

**Authors:****Laurence E. Platt**

+1.202.778.9034  
larry.platt@klgates.com

**Kris D. Kully**

+1.202.778.9301  
kris.kully@klgates.com

**Kerri M. Smith**

+1.202.778.9445  
kerri.smith@klgates.com

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## Was Chicken Little Right?

So what is the proper remedy for a violation of the new mortgage reform laws, and to what extent, if at all, should parties other than the wrongdoer be legally responsible for such violations?

The U.S. House of Representatives and the U.S. Senate have taken extraordinarily different approaches to these fundamental policy questions in their respective mortgage reform bills. While the mortgage industry generally believes that the more tempered approach taken by the House still goes too far, they fear even more the Senate's proposed approach. Either way, the Bills raise serious questions. How much money should an aggrieved borrower receive for a violation? What relationship should the amount of money damages bear to actual harm? Under what circumstance should an aggrieved borrower be able to extinguish his or her liability under the loan and receive a refund of all amounts paid to date? Should holders of mortgage-backed securities be held financially responsible for the acts, errors, and omissions of mortgage brokers, mortgage lenders, mortgage servicers, or appraisers? As we describe below, the Senate Bill answers the questions as follows, at least with respect to subprime loans: a lot of money; not much of a relationship; virtually any circumstance without regard to the materiality of the violation; and, yes, the certificate holders bear the ultimate risk of economic loss for the violations of others, without regard to their knowledge of or participation in the wrongdoing. We know of no one who would buy a mortgage-backed security under such a regulatory regime. Indeed, it would be hard to convince them that the sky is not falling if assignee liability of this magnitude were enacted into law – Chicken Little may be right!

We have written two recent alerts regarding other aspects of these mortgage reform proposals. The first alert dealt with the ability to repay and net tangible benefit requirements contained in the bills.<sup>1</sup> The second alert dealt with the imposition of duty of care requirements and anti-steering prohibitions upon mortgage originators.<sup>2</sup> This alert compares the proposed remedies for violations of the substantive provisions in the House Bill and the Senate Bill, and also looks at the remedies in the Federal Reserve Board's (the "Board") recent proposed rules on predatory lending.

### Background

In response to the current mortgage lending dilemma, Congress has dueling predatory lending Bills currently in the spotlight, each of which would amend the existing Truth in Lending Act ("TILA"). On December 12, 2007, Senator Christopher Dodd (D-Conn.) introduced the Home Ownership Preservation and Protection Act of 2007 (the "Senate Bill"). It generally is similar in structure and content to the Mortgage Reform and Anti-Predatory Lending Act of 2007 (the "House Bill"), sponsored by Representative Barney Frank (D-Mass.) (along with several of his colleagues), which the House of Representatives passed on November 15, 2007. Each of the Bills sets new standards for the brokering, making, servicing, and purchase and sale of residential mortgage loans, particularly with respect to subprime loans. Although the structure and content of these Bills are similar, the Bills are distinct in their presumptions of either compliance or violation, and their remedies, particularly assignee liability.

The Senate Bill, in its espousal of more strident assignee liability provisions, attributes liability to the holders of mortgage loans (which would include trusts that issue mortgage-backed securities) for the acts, errors and omissions of mortgage brokers, appraisers, lenders, and servicers, and in some cases for violations of inherently subjective requirements. This may take the form of both extensive monetary liability and rescission of the underlying mortgage loans. The House Bill, on the other hand, limits the circumstances in which assignees would be liable for the acts of lenders (but not other actors, such as brokers and servicers), the type of remedies that may be asserted against assignees, and the definition of assignees. Even this more limited liability greatly concerns the mortgage industry, but at least it is less onerous than that provided in the Senate Bill.

As this alert focuses on the remedy provisions for violations of the proposed mortgage lending regimes, rather than the substantive requirements themselves, certain terms such as “subprime,” and “duty of care,” are used rather loosely and do not reflect the intricacies of the substantively complex federal Bills. In addition, we refer rather generally to “underwriting requirements” to reflect the obligation to determine the borrower’s ability to repay a loan and a loan’s provisions of a net tangle benefit to the borrower. Ultimately the purpose of this alert is to ask, given the expansive subprime meltdown, who should be held accountable, for how long, and for how much?

