May 30, 2013

VIA E-MAIL

Mr. William R. Breetz, Jr., Chairman
Uniform Law Commission Drafting Committee
Residential Real Estate Mortgage Foreclosure Process and Protections
University of Connecticut School of Law
Knight Hall Room 202
35 Elizabeth Street
Hartford, CT 06105

Re: Residential Real Estate Mortgage Foreclosure Process and Protections

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to submit this letter to the Uniform Law Commission (the "Commission") in response to certain provisions of its discussion draft concerning "Residential Real Estate Mortgage Foreclosure Process and Protections."[2] In particular, Section 607 of the draft law, Abrogation of the Holder in Due Course Rule in Foreclosures, will present significant difficulties for secondary mortgage market participants in particular. While we appreciate the Uniform Law Commission's efforts, the ultimate language of this draft model legislation would appreciably reduce the availability of residential mortgage loans, increase the costs for available loans and reduce the value of outstanding loans. We write to address in particular the concerns of our institutional investor members, including asset managers, pension funds, mutual funds, insurance companies, and hedge funds who are the backbone of the secondary mortgage market that provides substantial private capital to consumers in the form of mortgage credit. **As the firmly established "holder in due course doctrine" provides certain basic protections for the assignee, we strongly urge the Commission to abandon its efforts to undermine these protections and thereby unduly increase the potential for legal liability for investors in residential mortgage loans.**

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[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. structured finance market advocate their common interests on important legal, regulatory and market practice issues. ASF includes hundreds of member firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in structured finance transactions. ASF also provides information, education and training on a range of structured finance market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

[2] *See* http://www.uniformlaws.org/shared/docs/Residential%20Real%20Estate%20Mortgage%20Foreclosure%20Process%20and%20Protections/2012mar25_RREMFPP_MtgDraft_Clean.pdf.

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Secondary mortgage market participants include banks, financial intermediaries, real estate investment trusts ("REITs"), institutional investors, and other financial institutions that buy and sell whole mortgage loans. The secondary market also includes the securitization market, through which lenders can fund their origination activities by converting illiquid mortgage loans into securities that can be sold through the capital markets to any number of institutional investors. Through this mechanism, institutional investors ultimately supply primary lenders with a substantial amount of the capital that is used to originate the nation's mortgage loans. Liquidity and efficiency in the secondary market, and ultimately affordable mortgage credit for borrowers, depend on confidence among investors that mortgage loans will be enforceable in accordance with their terms, without unnecessary impairment due to potential and unquantifiable assignee liability. Accordingly, as described below, it is essential that the Uniform Law Commission does not unduly increase the potential for legal liability for investors in residential mortgage loans by undermining firmly established holder in due course protections.

Under the "holder in due course" doctrine, where the "holder" of a negotiable mortgage note is deemed a "holder in due course," the holder takes the mortgage note subject only to specific limited defenses of the borrower. According to these terms, the holder in due course doctrine provides that an assignee that paid value for a loan in good faith and that lacked notice of certain claims and defenses to payment that the borrower has against the original lender, such as fraud, takes the loan free of those claims and defenses; the assignee remains subject to real defenses, such as duress. Under UCC § 3-302(a):

> [A] "holder in due course" means the holder of an instrument if:
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> (1) the instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and
>
> (2) the holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in Section 3-306 [regarding claims of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds], and (vi) without notice that any party has a defense or claim in recoupment described in Section 3-305(a).

Under Article 3, a holder in due course of a negotiable mortgage note takes the mortgage note free of (a) all prior claims to or regarding the mortgage note by any person and (b) most defenses to enforceability of the mortgage note that may be raised by parties with whom the holder in due course has not dealt.[3] The defenses to which a holder in due course may be subject are found in UCC § 3-305, and include:

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[3] *See* UCC §§ 3-305 and 3-306.

