The Housing and Economic Recovery Act of 2008: An Analysis

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The authors describe certain provisions of the Housing and Economic Recovery Act of 2008 that bear on the structured finance and securitization industry.

In order to address the ongoing housing crisis in the United States, Congress recently passed the Housing and Economic Recovery Act of 2008 (the ''2008 Act''). The 2008 Act, which was signed by President Bush on July 30, 2008, contains numerous provisions addressing the current state of the housing market and housing finance, including provisions regarding Fannie Mae, Freddie Mac and the Federal Home Loan Banks, foreclosure prevention provisions and certain tax-related provisions. This article describes certain provisions of the 2008 Act that bear on the structured finance and securitization industry.

The 2008 Act is divided into three parts: one addressing housing finance reform, one addressing foreclosure prevention, and a third containing tax-related provisions. This article is structured accordingly.

I. Housing Finance Reform

The housing finance reform provisions of the 2008 Act consist primarily of modifications and amendments to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (the ''1992 Act''). However, while the 1992 Act applied only to ''enterprises''—that is, Fannie Mae and Freddie Mac—the housing finance reform provisions of the 2008 Act apply to ''regulated entities,'' which include both the ''enterprises'' and the Federal Home Loan Banks (''FHLBs''). In addition, many of the housing reform provisions of the 2008 Act apply not just to each regulated entity but also to any ''entity-affiliated party,'' which includes directors, officers, employees, controlling stockholders, agents, shareholders, affiliates, consultants, joint venture partners, other persons that participate in the conduct of the affairs of the regulated entity, not-for-profit corporations that receive their principal funding on an ongoing basis from any regulated entity, and the Office of Finance of the Federal Home Loan Bank system (the ''Office of Finance''). Notably, the term ''entity-affiliated party'' also includes any independent contractor (including any attorney, appraiser or accountant) if (1) the independent contractor knowingly or recklessly participates in any violation of any law or regulation, any breach of fiduciary duty or any unsafe or unsound practice and (2) the violation, breach, or practice caused, or is likely to cause, more than a minimal financial loss to, or a significant adverse effect on, the regulated entity. The term ''violation'' includes ''any action (alone or in combination with another or others) for or toward causing, bringing about, participating in, counseling, or aiding or abetting a violation.''

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The Federal Housing Finance Agency

Creation of the Federal Housing Finance Agency

The centerpiece of the housing finance reform provisions of the 2008 Act is the creation of a new independent federal agency known as the Federal Housing Finance Agency (the ''FHFA''). As a general matter, the FHFA succeeds to many of the responsibilities formerly held by the Office of Federal Housing Enterprise Oversight (''OFHEO''), which is a part of the Department of Housing and Urban Development

(''HUD''). However, the FHFA will have greater status and broader powers. Its director (the ''FHFA Director'') will be appointed by the President and subject to confirmation by the Senate and will serve for a term of five years. Until a director is appointed and confirmed, the current director of OFHEO will serve as acting FHFA Director. The FHFA will have general supervisory and regulatory authority over each regulated entity and the Office of Finance.

The FHFA will have three deputy directors: one for the Division of Enterprise Regulation, one for the Division of Federal Home Loan Bank Regulation, and one for Housing Mission and Goals. The FHFA Director and deputy directors are prohibited from having any financial interest in any regulated entity and may not have served as an executive officer or director of any regulated entity or entity-affiliated party at any time during the three-year period preceding the date of the individual's appointment.

Principal Duties and Powers of the FHFA Director

The FHFA Director's principal duties are—

(1) to oversee the prudential operations of each regulated entity, and

(2) to ensure that—

(a) each regulated entity operates in a safe and sound manner, including maintenance of adequate capital and internal controls,

(b) the operations and activities of each regulated entity foster liquid, efficient, competitive and resilient national housing finance markets, and

(c) the activities of each regulated entity and the manner in which the regulated entity is operated are consistent with the public interest.

The FHFA Director has authority to review and reject any acquisition or transfer of a controlling interest in a regulated entity. In addition, the FHFA Director is empowered to limit executive compensation for regulated entities and to prohibit or limit, by regulation or order, any golden parachute payment or indemnification payment. The 2008 Act requires the FHFA Director to promulgate regulations prescribing the factors to be considered by the FHFA Director in limiting any such payment.

