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RMBS - US

SFIG TRID Draft Proposal Is Adequate to Address Risks for US RMBS Despite Some Uncertainty

Executive Summary

The Structured Finance Industry Group's (SFIG's) draft proposal to standardize the framework for reviewing and grading loans for TILA-RESPA Integrated Disclosure (TRID) rule compliance is adequate to identify those compliance risks that are likely to cause losses to residential mortgage-backed securitization (RMBS) trusts, aside from one grading provision with which we disagree. As SFIG disclaims in its introduction, some of the framework's legal positions are subject to uncertainty resulting from SFIG's reliance on a non-binding interpretive letter from the Consumer Financial Protection Bureau (CFPB) director; however, we believe that any risks to RMBS trusts from these positions are minimal over the long term. Furthermore, the SFIG proposal will likely benefit from the official guidance that the CFPB has signaled it will provide in July, as well as from feedback from other market participants.

SFIG TRID framework adequately addresses the relevant risks for US RMBS

The framework has a grading scale designed to distinguish material TRID violations from immaterial ones. While there is still some uncertainty about what kinds of errors could potentially lead a trust to suffer damages, a SFIG member work group, with the help of industry lawyers, have conducted a thorough risk analysis to determine what kinds of errors would most likely lead to damages and what kinds would not.

Of the three possible grades for each section of the rule that a third-party review (TPR) firm will review:

» EV1-A represents that no TRID violation has been determined to carry assignee liability;

» EV2-B represents an immaterial violation that, while it may carry assignee liability, is nevertheless unlikely to cause losses to an RMBS trust because it would not carry statutory damages; and

» EV3-C represents a material violation that is likely to carry assignee liability and statutory damages.

The risk analysis was based on statutory interpretation of the rule and existing case law. For example, to address whether a certain provision of the TRID rule had assignee liability, the analysis mapped the TRID rule to the underlying TILA or REPSA authority to determine whether or not assignee liability for a particular TRID provision existed. When doubt as to the

correct statutory authority existed, the SFIG members elected the conservative view that a violation of a particular provision would give rise to assignee liability and statutory damages.

SFIG's framework provides a thoughtful and standardized grading approach that will reconcile market disruptions. Initially, TPR firms tended to grade most errors as material because of a lack of legal certainty that such errors would not carry assignee liability. Furthermore, issuers complained because the different TPR firms all had different standards and TPR firms with the most lenient standards could cause the overall quality of the reviews to erode.

The framework also standardizes the scope of the review, making reviews more streamlined. While TPR firms previously have dedicated much time to reviewing loan files for compliance with every provision of the TRID rule, the framework establishes that the TPR firms will only review those parts of the TRID rule that are most significant to an RMBS trust. The framework reasonably proposes that the TPR firms focus their review primarily on the Closing Disclosure. Under the framework, the TPR firms will review the Loan Estimate, limited only to the few circumstances where there is potential liability to the RMBS trust, such as when the TPR firm reviews for monetary tolerance limits.

The framework also identifies what types of actions the TPR firms will deem acceptable to cure a material violation. When the market was faced with a 90%+ error rate on the initial wave of due diligence on TRID loans, the market was uncertain as to how such errors could be cured. For the most part, the framework adequately justifies the cures available for every provision that is significant to the RMBS trust and provides a clear path for lender action to cure a violation. The framework grounds the available cures in regulatory authority: the TRID post-consummation redisclosure obligations within the rule and the legacy cure provisions within TILA. For example, to cure certain exceptions, the framework requires the lender to provide a letter of explanation, send a corrected Closing Disclosure to the consumer and, if applicable, re-open the rescission period.

However, we disagree with the framework in one instance where it allows two cures that conflict with each other. One provision of the TRID rule imposes a disclosure obligation upon the creditor within a 60-day post-consummation period. The framework takes the overly broad view that the same provision could also be corrected by the legacy cure provisions within TILA whereby a cure could be presumptively made by an assignee within 60 days from identification of the error, a cure period that could stretch beyond the 60-days post-consummation period. There is a risk that a court may interpret the latter cure as inapplicable and subject the trust to statutory damages. Moreover, according to the CFPB's section-by-section analysis of TRID, extending the cure period beyond the 60-day post-consummation would undermine the incentive for creditors to conduct quality control reviews as soon as reasonably practicable after consummation. Given that the framework is a draft, we expect SFIG to consider our comment when finalizing the framework.

