COMMONWEALTH OF MASSACHUSETTS
SUPREME JUDICIAL COURT

No. 10258

COMMONWEALTH OF MASSACHUSETTS,
Plaintiff-Appellee,

v.

FREMONT INVESTMENT & LOAN
Defendant-Appellant,

and

FREMONT GENERAL CORPORATION,
Defendant.

On Direct Appeal From a Report of a
Single Justice of the Appeals Court

BRIEF OF THE AMERICAN FINANCIAL SERVICES ASSOCIATION, THE CONSUMER MORTGAGE COALITION, THE HOUSING POLICY COUNCIL OF THE FINANCIAL SERVICES ROUNDTABLE, AND THE MORTGAGE BANKERS ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF DEFENDANT-APPELLANT

Dated: September 19, 2008

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes, Regulations, and other Government Materials

Cases

Other Materials

INTEREST OF *AMICI*

This brief is filed by the American Financial Services Association, the Consumer Mortgage Coalition, the Housing Policy Council of the Financial Services Roundtable and the Mortgage Bankers Association (collectively the "*Amici*").

The American Financial Services Association ("AFSA") is the national trade association for the consumer credit industry protecting access to credit and consumer choice. AFSA's members include, among others, industrial banks, mortgage lenders, credit card companies and diversified financial services firms. AFSA has provided services to its members for over ninety years.

The Consumer Mortgage Coalition ("CMC") is a trade association of national mortgage lenders, mortgage servicers, and mortgage origination-service providers, committed to the nationwide rationalization of consumer mortgage laws and regulations. The CMC regularly appears as *amicus curiae* in litigation with implications for the national mortgage lending marketplace.

The members of the Housing Policy Council of the Financial Services Roundtable ("HPC/FSR") are 25 of the nation's largest mortgage lenders. It is estimated that the members of the HPC/FSR originate over 65% of mortgages for American home buyers.

The Mortgage Bankers Association ("MBA") is the national association representing the real estate finance industry, an industry that employs more than 370,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,400 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

The *Amici* frequently appear in litigation where the issues raised are of widespread importance and concern to their members. That is the case here, because the lower court's order unjustifiably exposes the residential mortgage industry to significant risks of unquantifiable liability. If a loan complies with federal and Massachusetts law, and if the loan is generally considered fair at the time it is made, lenders must have confidence that the loan complies with Massachusetts law. The lower court's order--following on the Attorney General's request for an injunction that initiated this action--makes confidence impossible. Given the severe penalties available under G.L. 93A, both in terms of civil damages and equitable remedies, and the likely impact on the residential mortgage market in Massachusetts, this issue is of crucial importance to *Amici*'s members and to the financial services industry generally.

INTRODUCTION

The superior court's preliminary injunction order--stopping foreclosures on loans it held are valid--is a significant departure from the judicial role. The lower court acknowledged that the loans at issue did not violate any of Massachusetts' extensive (and recent) body of statutes or regulations, including those issued by the Plaintiff-Appellee. Neither Massachusetts law in effect at the times the loans at issue were made nor now would make the loans originated by Fremont Investment & Loan ("Fremont") presumptively unfair.[1] The lower court has created a legal requirement that neither the Legislature, the Commissioner of Banks, nor even the Attorney General had seen fit to create. There is no basis whatsoever in Massachusetts law for the lower court's decision. Massachusetts law simply does not support such judicial activism.

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[1] While *Amici* note that the lower court acknowledged that Fremont's loans did not violate any statutory or regulatory provision, *Amici* do not address or endorse Fremont's particular lending practices. Instead, *Amici's* brief principally addresses the consequences of the lower court's order.

The lower court's *ex post facto* order is not only wrong as a matter of law, it is wrong as a matter of public policy. The lower court's preliminary injunction order will create additional significant uncertainty in the Massachusetts mortgage market, on top of the enormous level of uncertainty generated by current economic conditions. The lower court's order, rather than being a step toward solving the current economic situation, will likely only lead to higher prices for mortgage loans or a greater tightening of lending criteria, thereby reducing the availability of credit for borrowers. Under the lower court's reasoning, lenders will never be able to know at the time they make a mortgage loan whether the loan complies with Massachusetts law--no matter how fair the loan appears at the time it is made. If the lower court's order is allowed to stand, even loans that both (1) comply fully with all of the Commonwealth's extensive statutes and regulations, and (2) are considered at the time to be fair both in the industry and society generally could be deemed unfair years later. The lower court's order creates enormous uncertainty regarding the potential liability for loans that comply with all of the Commonwealth's comprehensive body of law governing mortgage lending--liability that could be overwhelming, but, given the absence of any meaningful standards resulting from the lower court's arbitrary and unprincipled decision, cannot be detected, quantified, nor managed at the time any loan is made.

This increased uncertainty will have severe negative effects on Massachusetts consumers--especially those who previously had or are now experiencing financial difficulties. Experience has shown repeatedly that when mortgage lenders and investors are faced with such an uncertain and unquantifiable risk of liability due to state law, lenders either must charge higher prices to protect against this risk or will not lend in the state at all. The result is that those consumers who can still get mortgage credit in the state will pay a higher price for it, while many consumers will no longer have access to mortgage credit at all. Ironically, the lower court's attempt to benefit a small number of borrowers will make the Massachusetts mortgage market --which is already experiencing significant difficulties--far worse for many more Massachusetts consumers.

Because the lower court's order threatens to harm Massachusetts consumers and cause enormous (additional) disruption to the mortgage market in Massachusetts, *Amici Curiae* respectfully urge this Court to grant Defendant's Petition and Supplemental Petition and to reverse the lower court's order.

BACKGROUND

The lower court reached its unprecedented conclusion that certain loans are "presumed to be structurally unfair" even though it acknowledged that "there was no federal or Massachusetts statute or regulation applicable to all mortgage loans that expressly prohibited" the loans at issue. (Order, at 15, 20.) And it did so notwithstanding its acknowledgement that "the lending conduct this Court describes as unfair was not generally recognized in the industry to be unfair at the time these loans were made." *Id.* at 22.[2] And it did so even though the

[2] The lower court was correct that the industry believed many of the various subprime products were not only fair and beneficial to consumers but also did not pose undue risk. *See, e.g.*, Brian Collins, *Freddie Gearing Up for B&C Deals*, NAT'L MORTG. NEWS, Feb. 13, 2006, at 38 (announcing that government sponsored enterprise Freddie Mac "is gearing up to purchase subprime loans directly from originators"); Charles Wisniowski, *Interview: Doug Duncan, chief economist,*
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court conceded that "we, as a society," did not consider these loans to be generally unfair. *Id.* at 25.[3] The court also found that there was no evidence

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Mortgage Bankers Association, MORTG. BANKING, Apr. 2006, at 27 ("And that's what the concern has been about--whether those folks will be able to meet their payments. The answer is 'yes,' the vast majority of them will be able meet their payments or they'll reorganize their loans so that they'll make payments on the new loan. So there's much too much concern about some disaster that's waiting out there with the newer products.").

3 Leading policy makers viewed the various developments in the subprime market as positive for consumers. *See, e.g.*, Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve Board, Speech at the Federal Reserve System's Fourth Annual Community Affairs Research Conference (Apr. 8, 2005), *available at* http://www.federalreserve.gov/BoardDocs/speeches/2005/20050408/default.htm.