The backdrop for any review of the proposed remedies in the two bills is the Homeownership Equity Protection Act (“HOEPA”).<sup>3</sup> Presently, virtually no one will make, purchase, finance, or securitize “high cost” loans under HOEPA because of the severe remedies that may be asserted against assignees. Both Bills propose to increase the number of residential mortgage loans that will be subject to HOEPA by, among other provisions, reducing and redefining the financial triggers that cause a loan to be subject to HOEPA. Presumably, Congress is making a legislative judgment that an expanded class of “high cost” loans should not be made at all, but the remaining residential mortgage loans should remain available in the marketplace. As you will see, however, the remedies under the Bills for non-high cost loans may be perceived to be so unreasonable as to cause the market to treat the remaining loans as if they were high cost loans.

## Money Damages

The standard civil liability provisions of TILA would apply to violations of both the Bills’ provisions. TILA provides for actual damages, statutory damages and, in the case of HOEPA violations, enhanced damages.<sup>4</sup> Statutory and enhanced damages bear no relationship to actual harm. They are designed to provide a powerful disincentive to violating a law. Both the House and Senate Bills would double the amounts of **statutory damages** available for a TILA violation (including a violation of existing and newly proposed requirements). The House Bill would increase the maximum statutory damages available in an individual action for a TILA violation from \$2,000 to \$4,000, and the maximum statutory damages available in a class action from \$500,000 to \$1,000,000 (or 1% of a creditor’s net worth, whichever is less). The Senate Bill would increase the maximum statutory damages in an individual action even higher to \$5,000, and, unlike the House Bill, allow for annual adjustments to that amount. The maximum statutory damages available in a class action under the Senate Bill would rise exponentially to \$5,000,000 (or 1% of a creditor’s net worth, whichever is less). In addition, the Senate Bill would appear to extend the availability of **enhanced damages**, currently available only for violations of HOEPA, to cover violations of the new underwriting standards, duty of care and other loan origination requirements applicable to subprime loans. Under TILA, enhanced damages equal the sum of all finance charges and fees paid by the consumer, unless the consumer demonstrates that the failure to comply is not material.<sup>5</sup>

TILA currently imposes liability primarily on lenders who fund loans in their name; it applies to “creditors,” but not mortgage brokers. Both Bills would extend TILA civil liability to include mortgage brokers. The House Bill effectively defines the term “mortgage originator” to include mortgage brokers, but not creditors; the Senate Bill uses the same term to include both mortgage brokers and creditors. Under the House Bill a mortgage originator that violates the new duty of care and anti-steering provisions is liable for actual and statutory damages but not enhanced damages. However, those monetary damages are capped at three times the total amount of direct and indirect compensation or gain accruing to the mortgage originator in connection with the mortgage loan, plus

costs and attorney's fees. A violation of the proposed underwriting requirements in the House Bill would also result in liability to a creditor for actual damages and statutory damages, but not enhanced damages, without that additional cap on the money damages. The Senate Bill does not distinguish the duty of care/anti-steering provisions from the underwriting provisions in determining the availability or amount of the various types of money damages.

### Rescission

Both the Senate and the House Bills materially expand rescission as an available remedy. Rescission, which extinguishes the loan and requires the creditor or assignee to return to the borrower all amounts he or she previously paid, is an extraordinary remedy. Under TILA currently, a borrower has a right to rescind a refinancing mortgage loan transaction for three days after closing or until the delivery of certain material disclosures, whichever is later.<sup>6</sup> If the creditor fails to provide those disclosures altogether, or fails to provide accurate material disclosures, the right to rescind extends to three years.<sup>7</sup> This three-year term is considered the "extended" right to rescind, compared to the "general" rescission right that is limited to three days following closing.

The House Bill provides an extended right to rescind for certain of its new loan origination provisions. Rescission is available to consumers under the House Bill as a remedy for violations of the proposed underwriting requirements. However, mortgage originators that violate the duty of care and anti-steering requirements are not expressly subject to rescission claims. If the creditor cannot provide, or a consumer cannot obtain, rescission, the liability must be satisfied by providing the financial equivalent of a rescission, plus costs and reasonable attorney's fees.