Impact of the Cordray letter will be minimal

The framework relies in large part on the assumption that the CFPB and the courts will enforce the TRID rule in a manner consistent with CFPB Director Cordray's 29 December 2015 letter to the Mortgage Bankers' Association, which addressed an RMBS trust's direct liability for TRID violations and potential cures for such violations. SFIG adequately recognizes the shortcomings of relying on a non-binding interpretive letter and has taken appropriate action; we believe that SFIG's commitment to revise the framework in a timely manner minimizes the risk of relying on the Cordray Letter.

Although the Cordray Letter provided some clarity on a number of TRID compliance issues, the Cordray Letter is not an official interpretation published in the Federal Register and is not binding on the CFPB, other regulators, or courts. SFIG caveats its framework with a notice that the proposal is an attempt to resolve compliance issues under TRID and that there is no guarantee how the CFPB or the courts will view the Cordray Letter. In tandem with designing the framework, SFIG has been leading the effort to encourage the CFPB to release an official interpretation of the TRID rule. Due in part to SFIG's efforts, the CFPB has signaled that it will issue a Notice of Proposed Rulemaking in July.

Appendix 1: How TRID Affects Securitization

Liability and damages for the RMBS trust under TRID

From time to time, originators may produce mortgage loans that are not compliant with the TRID rule. If these mortgage loans are securitized, the RMBS trust may be liable for some violations of the TRID rule.

According to the preamble to the final TRID rule, liability to the RMBS trust is based on whether the TRID provision relies on TILA or RESPA. Part B of TILA provides for a private right of action, with statutory damages for some violations, whereas RESPA does not provide a private right of action to the RESPA GFE and RESPA settlement statement requirements:

No liability to the RMBS Trust	Liability to the RMBS Trust
Violations of ➢ Part A of TILA ➢ RESPA ➢ Dodd Frank Act	Violations of ➢ Part B of TILA

Under TILA, there is liability to the RMBS trust if the violation is "apparent on the face of the disclosure statement provided in connection with [the] transaction" and the assignment to the assignee was voluntary.

Damages for a violation of Part B of TILA is equal to the sum of:
Actual Damages. Any actual damage sustained by the borrower as a result of the TILA violation;
Statutory Damages. (1) Between $400 and $4,000 for an individual suit; or (ii) in a class action, up to the lesser of $1,000,000 or 1% of the lender's net worth; and
Attorney's Fees and Court Costs for a successful lawsuit.

A one-year statute of limitations for affirmative claims is in place. After the one-year period, the borrower loses the right to bring an affirmative civil action but may raise the violation as a defense in a foreclosure proceeding, if allowed under state law. If successful, the amount is limited to the amount outlined in the table above in the form of offset or recoupment—not cash damages—and will not invalidate a lien or stop a foreclosure.

Initial TRID compliance results and market uncertainty

The implementation of the TRID rule created challenges for some originators. Initial due diligence results from third-party review (TPR) firms revealed that more than 90% of the first round of mortgage loans closed under TRID had TRID compliance violations. Many of these violations were technical in nature, such as issues with the alignment or shading of forms, rounding errors, time stamps with the wrong time zone, etc. However, TPR firms deemed these violations to be "material" because of the uncertainty as to whether the RMBS trust would bear damages or costs from delayed foreclosures without further court or CFPB interpretation. There was uncertainty among some mortgage market participants as to whether there was assignee liability to the RMBS trust given that CFPB did not clearly map out which provisions of the TRID rule relied on Part B of TILA. When TPR firms found violations, there was also uncertainty among mortgage market participants regarding how lenders may cure these violations. Mortgage loan investors became wary of purchasing mortgage loans with any TRID violations.

Appendix 2: The CFPB Response

The December 2015 Cordray letter

On 29 December 2015, the Director of the CFPB, Richard Cordray, replied to a letter from the Mortgage Bankers Association. The Cordray letter addresses a lender's or assignee's direct liability for TRID violations. Director Cordray stated that, while the TRID rule incorporates RESPA requirements into TILA's implementing regulation, "it did not change the prior, fundamental principles of liability under either TILA or RESPA." As a general matter, borrowers may file suit for violations of the mortgage disclosure requirements in Part B of TILA but not for violations of RESPA's mortgage disclosure requirements.

Furthermore, Director Cordray noted the following:

» There is no general TILA assignee liability unless the violation is apparent on the face of the disclosure documents and the assignment is voluntary. 15 U.S.C. 1641(e)

» By statute, TILA limits statutory damages for mortgage disclosures, in both individual and class actions to failure to provide a closed-set of disclosures. 15 U.S.C. 1640(a)

» Formatting errors and the like are unlikely to give rise to private liability unless the formatting interferes with the clear and conspicuous disclosure of one of the TILA disclosures listed as giving rise to statutory and class action damages in 15. U.S.C. 1640(a)

» The listed disclosures in 15 U.S.C. 1640(a) that give rise to statutory damages do not include either the RESPA disclosures or the new Dodd-Frank Act disclosures, including the Total Cash to Close and Total Percentage.

