III. The Future of Subprime Mortgage Markets

A. Introduction

Largely believed to be a significant cause of the recent U.S. financial crisis, subprime mortgages remain a contentious subject of litigation and regulatory action nationwide. Subprime mortgage lending increased from six percent of all mortgage originations in 1996 to twenty percent in 2006.[1] From 2004 until 2007, subprime delinquency rates were significantly higher than prime delinquency rates.[2] Since then, prime loan delinquencies have surpassed subprime loan delinquencies.[3] These numbers suggest that although subprime loans initiated the mortgage crisis, the effects have spread throughout the rest of the housing market.

The response to the role of subprime mortgages in the crisis has been two-fold: litigation against originators and securitizers of subprime loans and regulatory responses attempting to stem the crisis' effects and prevent it from happening again.

B. Litigation: The Threat of Enforcement

Over one trillion dollars of risky mortgage bonds remain outstanding, meaning the market is still saturated with "disgruntled

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[1] *See* KATALINA M. BIANCO, THE SUBPRIME LENDING CRISIS: CAUSES AND EFFECTS OF THE MORTGAGE MELTDOWN (CCH) 6, *available at* http://business.cch.com/bankingfinance/focus/news/Subprime_WP_rev.pdf (reviewing the rise of subprime lending in the United States in the context of the overall housing market).

[2] *See* Gene Amromin & Anna L. Paulson, *Default Rates on Prime and Subprime Mortgages: Differences and Similarities*, PROFITWISE NEWS AND VIEWS 2 (Sept. 2010), *available at* http://www.chicagofed.org/digital_assets/publications/profitwise_news_and_views/2010/PNV_Aug2010_ReEd_FINAL_web.pdf (depicting default rates of prime and subprime loans each year from 2004-2007 in terms of months since the mortgage began).

[3] *See* Bill McBride, *Mortgage Delinquencies by Loan Type*, CALCULATED RISK (May 23, 2011, 1:23 PM), http://www.calculatedriskblog.com/2011/05/mortgage-delinquencies-by-loan-type.html (explaining that since 2007, subprime loan delinquencies have fallen by roughly a third, prime loan delinquencies have fallen only six percent, and Federal Housing Administration (FHA) loan delinquencies have increased by over one hundred percent).

investors" seeking remedies in court.[4] Major banks face tens of billions of dollars in regulatory charges and investor lawsuits, the potential payouts of which would, according to some, "reduce earnings and weaken capital levels, perhaps harming the ability of banks to lend money and provide much-needed life to a stalled housing market and weakened economy."[5] In addition, banks have recently expressed concerns about exposure to liability for the servicing and sale of mortgages in their possession; consequently, the quantity and outcomes of these lawsuits could influence the way banks do business.[6]

1. Regulator Lawsuits

Regulators have been slow to file court actions against lenders and securitizers, initially focusing on individual executives of originators and securitizers.[7] Importantly, the Federal Housing Finance Agency ("FHFA"), which oversees Fannie Mae and Freddie Mac,[8] filed lawsuits on September 2, 2011, against seventeen major

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[4] *See* Agnes T. Crane & Reynolds Holding, *Breakingviews: No Quick Fix for Banks' U.S. Mortgage Liability*, THOMSON REUTERS NEWS & INSIGHT (Sept. 9, 2011),http://newsandinsight.thomsonreuters.com/New_York/News/2011/09__September/Breakingviews__No_quick_fix_for_banks__U_S__mortgage_liability/ ("With roughly $1.1 trillion of risky mortgage bonds still outstanding, there are sure to be plenty of disgruntled investors contemplating whether they should take their complaints to the courts.").

[5] Margaret Chadbourn & Jonathan Stempel, *U.S. Regulator Sues Major Banks Over Subprime Bonds*, REUTERS (Sept. 2, 2011, 7:40 PM), http://www.reuters.com/article/2011/09/02/us-usa-fhfa-suit-idUSTRE7815VI20110902.