Further, under the House Bill, a creditor would not be liable for this new rescission remedy if the creditor cures the violation within 90 days after the consumer notifies the creditor of the violation, as detailed below in the section on assignee liability. The House Bill also creates an exemption from liability and rescission in the context of borrower fraud or deception.

The Senate Bill's proposed rescission remedy is even broader than the House Bill's. First, it applies to any violation of the Bill's loan origination requirements, including those relating to underwriting, duty of

care, and anti-steering. For example, if a mortgage originator were found not to have used a sufficient amount of "reasonable skill" in a particular situation, the borrower would have the right to rescind the entire loan, without regard to materiality. Second, the Senate Bill does not offer creditors or others expanded cure rights that the House Bill offers, leaving a creditor with the much more limited existing TILA cure provision, as discussed below. Third, the Senate Bill provides no parallel exemption from liability in the event of borrower fraud.

The rescission remedy under TILA excludes home purchase loans, construction loans, and certain refinancings with the same creditor under Section 125(e), but the House Bill expressly states that this exclusion would not apply to a violation of the Bill's underwriting requirements. This means that the right to rescind based on a violation of the House Bill's underwriting provisions would be applicable to both purchase money loans and refinancings, including refinancings with the same creditor. In practice, however, this right to rescind would be limited under the House Bill to residential mortgage loans that do not fall within the safe harbor for "qualified mortgages" and "qualified safe harbor mortgages," which are presumed to satisfy the Bill's underwriting requirements.<sup>8</sup> Unlike the House Bill, the Senate Bill does not expressly indicate that Section 125(e) is inapplicable. In one of the only ways in which the Senate Bill is less restrictive than the House Bill, it appears that under the Senate Bill a borrower would not have a right to rescind a home purchase loan, construction loan, or certain refinancing loans with the same creditor based on a violation of the Senate Bill, even though these loans could be subject to the Bill's substantive requirements.

### Assignee Liability

What distinguishes the two federal Bills most clearly is their treatment of assignee liability. The House Bill more narrowly defines "assignees," precludes the assertion of money damages or the use of class actions against assignees, provides expanded cure rights in lieu of rescission, and offers a "safe harbor" from assignee liability. The House Bill is premised on the theory that a borrower should be able to get out of a loan that arguably never should have been made. Based on this premise, the Bill focuses on rescission rather than money damages against an assignee. The Senate Bill, on the other hand, reflects the sponsors' beliefs that the

capital markets should have joint and several liability with mortgage brokers and creditors (and even perhaps servicers and appraisers), with very few exceptions.

### Scope of Assignee Liability

A fatal flaw in each Bill is its failure to define “assignee.” As a result, it is not clear what level of ownership interest in a mortgage loan is sufficient to invoke potential liability. HOEPA suffers from the same problem, but the industry has not had to confront the issue since it generally refuses to participate in the HOEPA loan market. This ambiguity as to who is an “assignee” could cause the same result if these Bills are enacted in their current forms. While neither of the Bills defines “assignee,” the House Bill at least attempts to cut off liability at a certain level. In contrast, the Senate Bill applies broadly to all “assignees, holders and purchasers.”

Assignee liability under the House Bill would extend to assignees and “securitizers,” but would exclude “securitization vehicles.” A “securitizer” would be any person that assigns residential mortgage loans, to any securitization vehicle, but would exclude any trustee that holds those loans solely for the benefit of the securitization vehicle. The House Bill exempts “securitization vehicles” from assignee liability, which means that trusts or other entities that issue securities backed by the loans and that also hold those loans, as well as the purchasers or repackagers of the securities, are not liable for violations. In other words, assignees up to but excluding the trusts that issue mortgage-backed securities would be subject to liability under the House Bill, while the Senate Bill would extend liability all the way up to the trusts.