Additionally, the general perception was that housing prices would continue increasing. *See, e.g.*, Jennifer Steinhauer & Jim Ruternberg, *In New York Real Estate, What Goes Up Keeps Rising*, N.Y. TIMES, Jan. 15, 2005 ("These increases [in property values], even in the face of sluggish job growth on Wall Street and an overall economy that lags the nation's, indicate that 'the rules of real estate have changed' . . . ."); Andrea Coombes, *Few Homeowners See Home Values Declining: Survey*, DOW JONES BUS. NEWS, Oct. 30, 2006 ("[M]any homeowners are likely still enjoying recent gains. . . . The economy is not very strong, but if it continues with some positive growth and if interest rates stay stable over the next year or so, we will see the housing market towards the end of 2007 start appreciating again.").

that Fremont made or knew of any misrepresentations to borrowers. *Id.* at 12-13.

The lower court acknowledged that the loans violated no provision of Massachusetts' extensive statutory or regulatory regime--one of the most expansive in the nation. Nevertheless, the court looked to the "spirit" of the law rather than its plain language. *Id.* at 16-17. The Predatory Home Loan Practices Act (the "PHLPA") is expressly limited to "high cost mortgage loans." G.L. c. 183C, § 2. The lower court acknowledged that the loans at issue are not "high cost mortgage loans" and therefore not subject to the PHLPA. (Order, at 17.)

Notwithstanding that conclusion and the plain language of the statute, the lower court resorted to what it believed the Legislature "thought" and "imagined" when enacting the PHLPA. *Id.* at 21. And based on its belief of what the Legislature "thought" and "imagined"--but never said, much less passed into law--the lower court made the leap that the Legislature somehow created an unarticulated "concept of unfairness" that applies to "<u>any</u> mortgage loan." *Id.* at 20 (emphasis in original). Then, looking to "the penumbra of that concept of unfairness," the court made another leap and found that loans with the four characteristics it (not the legislature) selected are presumptively unfair. *Id.*

Thus, in spite of the plain language of the PHLPA, the lower court divined a previously unknown "concept of fairness" based solely on what it thought the Legislature would do (but did not do), and from the "penumbra" of that newly divined concept created new law that applies to the entire mortgage lending industry. Not only is the lower court's order bad law, but it threatens to cause significant harm to Massachusetts consumers and the Massachusetts mortgage market generally.

SUMMARY OF ARGUMENT

The lower court's order not only threatens to further destabilize the financial markets, but also threatens to harm many Massachusetts consumers. Before the lower court's order, mortgage lenders, loan servicers, and investors believed--reasonably--that loans that complied with Massachusetts' extensive laws and regulations governing mortgage lending were lawful under Massachusetts law. The pricing of mortgage loans was based on this assumption.

The lower court's order not only eliminates the market's ability to determine in advance whether a loan complies with Massachusetts law, but it creates the dangerous precedent of imposing liability retroactively based on previously unknown standards. Loans that the court acknowledges complied with all Massachusetts statutes and regulations, and that were considered fair by all of society at the time, are now declared "presumptively" unfair retroactively. As a result, no lender, servicer or investor--no matter how responsible its lending practices--will ever know with certainty whether a loan will be valid and enforceable in the future.

This uncertainty will not only have dire consequences for the financial markets, but also for Massachusetts consumers. Investors will be very reluctant to invest in mortgage loans if they are not sure that the loans will be enforceable in the future. The result will be that mortgage credit will be less available to Massachusetts consumers. And, any investors willing to purchase such loans will surely price the additional risk that they perceive--even if their perception is exaggerated--into the purchase price. Those Massachusetts consumers who can find mortgage loans therefore will likely pay more for them.

The current market difficulties forcefully show that policy-making in this area is difficult even for those with expertise in the financial markets. The lower court had no such expertise, and its order threatens to undermine the decisions of law and policy-makers who do.

Finally, even if the lower court's order were defensible as a matter of public policy--and it is not--it would be indefensible as a matter of law. Section 3 of Chapter 93A expressly excludes from its coverage transactions permitted under regulations administered by state agencies. The lower court's order effectively reads Section 3 out of Chapter 93A.

ARGUMENT

The lower court's experiment in policy-making could hardly have come at a worse time. As the Court is no doubt aware, the financial markets are in upheaval to an extent our country has rarely, if ever, experienced. Major financial institutions, most recently Lehman Brothers, have failed. Others, including Fannie Mae, Freddie Mac, and AIG, have been placed under government control. Government leaders and financial experts--both in the United States and abroad--are working to find solutions to the credit crisis.[4]

The central cause of the current crisis is uncertainty about the value of mortgage loans. Financial institutions cannot obtain needed capital because investors are uncertain about the value of mortgages held by these institutions.[5] Until the

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4 See, e.g., *Statement by Secretary Henry M. Paulson, Jr. on Comprehensive Approach to Market Developments* (Sept. 19, 2008) ("*Paulson Statement*"), *available at* http://www.ustreas.gov/press/releases/hp1149.htm; David Stout, Officials Meet to Chart Course Through Credit Crisis, N.Y. TIMES, Sept. 18, 2008.

5 *See, e.g.*, *Paulson Statement*, *supra* ("The inability to determine their worth has fostered uncertainty about mortgage assets, and even about the financial condition of the institutions that own them. The normal buying and selling of nearly all types of mortgage assets has become challenged. . . . These illiquid assets are clogging up our financial system, and undermining the strength of our otherwise sound financial institutions."); David Bogoslaw, *Markets: What You Should Be Watching Now*, BUS. WEEK ONLINE, Sept. 18, 2008 ("Uncertainty about the extent of the fallout from whatever happens to American International Group has caused more stagnation in the credit markets, with investors 'hoarding cash right now and building up for the rainy day.'" (quoting Portfolio Manager for Fixed Income, Cabot Capital Management)); Charles Duhigg & Vikas Bajaj, *Uncertainty Over Fannie and Freddie*, N.Y. TIMES, Aug. 23, 2008, at C1 ("Any investor stepping in will need certainty around the financing and leverage of their equity. . . . Right now, those are the things

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uncertainty regarding the value of mortgages and their effect on financial institutions is resolved, investors will not be willing to invest in the mortgage market.[6] The resulting lack of capital flow to banks and other lenders threatens the financial security of all Americans and increases the cost of credit to consumers--in Massachusetts and elsewhere.[7]

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that are uncertain. . . . As long as there is uncertainty over Treasury's plan, we can't raise money . . . ."); *Casualty Count*, AKRON BEACON J., Sept. 16, 2008, at A8 ("As the housing market implodes, many financial companies, their portfolios afflicted by virus-like mortgage-based securities, have been desperate to raise capital. Unfortunately, investors are increasingly uncertain about what the companies are precisely worth. Thus, Lehman and others watched their stock prices plunge, making the task of raising capital all the more difficult.").

6 *See, e.g.*, *Paulson Statement*, *supra* ("To restore confidence in our markets and our financial institutions, so they can fuel continued growth and prosperity, we must address the underlying problem [of the inability to determine the worth of mortgage assets]."); Steve Adams & Jennifer Santos, *New Life Seen for Housing*, QUINCY PATRIOT LEDGER, Sept. 9, 2008, at 7 ("'[o]nce you start to remove uncertainty, you start getting investors back in the market . . . .'" (quoting Robert Fraser, President, South Coastal Bank)).