[6] *See* E-mail from Wendell J. Chambliss, Vice President and Deputy General Counsel for Mission and Anti-Predatory Lending at Freddie Mac, to Jennifer J. Johnson, at 8-9 (Jul. 22, 2011), *available at* http://www.federalreserve.gov/SECRS/2011/July/20110726/R-1417/R-1417_072211_84155_591648516501_1.pdf (expressing concern that high-cost, high-fee loans pose too much legal risk for delivery to Freddie Mac).

[7] *See* Complaint, SEC vs. Angelo Mozilo, No. CV 09–3994–JFW (C.D. Cal. June 4, 2009), *available at* http://www.sec.gov/litigation/complaints/2009/comp21068.pdf (setting out the SEC's case against executives at Countrywide Financial for misleadingly representing Countrywide's business model and failing to disclose the company's inadequate mortgage underwriting standards).

[8] *See About FHFA*, FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=4 (last visited Oct. 13, 2011) ("FHFA's mission is

banks and mortgage lenders, including Bank of America, Countrywide Financial and J.P. Morgan.[9] The suits allege that the nation's biggest mortgage originators "systematically disregarded their respective underwriting guidelines in order to increase production and profits derived from their mortgage lending businesses."[10] The seventeen defendants' false reporting of owner occupancy and loan-to-value ratios in their prospectus supplements for the initial securities offerings are the main issue involved in the suits.[11] Only six of the suits allege fraud.[12]

Because the FHFA, unlike private plaintiffs, can essentially perform discovery on loan files before suing, it has been able to compile a substantial portion of the available information concerning the defendants' alleged wrongdoings, including information from other lawsuits, regulatory investigations and FHFA loan reviews.[13] FHFA did the same thing prior to an earlier suit against United Bank of Switzerland; in that suit, FHFA reviewed 966 loans and, thus, obtained a large amount of data with which to support its claims.[14]

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to provide effective supervision, regulation and housing mission oversight of Fannie Mae, Freddie Mac and the Federal Home Loan Banks . . . .").

[9] *See FHFA Filings in PLS Cases, September 2, 2011*, FED. HOUS. FIN. AGENCY, http://www.fhfa.gov/Default.aspx?Page=110 (last visited Oct. 13, 2011) (listing all seventeen defendants).

[10] Complaint at 45, Fed. Hous. Fin. Agency v. Citigroup, Inc., No. 11-CV-6196 (S.D.N.Y. Sept. 2, 2011), *available at* http://www.fhfa.gov/webfiles/22593/FHFA%20v%20Citi.pdf.

[11] *See id.* at 40-44 (detailing how Citibank's representations of owner occupancy and loan-to-value ratios were materially false).

[12] *See* Isaac Gradman, *The Government Giveth and It Taketh Away: The Significance of the Game Changing FHFA Lawsuits*, THE SUBPRIME SHAKEOUT (Sept. 15, 2011), http://www.subprimeshakeout.com/2011/09/the-government-giveth-and-it-taketh-away-the-significance-of-the-game-changing-fhfa-lawsuits.html ("In particular, FHFA has levied fraud claims against Countrywide . . . Deutsche Bank, J.P. Morgan . . . Goldman Sachs, Merrill Lynch . . . and Morgan Stanley . . . .").

[13] *See* Kerry Panchuk, *Analyst Calls* FHFA v. UBS *Suit a Game-Changer*, HOUSINGWIRE (Aug. 2, 2011, 5:03 PM), http://www.housingwire.com/2011/08/02/analyst-calls-fhfa-v-ubs-suit-a-game-changer ("In his report on the case, Gamaitoni says FHFA, unlike private plaintiffs, had the option to perform discovery on loan files before filing suit in court.").

[14] *See id.* ("After reviewing 966 loans, he said the FHFA found a 'material amount of violations to loan underwriting guidelines and misrepresentations of collateral data in prospectuses.'").

