

# Regulatory Compliance Conference

Secondary Market Developments

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# Heightened Fannie Mae / Freddie Mac Scrutiny of Seller-Servicers and Loans



- a) Conservatorship highly unlikely to affect Fannie Mae's and Freddie Mac's existing contracts with counterparties.
- b) Under applicable law, the conservator may cancel all or none of the Qualified Financial Contracts – which include residential MBS, residential repurchase agreements and residential swap agreements – of a contracting party.
- c) Counterparties should expect Fannie Mae and Freddie Mac to demand strict adherence to their respective underwriting guidelines and sellers-servicer eligibility requirements.
- d) The GSEs carefully scrutinize all indicia of misrepresentation and fraud; insist on repurchase of loans that do not meet eligibility criteria and are terminating seller-servicers for breaches of material obligations.

# Current Environment for Non-Agency Whole Loan Trades



- a) Continued anemic market for new residential originations, but investment banks are trying to sell their inventories of seasoned loans.
- b) Very limited representations and warranties made by sellers of performing residential mortgages.
  - note status
  - compliance with applicable law
  - title insurance
  - no high cost
  - validity of lien
  - but sellers typically no longer give “no fraud rep.”
- c) The extent of the representations and warranties given depends upon the price the seller is willing to pay and whether the loan is performing
- d) Remedies for “breaches” also very limited
  - materiality of breach
  - seller’s obligation to cure and repurchase (60 to 90 day cure periods)
  - indemnities rarely given.

# Typical Servicer Loss Mitigation Authority



- a) Requirement to service in accordance with customary standards.
- b) Requirement to act in the best interests of investors;
  - ASF interpretation – best interests of investors in the aggregate.
- c) REMIC limitation on loan mods
  - Loan must be in default or default must be reasonably foreseeable
  - Implicit and explicit authority for loan mods such as partial forgiveness, rate reduction, if in default or default reasonably foreseeable.
- d) Implicit or explicit authority for loss mitigation such as forbearance, capitalizing arrearages, short sales.
- e) No clear authority to sell as distressed asset out of trust at discount.
- f) Some deals have 5% of pool limit on mods.

## Qualified Safe Harbor for Mortgage Servicers

The Housing and Economic Recovery Act of 2008 aims to provide legal continuity for mortgage loan servicers by amending TILA.

- a) Creates a fiduciary duty of mortgage servicers when making loan modifications – absent contractual provisions to the contrary – to act in the best interests of all of the investors in the aggregate – as long as the modification meets the following criteria:
  - default has occurred or is reasonably foreseeable
  - the property is occupied by the mortgagor
  - the anticipated recovery on the outstanding principal obligation exceeds on a net present value basis, the anticipated recovery on the obligation through foreclosure.
- b) Federal Reserve Board to implement regulation.
- c) Servicers will still be reluctant to antagonize certain classes of investors.

## The “Hope for Homeowners” Program

- a) The principal amount of the refinanced loan is to be determined by the reasonable ability of the mortgagor to make his or her payments, but the amount of the refinanced loan may not exceed 90% of the appraisal value of the mortgaged property.
- b) All holders of current liens must agree to accept the proceeds of the new insured loan as payment in full of all indebtedness under the current mortgage. All subordinate liens must be extinguished through negotiation with the first lien holder.
- c) Upon the sale or disposition of any new refinanced mortgage, HUD – not the previous mortgage holder – will retain a share of the borrower’s future profits:
  - from 100% in year one to 50% after year five.

## States Impeding the Foreclosure Process

- a) New Jersey Assembly Bill 2780 “Save New Jersey Homes Act of 2008” (awaiting Governor Corzine’s signature), provides that notwithstanding any law or contract right to the contrary, prior to the initial interest rate reset of an introductory rate mortgage, a creditor must provide an eligible borrower with a three year extension, during which the interest rate on the introductory rate mortgage will not increase above the original introductory rate.
  
- b) “Waiting periods,” foreclosure delays and extended “rights to cure” recently enacted in California, Colorado, Connecticut, Georgia, Indiana, Massachusetts, New York, Pennsylvania, Rhode Island and Virginia.

## Other Salient Developments

- a) Fannie Mae and Freddie Mac have announced that they will not purchase New York State “Subprime Home Loans,” which are loans in which the fully indexed APR exceeds by more than 1.75% for a first lien loan or by more than 3.75% for a subordinate lien loan, the average commitment rate for loans in the Northeast Region with a comparable duration to the duration of the home loan as published by Freddie Mac in its weekly primary mortgage market survey.
- b) Will investors purchase “higher-priced mortgage loans” as they are defined by the Federal Reserve Board in the Final Rule Amending the Home Mortgage Provisions of Regulation Z?
  - for first-lien loans, 1.5% above the average prime offer rate
  - for subordinate-lien loans, 3.5% above the average prime offer rate
- c) If Sen. Obama is elected and a similar version of the Mortgage Reform and Anti-Predatory Lending Act of 2007 is enacted, will investors purchase non-“qualified mortgages” and non- “qualified safe harbor” mortgages?