7 *See, e.g.*, *Paulson Statement*, *supra* ("Right now, our focus is restoring the strength of our financial system so it can again finance economic growth. The financial security of all Americans--their retirement savings, their home values, their ability to borrow for college, and the opportunities for more and higher-paying jobs--depends on our ability to restore
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The lower court's order exacerbates the uncertainty regarding the value of mortgage assets at precisely the wrong time. The lower court acknowledged both that (1) the loans at issue complied with all of Massachusetts' extensive statutory and regulatory requirements;[8] and (2) everyone considered the loans to be fair at the time they were made. Nevertheless, the lower court created a previously unknown legal requirement, applied it retroactively, and effectively rendered what once were valid mortgage loans invalid and unenforceable. Making entire classes of loans unenforceable only increases the uncertainty regarding the financial health of those

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our financial institutions to a sound footing."); Robert Gavin & Kimberly Blanton, *Takeover Seen Easing Loan Crisis*, BOSTON GLOBE, Sept. 7, 2008, at 1 (explaining that the government take-over of Fannie and Freddie was intended to address the uncertainty in the mortgage market: "That uncertainty, as well as billions of dollars in losses, have made investors reluctant to buy bonds that the two government-created companies use to finance mortgages, reducing the amount of money available for loans and raising rates for borrowers.").

[8] *See, e.g.*, G.L. c. 183C (Predatory Home Loan Practices Act); G.L. c. 255E (Licensing of Certain Mortgage Lenders and Brokers Act); G.L. c. 140D, §§ 1 et seq. (state Truth in Lending Act), G.L. c. 93, § 58-60 (state Credit Reporting Reform Act); G.L. c. 93, § 24-28 (state Fair Debt Collection Act).

institutions holding those loans. The result is that the lower court's order likely will further destabilize the financial markets.

Not only does the lower court's order threaten to worsen the current credit crisis, but it also threatens to harm many Massachusetts consumers. As discussed in greater detail below, the lower court's order creates a precedent that casts doubt on the validity of all mortgage loans made in Massachusetts. Even lenders that comply strictly with Massachusetts' expansive statutory and regulatory regimes applicable to mortgage loans will never be able to know whether the loan will be valid and enforceable in the future. This uncertainty will deter investors from purchasing Massachusetts loans, thereby making it more difficult, if not impossible, for many lenders to make such loans. This uncertainty also will likely deter multi-state lenders from focusing as many resources on Massachusetts. As a result, the availability of credit to Massachusetts consumers likely will be substantially diminished--and what credit is available likely will be significantly more costly.

I. POLICY-MAKING SHOULD BE LEFT TO LAWMAKERS.

Before discussing the ways in which the lower court's order will harm Massachusetts consumers and further destabilize the financial markets, *Amici* wish to note that the lower court is not equipped to resolve policy matters as complex as insuring liquidity for sustainable mortgages.

A. Courts Are Ill-Suited to Create Public Policy in Such Complex Areas as Mortgage Lending.

The lower court's order is a classic example of why law and policy-making should be left to lawmakers who have the resources and access to experts needed to make well-informed decisions in such a complex area. While the lower court acknowledged early in its order that the record before it was limited (Order, at 5-6), this did not stop the court from making numerous sweeping (and incorrect) generalizations about the residential mortgage market and the origins of the current difficulties in that market. Surprisingly, the lower court engages in its own economic analysis of housing price appreciation--notwithstanding the limited record before it and the utter absence of any expert testimony--in order to justify its arbitrary selection of four characteristics that render loans presumptively unfair. *Id.* at 19 n.11.[9] It has long been recognized that courts are ill-suited to perform such analyses. *See, e.g., United States v. Philadelphia Nat'l Bank*, 347 U.S. 321, 371 (1963) (explaining that balancing "economic debits and credits . . . [is] beyond the ordinary limits of judicial competence").

While the the lower court's order contains many incorrect inferences and conclusions, one in particular may suffice for illustration. The lower

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[9] The lower court also misinterprets the findings of the Gerardi, Shapiro, and Willen study upon which court so heavily relies. Rather than finding that subprime lenders "created a group of borrowers that were much more likely to default" (Order at 19 n.11), the study finds that when subprime borrowers become delinquent--which the authors state is at least five times as likely as for prime borrowers even in the best of times--they have fewer options available to them to address those delinquencies. In other words, the study does not find that subprime products force subprime borrowers into becoming delinquent and defaulting on loans; it merely finds that foreclosure is one of the only options available to otherwise delinquent borrowers when housing prices decline. *See* Kristopher Gerardi, Adam Hale Shapiro, & Paul S. Willen, *Subprime Outcomes: Risky Mortgages, Homeownership Experiences, and Foreclosures*, Federal Reserve Working Paper No. 07-15, at 3-4 (Dec. 3, 2007). Additionally, the study found that while some people who purchase homes with subprime mortgages may experience foreclosure, the study also found that "82 percent will either remain in the home or sell the property." *Id.* at 2. Thus, according to this study,

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court concludes that "[t]o issue a home mortgage loan whose success relies on the hope that the fair market value of the home will increase during the introductory period is as unfair as issuing a home mortgage loan whose success depends on the hope that the borrower's income will increase during that same period." (Order, at 19.) However, three noted housing economists have concluded that people "tend to make good decisions about their own economic prospects," including their prospects for future increases in income.[10] Indeed, Professor Rosen of Princeton explained that their study found that

> people make sensible housing decisions in that the size of the house they buy today relates to their future income, not just their current income and that the innovations in mortgages over 30 years gave many people the opportunity to own a home that

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the vast majority of such borrowers do not end up in foreclosure.

[10] Austan Goolsbee, *'Irresponsible' Mortgages Have Opened Doors to Many of the Excluded*, N.Y. TIMES, Mar. 29, 2007 (citing Kristopher Gerardi, Harvey S. Rosen, & Paul Willen, *Do Households Benefit from Financial Deregulation and Innovation: The Case of the Mortgage Market*, Federal Reserve Public Policy Paper Discussion Paper No. 06-6 (Sept. 2006), *available at* http://www.bos.frb.org/economic/ppdp/2006/ppdp066.pdf).

> they would not have otherwise had, just because they didn't have enough assets in the bank at the moment they needed the house.[11]

Thus, there is strong support that it is not unfair to allow consumers to make mortgage borrowing decisions based on future income--including from two of the economists on which the lower court relied elsewhere. (Order, at 19 n.11.)

The residential mortgage market and the causes of the recent difficulties in that market are extraordinarily complex.[12] As can be seen from recent events in the marketplace, even experts with deep experience with the market face challenges in analyzing this complex market. A court--with a limited preliminary injunction record before it--

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[11] Goolsbee, *supra* (quoting Prof. Harvey S. Rosen).

[12] *See, e.g.*, Michael Kranish, *Amid Fiscal Woes, Obama Reshapes Campaign Message*, BOSTON GLOBE, Sept. 19, 2008, at 12 (questioning whether any candidate has the experience to deal with the complexities of the current crisis); Kevin G. Hall, *Battered Financial Markets Nervously Await What's Next*, KNIGHT-RIDDER, Sept. 17, 2008 ("Today's financial crisis is far more complicated [than the S&L crisis] because of the many complex financial instruments and unregulated markets for which little information is available. The systemic risk pieces are much more complicated. We don't begin to see the full picture. With S&Ls you knew who they were, they had quarterly reports. Today we don't have that . . . ." (citation omitted)).

simply is not in a position to draw any well-informed conclusions regarding the factors that contribute to delinquency and default. If allowed to stand, the lower court's order likely will have disastrous results.

B. State and Federal Lawmakers Are Already Addressing the Issues in the Mortgage Market.

Federal and state lawmakers have been heavily engaged in addressing the difficulties in the residential mortgage market in Massachusetts and nationwide in ways that do not negatively impact the availability of credit to consumers. Given these extensive efforts, the lower court's order is unnecessary and unwarranted.

