provide them interim financing are starting to show a willingness to originate and fund riskier loan products. And some smaller warehouse lenders that have only four to six lines are in the market.

The main protection against double-pledging today is warehouse lenders' use of the MERS System. But these smaller warehouse lenders are probably the only players that might not be using it, said Michele Perrin, an industry consultant who has served as an expert witness in double-pledging cases. She previously worked for a bank warehouse lending unit.

"The warehouse lender can name themselves in MERS, in the MERS chain of title, as interim funder, so once anyone has named themselves as interim funder, that's in MERS. If somebody else tries five minutes later or five days later to name themselves as interim funder on that

same loan, it's going to pop up as a duplicate right away to get notified that there's already a party in that position," she said.

When asked if all warehouse lenders are registering as interim funders, Perrin said the mainstream lenders are but she occasionally has to advise smaller ones to use the registration system. The technology is accessible to smaller players so long as they know to use it, she said.

Some warehouse lenders used MERS when double-pledging abuses were rampant. The problem was the use wasn't widespread or frequent enough, said Perrin.

"You need to know where your money is moment by moment. So hopefully people are using it all throughout the day as they're funding loans," she said.

MERS might not provide complete protection against double-pledging if there is a gap between when warehouse lenders fund loans and when they register them on the system, Fitzpatrick said.

"MERS has had its challenges relative to accurately recording information," he said. "It will eventually be accurate and eventually work out, but these particular cases of fraud are perpetrated so quickly." He advises warehouse lenders to be wary of the risk even if they use the system.

Past challenges at MERS related to user delays in registering loans are addressed by tighter MERS policies regarding those members, said Janis Smith, a spokeswoman for MERSCorp Holdings in Reston, Va., which owns and runs the system.

"There are really tighter compliance protocols and reconciliation requirements," she said. "MERS members really are required to adhere to our quality assurance protocols and if they don't they are in violation of MERS rules and could be subject to penalties or even termination" of their participation in the system.

It is unclear how many warehouse lenders might be operating outside of the system, Smith said. "I know that within the system it is a deterrent to double-pledging fraud," she said.

Such fraud may be severely reduced today compared to the TBW era, but without assurance that every property securing a loan is accounted for and can be referenced, it will remain a risk, said Cy Brinn, chief operating officer of VirPack. Wholesale and correspondent lender customers of his McLean, Va., technology vendor potentially face a similar concern.

"I think that until there is a universal system that is used to track all real estate loan collateral there is a risk of double-pledging," he said.

EXHIBIT _

FHFA EASES RULES FOR BANKS

FHFA to Change Buyback Rules for Fannie, Freddie

by Brian Collins
OCT 20, 2014 3:13pm ET

The Federal Housing Finance Agency is close to issuing refinements to the government-sponsored enterprises' representation and warranty framework that will limit lender liability on buybacks of legacy loans.

"We have reached an agreement in principal on how to clarify and define the life-of-loan exclusions," Federal Housing Finance Agency Director Mel Watt said in a speech to the Mortgage Bankers Association's annual conference in Las Vegas on Monday.

Life-of-loan exclusions essentially allow Fannie Mae and Freddie Mac to require lenders to repurchase loans at any point during the term of the loan, increasing liability for banks and mortgage lenders. But the FHFA wants to change that in an effort to boost credit availability.

"The current life-of-loan exclusions are open-ended and make it difficult for a lender to predict when, or if, Fannie Mae or Freddie Mac will apply one of them," Watt said. "The new life of loan exclusions will result in better representation and warranty framework and facilitate market liquidity."

Buybacks by the GSEs have been blamed in part for the continuing credit crunch, a problem Watt acknowledged in his speech. Worried about a potential putback, lenders have raised prices on loans by purchasing credit overlays and limited lending to borrowers with lower credit scores.

Watt pledged to "more clearly" define life-of-loan exclusions so that lenders will know "what they are and when they apply to loans that have otherwise obtained repurchase relief."

The exclusions fall into six categories: misrepresentations, data inaccuracies, charter compliance issues, first-lien priority, legal compliance violations and unacceptable mortgage products.

The GSEs are in the process of updating the definitions for each of those categories, which will be unveiled in the next few weeks, Watt said.

But he previewed a few changes, saying Fannie and Freddie will set a "minimum number of loans that must be identified with misrepresentations or data inaccuracies to trigger the life-of-loan exclusion."

"This approach allows the enterprises to act when there is a pattern of misrepresentations or data inaccuracies that warrant an exclusion, but not to revoke repurchase relief they have already granted if they subsequently discover that a lender incorrectly calculated the debt-to-income ratio or loan-to-value ratio on a single loan," Watt said.

The GSEs are also planning to add a "significance" requirement to the misrepresentation and data inaccuracy definitions. That test will require Fannie and Freddie, using their automated underwriting loans, to test whether the loan would have been ineligible for purchase if the loan data had been accurately reported.

Watt said that the GSEs remain focused on developing an independent dispute resolution process and identifying "cure mechanisms" for loan defects that are not considered severe.

Additionally, Watt pledged to increase access for less affluent borrowers, saying the FHFA is working with the GSEs to develop guidelines for mortgages with loan-to-value ratios between 95% to 97%.

"Through these revised guidelines, we believe that the Enterprises will be able to responsibly serve a targeted segment of creditworthy borrowers with lower-down payment mortgages by taking into account 'compensating factors,'" said Watt.

He also discussed the progress the GSEs are making in designing and building the Common Securities Platform that Fannie and Freddie will jointly own and use to issue mortgage backed securities.

The FHFA director noted it will be multiyear project and each enterprise has designated staff to work in the CSP project.

"During 2014, this team has been developing the technology and infrastructure of the common securitization platform," Watt said.

He expects to announce new management structure for the common platform and a chief executive before the end of the year.