The consequence of this distinction is significant. Under the House Bill, a holder of an interest in a mortgage-backed security or collateralized debt obligation would NOT bear the economic risk of loss for a violation of the loan origination requirements. Indeed, the holder may be better off, because the assignee or securitizer would have to buy the loan out of the pool, presumably at par, in order to effect a rescission. **Under the Senate Bill, however, the economic cost of money damages and rescission in respect of mortgage originator violations would be borne by the securities holders.**

Additionally, under the House Bill, a creditor, and any assignee or securitizer of a loan, may presume that the loan is not in violation of the underwriting requirements if the loan is a “qualified mortgage” or a “qualified safe harbor mortgage.” Thus, traditional prime mortgage loans, while technically subject to the underwriting requirements, will benefit from a presumption of compliance. Because the presumption is deemed irrebuttable against everyone, (including assignees) other than the creditor, the House Bill’s scope is fairly limited to only a certain subset of subprime loans that policymakers apparently believe need heightened scrutiny. This differs widely from the Senate Bill, which provides no presumption of compliance for any loans, but rather imposes assignee liability in connection with all home loans for violations of certain requirements. Further, unlike the House Bill, which has assignee liability provisions that apply only to the Bill’s new underwriting requirements, the Senate Bill holds assignees liable for all the proposed requirements under the Bill, including those related to broker duties, anti-steering, required documentation, lease recognition, and other requirements, thus making the Senate Bill’s assignee liability provisions much broader in scope and applicability.

In addition, under the House Bill, a securitizer must have the ability to identify and access every residential mortgage loan in a pool of assets and must be able to provide for and obtain a remedy under the Bill, such as rescission. By mandating that a loan must always be able to be taken out of a pool, the Bill would minimize certain obstacles, ensuring that the borrower is able to obtain relief for a violation.

### Types of Actions

Under the House Bill, if there is a violation of the underwriting requirements, an assignee or securitizer that acts in good faith would be liable in an individual action (but not a class action) for rescission, costs and attorney’s fees, but not for money damages. The assignee could avoid even those remedies if the assignee is subject to safe harbor detailed below and cures the violation. The House Bill expressly states that these are the exclusive liabilities that may be imposed on an assignee for violation of the proposed underwriting requirements. As previously stated, an assignee is not liable for violations of the duty of care and anti-steering requirements under the House Bill.

Under the Senate Bill, if there are violations of the underwriting and duty of care provisions with respect to subprime and nontraditional loans, an assignee would be liable in an individual or class action for rescission, monetary damages, and enhanced damages. Further, assignees would be liable in an individual action for violations of the duty of care provisions for prime loans, but only for monetary damages capped at the amount of the remaining indebtedness, and not for rescission. However, under the Senate Bill, no assignee liability would be available for a violation of the underwriting requirements for prime loans.

### Cure and Safe Harbor

TILA currently provides that a creditor or assignee will avoid liability if it “cures” an error. Specifically, within 60 days after discovering an error, and prior to the institution of a civil action or the receipt of written notice from the borrower, the creditor or assignee can cure a violation by making adjustments in the account to assure that the person will not be required to pay more than the amount of the charge actually disclosed.<sup>9</sup>

The House Bill provides a newly tailored cure provision that would actually require that the loan be modified to make it compliant with the amended requirements. Under Section 204 of the House Bill, the assignee may cure a violation within 90 days of notification. To effect a cure, the assignee must modify or refinance the loan, at no cost, to provide terms that would have complied with TILA (as amended) at time of origination, plus refund costs and pay reasonable attorney’s fees. While the cure may be implemented unilaterally by the assignee, the House Bill affords the borrower a right to challenge the adequacy of the cure. If the challenge is successful, the creditor, assignee or securitizer would be liable for rescission and costs. The choice to cure or rescind, however, rests with the creditor or the assignee.

In addition to allowing an assignee to cure a violation, an assignee or securitizer would not be subject to assignee liability under the House Bill if the assignee or securitizer could satisfy a due diligence safe harbor, which is referred to as the “securitizer safe harbor.” The assignee would have to demonstrate that it:

(1) established a policy against buying residential mortgage loans other than “qualified mortgages” or “qualified safe harbor mortgages”;

- (2) required the seller to represent and warrant in the loan sale agreement that all of the loans are qualified mortgages or qualified safe harbor mortgages; and
- (3) in accordance with rules to be promulgated by federal banking agencies and the Securities and Exchange Commission (“SEC”), exercised reasonable due diligence to adhere to its policy in purchasing mortgage loans, including through “adequate, thorough, and consistently applied sampling procedures.”

The language is silent on the required scope or method of due diligence, and on the consequence of adverse findings from the samplings.