Federal and state lawmakers have taken a very active role in addressing the origination of mortgage loans. In the last two years, the federal banking agencies have issued joint guidance on nontraditional mortgage products[13] and on subprime lending.[14] The

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[13] *See Interagency Guidance on Nontraditional Mortgage Product Risks*, 71 Fed. Reg. 58609 (Oct. 4, 2006). The Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR") adopted parallel guidance. *See* CSBS & AARMR, *Guidance on*

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Massachusetts Commissioner of Banks has formally adopted both.[15] The Federal Reserve Board also has adopted comprehensive regulations addressing mortgage lending activities under its HOEPA authority.[16] Massachusetts recently enacted an Act Preserving and Protecting Home Ownership, which became effective on May 1, 2008.[17] The Commissioner of Banks recently updated its regulatory bulletin regarding subprime ARMs to first time borrowers.[18] Additionally, in October of last year the Massachusetts Attorney General amended its regulations regarding unfair and deceptive practices to address additional mortgage

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Nontraditional Mortgage Product Risks (Jan. 31, 2007), *available at* http://www.csbs.org.

14 *See Statement on Subprime Lending*, 72 Fed. Reg. 37569 (July 10, 2007). CSBS and AARMR also adopted parallel guidance. *See* CSBS & AARMR, *Statement on Subprime Lending, available at* http://www.csbs.org.

15 *See Industry Letter Regarding Regulatory Bulletin 5.1-103: Guidance on Non-Traditional Mortgage Product Risks* (Jan. 2, 2007); *Industry Letter on Final Subprime Lending Guidance, Amendments to 209 CMR 42.00 and Proposed Regulatory Bulletin on Bond for Licensed Lenders and Brokers* (Sept. 10, 2007).

16 *See* 73 Fed. Reg. 44522 (July 30, 2008).

17 *See* House No. 4387.

18 *See Updated Regulatory Bulletin 1.3-104 Subprime Adjustable Rate Mortgage Loans to First Time Home Loan Borrowers* (Mar. 12, 2008).

lending practices, and earlier this month completed the comment period on those regulations.[19]

Lawmakers also have taken an active role in working to keep delinquent borrowers out of foreclosure. On July 30, the President signed the Housing and Economic Recovery Act of 2008 ("HERA"), which contains a comprehensive HOPE for Homeowners program to help homeowners avoid foreclosures.[20] The federal banking agencies also issued joint guidance urging federally regulated lenders to work with borrowers in financial distress.[21] While the Commissioner of Banks has not formally adopted this statement, the statement is cited on the Division's website suggesting the Commissioner's agreement with the statement. Additionally, Governor Patrick's

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[19] *See Notice of Public Hearing: Mortgage Lenders and Brokers Regulations, available at* http://www.mass.gov.

[20] *See* Pub. L. 110-289, tit. IV, div. A.

[21] *See Statement on Working with Mortgage Borrowers* (Apr. 17, 2007), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20070417a1.pdf. CSBS and AARMR adopted a parallel statement. *See Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages, available at* http://www.csbs.org.

efforts to help keep Massachusetts borrowers in their homes have been widely publicized.[22]

The U.S. Department of Treasury and the Department of Housing and Urban Development have also taken the lead in forming the HOPE NOW alliance, an alliance of mortgage servicers, counselors, investors, and other mortgage market participants--including *Amici* and many of their members. This alliance has successfully worked out over 2,000,000 loans since July of last year, with over 192,000 workouts in July 2008 alone.[23] In Massachusetts, HOPE NOW members have successfully worked out nearly 9,000 loans, and the percentage of work-outs in Massachusetts has increased 684% since the first quarter of 2007.[24] Importantly, HOPE NOW members tailor their efforts to the individual circumstances of each borrower to maximize

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22 *See, e.g.*, Scott Van Voorhis, *Gov's Move May Delay Mass. Foreclosures*, BOSTON HERALD, May 1, 2007, at 22; Jay Lindsay, *Lenders Say Many Won't Be Helped by Foreclosure Delay*, ASSOC. PRESS, May 1, 2007.

23 *See Over 2 Million Foreclosures Prevented in Past Year by HOPE NOW Alliance Members* (Aug. 27, 2008), *available at* http://www.hopenow.com/upload/press_release/files/July%202008%20Data%20Release%20.pdf

24 *See* HOPE NOW, *July State Data 2008*, *available at* http://www.hopenow.com/upload/data/files/July%20State%20Data%202008.pdf.

the chances for sustainable homeownership.[25] Indeed, two federal banking agencies recently reported that lenders' efforts to avoid foreclosures in the first two quarters of this year increased faster than new foreclosures filed.[26]

Unlike the efforts of federal and state lawmakers and the HOPE NOW alliance, the lower court's order does not take the sustainability of arrangements meeting the needs of individual borrowers into account. The lower court's blanket memorandum serves only to create uncertainty regarding the

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[25] *See* HOPE NOW, *Alliance Statement* (last visited Sept. 19, 2008) ("The alliance will develop common communications guidelines that will be used to respond to at-risk borrowers in order to offer them the best possible solutions, customized for each borrower."), *available at* http://www.hopenow.com/media/alliance_statement.html; HOPE NOW, *Hotline Services* (last visited Sept. 19, 2008) ("Our counselors are experts in foreclosure prevention and trained to set up a plan of action designed just for you and your situation. When you talk to us, you won't be judged and you won't pay a dime. That's because we don't just offer general advice - we help you take action. Counselors will arm you with education and support that assists you in overcoming immediate financial issues...at no cost to you."), *available at* http://www.hopenow.com/hotline_services/hotline_services.html.

[26] *See OCC and OTS Mortgage Metrics Report: January-June 2008* (Sept. 12, 2008), *available at* http://www.occ.treas.gov/ftp/release/2008-105a.pdf.

enforceability of mortgage loans--and thereby increases the uncertainty regarding the value of the loans. The law and policy-makers who understand the mortgage market--in partnership with many participants in the mortgage industry--are hard at work in efforts to protect consumers, keep borrowers in their homes when possible, and preserve an efficient mortgage market for the benefit of all consumers. The lower court's order will have harmful effects on the financial markets and the availability of credit to Massachusetts consumers, without benefitting consumers by furthering sustainable homeownership. The lower court should have left law and policy-making to the law and policy-makers.

II. THE LOWER COURT'S ORDER, IF ALLOWED TO STAND, WILL HAVE SEVERE NEGATIVE CONSEQUENCES FOR CONSUMERS.

A. The Lower Court's Order Creates Enormous Uncertainty in the Mortgage Industry and Will Constrict the Availability of Mortgage Credit to Consumers.

Prior to the lower court's order, lenders believed that if a mortgage complied with the myriad provisions of the Massachusetts statutes, the Commissioner's regulations and the Attorney General's regulations--and if the loan was generally considered lower court here.[27] Such "Monday morning quarterbacking" is fundamentally inconsistent both with principles of fairness and due process that are at the core American law and with the Attorney General's own regulations. *See* 940 CMR 8.06(15).[28]

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[27] For example, Massachusetts law prohibits both prepayment penalties and balloon loan payments in "high cost mortgage loans." *See* G.L. ch. 183C, §§ 5, 8. In other loans, such terms are not prohibited by federal or Massachusetts law--indeed, are commonplace--and provide important benefits to consumers. Under the lower court's reasoning, however, such provisions could perhaps be found to be unfair--and in violation of Massachusetts law--based on a "penumbra" of a "concept of fairness" contained in the high cost mortgage loan law (or some other statute or regulation).