Director Cordray also addressed how TRID violations may be cured:

» A corrected Closing Disclosure, even after closing, may be used to correct non-numerical clerical errors or as a component of curing any violation of the monetary tolerance limits.

» Consistent with existing TILA principles, liability for statutory damages would be assessed with reference to the final Closing Disclosure issued, not the Loan Estimate.

» The TRID rule provides for specific cure mechanisms.

» Provisions in TILA for the correction of errors would continue to apply to the integrated disclosures. For example, TILA has long permitted creditors to cure violations, provided the creditor notifies the borrower of the error and makes appropriate adjustments to the account before the creditor receives notice of the violation from the borrower. 15 U.S.C. 1640(b). Similarly, TILA provides an exception from liability for unintentional errors, subject to certain conditions. 15 U.S.C. 1640(c).

Although the Cordray letter provided some clarity on a number TRID compliance issues, the Cordray letter is not an official interpretation published in the Federal Register and is not binding on the CFPB, other regulators, or courts.

The April 2016 Cordray Letter

In response to industry concerns over compliance with TRID, Director Cordray issued a letter announcing that the CFPB intends to publish a Notice of Proposed Rulemaking for comment in July 2016.

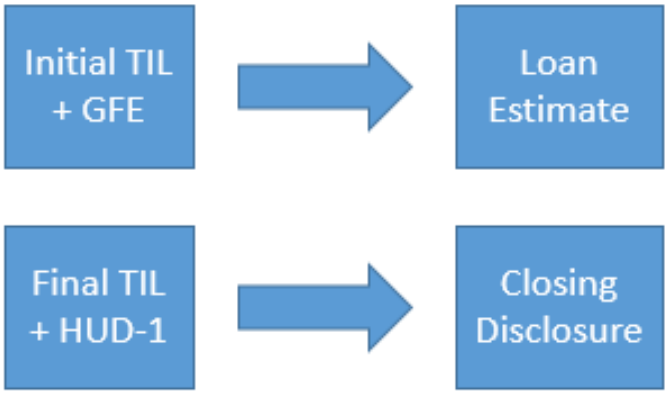
Appendix 3: Background on TRID

For more than 30 years, Federal law required lenders to provide two sets of different disclosure forms to mortgage loan consumers. Two different Federal agencies developed these forms separately, under two Federal statutes: the Truth in Lending Act (TILA) and the Real Estate Settlement Procedures Act of 1974 (RESPA).

Forms to be provided by lender after receiving the loan application from consumer	Forms to be provided by the lender to consumer shortly before closing
Initial TIL (statute – TILA)	Final TIL (statute – TILA)
Good Faith Estimate (statute – RESPA)	HUD-1 Settlement Statement (statute – RESPA)

The Dodd-Frank Act directed the Consumer Financial Protection Bureau (CFPB) to integrate the mortgage loan disclosures. Sections 1032(f), 1098 and 1100A of the Dodd-Frank Act address Congress' concern that Federal mortgage disclosures did not adequately explain to consumers the terms of their loans by requiring new disclosure forms that will improve consumer understanding of mortgage transactions. In 2012, the CFPB published the proposed TRID rule for comment. In 2013, the CFPB issued the final TRID rule to be effective in 2015.

TRID is an acronym for TILA-RESPA Integrated Disclosure and applies to most mortgage loan transactions. The rule does not apply to HELOCs, reverse mortgage, and a dwelling not attached to real property (i.e. mobile homes). TRID consolidates disclosures under TILA and RESPA as well as new disclosures under Dodd-Frank into two forms – the Loan Estimate and the Closing Disclosure.



The CFPB designed the Loan Estimate to provide disclosures so that consumers may understand the key features, costs and risks of the mortgage loan for which they have applied. The CFPB designed the Closing Disclosure to provide disclosures that will assist consumers in understanding all the costs of the transaction.

Moody's Related Research

» Lack of Diligence For TRID Compliance Violations Exposes Future GSE Credit-Risk Transfer RMBS to Some Incremental Losses, April 2016 (1019458)

» US Mortgage Lenders Face Difficulties Complying with New Rules, a Credit Negative for RMBS, December 2015 (SF245038)

» New TILA-RESPA Rule Will Heighten Possibility of Losses in US RMBS for Rule Violations, May 2015 (1005142)

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