The House Bill limits the availability of the securitizer safe harbor in one circumstance. If a creditor ceased to exist, filed for bankruptcy, or had a receiver or liquidating agent appointed, a consumer may maintain a civil action against an assignee to cure the violation, but not rescind the loan, and to recover costs and reasonable attorney’s fees. If the creditor and each assignee have ceased to exist, filed for bankruptcy, or had receivers or liquidating agents appointed, the consumer may maintain a civil action against the securitizer to cure, but not to rescind. Again, the purpose of these provisions is to all but guarantee that the consumer is able to get out of a bad loan that arguably should not have been made.

Unlike the House Bill, the Senate Bill does not provide assignees with the option to cure a violation in lieu of rescission. It does, however, grant the consumer the right to require any person who holds, purchases, or is otherwise assigned a home mortgage loan to make adjustments to the balance, and modify or refinance the loan at no cost to the consumer, providing terms that would have complied with the applicable TILA requirements at the origination of the loan, and to pay costs and reasonable attorney’s fees. While the consumer may invoke this alternative remedy, neither the creditor nor the assignee may elect it.

The Senate Bill provides a safe harbor for assignees to avoid class actions, but not for individual actions. The Bill provides that an assignee of a non-HOEPA subprime or nontraditional loan will not be liable in a class action if a reasonable person exercising ordinary and independent due diligence could not determine that the loan violated the new underwriting provisions.

This is in marked contrast to the House Bill in two key ways. First, under the Senate Bill assignees may be liable in class actions for violations of the underwriting requirements. Second, the safe harbor for individual actions is based on whether the substantive provisions of the Section were violated, not merely whether the loan was a qualified mortgage or a qualified safe harbor mortgage. Even the Senate Bill strays from the safe harbor language of HOEPA, which provides liability only upon a showing that the assignee could determine that the loan is a HOEPA loan, and not that the assignee could know there was a violation. Further, unlike the House Bill, the Senate Bill does not expressly allow assignees to rely on a sampling of loans to stay within the safe harbor, although rule making could provide that “independent due diligence” would be satisfied through sampling.

### Statute of Limitations

Currently, TILA imposes a one-year statute of limitation within which an aggrieved borrower must bring an action.<sup>10</sup> Under the House Bill, the general one-year statute of limitations for TILA actions remains, but liability of a creditor, assignee, or securitizer for an affirmative claim for monetary damages and/or rescission based on a violation of the new underwriting requirements would generally be three years from consummation. However, the statute of limitations under the House Bill for loans with a fixed introductory rate that adjust to a variable rate (think a 2/28 ARM) is the earlier of: (1) the end of the one-year period beginning on the date of reset or adjustment; or (2) the end of the six-year period beginning on the date of consummation.

The House Bill applies the same time periods to claims asserted as a defense to foreclosure. However, if the applicable period has passed, and the consumer would have had a valid basis for rescission had the consumer brought the action within the applicable period, the consumer may seek against a creditor, any assignee or securitizer, the consumer’s actual damages, costs, and reasonable attorney’s fees.

Similarly, the Senate Bill would sustain TILA’s general statute of limitations, while also extending to three years the time period within which a borrower must bring affirmative claims against an entity that violated the new underwriting requirements. The Senate

Bill does not establish a limit for defensive claims. Therefore, a borrower seeking recoupment or a set-off in connection with the attempted enforcement of a loan agreement may apparently bring defensive claims at any time. The Senate Bill would also extend the TILA rescission period for both affirmative and defensive claims for all loans that are subject to an extended right of rescission, not just loans that apparently violate the provisions of the Senate Bill. Under this Bill, the TILA rescission period would be extended to six years for an affirmative action, and a consumer could assert defensively a right to rescind in collection or foreclosure action up to ten years after closing. Unlike the House Bill, the Senate Bill does not contemplate remedies for defensive claims past that lengthy time period. Again, the availability of the rescission remedy for as long as ten years after any violation of TILA that currently allows for an extended right to rescind, would likely restrict the availability of credit across the board.