[28] *Amici* note that this uncertainty has been exacerbated by the Attorney General's enforcement efforts in this case. *Amici* understand the importance of the Attorney General's mission in protecting consumers. Nevertheless, the Attorney General's enforcement activities have further deepened the uncertainty in Massachusetts. The Attorney General amended her regulations regarding mortgage lending in October 2007 to address some of the lending practices at issue in this case. While these new rules did not exist at the time Fremont made many of its loans, the Attorney General's claims in this case appear to be designed essentially to enforce the new regulations on conduct that pre-dated those new regulations. However, the Attorney General's claims in this case are inconsistent even with the Attorney General's amended rules, in that she seeks to have loans declared unfair that were not deemed unfair at the time the loan was made. Thus, the Attorney General herself appears to be operating under three different and inconsistent standards: (1) the regulations as they existed at the time the loans were made; (2) the regulations as amended in October 2007; and (3) the

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to be fair at the time it was made--then the loan complied with Massachusetts law. Given the expansive nature of the Commonwealth's statutory and regulatory regime, as discussed above, *Amici* assert that this belief was both reasonable and justifiable. Indeed, even the Attorney General's recent amendments to her regulations provide that unfairness is determined "based on information known at the time the loan is made" and what the lender "reasonably believes at the time the loan is expected to be made." 940 CMR 8.06(15).

The lower court's order fundamentally re-writes the rules--or, in a real sense, leaves the industry without any meaningful rules and standards regarding which loan terms and activities are lawful. After the lower court's order, even lenders who comply fully with all federal and Massachusetts statutes and regulations, and who make only loans considered fair at the time, will not know if any loan could be found to be presumptively unfair years later. If the lower court's order is allowed to stand, lenders will always face the risk that a court could expand statutory or regulatory provisions based on "penumbras" of previously unknown "concepts of fairness"--as did the

Indeed, the lower court's order places lenders in the untenable position of being required to foretell as-yet-unknown and unknowable future events. As a result, lenders will now be unable to evaluate accurately the legal risk associated with any given loan or to take reasonable measures to ensure compliance and avoid such risk.[29]

This unquantifiable risk will significantly restrict the availability of affordable mortgage credit in Massachusetts because it will impair lenders' ability to make, hold, sell or fund such loans. Banks and other portfolio lenders will have to assess, in addition to traditional credit risk issues, the risk that mortgage loans could later be found unfair and thus unenforceable or subject to other remedies. Moreover, the uncertainty will strongly

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standard the Attorney General seeks to apply in its enforcement efforts in this case. The lower court's order departs from all three of these standards, adopting its own fourth standard. The result is that lenders cannot even know which standard might apply to them, let alone how that standard might be applied.

[29] Liability under Ch. 93A is substantial: treble damages plus attorneys fees and costs per violation. G.L. ch. 93A, § 11. Additionally, injunctions like the one fashioned by the lower court impose severe financial costs on lenders and loan servicers.

affect the willingness of warehouse lenders (i.e., commercial lenders who extend credit to mortgage lenders to enable them to make loans) to provide funding for, and loan purchasers to buy, residential mortgage loans. Many loan purchasers or warehouse lenders will not be located in Massachusetts or perhaps even the United States. While local lenders and investors may be comfortable that they can understand and manage what a future court or enforcement authority might subjectively--and retroactively--determine to be "unfair," others, especially those that are distant, are likely to have trouble achieving that comfort.[30] Those lenders who

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[30] *See, e.g.,* Hearing Testimony of the National Consumer Law Center ("NCLC") to Senate Special Committee on Aging (March 16, 1998) (listing numerous then-widespread market practices it considers unfair including payment of a yield spread premium payment to a broker; the inclusion of a prepayment penalty in a residential mortgage loan; an interest rate that is simply "too high" in the advocates' view for the risk the lender is taking). In the past, other advocacy groups campaigned heavily against home equity lines of credit, a product offered by nearly every bank in the nation. Perceptions of unfairness change with both time and market conditions. No one complains about adjustable rate mortgages when rates are dropping but they are called "exploding" when rates rise. *Amici* provide these examples not so much to take issue with the advocates' views but rather to show that allowing the evolving concept of unfairness (with related remedies that are severe) to be applied retroactively

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sell most of their residential mortgage loans rather than hold them in portfolio (which includes many bank lenders and nearly all non-bank lenders) will not make loans subject to unquantifiable risk because they will not be able to sell them. Those lenders who hold loans in their portfolios (such as some banks) will be unwilling to make loans subject to unquantifiable liability. Indeed, they may be prohibited from doing so because making loans subject to such unquantifiable liability likely would be deemed an unsafe and unsound practice. Additionally, prudent portfolio lenders seek to make loans that could be easily sold to investors if the bank were to need additional liquidity--a condition many lenders find themselves in today.

Lenders will be unable to sell such loans because investors will not or cannot invest in such loans. Many investors can purchase mortgage loans (or invest in mortgage-backed securities) only if the investment

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creates very significant uncertainty for lenders and other market participants.

is rated by a rating agency.[31] For a loan to be saleable, it generally must be eligible for inclusion in a security that would be rated by a rating agency. When the risk exposure of a transaction is not quantifiable, the rating agencies cannot estimate the potential risk and therefore will not rate the transaction.[32] If state law creates such unquantifiable risk that the rating agencies will not rate a transaction that includes loans made in that state, loans made in that state cannot be sold to investors subject to those restrictions.

While the lower court's action is unprecedented, there are precedents of state legislatures prospectively creating unquantifiable liability for mortgage lenders and loan purchasers. Whenever a state law has created such unquantifiable liability, that law has choked off the availability of affordable mortgage credit to consumers in that state. For

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[31] *See, e.g.*, Richard Cantor & Frank Packer, *The Credit Rating Industry*, FED. RESERVE BANK OF N.Y. Q. REV. 1, 10-12 (Summer-Fall 1994); Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J. OF L. BUS. & FIN. 133, 136 (1994).

[32] *See, e.g.*, Standard & Poor's, *Legal Criteria for U.S. Structured Finance Transactions*, at 102 (Oct. 2006).

example, Georgia enacted a law in 2002 that provided for unquantifiable assignee liability.[33] As a result, many lenders substantially increased the price of loans to Georgia borrowers[34] while others left Georgia altogether.[35] The decreased availability of affordable mortgage credit was so harmful to consumers that the Georgia legislature quickly repealed the offending provision in 2003.[36] New Jersey had the same experience.[37]

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33 Ga. Laws 2002, p.455, § 1.

34 *See, e.g.*, Testimony of Larry Craig, Chairman, The Bond Market Association, Before the Special Committee on Aging, United States Senate (Feb. 24, 2004) (noting that interest rates jumped approximately 250 basis points as lenders withdrew from Georgia); Harold Cunliffe, *Fair Lending Legislation Has Unintended Fallout*, ATL. J. CONST., Jan. 27, 2003, at A9; Robert Luke & Henry Unger, *Mortgage Loan Law Problems Start to Hit Home With Buyers*, ATL. J. CONST., Feb. 15, 2003, at F3.

35 *See, e.g.*, Government Accountability Office, Testimony Before the Special Committee on Aging, United States Senate (Feb. 24, 2004).