The responsibilities and powers of the FHFA described in this article are generally vested by the 2008 Act in the FHFA Director.

Reports; Examination; Assessments

The FHFA is empowered to require a regulated entity to submit regular reports, including financial statements determined on a fair value basis, on the condition (including financial condition), management, activities, or operations of the regulated entity. Penalties can be assessed for (1) a failure to provide a required report or (2) false or misleading information in required reports. The penalties accrue on a daily basis and can reach $1,000,000 per day depending on the severity of the violation and the attendant circumstances.

The FHFA is required to conduct an annual on-site examination of each regulated entity to determine its condition for the purpose of ensuring its financial safety and soundness. The FHFA is also permitted to conduct other examinations whenever it determines that an examination is necessary or appropriate. The FHFA may arrange to borrow examiners from certain other federal agencies and may also hire its own accountants, economists and examiners.

The FHFA's activities will be funded through annual assessments made by the FHFA on the regulated entities. The assessments may be adjusted for various contingencies.

Standards for Regulated Entities; Remedies for Failure to Meet Standards

The FHFA is required to establish standards, by regulation or guideline, for each regulated entity relating to—

(1) adequacy of internal controls and information systems;

(2) independence and adequacy of internal audit systems;

(3) management of interest rate risk exposure;

(4) management of market risk;

(5) adequacy and maintenance of liquidity and reserves;

(6) management of asset and investment portfolio growth;

(7) investments and acquisitions of assets by a regulated entity;

(8) overall risk management processes;

(9) management of credit and counterparty risk;

(10) maintenance of adequate records; and

(11) such other operational and management standards as the FHFA determines to be appropriate.

If any regulated entity fails to meet any standard established by regulation, the regulated entity will be required to submit an acceptable plan to comply with the standard within a specified period of time to be established by FHFA regulation, generally not to exceed 30 days following the determination of failure. In addition, if any regulated entity fails to meet any standard established by guideline, the FHFA may require the regulated entity to submit such a plan. The FHFA will be required to act on (that is, either approve or reject) submitted plans within a specified period of time established by regulation, generally not later than 30 days after the plan is submitted.

If a regulated entity fails to submit an acceptable plan or fails in any material respect to implement a plan accepted by FHFA, the FHFA is required to order the regulated entity to correct the deficiency. Furthermore, in such a circumstance, the FHFA is permitted to take appropriate action, including restricting the asset growth of the regulated entity or requiring the regulated entity to increase its capital. In addition, if the subject failure followed a period of ''extraordinary growth'' of the affected entity over the preceding 18 months, and the entity has not corrected the deficiency, the FHFA is required to take action.

Enterprise Portfolio Management

Enterprise Assets and Liabilities

The FHFA is required to publish regulations within 180 days establishing criteria governing the portfolio holdings of the enterprises, to ensure that the holdings are backed by sufficient capital and consistent with the mission and the safe and sound operations of the enterprises. In establishing the criteria, the FHFA is required to consider the ability of the enterprises to provide a liquid secondary market through securitization activities, the portfolio holdings in relation to the overall mortgage market, and adherence to the standards described above. Furthermore, the FHFA is permitted to make temporary adjustments to the established standards for either or both enterprises, such as during times of economic distress or market disruption. The FHFA is also required to monitor the portfolio of each enterprise and is permitted, regardless of the capital classification of the enterprises, to require an enterprise to dispose of or acquire any asset if the FHFA determines that the action is consistent with the purposes of the 2008 Act.

Prior Approval of New Enterprise Products

Under the 2008 Act, each enterprise is required to obtain approval from the FHFA for any product before initially offering the product. The 1992 Act provided for a similar approval process for ''new programs,'' but it required the HUD Secretary to approve the new program unless it made a finding that the new program was not authorized by the applicable enterprise's charter or was not in the public interest. Under the 2008 Act, before the new product can be offered, the FHFA must make an affirmative determination that the new product is (1) authorized under the applicable enterprise's charter, (2) in the public interest and (3) consistent with the safety and soundness of the enterprise or the mortgage finance system. Any request for new product approval will be subject to a 30-day public comment period, after which the FHFA is required to approve or deny the request. The 2008 Act also provides for temporary approval and conditional approval of new products, as well as separate procedures and expedited review for new activity that an enterprise considers not to be a new product. While the 2008 Act does contain ''grandfathering'' provisions for certain existing products, it also provides that the authority over new products in no way restricts (1) the safety and soundness authority of the FHFA over all new and existing products or activities or (2) the authority of the FHFA to review all new and existing products or activities to determine that such products or activities are consistent with the statutory mission of an enterprise.

