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VIA FEDERAL EXPRESS

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Interim Rule Implementing Section 404(a) of the Helping Families Save Their Homes Act

Dear Ms. Johnson:

We appreciate the opportunity to comment on the Interim Final Rule that the Board of Governors of the Federal Reserve (the "Board") recently promulgated to implement Section 404(a) of the Helping Families Save Their Homes Act[1] ("Section 404"). We are submitting this comment letter on behalf of certain of our clients that offer temporary purchase facilities to residential mortgage lenders. These facilities provide lenders with a source of funds to make residential mortgage loans pending the sale of such loans to an investor.

In the Interim Final Rule, the Board indicated that Congress intended the disclosure requirement in Section 404 to provide a consumer with information about the identity of the owner of his or her mortgage loan in order to enable the consumer to contact the assignee or its agent for the purpose of exercising the consumer's legal rights. As a general matter, we believe that the Interim Final Rule provides valuable guidance to the residential mortgage lending industry by clarifying, among other issues, that the notice requirement is not intended to apply to an assignee that holds a residential mortgage loan for a limited period of time pursuant to a repurchase agreement or other temporary financing arrangements.

As discussed in detail below, however, we are concerned that the exemptions from the Section 404 disclosure requirement provided by the Interim Final Rule are drawn too narrowly and would not cover certain common, short-term purchase facilities used to enable residential mortgage lenders to obtain the funds they need to make mortgage loans. While these transactions may operate like revolving warehouse lines of credit or repurchase agreements, they are not financings as a matter of law or accounting and may take more than thirty days to complete. Requiring short-term purchasers to provide a Section 404 notice in such circumstances is an

[1] 15 U.S.C.A. § 131(g).

unnecessary burden that, in light of the temporary nature of the purchaser's ownership of the residential mortgage loans, does very little to further the consumer protection goals of Section 404.

Accordingly, we urge the Board to adopt a new exception in Section 226.39(c) for short term purchase facilities. A purchaser of a current residential mortgage loan would not be subject to the notice requirements of Section 226.39 if the purchaser subsequently transferred the mortgage loan at the direction and in the name of the selling residential mortgage lender to a third party investor pursuant to a pre-arranged purchase or "take out" commitment by and between the selling residential mortgage lender and the third party purchaser. Alternatively, the new exemption could provide that the covered person would be required to provide a Section 404 notice if it does not transfer ownership of the residential mortgage loans within 60 days. In either case, the Board should retain the exemption for repurchase agreements when the transferor continues to recognize the loan as an asset on its own books and records.

I. DISCUSSION

Residential mortgage lenders that do not have access to customer deposits or other internal liquidity, such as state-chartered mortgage companies, require a source of funds to lend to consumers. Traditionally, many lenders have relied on warehouse lines of credit, in which a bank or other financing institution will offer the lender a revolving line of credit and take a security interest in any residential mortgage loans originated using funds drawn from the line. However, Section 362(a) of the Bankruptcy Code creates an "automatic stay" that prevents any creditor from immediately enforcing rights against a debtor or its property, which, among other concerns, impairs the ability of the secured creditor to realize the market value of its collateral at the time of a default by a mortgage lender that is a commercial borrower under a warehouse line of credit.[2] Repurchase agreements, on the other hand, are exempt from the automatic stay provisions of the Bankruptcy Code and often are used as an alternative to revolving credit lines; these arrangements permit a residential mortgage lender to sell, transfer and assign title to a loan to the investor, subject to an obligation to repurchase the loan within a brief period of time at a pre-determined price.[3] If the selling mortgage lender files for bankruptcy, the investor is free to liquate the purchased mortgages and is not subject to the automatic stay under the Bankruptcy Code.