These larger, regulator-driven suits will now serve as a fertile source of data for other regulatory actions and private lawsuits across the country.[15]

2. Private Lawsuits

In addition to a slew of class-action suits, which did not initially fare well in courts[16] but have seen a few recent successes,[17] numerous major banks and other financial companies have sued other banks or lenders over toxic mortgage defaults.[18] Bank of America, for example, is potentially liable to U.S. Bancorp,[19] AIG[20]

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[15] *See* Isaac Gradman, *RMBS Legal Roundup: The Top Five Developments You Might Have Missed While Obsessing Over the BofNY/BofA Settlement*, THE SUBPRIME SHAKEOUT (Aug. 25, 2011), http://www.subprimeshakeout.com/2011/08/rmbs-legal-roundup-the-top-five-developments-you-might-have-missed-while-obsessing-over-the-bonybofa-settlement.html ("While the claims asserted in the cases filed by the FHFA and NCUA may not be novel, they are significant because of their size and the fact that they are being driven by federal regulators," opined one commentator. "[I]nvestors of all sorts . . . are looking to recover their losses however they can, and in particular from the banks that make for ready villains.").

[16] *See* Richard R. Zabel, *Still Trapped with Toxic Assets: Dismissal of Private-Label RMBS in Class Actions*, ROBINS, KAPLAN, MILLER & CIRESI (Oct. 12, 2010), http://www.rkmc.com/Still-Trapped-with-Toxic-Assets-Dismissal-of-Private-Label-RMBS-in-Class-Actions.htm ("Recent court rulings have dismissed claims for 85% of the RMBS that had initially been included under the scope of the claims in those cases.").

[17] *See* Gradman, *supra* note 15 (detailing a recent uptick in class action RMBS litigation).

[18] *See* Gradman, *Top Five Reasons that MBS Lawsuits Are Just Beginning* (May 5, 2011), http://www.subprimeshakeout.com/2011/05/top-five-reasons-we-havent-seen-the-last-of-the-mbs-lawsuits.html (detailing five developments that signal an uptick in private litigation over subprime mortgages).

[19] *See* Margaret Cronin Fisk, *U.S. Bancorp Unit Sues BofA's Countrywide Over Loan Pool*, BLOOMBERG (Aug. 30, 2011, 4:02 PM), http://www.bloomberg.com/news/2011-08-30/u-s-bank-national-association-sues-bofa-over-home-loans.html (reporting on the suit by U.S. Bancorp).

[20] *See* Louise Story & Gretchen Morgenson, *A.I.G. Sues Bank of America Over Mortgage Bonds*, N.Y. TIMES, Aug. 8, 2011, at A1 (reporting on the AIG suit).

and various foreign lenders.[21] To better administer all of this liability, Bank of America proposed an $8.5 billion settlement to cover a large portion of its mortgage-related claims.[22] Forty-four groups have petitioned to challenge the settlement,[23] including the FDIC,[24] AIG[25] and Goldman Sachs & Co. Securities Division.[26]Various others back the deal, including Goldman Sachs Asset Management.[27] However, a federal judge decided on October 19, 2011, that the case belonged in

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[21] *See* Jonathan Stempel, *JPMorgan, BofA Sued Over Mortgage Debt Losses*, REUTERS (Sept. 30, 2011, 4:34 PM), http://www.reuters.com/article/2011/09/30/us-mortgages-lawsuits-idUSTRE78T2M320110930 (explaining that Bank of America faces liability to Irish entity Sealink and Germany's Landesbank Baden-Wurttemberg).

[22] *See* Petition at 1, In re Bank of N.Y. Mellon, No. 651786/2011 (N.Y. Sup. Ct., June 29, 2011), *available at* http://cwrmbssettlement.com/docs/Verified%20Petition.pdf ("This settlement requires a payment of $8.5 billion . . . .").

[23] *See* Isaac Gradman, *BREAKING NEWS: Judge Determines BofA $8.5 bn Settlement Belongs in Federal Court*, THE SUBPRIME SHAKEOUT (Oct. 20, 2011), http://www.subprimeshakeout.com/2011/10/breaking-news-judge-deterimines-bofa-8-5-bn-settlement-approval-case-belongs-in-federal-court.html (reporting on a federal judge's decision to move the Bank of America settlement to federal court).

