

Subprime Mortgage Crisis: Congressional Developments

SUBPRIME MORTGAGE
PRACTICE GROUP

October 2007

By David W. Dykhouse

Client Alert

As surely as shorter days and cooler nights color the leaves, so the subprime mortgage crisis has brought interesting stirrings in Congress, both legislative and investigative. Here are two of the developments we are following:

Mortgage Originator and Securitizer Liability

On October 22, the chair of the Committee on Financial Services of the House of Representatives and co-sponsors introduced the Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915. The bill would reform the residential mortgage origination process in a number of ways, including by requiring all originators to be licensed or registered under state or federal law (§ 104). Among other things, it would amend the Truth in Lending Act ("TILA") to provide that —

no creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance, and assessments. (§ 201)

It would also amend TILA to forbid a refinancing of a residential mortgage —

unless the creditor reasonably and in good faith determines, at the time the loan is consummated and on the basis of information known by or provided in good faith to the creditor, that the refinanced loan will provide a net tangible benefit to the consumer. (§ 202)

The bill creates a cause of action in favor of consumers against originators violating the new requirements, with damages capped at treble the originator's fees and the consumer's costs including attorney's fees. (§ 105)

Perhaps the most innovative provision of the bill is Section 204, entitled "Securitizer Liability," which would amend TILA to provide that any civil action that may be brought against an originator for violation of the "reasonable ability to repay" and "net tangible benefit" provisions "may be maintained against an assignee, including a securitizer." The remedies against an assignee would be limited to rescission of the mortgage loan and recovery of the consumer's costs including attorney's fees, and class actions are forbidden. An assignee/secritizer would be exempt from liability to the consumer if either (A) the mortgage terms are promptly reformed to comply with the TILA requirements or (B) the assignee/secritizer (1)(a) has a policy against buying non-complying mortgages and (b) "exercises reasonable due diligence to adhere to such policy ... through a adequate, thorough, and consistently applied sampling

procedure in accordance with [applicable] regulations" and (2)(a) has obtained representations and warranties from the seller or assignor of the mortgage regarding not selling or assigning mortgages violating TILA and regulations thereunder and (b) "in good faith takes reasonable steps to obtain the benefit of such representation or warranty." Liability will in any event not be imposed on pools of mortgages created "for the purpose of issuing or selling instruments representing interests in such pools" "or any original or subsequent purchaser of any instrument representing an interest in such pool."

Mortgage Restructuring in Chapter 13 Bankruptcy

On October 4, a subcommittee of the House Judiciary Committee reported out the Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609. Present law allows Chapter 13 debt adjustment plans to "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence,"¹ an exception that has been in Chapter 13 since the Bankruptcy Code's enactment in 1978. This bill would eliminate the exception, thus authorizing Chapter 13 plans to modify residential mortgage debt for the first time (§ 3). This change would have the effect of allowing most individual debtors to restructure their principal-residence mortgage debt in bankruptcy, and all the more so because the several arduous hurdles to personal bankruptcy erected by Congress in 2005² have diverted many more individual debtors into Chapter 13 from Chapter 7 liquidation. In addition, the bill would eliminate the credit-counseling requirement, one of more onerous 2005 hurdles, if the debtor certifies that a mortgagee has commenced a foreclosure proceeding against the debtor's principal residence (§ 5).

Endnotes

¹ 11 U.S.C. § 1322(b)(2) (emphasis added).

² See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8.

If you would like more information, please contact a member of Patterson Belknap Webb & Tyler LLP's Subprime Mortgage Practice Group.

David W. Dykhouse	212.336.2850
Philip R. Forlenza	212.336.2140
Paul G. Gardephe	212.336.2310
Eric Haas	212.336.2117
Alexander Shapiro	212.336.2935
William W. Weisner	212.336.2085

This client alert is provided for general informational purposes only and should not be construed as specific legal advice. Please contact any of the attorneys listed above if we can provide assistance regarding the matters discussed herein.

To subscribe to any of our publications, call us at 212.336.2329, email: mktg@pbwt.com, or sign up on our website, www.pbwt.com/resources.