### Preemption

Many had hoped that both the House Bill and the Senate Bill would have provided a broad federal preemption. Unfortunately, neither Bill offers that. The House Bill, however, does provide limited federal preemption with respect to the remedies that may be asserted against assignees for violations of the underwriting requirements by creditors. The proposed remedies would constitute the sole remedies that may be asserted against any assignee, securitizer, or securitization vehicle for violations of these provisions, or of any other state law which addresses the specific subject matter of these new provisions, namely the ability to repay and net tangible benefit provisions. Remedies based upon fraud, misrepresentation, deception, false advertising, or civil rights laws would not be preempted against any assignee, securitizer, or securitization vehicle for its own conduct related to the making of residential mortgage loans, or in the sale of or purchase of those loans or securities. It appears clear then that the House Bill’s intent is to preempt - for the benefit of the assignee but not the creditor - those state laws that specifically require an ability to repay and/or net tangible benefit analysis.

The House Bill would not preempt all the substantive underwriting requirements found in state laws, but rather would only shield assignees from liability under

those regimes. Lenders and brokers would still be subject to those state law restrictions, exemplifying another trend in the House Bill in which assignees are given extra protections, while lenders are made subject to more onerous requirements. Unlike the House Bill, the Senate Bill does not address preemption at all.

### Attorney General Enforcement

The House Bill does not give specific enforcement authority to state attorneys general for violations of the underwriting requirements. The House Bill limits assignee liability to actions brought by individuals for rescission and costs. Under the Senate Bill, state attorneys general are given a specific right of enforcement of the newly proposed Sections 129A and 129B against assignees and creditors, although those actions would not create an independent basis for removal to federal court.

### Other Notable Provisions

There are three other forms of assignee liability that arise under the Senate Bill. First, servicers would be deemed to be the agent of holders of mortgage loans. This might encourage aggrieved consumers to claim that holders of mortgage loans should be directly liable for the acts, errors or omissions of their servicers under common law theories of principal/agent relationships. Attributing liability to holders of loan based servicer violations could be huge.

Second, the Senate Bill requires the holder to modify the loan and recast it ab initio if the property's value was overappraised by 10% or more. Specifically, if a new appraisal reflects that the lender's initial appraisal exceeded the home's true market value by 10% or more, the holder must modify the loan and recast it from day one. The holder must set the new (reduced) loan amount to the amount that results from applying the original loan-to-value ratio to the newly appraised value. In addition, all payments made prior to recasting would be applied to the reduced loan amount.

**Third, the creditor would be legally responsible for the acts, omissions, and representations made by the mortgage broker in connection with such home mortgage loan, irrespective of whether the creditor knew of or participated in the violations.** This provision would appear to go well beyond holding a creditor responsible for a mortgage broker's violation

of any of the new substantive provisions pertaining to subprime loans. Similar liability would be extended to prime loans if the creditor paid a yield spread premium. And the bill's assignee liability provisions would then make assignees liable for the broker's acts, errors or omission.

### Proposed Amendments to TILA/ HOEPA Regulations

Members of Congress are not the only policymakers plucking away at possible solutions to the subprime crisis. The Board hatched its own plan to respond to the rising number of delinquencies and foreclosures involving subprime mortgages and the perception of "abusive and unaffordable loans" in the subprime market. On January 8, 2008, the Board published proposed amendments to Regulation Z,<sup>11</sup> which implements TILA and the HOEPA. Under these proposed amendments, creditors would be liable if they engage in a "pattern or practice" of newly prohibited acts (including a pattern or practice of extending credit based on collateral without regard to consumers' ability to repay or making a loan without verifying the income and assets relied upon to make the loan for higher-cost loans).

Under the proposed amendments to Regulation Z, if a court determines that a creditor engaged in a "pattern or practice" of activities in violation of the amendments, the creditor would be liable for actual, statutory and enhanced civil money damages. Recall that, presently, enhanced damages only are available for violations of HOEPA with respect to high cost loans. Unlike the two proposed federal Bills, the Board did not increase the civil money penalties under TILA.

In comparison to the House and Senate Bills, the two most striking attributes of the Board's remedies provisions in its amendments, aside from this "pattern or practice" standard is: (1) there is no extended right to rescind the loan based on a violation of the proposed amendments (except if a lender included a prohibited prepayment penalty) and (2) there is no new express assignee liability afforded for violations of the proposed amendments to Regulation Z. Also according to the Board, because none of the amendments, with the exception of the prepayment penalty restrictions, are prohibitions of a particular loan term, violations of these amendments would not trigger the extended

right of rescission.<sup>12</sup> Notably, the Senate Bill, as proposed, would eviscerate this distinction between a prohibited loan term and a prohibited practice by amending Section 125 to allow a borrower an extended right to rescind a loan for violating a provision of the regulation, rather than for making a loan that contains a provision prohibited by a regulation.