36 Ga. Laws 2003, Act 1, § 1.

37 *See* Standard & Poor's, *Standard & Poor's Addresses New Jersey Predatory Lending Law* (May 2, 2003). The offending provision was quickly repealed as the adverse results became evident. *See* N.J. Laws 2004, ch. 84, § 4.

Massachusetts' fate will be no better--and perhaps will be worse.[38] Massachusetts' experience could be worse both because the lower court's order prevents mortgage holders from foreclosing on delinquent borrowers and because of the retroactive nature of the action. Interest rates on mortgage loans are much lower than for unsecured loans (like credit cards) because mortgage loans are secured.[39] No rational investor would pay secured-loan prices for an unsecured loan--or for loans with unenforceable

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[38] Indeed, the uncertainty created by the Attorney General's new mortgage regulations--which arguably create less risk than the lower court's order--has even prompted some prominent banking lawyers to suggest that the regulations are tantamount to an invitation for lenders to stay out of Massachusetts. *See* Laurence E. Platt & Nanci L. Weissgold, *Don't Fence Me Out: Massachusetts Encourages Lenders to Stay Away* (Nov. 2007), *available at* http://www.klgates.com/files/Publication/f7f4d854-6f60-45eb-8954-1ef77e0f86b0/Presentation/PublicationAttachment/4a709abd-0abe-4ca4-9cdf-21dd3224fdb5/MBA_1107.pdf.

[39] The Federal Reserve Board's most recent report indicates that the average interest rate for a 24-month personal credit card is 11.09%. *See* Federal Reserve Board, Statistical Release G.19 (Consumer Credit) (Sept. 8, 2008), *available at* http://www.federalreserve.gov/releases/g19/Current. In contrast, the average interest rate for a conventional mortgage for the week ending September 12, 2008, was 5.93%. *See* Federal Reserve Board, Statistical Release H.15 (Selected Interest Rates) (Sept. 15, 2008), *available at* http://www.federalreserve.gov/releases/h15/current.

security interests. And while current market conditions have limited the availability of some loan products, this increased uncertainty will further limit that availability and prevent them from being offered more broadly when market conditions improve. Even if the current market conditions remain and there is no market for loans that are not eligible to be sold to or guaranteed by a federally-backed agency, these issues will likely have an even greater effect on portfolio lenders such as banks and finance companies.

Additionally, unlike the climate surrounding the Georgia and New Jersey legislation, the lower court's order was not issued in a climate of decreasing home prices and market turmoil. If loan purchasers, including in some cases Fannie Mae and Freddie Mac, were unwilling to purchase loans and the rating agencies were unwilling to rate transactions subject to the Georgia and New Jersey statutes when home prices in those states were increasing, they surely will be less willing to rate transactions in Massachusetts in the current environment. If the lower court's order is permitted to stand, this experiment with unquantifiable risk exposure may result in more harm to consumers than experienced previously in other states.

B. The Uncertainty Caused by the Lower Court's Order Will Have Potentially Devastating Consequences for Massachusetts Consumers.

It is hard to imagine this reduction in the availability and affordability of mortgage credit happening at a worse time. Many Massachusetts consumers--not just subprime borrowers--received ARM loans with the intention of refinancing the loan once the loan changed from a fixed to variable rate. With declining home values[40] and current market disruption, many of these borrowers already will find it difficult to refinance in the near future. The lower court's order will only make it more difficult for borrowers with adjustable-rate mortgages to refinance. Ironically, the lower court's order likely will exacerbate borrowers' distress and likely increase their rates of delinquency.

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[40] For example, the Office of Federal Housing Enterprise Oversight's Housing Price Index shows that Worcester, Massachusetts experienced at least a 2% decline in housing prices during that last two quarters of 2007 and first two quarters of 2008 compared to the previous year, with the decline reaching 4.45% in the second quarter of 2008. *See* http://www.ofheo.gov/hpi_city.aspx.

The lower court's order will also make it much harder for many borrowers with equity in their homes to tap into that equity to help them weather tough times. For most homeowners, their largest financial asset is the equity in their home. In the past, when these homeowners experienced financial difficulties (e.g., job loss, medical expenses, etc.) they could draw on the equity to help them through those difficulties. However, borrowers with financial difficulties are more likely to pose higher credit risks and, therefore, less likely to qualify for conventional mortgage products. As a result, many Massachusetts consumers who otherwise would have been able to remain in their homes during difficult periods will have little choice but to sell--and, given current housing prices, potentially for a loss.

The lower court's order also threatens to stifle innovation and prevent many Massachusetts consumers in the future from participating in the American dream of homeownership. Innovations in the mortgage market have enabled more Americans to own their own home than at any time in our nation's history. Many of the products we now think of as conventional--including the 30-year fixed mortgage--were once radical departures from established lending practices.[41] Several noted housing economists have argued forcefully that innovations in the mortgage market have made homeownership available to more Americans--including people with low- and moderate-incomes--than ever before.[42] Austan Goolsbee, prominent housing economist and, until recently, Senator Obama's chief economic advisor, has noted that even though each new form of innovation has been greeted by a chorus of criticism, each has "tended to expand the pool of people who qualify" for mortgage credit and homeownership.[43]

The lower court's order will turn back the clock on this innovation--and the cost of this regression will fall particularly hard on low- and moderate-income consumers.[44] Professor Rosen of Princeton has

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41 *See, e.g.*, LENDOL CALDER, FINANCING THE AMERICAN DREAM: A CULTURAL HISTORY OF CONSUMER CREDIT ch. 6 (1999) (recounting the introduction of 20- and 30-year fixed rate mortgages when previously only short term (e.g., 5 yr.) mortgages with large down payment requirements were available).

42 *See, e.g.*, Gerardi, Rosen & Willen, *supra*.

43 Goolsbee, *supra*.

44 *See, e.g.*, *id.* (explaining that "the historical evidence suggests that cracking down on new mortgages may hit exactly the wrong people").

explained that "[t]he main thing that innovations in the mortgage market have done over the past 30 years is to let in the excluded: the young, the discriminated against, the people without a lot of money in the bank to use for a down payment."[45] Mortgage innovations have allowed the excluded "access to mortgages whereas lenders would have once just turned them away."[46] Unfortunately, the uncertainty created by the lower court's order will make lenders reticent to introduce beneficial innovations in Massachusetts. Indeed, the lower court's order

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[45] *Id.* (quoting Professor Harvey S. Rosen); *see also* Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve Board, Speech at the Federal Reserve System's Fourth Annual Community Affairs Research Conference (Apr. 8, 2005) ("[I]nnovation and structural change in the financial services industry have been critical in providing expanded access to credit for the vast majority of consumers, including those with limited means. Without these forces, it would have been impossible for lower-income consumers to have the degree of access to credit markets that they now have."); Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve Board, Speech at the Credit Union National Association 2004 Governmental Affairs Conference (Feb. 23, 2004) ("American consumers might benefit if lenders provided greater mortgage product alternatives to the traditional fixed-rate mortgage. To the degree that households are driven by fears of payment shocks but are willing to manage their own interest rate risks, the traditional fixed-rate mortgage may be an expensive method of financing a home.").

[46] Goolsbee, *supra*.

threatens to return Massachusetts to the days when many hard working Massachusetts families were "shut out" from traditional sources of mortgage credit.[47]

The lower court's order will also harm consumers by increasing the price for mortgage credit. Lenders' liability exposure from class action lawsuits could be overwhelming. G.L. c. 93A provides for statutory damages, treble damages, attorneys' fees and costs per violation and permits class actions. G.L. c. 93A, § 9. The lower's courts flawed conclusion that loans otherwise compliant with Massachusetts law can be presumptively unfair threatens to open the floodgates of class action lawsuits against even the most responsible lenders. These litigation costs are likely to be passed on to consumers in the form of higher prices.