Under the Interim Final Rule, an investor that extends a warehouse line of credit to a residential mortgage lender would not be required to provide a Section 404 notice to the borrowers on the residential mortgage loans in which it obtains a security interest, because the disclosure obligation is only triggered by the acquisition of legal title to the debt obligation.[4] An

[2] 11 U.S.C.A. § 362(a).
[3] *Id.* §§ 101(47); 362(b)(7).
[4] 12 C.F.R. Part 226, Appendix I ("Commentary") ¶ 39(a)-2.

investor also would not be required to provide a notice to consumer when it acquires residential mortgage loan obligations pursuant to a repurchase agreement, provided that the residential mortgage lender continues to recognize the loan as an asset on its own books and records.[5] The Board adopted the latter exemption because it believes that providing disclosures in a repurchase transaction "would not provide a meaningful benefit to consumers in the form of useful information or protection" and "would complicate compliance and impose unnecessary burden and expense for persons that would be required to comply, that would not be outweighed by the benefits to consumers."[6] We agree with these determinations and urge the Board to retain the exemption for transfers pursuant to repurchase transactions in the Final Rule.

Significantly, however, repurchase agreements are only one of many short-term funding alternatives available to residential mortgage lenders. For a variety of legal, business and accounting reasons, many lenders and investors use an alternate funding mechanism in which the investor acquires all right, title and interest in and to the residential mortgage loan in a transaction that is recognized as a "true sale" for bankruptcy purposes.[7] This type of funding is attractive because Section 541(a)(1) of the Bankruptcy Code provides (with exceptions not relevant here) that the property of a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[8] Property that has been effectively sold by the debtor prior to the date of the bankruptcy petition (subject to any fraudulent transfer or other avoidance issues) is no longer property of the bankruptcy estate.[9]

In a typical short-term, "true sale" funding arrangement, the purchaser only will purchase current loans for which the selling mortgage lender has in place a commitment with a third party to purchase either the loans or, if a securitization is contemplated, the securities based on and backed by such loans. The price paid by the short-term purchaser is pegged to this commitment price. The short term purchaser subsequently delivers the loans into the commitment in the name of the selling lender, and the short term purchaser relinquishes any ownership interest it has in the loans in exchange for the purchase price paid by the third party purchaser under the pre-existing commitment. The selling mortgage lender grants the investor a power-of-attorney to act as attorney-in-fact for the selling mortgage lender to help facilitate the delivery of the mortgage loans to the third party investor; alternatively, for administrative purposes, the investor may transfer nominal title to the mortgage loans back to the selling mortgage lender so that the selling

[5] 12 C.F.R. § 226.39(c)(2).
[6] 74 Fed. Reg. 60143, 60147 (Nov. 20, 2009).
[7] The transfer may or may not be recognized as a sale on the books and records of the residential mortgage lender for accounting purposes. For example, if the residential mortgage lender and the financing institution are affiliates with consolidated financial statements, the transfer may not be reflected as a sale in the books and records of the transferor, but still arguably be considered a "true sale" for bankruptcy purposes.
[8] 11 U.S.C.A. § 541(a)(1).
[9] *See In re Contractors Equipment Supply Co.*, 861 F.2d 241, 245 n.8 (9th Cir. 1988) ("[had] the present case involved a true assignment, under basic contract law principles, the notification would have taken the account receivable out of the estate") (dictum).

mortgage lender can make the required representations and warranties and transfer title to the third party investor. Purchase proceeds in excess of a specified amount may be returned by the investor to the selling mortgage lender under a variety of arrangements. The residential mortgage lender retains responsibility to service the loan during the period the short-term purchaser owns the loan.

These short-term purchase arrangements are like warehouse lines of credit and repurchase agreements in five important respects. First, they provide the source of funds to a residential mortgage lender to make a loan to a consumer. Second, these short-term purchases only are made against a "take out" commitment by and between the selling residential mortgage lender and a third-party purchaser, such as Fannie Mae, Freddie Mac or a purchaser of Ginnie Mae securities. Third, the short-term purchaser delivers the loans to the third-party purchaser in the name of the residential mortgage lender in accordance with the terms of the take out commitment. Fourth, the short-term purchaser relinquishes any ownership interest in the delivered loans as a condition to the purchase of the loans by the third party investor. Last, the short-term purchaser is the initial recipient of the purchase proceeds paid by the third party investor and in turn pays such proceeds in excess of a pre-determined amount to the residential mortgage lender. The principal difference is that, because the transaction is structured as a "true sale," the residential mortgage lender does not continue to recognize the sold loan on its books and records following the sale to the short-term purchaser.