[24] *See* David McLaughlin & Dakin Campbell, *FDIC Objects to BofA's $8.5 Billion Mortgage-Bond Settlement*, BLOOMBERG (Aug. 30, 2011, 12:01 AM), http://www.bloomberg.com/news/2011-08-29/fdic-objects-to-bank-of-america-s-proposed-8-5-billion-mortgage-bond-pact.html (reporting on the FDIC's objection).

[25] *See* Nathan Vardi, *AIG's Attack On Bank of America's $8.5 Billion Settlement Questioned*, FORBES (Aug. 15, 2011, 3:22 PM), http://www.forbes.com/sites/nathanvardi/2011/08/15/aigs-attack-on-bank-of-americas-8-5-billion-settlement-questioned/ ("The institutional investors . . . suggested that AIG was trying to hold the $8.5 billion settlement hostage, arguing that they suspected 'the motive for AIG's settlement objection is tied to its own lawsuit against Bank of America' and that AIG was potentially attempting to 'leverage those separate and simultaneously-filed securities claims.'").

[26] *See* Nathan Vardi, *Goldman Sachs Is Playing Both Sides Of The $8.5 Billion Bank Of America Settlement*, FORBES (Sept. 6, 2011, 10:04 AM), http://www.forbes.com/sites/nathanvardi/2011/09/06/goldman-sachs-is-playing-both-sides-of-the-8-5-billion-bank-of-america-settlement/ ("[T]he Goldman Sachs that is now objecting to [the settlement] is Goldman Sachs & Co. Securities Division.").

[27] *See id.* ("The Goldman Sachs that is backing the $8.5 billion settlement with Bank of America is Goldman Sachs Asset Management . . . .").

federal court,[28] exposing the settlement to less friendly standards and ultimately defeating Bank of America's purpose—decreasing the uncertainty of its liability—in proposing the settlement in the first place.[29]

C. The Regulatory Future: Increasing Information Flow

Information asymmetry results when two parties to an economic transaction possess unequal amounts of information pertinent to the transaction. Financial markets are often perceived to suffer from such asymmetries, especially in light of frequently evolving innovations.[30] Thus, much of the recent legislation and regulation of subprime markets aims to increase the pertinent information available to all parties to a transaction through new and more stringent disclosure rules for originators and securitizers.

1. Know Before You Owe

The Consumer Financial Protection Bureau ("CFPB"), which took over consumer protection in the mortgage industry from the Federal Reserve on July 21, 2011, proposed two new disclosure forms in May 2011, which combined the current array [31] of required mortgage disclosure documents for adjustable rate mortgages

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[28] *See* Memorandum & Order at 1, Bank of N.Y. Mellon v. Walnut Place LLC, No. 11 Civ. 5988 (WHP) (S.D.N.Y. Oct. 19, 2011), *available at* http://www.scribd.com/doc/69508994/Judge-Pauley-Order-Denying-Remand-in-11-CV-5988-Bank-of-New-York-et-al-v-Walnut-Place-et-al (denying Bank of New York's motion to move the case back to state court).

[29] *See* Gradman, *supra* note 23 ("[The settlement's treatment in federal court] will completely undermine BofA's strategy of settling uncertainty in the markets and resolving its legacy Countrywide liability in a rapid and favorable manner.").

[30] *See, e.g.,* Zachary J. Gubler, *The Financial Innovation Process: Theory and Application*, 36 DEL. J. CORP. L. 55, 118-19 (2011) ("This pattern [of increasing complexity] . . . complicates the economics of financial regulation by increasing informational asymmetries between market participants and regulators and implies the need for a new regulatory paradigm . . . .").

[31] *See* Sovern, *infra* note 33, at 772 (listing the current required disclosure forms).