While subprime lending is now disparaged in the popular press, it has been a key factor in increasing homeownership among many of the "excluded" who otherwise would not have access to mortgage credit.[48]

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[47] Laura A. Kiernan, *Cash-Poor Look Past Traditional Banks*, BOSTON GLOBE, Mar. 8, 1993.

[48] *Id; see also* Board of Governors of the Federal Reserve System, *Report to the Congress on Credit Scoring and Its Effects on the Availability and*

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While the recent rate of default among subprime borrowers is undeniably a cause for concern, it is crucial to remember that the large majority of subprime borrowers continue to make their mortgage payments and enjoy the benefits of homeownership.[49] While seeking to protect a small number of borrowers from foreclosure, the lower court's order threatens to "wreck the ability of [the majority of subprime borrowers] to obtain mortgages."[50]

Amici are also concerned that if Massachusetts consumers cannot obtain affordable mortgage financing from legitimate lenders, they may turn to pernicious sources for (what they may believe is) help. For

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Affordability of Credit (Aug. 2007), *available at* http://www.federalreserve.gov/boarddocs/RptCongress/creditscore/ creditscore.pdf. Because of lower credit scores, many borrowers cannot qualify for conventional Fannie Mae, Freddie Mac, or FHA loans.

[49] *See, e.g.*, Eric S. Rosengren, President and Chief Executive Officer, Federal Reserve Bank of Boston, speech to the Massachusetts Institute for a New Commonwealth (Dec. 3, 2007) (explaining that 87% of subprime ARM borrowers are not seriously delinquent), *available at* http://www.bos.frb.org/news/speeches/rosengren/2007/120307.htm; *OCC and OTS Mortgage Metrics Report: January-June 2008*, *supra* (explaining that 9 of 10 mortgage loans made by federally-chartered entities remain current).

[50] Goolsbee, *supra*.

example, many consumers in Massachusetts and nationwide have fallen victim to foreclosure rescue scams. The Massachusetts Attorney General recently issued emergency regulations aimed at preventing such foreclosure rescue scams. *See* 940 CMR 25.00. It would indeed be tragic if the lower court's order had the effect of driving Massachusetts consumers away from legitimate mortgage lenders and into the arms of con artists.

C. The Lower Court's Order Applies to Far More Than Fremont.

The lower court's order is not limited to Fremont alone. The Attorney General's recent filing in this case underscores that servicers (i.e., those who accept the payments from consumers on mortgage loans on behalf of investors) unrelated to the making of loans face risk of substantial losses. After Fremont announced it was selling its servicing portfolio, the Attorney General filed a motion on March 21 seeking to block that sale unless the new servicer agreed to the same limitations imposed on Fremont by the lower court.[51] In so doing, the Attorney General

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[51] *See* Commonwealth's Emergency Motion to Modify the Preliminary Injunction (filed Mar. 21, 2008).

dramatically expands the potential scope of the injunction from a single lender that is alleged to have engaged in wrongful acts to <u>any</u> servicer that agrees to service loans that even the lower court stated are valid.

Lenders and servicers historically have protected themselves from potential liability either by imposing higher prices--that ultimately are passed on to consumers--or by refusing to lend or service in the state. If lenders and servicers continue doing business in Massachusetts in this new and unpredictable legal environment, their risk of exposure to severe losses will be substantial.

III. THE LOWER COURT'S ORDER, IF ALLOWED TO STAND, WILL HAVE SEVERE NEGATIVE CONSEQUENCES FOR LENDERS AND SERVICERS.

Not only will the lower court's order harm consumers, it will also harm mortgage lenders and servicers. As discussed above, no matter how diligently a lender seeks to comply with Massachusetts law and shield itself from liability, it will be unable to do so with any degree of certainty. Post hoc court decisions--such as the lower court's order--

could expose even the most cautious lenders to substantial, or even catastrophic, liability.

Lenders' liability exposure from class action lawsuits could be overwhelming. G.L. Ch. 93A provides for statutory damages, treble damages, attorneys' fees and costs per violation and permits class actions. G.L. ch. 93A, § 9. The lower's court's flawed determination that loans otherwise compliant with Massachusetts law can be presumptively unfair threatens to open the floodgates of class action lawsuits against many lenders and other participants in the mortgage industry.

Lenders' liability exposure is not limited to liability from consumer lawsuits, however. Lenders provide representations and warranties to those who purchase the loans that the loans comply with all applicable laws and are valid and enforceable obligations. While lenders are required to make these representations and warranties at the time of sale, they will be unable to know with certainty whether the representations and warranties are correct. A lender's risk exposure in such circumstances could be substantial--and, again, is ultimately unquantifiable in advance.

Additionally, the uncertainty regarding whether a lender can foreclose on any significant number of loans in its portfolio can negatively impact a lender's ability to obtain its own financing. Recent events have shown that commercial lenders are reluctant to extend credit to institutions that have potentially problematic loans in their portfolios.[52] Lenders who make residential mortgage loans in Massachusetts and hold them in their own portfolios may find themselves paying more for their own financing because of the uncertainty sown by the lower court.

The uncertainty created by the lower court's order will also have severe consequences for mortgage servicers (those who accept the payments from consumers on mortgage loans on behalf of investors). Typically, if a borrower is delinquent in making payments, the servicer must make up that shortfall to the investors until such time as the servicer

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52 *See, e.g.*, Satoshi Kambayashi, *Dog Days of Winter*, THE ECONOMIST, Nov. 29, 2007, *available at* http://www. Economist.com/finance/ displaystory.cfm?story_id=10231806; *The Long and the Short of It*, THE ECONOMIST, Aug. 30, 2007, *available at* http://www.economist.com/finance/ displaystory.cfm?story_id=9725837.

initiates a foreclosure. The servicer is not reimbursed for those advances until the borrower reinstates the loan or foreclosure proceeds have been obtained. Delays in foreclosure--such as those imposed by the lower court's order--create substantial costs for servicers (as well as for those who own the loan or an interest in the loan).

Because servicers have a significant stake in the performance of the loans they agree to service, they take great care to ensure that they are adequately compensated for the risk posed by a particular pool of loans. However, under the lower court's order, a servicer cannot know in advance if it could foreclose upon a delinquent Massachusetts loan. As a result, servicers could face crippling losses based on standards that no longer can be determined in advance--no matter how diligent and cautious the servicer might be.

As discussed above, lenders historically have sought to protect themselves from uncertainty either by imposing higher prices on mortgage loans or by refusing to lend in the state altogether. Similarly, servicers would be forced to protect themselves either by charging more for servicing Massachusetts loans--an additional cost that would be passed on to consumers--or by refusing to service loan pools that contain Massachusetts loans. (Given the financial consequences to a servicer if it is unable to foreclose on a delinquent loan, it would be surprising if most servicers did not choose the latter.) If lenders and servicers continue doing business in Massachusetts in this new and unpredictable legal environment, they would expose themselves to substantial risk of severe losses.

IV. THE LOWER COURT'S ORDER WILL HAVE ADDITIONAL UNINTENDED AND UNDESIRABLE CONSEQUENCES.

As if the negative consequences discussed above were not enough to show the folly of the lower court's order, the order will have additional negative consequences. One additional negative consequence is that the lower court's order will place state-licensed and state-chartered financial institutions at a disadvantage relative to federally-chartered entities.