Conforming Loan Limits

The 2008 Act generally restates the current permanent principal balance limits for conforming mortgage loans (the current limit for a single-family residence being $417,000) but provides that those limits shall be adjusted in accordance with a new housing price index to be established and maintained by the FHFA based on various sources. However, the 2008 Act provides for increases to the conforming loan limits for properties of a particular size in any area for which 115 percent of the median house price for a residence of that size exceeds the applicable conforming loan limit. In such a high-cost area, the increased conforming loan limit will be the lesser of 150 percent of the applicable conforming loan limit (that is, $625,500 in the case of a single-family residence) and 115 percent of the median house price for a residence of that size. The changes to the conforming loan limits take effect on January 1, 2009.

Treasury Purchase of Obligations of Regulated Entities

The 2008 Act authorizes the Treasury Secretary to use government funds (including the proceeds of sales of Treasury securities) to purchase any obligations and other securities issued by an enterprise, and any obligations issued by an FHLB, on such terms and in such amounts as the Treasury Secretary may determine. (Previously, any such purchase by the Treasury Secretary of obligations of either enterprise had been limited to $2.25 billion by the enterprises' respective charters.) Any purchase will be by mutual agreement between the Treasury Secretary and the applicable regulated entity. No open market purchases by the Treasury Secretary are permitted. If the Treasury Secretary uses the foregoing authority, it is required to determine that the action is necessary to (1) provide stability to the financial markets, (2) prevent disruptions in the availability of mortgage finance and (3) protect the taxpayer. The 2008 Act contains guidelines for evaluating the taxpayer protection provisions of securities to be purchased.

In the event of any purchase, the Treasury Secretary is required to report to Congress on the necessity of the purchase and the related determinations made in accordance with the 2008 Act. In that report, the Treasury Secretary is required to describe the size, terms and probability of repayment or fulfillment of other terms of the purchase. The authority of the Treasury Secretary expires on December 31, 2009, although after that date the Treasury Secretary will still be entitled to exercise any rights associated with any securities or obligations purchased. The Treasury Secretary is also empowered to dispose of any obligations or securities upon such terms and conditions as he or she determines.

Capital Requirements; Capital Levels and Classifications; Conservatorship and Receivership

Risk-Based Capital Requirements; Minimum Capital Levels

The FHFA is required to publish regulations establishing risk-based capital requirements for the regulated entities. The 1992 Act had contained a similar requirement with respect to the enterprises, but the extensive guidance regarding actual risk-based capital standards that had been included in the 1992 Act does not appear in the 2008 Act. Accordingly, the 2008 Act vests in the FHFA far broader discretion to determine risk-based capital requirements for the enterprises.

The 2008 Act leaves the existing minimum capital levels for the regulated entities intact but permits the FHFA to increase those levels pursuant to regulations to the extent needed to ensure that the regulated entities operate in a safe and sound manner. In addition, the FHFA may temporarily increase minimum capital levels for a regulated entity by order when it determines that an increase is necessary and consistent with the prudential regulation and the safe and sound operation of a regulated entity. The FHFA is required to publish regulations regarding standards for temporary increases in minimum capital and time frames for periodic review of temporary increases.

In addition to general capital requirements, the FHFA is also authorized to establish, by order or regulation, capital or reserve requirements with respect to any particular product or activity of a regulated entity. The FHFA is also required to conduct periodic reviews of core capital maintained by the enterprises, the amount of capital retained by the FHLBs, and the minimum capital levels established for the regulated entities.

Critical Capital Levels; Capital Classifications

The 2008 Act leaves in place the critical capital levels and capital classifications for the enterprises and requires the FHFA to establish critical capital levels and capital classifications for the FHLBs by promulgating regulations within 180 days. The capital classifications for the FHLBs will be consistent with the classifications currently in existence for the enterprises: (1) adequately capitalized, (2) undercapitalized, (3) significantly undercapitalized and (4) critically undercapitalized. The FHFA is permitted to reclassify a regulated entity for one or more of several specified reasons specified in the 2008 Act. In addition, with limited exception, a regulated entity is prohibited from making a capital distribution if the distribution would leave the regulated entity undercapitalized.