("ARMs") into one form.[32] Because "most subprime mortgages carry [an] adjustable rat[e],"[33] most subprime borrowers will likely see some version of these new forms, which exhibit a borrower's expected future payments in tabular form.[34] Legislators and regulators hope the form will make current disclosure information "more useful to consumers and . . . reduce burdens on lenders."[35] However, Dodd-Frank specifies that model forms, like those proposed by the CFPB, "may be used at the option of the covered person for provision of the required disclosures."[36] Consequently, whether or not lenders will adopt one of the forms on a widespread basis is still uncertain.

2. SEC Asset-Backed Securities Disclosure Rules

The Securities Exchange Commission ("SEC") issued a set of rules in January 2011 implementing a new disclosure regime, mandated by Dodd-Frank, concerning the issuance of asset-backed securities ("ABS"). Rule 193, for example, requires that issuers of ABSs (including RMBS) "shall perform a review of the pool assets

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[32] *See Know Before You Owe*, CONSUMER FIN. PROTECTION BUREAU, http://www.consumerfinance.gov/knowbeforeyouowe/ (last visited Oct. 12, 2011) ("We began Know Before You Owe in May by asking the public to compare two different draft designs of a new mortgage disclosure.").

[33] Jeff Sovern, *Preventing Future Economic Crises Through Consumer Protection Law or How the Truth in Lending Act Failed the Subprime Borrowers*, 71 OHIO ST. L.J. 761, 772 (2010) ("Most subprime loans carry adjustable rates . . . .").

[34] *See, e.g., Jasmine Form*, CONSUMER FINANCIAL PROTECTION BUREAU, http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/kbyo/jasmine.pdf (depicting increasing payments); *Nandina Form*, CONSUMER FINANCIAL PROTECTION BUREAU, http://www.consumerfinance.gov/wp-content/themes/cfpb_theme/images/kbyo/nandina.pdf (depicting increasing payments).

[35] *See* FIN. STABILITY OVERSIGHT COUNCIL, 2011 FSOC ANNUAL REPORT 122 (2011), *available at* http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20(FINAL).pdf (summarizing the CFPB's efforts regarding the Know Before You Owe form).

[36] *See* 15 U.S.C. § 5532 (West 2011).

underlying the [ABS]."[37] The rule also sets out a minimum standard by which the review "must be designed and effected to provide reasonable assurance that the disclosure regarding the pool assets . . . is accurate in all material respects."[38]

Much debate surrounded this minimum standard during the rule's comment period. The SEC added this minimum standard after comments on the initial version of the rule expressed concern that "it would be difficult if not impossible to write a detailed, prescriptive rule outlining exactly how asset reviews should be conducted in each circumstance."[39] Many commentators, however, opined that this standard is unnecessary. For example, the American Securitization Forum stated that the statute and regulation already mandate a very detailed asset review, and the additional requirement of assuring minimum accuracy adds little value for disclosure purposes.[40] The burdens thus could "turn a well-intentioned reform into one more obstacle to the recovery of the securitization markets" with very little gain.[41]

The SEC also issued rules requiring certain securitizers to fill out a form, ABS-15G. This form details a securitizer's history of demands for repurchase, actual repurchases or replacements of ABS where the ABS contained warranties or representations about the underlying assets' quality.[42] The rule requires this disclosure for securitizers who issued such ABS from January 1, 2009 to December

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[37] *See* 17 CFR § 230.193 (2011) (providing new rules regarding review of underlying assets in asset-backed securities).
[38] *See id.* (setting out the minimum reasonable assurance standard).
[39] *See, e.g.,* E-mail from Barbara Roper, Director of Investor Protection, to Elizabeth M. Murphy, Secretary of the Securities Exchange Commission, 6 (2010), *available at* http://www.sec.gov/comments/s7-26-10/s72610-15.pdf (commenting on the proposed asset review rule).
[40] *See, e.g.,* American Securitization Forum, Comment Letter to Elizabeth M. Murphy, Secretary of the Securities Exchange Commission, regarding ASF Due Diligence 4 (2010), *available at* http://www.sec.gov/comments/s7-26-10/s72610-44.pdf (arguing that the additional minimum standard, far from providing investors with actual information pertinent to making investment decisions, merely "require[s] issuers to describe what they did to get comfortable that they met their disclosure obligations").
[41] *Id.* at 5.
[42] 17 CFR § 240.15Ga-1(a) (2011) (depicting the form).