Chapter 93A of the Massachusetts General Laws does not apply to federally-chartered entities. State laws, such as Chapter 93A, are preempted if they limit a federally-chartered entity's ability to engage in the business of banking--including the making of mortgage loans. In particular, federal law preempts state laws that limit the ability of national banks and federal savings banks to make mortgage loans. *See, e.g.*, 12 C.F.R. § 7.4009 (national banks); 12 C.F.R. § 560.2 (federal savings banks). To the extent Chapter 93A would limit the permissible terms of loans or the federally-chartered entity's ability to enforce the loan and accompanying security interest, Chapter 93A would be preempted.

Because Chapter 93A would apply to state-licensed and state-chartered entities, but not to federally-chartered entities, any limitations on mortgage lending created under Chapter 93A will place state-licensed and state-chartered entities at a competitive disadvantage. This disadvantage may lead to more entities choosing to obtain a federal charter in order to compete with other federally-chartered entities.

And, as a result, Massachusetts may have regulatory authority over fewer and fewer lenders. Such a consequence is obviously an important consideration in forming public policy regarding mortgage lending--and one of which the lower court appears to have been entirely unaware. This further underscores that the lower court was ill-suited to make such policy decisions.

V. THE LOWER COURT'S ORDER IS CONTRARY TO MASSACHUSETTS LAW.

The lower court's order is not only wrong as a matter of public policy, it is wrong as a matter of law. The lower court recognized that the loans at issue did not violate any Massachusetts statute or regulation. Massachusetts has one of the most (if not the most) comprehensive and expansive bodies of law governing mortgage lending of any state. The Massachusetts Legislature has enacted numerous statutes that impose many significant requirements on mortgage lenders,[53] including substantive limitations on loan structures and fees. *See, e.g.*, G.L. ch. 183, §§ 60-63. The Commissioner of Banks ("Commissioner") also has issued numerous regulations and extensive guidance applicable to mortgage lending,[54] including

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[53] *See, e.g.*, G.L. c. 183C (Predatory Home Loan Practices Act); G.L. c. 255E (Licensing of Certain Mortgage Lenders and Brokers Act); G.L. c. 140D, §§ 1 et seq. (state Truth in Lending Act), G.L. c. 93, § 58-60 (state Credit Reporting Reform Act); G.L. c. 93, § 24-28 (state Fair Debt Collection Act).

[54] *See, e.g.*, 209 CMR 18.00 (Conduct of the Business of Debt Collectors and Loan Servicers); 209 CMR 31.00 (Disclosure of Consumer Credit Costs and Terms); 209

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guidance regarding adjustable rate mortgages ("ARMs") like those at issue here. *See, e.g.*, Reg. Bull. 1.3-101. The Attorney General has also issued extensive regulations applying Chapter 93A's prohibitions on unfair and deceptive acts or practices to mortgage lending. *See* 940 CMR 8.00.[55]

Given this extensive statutory and regulatory framework governing mortgage lending, the lower court's order is directly contrary to Chapter 93A itself. Section 3 of Chapter 93A expressly provides that "[n]othing in this chapter shall apply to transactions or actions <u>otherwise permitted under laws as administered by any regulatory board</u> or officer acting under statutory authority of the Commonwealth or of the United States." G.L. c. 93A, § 3 (emphasis added). There can be no question that Massachusetts' comprehensive and expansive legal regime qualifies

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CMR 40.00 (Unfair and Deceptive Practices in Consumer Transactions); 209 CMR 42.00 (Licensing of Mortgage Lenders and Mortgage Brokers). The Commissioner has also issued numerous Regulatory and Administrative Bulletins providing comprehensive guidance on mortgage lending and other financial issues. The Commissioner's Regulatory Bulletin Manual is available on the Division of Banks' website.

[55] Subsections 15-18 of 940 CMR 8.06 were added on October 17, 2007.

under Section 3. Consequently, when lenders comply with the myriad statutes and regulations governing mortgage lending--as the court concedes Fremont has done here--they are exempt from Chapter 93A. *See, e.g., Bierig v. Everett Square Plaza Assocs.*, 34 Mass. App. Ct. 354, 367-68 (1993) (exempting landlord from Ch. 93A in suit for excessive rent because rent charged was permitted by regulation); *Rini v. United Van Lines, Inc.*, 903 F. Supp. 224, 231 (D. Mass. 1995) ("The rationale behind the exemption [in Section 3] is to ensure that a business is not subjected to 93A liability if it relies on activity permitted by law."), *rev'd on other grounds*, 104 F.3d 502 (1st Cir. 1997).

Not only is mortgage lending exempt from the purview of Chapter 93A, the court's order is squarely at odds with Massachusetts statutes. As Fremont correctly notes in its Brief, the Massachusetts Legislature enacted the PHLPA in 2004 after loans such as those at issue were commonplace and had been the subject of much regulatory attention. (Fremont's Br., at 15-36.) The lower court cannot expand the statute beyond the limits the Legislature has set. *See, e.g.,* *Suliveres v. Commonwealth*, 449 Mass. 112, 116-117 (2007).

The court's order also goes well beyond the Commissioner's recent regulatory action. On March 12 of this year, the Commissioner updated its regulatory bulletin regarding the origination of subprime ARMs to first-time borrowers.[56] In its update, the Commissioner did not declare any category of loans to be presumptively unfair.

The court's order also goes well beyond--and is fundamentally inconsistent with--the Attorney General's own rules. In October of last year, the Attorney General amended its mortgage regulations to address additional mortgage lending practices.[57] The Attorney General--the plaintiff-appellee in this case--did not declare any category of loans to be presumptively unfair. Indeed, the Attorney General's new regulations provide that unfairness is determined "based on information known <u>at the time the loan is</u>

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56 *See Updated Regulatory Bulletin 1.3-104 Subprime Adjustable Rate Mortgage Loans to First Time Home Loan Borrowers* (Mar. 12, 2008).

57 *See Notice of Public Hearing: Mortgage Lenders and Brokers Regulations, available at* http://www.mass.gov.

made" and on what the lender "reasonably believes at the time the loan is expected to be made." 940 CMR 8.06(15) (emphasis added).[58] The lower court reached its conclusion in spite of what everyone believed at the time the loans were made.

CONCLUSION

Because the lower court's order is both wrong as a matter of law and wrong as a matter of public policy, it should be reversed. Accordingly, *Amici* respectfully urge this Court to grant Defendant-Appellant's Petition and Supplemental Petition and to reverse the lower court's order.

[58] Similarly, in its recent rule addressing practices in the mortgage industry it considered unfair and deceptive, the Federal Reserve Board took care to explain that practices it determined were unfair or deceptive would not be considered such until the effective date of the rule. *See* 73 Fed. Reg. 44522, 44523 (July 30, 2008) ("Compliance with the rules is not required before the effective dates. Accordingly, nothing in this rule should be construed or interpreted to be a determination that acts or practices restricted or prohibited under this rule are, or are not, unfair or deceptive before the effective date of this rule.").

Dated: Sept. 19, 2008

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RULE 16(k) CERTIFICATION

I, Robert B. Serino, hereby certify that the foregoing brief complies with the rules of court that pertain to the filing of briefs.

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ACKNOWLEDGEMENT OF SERVICE

I, Robert B. Serino, hereby acknowledge under penalty of perjury that, on September 19, 2008, I caused two true copies of the foregoing to be served by Federal Express Overnight Delivery upon the following:

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