Supervisory Actions for Undercapitalized and Significantly Undercapitalized Entities

The 1992 Act included provisions regarding supervisory actions for undercapitalized and significantly undercapitalized enterprises. The 2008 Act applies those provisions to the FHLBs and expands those provisions for all regulated entities.

—Undercapitalized Regulated Entities

An undercapitalized regulated entity is required to submit a capital restoration plan to the FHFA and is not permitted to make any capital distribution that would result in the entity's being reclassified with a lower capital classification. In addition, the FHFA is required to closely monitor the condition of any undercapitalized regulated entity and its compliance with its capital restoration plan. Asset growth of and new acquisitions and new activity by an undercapitalized entity are restricted unless certain conditions are met.

The 1992 Act permitted reclassification of an undercapitalized enterprise as significantly undercapitalized if it did not submit a capital restoration plan, if its plan was not accepted, or if it did not make good faith reasonable efforts to comply with its plan. However, the 2008 Act requires the reclassification of an undercapitalized regulated entity as significantly undercapitalized if it does not submit such a plan, if its plan is not accepted, or if it does not comply with its plan in any material respect.

In the case of an undercapitalized regulated entity, the FHFA is authorized to take actions authorized to be taken with respect to a significantly undercapitalized entity if the FHFA determines that such actions are necessary.

—Significantly Undercapitalized Regulated Entities

Like an undercapitalized regulated entity, a significantly undercapitalized regulated entity is required to submit a capital restoration plan to the FHFA and is not permitted to make any capital distribution that would result in the entity's being reclassified with a lower capital classification. In addition, a significantly undercapitalized regulated entity is not permitted to make any other capital distribution without the approval of the FHFA. Furthermore, while the 1992 Act listed additional discretionary supervisory activities with respect to significantly undercapitalized regulated entities, the 2008 Act deems those activities mandatory and requires the FHFA to take at least one such action with respect to such an entity. The actions include—

(1) limiting the increase in obligations, or ordering the reduction of, any obligations of the regulated entity,

(2) limiting or prohibiting the growth of, or requiring the contraction of, the assets of the regulated entity,

(3) requiring the regulated entity to acquire new capital,

(4) restricting the regulated entity's activities,

(5) ordering the election of a new board of directors,

(6) dismissing directors or executive officers,

(7) directing the entity to hire qualified executive officers approved by the FHFA or

(8) reclassifying the regulated entity as a critically undercapitalized entity if certain conditions are met.

Significantly undercapitalized entities are not permitted to pay bonuses or excessive compensation to any executive officer.

Conservatorship and Receivership Provisions

The 2008 Act virtually rewrites the provisions of the 1992 Act regarding conservatorship and receivership for regulated entities so that they are similar in many ways to the conservatorship and receivership powers given to federal banking regulators.

—Grounds for Conservatorship and Receivership

The 2008 Act permits the discretionary appointment by the FHFA of a conservator or receiver for the purpose of reorganizing, rehabilitating or winding up the affairs of a regulated entity for one or more of the following grounds—

(1) the assets of the regulated entity are less than its obligations;

(2) substantial dissipation of assets or earnings due to a violation of federal or state law or any unsafe or unsound practice;

(3) an unsafe or unsound condition to transact business;

(4) any willful violation of a final cease and desist order;

(5) any concealment of books, papers, records or assets of the regulated entity, or any refusal to submit the books, papers, records, or affairs of the regulated entity for inspection to any examiner or any other agent of the FHFA;

(6) the regulated entity is likely to be unable to pay its obligations or meet the demands of its creditors in the normal course of business;

(7) the regulated entity has incurred or is likely to incur losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the regulated entity to become adequately capitalized;

(8) any violation of law or regulation, or any unsafe or unsound practice or condition that is likely to cause insolvency or substantial dissipation of assets or earnings or weaken the condition of the regulated entity;

(9) by consent of the board of directors, shareholders or members of the regulated entity;

(10) the regulated entity is undercapitalized or significantly undercapitalized and—

(a) has no reasonable prospect of becoming adequately capitalized,

(b) fails to become adequately capitalized as required,

(c) fails to timely submit an acceptable capital restoration plan or

(d) materially fails to implement an accepted capital restoration plan;

(11) the regulated entity is critically undercapitalized; or

(12) the regulated entity has been found guilty of a money laundering offense.