In addition, the proposed amendments to Regulation Z do not impose assignee liability for non-HOEPA loans that violate Regulation Z's underwriting requirements. The Board specifically asserts that TILA limits the liability of assignees for violations of Regulation Z to violations that are apparent on the face of the disclosures. Because the restrictions on underwriting are not disclosure violations, assignee liability would apparently not apply to the proposed amendments.

## Conclusion

What can we tell from these Bills about the policymakers' underlying preferences for the mortgage marketplace? From fleshing out the House Bill provisions, one could discern that by leaving a subset of loans like reduced documentation loans, payment option ARMs, and certain hybrid ARMs, among other types of loans, open for heightened scrutiny, the policymakers are attempting to create disincentives, to limit these products from the marketplace, without proposing an outright ban on the products. Whether the secondary market effectively would ban the loans because of the rescission risk remains to be seen. The Senate Bill, on the other hand, is anything but narrow. One has to wonder whether Congress believes the capital markets would play in the sandbox under the new rules. The Senate Bill sweeps broadly, covering prime and subprime loans, and holds innocent assignees responsible for violations on the part of brokers, appraisers, lenders, and servicers. Given the scope of the Senate Bill's remedies provisions, coupled with the substantial increase in monetary damages, the lengthy rescission period, and class action liability, it's hard to imagine what the marketplace would look like after the sky has fallen.

- 1 Kris D. Kully & Laurence E. Platt, *Regulating Wrongful Lending: Protecting Borrowers from Themselves*, [Mortgage Banking and Consumer Credit Alert](#), January 23, 2008.
- 2 Laurence E. Platt, R. Bruce Allensworth, Phoebe S. Winder, Andrew C. Glass, David D. Christensen, *Consumers Clog Courts with Codified Care Claims*, [Mortgage Banking and Consumer Credit Alert](#), January 30, 2008.
- 3 Pub. L. No. 103-325, Title I, Subd. B, 108 Stat. 2160, 2190 (1994) (codified at scattered sections of 15 U.S.C. (2000)).
- 4 15 U.S.C. § 1640(a).
- 5 15 U.S.C. § 1640(a)(4).
- 6 15 U.S.C. § 1636.
- 7 15 U.S.C. § 1639(j).
- 8 A creditor may presume that a “qualified mortgage” (essentially a prime loan) or a “qualified safe harbor mortgage” (essentially a proxy for a subprime or Alt-A loan meeting the requirements of the federal Interagency Guidance on Non-Traditional Mortgages and Statement on Subprime Lending) has met the underwriting requirements, and thus there would be no violation that could give rise to a rescission remedy.
- 9 15 U.S.C. § 1640(b).
- 10 15 U.S.C. § 1640(e).
- 11 12 CFR part 226.
- 12 We understand that others in the mortgage industry read Section 125 to mean that any rule promulgated under the authority of Section 125 will result in a rescission right and thus all of the proposed amendments related to subprime-loans would grant a rescission right. However, based on the position of the Board that none of these additional amendments are loan provisions contained in the mortgage, we believe the correct interpretation is that a new rescission right has been created only with respect to the amendments addressing a the prohibited prepayment provision.

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For more information, please contact one of the professionals listed below.

## LAWYERS

### Boston

R. Bruce Allensworth	bruce.allensworth@klgates.com	+1.617.261.3119
Irene C. Freidel	irene.freidel@klgates.com	+1.617.951.9154
Stephen E. Moore	stephen.moore@klgates.com	+1.617.951.9191
Stanley V. Ragalevsky	stan.ragalevsky@klgates.com	+1.617.951.9203
Nadya N. Fitisenko	nadya.fitisenko@klgates.com	+1.617.261.3173
Brian M. Forbes	brian.forbes@klgates.com	+1.617.261.3152
Andrew Glass	andrew.glass@klgates.com	+1.617.261.3107
Phoebe Winder	phoebe.winder@klgates.com	+1.617.261.3196

### Los Angeles

Thomas J. Poletti	thomas.poletti@klgates.com	+1.310.552.5045
-------------------	----------------------------	-----------------