31, 2011, and quarterly thereafter[43] but exempts securitizers from providing information "unknown and not available to the securitizer without unreasonable effort or expense."[44] Ideally, this form will help investors "identify asset originators with clear underwriting deficiencies"[45] and push such originators out of the market by encouraging securitizers not to do business with them.

3. Mortgage Borrower Protections

From 2008 to 2011, the Federal Reserve Board ("Board") issued a total of seven final rules under the Home Ownership and Equity Protection Act ("HOEPA") and the Truth in Lending Act ("TILA").[46] The CFPB, in addition, took over responsibility for five other proposed rules on July 21, 2011.[47] These Board and (soon-to-be) CFPB rules are the first federal regulations to apply to all mortgage lenders, and contain several restrictions on "higher-priced" loans in response to problems specific to the subprime market.[48]

The Board's HOEPA rules set out, among other things, several key restrictions concerning "higher-priced" loans (with

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[43] *Id.* §§ 240.15Ga-1(c)(1)-(2) ("The disclosures in paragraph (a) of this section shall be provided by a securitizer . . .[f]or the three year period ended December 31, 2011 . . . For each calendar quarter . . . .").

[44] 17 CFR § 240.15Ga-1(a)(2) (stipulating that securitizers need not provide information they do not have and cannot easily obtain).

[45] Disclosure for Asset-Backed Securities, Securities Act Release No. 33-9175, Exchange Act Release No. 34-63741, 2011 WL 194493, at 5 (Jan. 20, 2011), *available at* http://www.sec.gov/rules/final/2011/33-9175.pdf (listing the goals of Rule 240.15Ga-1(a)).

[46] *See Mortgage Origination: The Impact of Recent Changes on Homeowners and Businesses: Hearing Before the Subcomm. on Ins., Hous., and Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 112th Cong. 1 (2011) (statement of Sandra F. Braunstein, Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System), *available at*http://financialservices.house.gov/UploadedFiles/071311braunstein.pdf("[T]he Board comprehensively addressed the need for mortgage reform by issuing seven final rules under the Truth in Lending Act (TILA) and Home Ownership and Equity Protection Act (HOEPA).").

[47] *See id.* at 1 ("[F]ive additional proposed rules . . . will become the responsibility of the Consumer Financial Protection Bureau (the Bureau).").

[48] *See id.* at 2 ("In response to specific problems we saw in the subprime market, some restrictions in the final rules apply only to higher-priced mortgage loans.").

interest rates exceeding the prime rate by 1.5% for first-lien loans or 3.5% for subordinate lien loans) and other high-interest rate loans.[49]

i. Assessing High Risk Borrowers' Ability-to-Repay

First, the new regulations prohibit anyone from extending with interest rates above 8% for first lien loans or 10% for subordinate lien-loans (higher-priced loans) without considering the consumer's ability-to-repay.[50] The Board's initial rule was fairly flexible, allowing creditors to adapt their underwriting standards to particular borrowers as necessary. Dodd-Frank later mandated something similar[51] but expanded the ability-to-repay requirement "to cover any consumer credit transaction secured by a dwelling regardless of how the loan is priced."[52] This newly proposed rule, which is being considered by the CFPB as of July 21, 2011, would give creditors four ways to comply with the ability-to-repay rule: undertaking a typical assessment of ability-to-repay factors (like income and other obligations),[53] originating qualified mortgages,[54] originating qualified balloon payment mortgages in rural or underserved areas[55] or refinancing under a streamlined process meeting certain conditions.[56]

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[49] *See* 12 C.F.R. § 226.35(a)(1) (2010) (defining "higher-priced mortgage loans").