The exception in the Interim Final Rule that provides that an institution acquiring legal title to a residential mortgage loan is not required to provide a Section 404 notice if it transfers or assigns the loan to another party within thirty days[10] is certainly helpful for institutions engaged in such alternative funding arrangements, because in many circumstances the short-term purchaser will only own the residential mortgage assets for less than thirty days. However, we have been advised by our clients that it is not uncommon for a short-term purchaser in a true sale funding transaction to own the residential mortgage loans for a period of forty-five to sixty days, and sometimes even longer.

Even when a short-term purchaser owns residential mortgage loans for longer than thirty days, it would not provide a meaningful benefit to consumers to require the short-term purchaser to provide a transfer of ownership disclosure, because the short-term purchaser does not intend to own the residential mortgage loans for any significant length of time and it is unlikely that the consumer will need to exercise legal rights against the short-term purchaser during that period. To this extent, a short-term, true sale purchase is equivalent to a repurchase agreement – the short-term purchaser only acquires ownership to facilitate the initial funding of the residential mortgage loan and its subsequent sale to the end investor pursuant to the terms of a "take out" commitment arranged by the residential mortgage lender. While the transaction may be

[10] 12 C.F.R. § 226.39(c)(1).

recognized as a "true sale" for bankruptcy and/or accounting purposes, the treatment of the transaction for these purposes makes no difference from the consumer's point of view. Further, the underlying intent of the parties to the transaction is precisely the same. For these reasons, we believe that the transfer of title pursuant to short-term, true sale funding arrangements should not be considered a transfer that triggers disclosure requirements under Section 404.

Requiring an institution that acquires title to residential mortgage obligations purely pursuant to a short-term funding facility extended to a residential mortgage lender would unnecessarily complicate the funding transaction and impose unnecessary administrative burdens and expenses on the short-term purchaser. More importantly, it would confuse the consumer since the residential mortgage lender is retaining the servicing rights and the loan soon will be sold again with or without the servicing rights Accordingly, we suggest that the Board create a new exception in Section 226.39(c) of the Final Rule under which a covered person would not be subject to the requirements of Section 226.39 with respect to a current mortgage loan if the mortgage loan is sold to a short-term purchaser for subsequent resale to a third party investor pursuant to the terms of a take out commitment arranged by the transferor and in whose name the loans are delivered to the third party purchaser in the manner described above.

We recognize, however, that the Board may find that it has an interest in ensuring that the retention of ownership by the short term purchaser truly will not last indefinitely. In that case, we alternatively suggest that the new exemption provide that a covered person will not be subject to the requirements of Section 226.39 with respect to a particular mortgage loan if the mortgage loan is transferred to the covered person in connection with a transaction that is intended to provide short-term funding to the transferor and the covered person does not intend to retain title to the residential mortgage loans for longer than sixty days based on the terms of the take out commitment with a third party purchaser. If the covered person actually retains legal title for more than sixty days, it would be required to provide the notice required under Section 226.39.

In either case, we would request that the Board retain unchanged the exception for a transfer of a mortgage loan pursuant to a repurchase agreement during the time that the transferor continues to recognize the loan as an asset on its own books and records.

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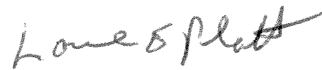
We appreciate your consideration of these comments. If we can provide any further information or clarify the views expressed herein, please do not hesitate to contact me at 202.778.9034.

Sincerely,

K&L Gates LLP



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