### Miami

Paul F. Hancock	paul.hancock@klgates.com	+1.305.539.3378
Melissa Sanchez	melissa.sanchez@klgates.com	+1.305.539.3373

### New York

Elwood F. Collins	elwood.collins@klgates.com	+1.212.536.4005
Steve H. Epstein	steve.epstein@klgates.com	+1.212.536.4830
Drew A. Malakoff	drew.malakoff@klgates.com	+1.216.536.4034

### San Francisco

Jonathan Jaffe	jonathan.jaffe@klgates.com	+1.415.249.1023
Erin Murphy	erin.murphy@klgates.com	+1.415.249.1038

### Seattle

Holly K. Towle	holly.towle@klgates.com	+1.206.370.8334
----------------	-------------------------	-----------------

### Washington, D.C.

Costas A. Avrakotos	costas.avrakotos@klgates.com	+1.202.778.9075
Melanie Hibbs Brody	melanie.brody@klgates.com	+1.202.778.9203
Eric J. Edwardson	eric.edwardson@klgates.com	+1.202.778.9387
Steven M. Kaplan	steven.kaplan@klgates.com	+1.202.778.9204
Phillip John Kardis II	phillip.kardis@klgates.com	+1.202.778.9401
Rebecca H. Laird	rebecca.laird@klgates.com	+1.202.778.9038
Laurence E. Platt	larry.platt@klgates.com	+1.202.778.9034
Phillip L. Schulman	phil.schulman@klgates.com	+1.202.778.9027
H. John Steele	john.steele@klgates.com	+1.202.778.9489
Ira L. Tannenbaum	ira.tannenbaum@klgates.com	+1.202.778.9350
Nanci L. Weissgold	nanci.weissgold@klgates.com	+1.202.778.9314
David L. Beam	david.beam@klgates.com	+1.202.778.9026
Emily J. Booth	emily.booth@klgates.com	+1.202.778.9112

Krista Cooley	krista.cooley@klgates.com	+1.202.778.9257
David Keith Gaston	david.gaston@klgates.com	+1.202.778.9061
Anthony C. Green	anthony.green@klgates.com	+1.202.778.9893
Laura A. Johnson	laura.johnson@klgates.com	+1.202.778.9249
Kris D. Kully	kris.kully@klgates.com	+1.202.778.9301
David G. McDonough, Jr.	david.mcdonough@klgates.com	+1.202.778.9207
Lorna M. Neill	lorna.neill@klgates.com	+1.202.778.9216
Staci P. Newman	staci.newman@klgates.com	+1.202.778.9452
Stephanie C. Robinson	stephanie.robinson@klgates.com	+1.202.778.9856
Kerri M. Smith	kerri.smith@klgates.com	+1.202.778.9445
Holly M. Spencer	holly.spencer@klgates.com	+1.202.778.9853
Erin E. Troy	erin.troy@klgates.com	+1.202.778.9384
Morey E. Barnes	morey.barnes@klgates.com	+1.202.778.9215
Elena Grigera	elena.grigera@klgates.com	+1.202.778.9039

**DIRECTOR OF LICENSING****Washington, D.C.**

Stacey L. Riggan	stacey.riggan@klgates.com	+1.202.778.9202
------------------	---------------------------	-----------------

**REGULATORY COMPLIANCE ANALYSTS****Washington, D.C.**

Dameian L. Buncum	dameian.buncum@klgates.com	+1.202.778.9093
Nancy J. Butler	nancy.butler@klgates.com	+1.202.778.9374
Teresa Diaz	teresa.diaz@klgates.com	+1.202.778.9852
Jennifer Early	jennifer.early@klgates.com	+1.202.778.9291
Marguerite T. Frampton	marguerite.frampton@klgates.com	+1.202.778.9253
Robin L. Gieseke	robin.gieseke@klgates.com	+1.202.778.9481
Angela M. Gonzalez	angela.gonzalez@klgates.com	+1.202.778.9369
Joann Kim	joann.kim@klgates.com	+1.202.778.9421
Brenda R. Kittrell	brenda.kittrell@klgates.com	+1.202.778.9049
Dana L. Lopez	dana.lopez@klgates.com	+1.202.778.9383
Jeffrey Prost	jeffrey.prost@klgates.com	+1.202.778.9364

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