[50] *See* 12 C.F.R. § 226.34(a)(4) (2009) (prohibiting creditors from extending "higher-priced mortgage loans" without considering the consumer's repayment ability).

[51] *See* 15 U.S.C. § 1639c (West 2011) ("[N]o creditor may make a residential mortgage loan unless the creditor makes a reasonable and good faith determination . . . that . . . the consumer has a reasonable ability to repay the loan . . . .").

[52] *See Mortgage Origination*, *supra* note 46, at 17-18 (summarizing the Dodd-Frank rules on ability-to-repay).

[53] *See* 15 U.S.C.A. § 1639c (West 2011) (listing the eight factors to be considered in determining a borrower's ability-to-repay).

[54] *See id.* § 1639c(b)(1) (setting out the presumption of compliance for qualified mortgages).

[55] *See id.* § 1639c(b)(2)(E)(iv)(I) (allowing exemption for balloon payment mortgages with certain characteristics made by originators operating in predominantly rural or underserved areas).

[56] *See id.* § 1639c (a)(5) (providing an exemption for certain streamlined refinancings).

One of the major issues the CFPB is reconsidering with this rule is exactly what sort of protections will be given to those extending qualified mortgages—loans without excessive fees, interest-only payments or several other troublesome features.[57] Banks and mortgage lenders and especially secondary market investors want a strong safe harbor, so that, in addition to a presumption of compliance, they are protected from liability for any default due to shoddy underwriting by originators.[58] Secondary market investors especially worry that without this additional protection, they "may be held accountable for the actions of originators that could neither be detected nor controlled."[59] CFPB to this point has given no indication of whether it prefers or plans to implement a strong or weak safe harbor rule.

ii. Prohibition of Prepayment Penalties

Second, in addition to the ability to repay requirement, the Board promulgated a 2008 rule prohibiting inclusion of prepayment penalties in mortgages unless: (1) such penalties will not apply within two years after the loan's consummation; (2) the prepayment is not the result of refinancing; and (3) the borrower's payment does not change in the four years following consummation.[60] Prepayment penalties tend to lock adjustable-rate borrowers into monthly payment increases they cannot afford,[61] and thus, this rule largely aims to protect subprime borrowers with ARMs.

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[57] *See id.* § 1639c (b)(2)(A)(i)-(ix) (listing the requirements of a qualified mortgage).
[58] *See, e.g.,* E-mail from Wendell J. Chambliss to Jennifer J. Johnson, *supra* note 6, (explaining Freddie Mac's concern with a weak presumption of compliance, rather than safe harbor, interpretation).
[59] *See id.* at 9 (explaining the concern that safe originators like Freddie Mac will be exposed to liability even when they could not foresee defaults).
[60] 12 C.F.R. § 226.35(b)(2)(ii) (setting out the general restriction on prepayment penalties).
[61] *Mortgage Origination*, *supra* note 46, at 4 ("Prepayment penalties can prevent borrowers from refinancing their loans to avoid monthly payment increases or if their loan becomes unaffordable for other reasons.").

D. Conclusion

Federal regulators, namely the CFPB and FHFA, have attempted to crack down on those who engaged in harmful subprime lending that purportedly misled borrowers and securities purchasers. The intended result is seemingly a regulatory atmosphere that favors traditional mortgages over riskier mortgages (including subprime), copious amounts of added disclosure and an enforcement atmosphere where deceptive originators and securitizers face liability. Whether by regulator design or not, this atmosphere seems to be materializing to some extent: While mortgages that don't meet government standards for a guarantee have, once again, begun growing as a share of total mortgages, the originators making such loans are requiring higher down payments and requiring documentation of ability-to-repay in all cases.[62] Only with more time and data, however, will we really know the effects on the subprime market of the recent litigation and regulatory efforts.

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[62] Annamaria Andriotis, *Riskier Loans Make a Comeback, as Private Firms Take the Field*, WALL ST. J., (July 12, 2011), http://online.wsj.com/article/SB10001424052702304793504576434221237511868.html (reporting on the recent increase in subprime and other risky loans).

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