> 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.[4]

The rationale behind the holder in due course doctrine is promotion of the free market transfer of negotiable instruments. Indeed, by encouraging the liquid secondary market to purchase large quantities of loans without the need for costly and intrusive vetting of each individual loan for potential claims, the holder in due course doctrine serves as an essential cornerstone for availability of mortgage credit to prospective home owners. The doctrine also recognizes that, in the vast majority of cases, it is neither fair nor efficient for innocent assignees to be held responsible for the predatory lending practices of loan originators. This draft proposal, by abrogating holder in due course provisions, imposes a significant risk of liability on investors and other assignees of mortgage loans if and when borrowers claim that a lender failed in some way to properly originate the loan.

We, of course, cannot predict with any certainty the frequency and costs of claims that may be asserted by borrowers to challenge the lawfulness of the loans that they willingly undertook. One fact we have learned from the foreclosure crisis, however, is that borrowers routinely will use all lawful means at their disposal to delay or stop a foreclosure, even if the action merely delays the inevitable. We must assume that wrongful lending claims will proliferate regardless of the merits of the underlying facts simply because a tool to do so is made available. We believe any final language in this draft law should preserve borrowers' rights to make legitimate claims, but not empower them to make frivolous ones. Otherwise, the resulting significant risk and costs of potential litigation will constrain investors from purchasing loans in the secondary market and investing in residential mortgage-backed securities ("RMBS"), or a substantial risk premium will be necessary to offset the risk.

It is important to remember that, although the holder in due course doctrine constitutes an important protection for innocent assignees, it does not afford an absolute protection to all assignees. In order to benefit from holder in due course status, an assignee must take the loan in good faith and cannot have actual or implied knowledge of a variety of loan defects, including that the loan was originated through fraudulent means. Courts will also deny holder in due course status to an assignee that has such a close connection with the originator that the originator effectively is an agent of the assignee or where knowledge of the originator's wrongdoing can be imputed to the assignee on some other basis, such as joint-venture or aiding-and-abetting theories. In addition, assignees that engage in wrongful conduct themselves in connection with mortgage loans are subject to potentially serious liability under a variety of federal and state legislation.

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[4] UCC § 3-305(a)(1).

We also note that the Consumer Financial Protection Bureau ("CFPB") recently released its ability to repay rule, which provides that a borrower must have a reasonable ability to repay a mortgage loan or a lender may face certain claims by the borrower.[5] Additionally, Section 1413 of Dodd-Frank provides that a borrower may raise a defense to foreclosure against the holder of the loan, whether it be a lender or an assignee, claiming that the ability to repay rule was not met. The CFPB (and Congress) recognized the disastrous effects that assignee liability could have on the secondary mortgage market and implemented a safe harbor/rebuttable presumption for loans meeting "qualified mortgage" status. In light of this rulemaking, the Commission should reverse its course from eliminating holder in due course protections, given the negative consequences of such action. It's also worth considering that the Federal Housing Finance Agency ("FHFA") recently directed Fannie Mae and Freddie Mac to only purchase qualified mortgages starting in 2014, meaning that purchases of mortgage loans that don't have adequate protections against assignee liability will no longer be an option.[6]

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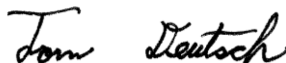
Secondary market participants are not currently in a position to take on risks that sharply increased assignee liability would entail. In order to ensure the continuing recovery and increase affordable and accessible mortgage credit for borrowers, liquidity and efficiency in the secondary market should not be unnecessarily curtailed by undermining accepted holder in due course provisions.

We very much appreciate the opportunity to provide the foregoing comments to the Commission. If you have any questions or would like any clarification concerning the matters addressed in this letter, please feel free to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com.

Sincerely,



Tom Deutsch
Executive Director
American Securitization Forum

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[5] *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=8792 for ASF's summary of the rule.

[6] *See* http://www.fhfa.gov/webfiles/25163/QMFINALrelease050613.pdf.