In addition, the 2008 Act requires that a receiver be appointed for a critically undercapitalized regulated entity for the sole purpose of its liquidation if the FHFA determines in writing that—

(1) the assets of the regulated entity are, and during the preceding 60 calendar days have been, less than the obligations of the regulated entity to its creditors and others; or

(2) the regulated entity is not, and during the preceding 60 calendar days has not been, generally paying the debts of the regulated entity (other than debts that are the subject of a bona fide dispute) as they become due.

If a regulated entity is classified as critically undercapitalized, the FHFA is required to determine within 30 days of the classification, and at least once within each successive 30-day period, whether either of the conditions for mandatory receivership exists. The 2008 Act also provides that a regulated entity may obtain judicial review of a decision to appoint the FHFA as a conservator or receiver of the regulated entity.

—Powers of Conservator and Receiver

The 2008 Act vests the FHFA with broad powers as conservator or receiver and permits the FHFA to publish regulations governing the conduct of conservatorships or receiverships. The 2008 Act provides that the liquidation of an affected regulated entity may be made in such manner as the FHFA deems appropriate, including a sale of assets, the transfer of assets to a ''limited-life regulated entity'' (which is defined in the 2008 Act), or in the case of an enterprise, to a successor enterprise.

The 2008 Act also contains provisions regarding the claims process to be established for creditors of the regulated entity in the event of a receivership. In addition, special priority in the claims process is assigned to credit extended to a regulated entity by, or a security interest in regulated entity assets granted to, any Federal Reserve Bank, any FHLB or the Treasury.

—Treatment of Mortgage Loans Held for Others; Treatment of Certain Contracts

Of particular note to the securitization and structured finance industry in the conservatorship and receivership provisions of the 2008 Act is a measure that provides that no pool of mortgages held in trust, custodial or agency capacity by a regulated entity for others may be used to satisfy the claims of creditors generally.

In addition, the 2008 Act contains provisions addressing the treatment of various types of contracts. Generally, the FHFA as conservator or receiver has the power to affirm, reject or transfer contracts. However, the treatment of any given contract in a conservatorship or receivership depends on its type. Examples in the 2008 Act include leases, contracts for the sale of real property, service contracts, and qualified financial contracts such as securities contracts, commodity contracts, forward contracts, repurchase agreements, and swap agreements. Of particular note are a provision prohibiting the enforceability of ''walkaway'' clauses in qualified financial contracts and a provision prohibiting the assignment of certain, but not all, qualified financial contracts (and related claims and property) between a regulated entity and a particular counterparty. In addition, the 2008 Act prohibits the termination by a counterparty of any qualified financial contract (1) solely on the grounds of a receivership or financial condition of a regulated entity until (a) 5:00 p.m. eastern time on the business day following the date of appointment of the receiver or (b) receipt of notice of transfer of the qualified financial contract from the regulated entity to a substitute counterparty and (2) solely on the grounds of a conservatorship of a regulated entity.

Enforcement Provisions

Cease and Desist Proceedings

The 2008 Act revises the provisions in the 1992 Act regarding cease and desist proceedings, in particular providing the FHFA with the power to proceed against regulated entities and entity-affiliated parties for unsafe or unsound practices and unsatisfactory ratings. Furthermore, the 2008 Act broadens the grounds for issuance of temporary cease and desist orders and extends the authority to both regulated entities and entity-affiliated parties. The 2008 Act also allows the FHFA to remove officers and directors of regulated entities under certain circumstances and also to prohibit entity-affiliated parties from participating further in the conduct of the affairs of a regulated entity under certain circumstances.

Civil Money Penalties

The 2008 Act also amends the provisions of the 1992 Act regarding the assessment of civil money penalties, such that the FHFA may impose civil money penalties on any regulated entity or entity-affiliated party. The potential penalties are segregated into three tiers depending on the circumstances of the violation or conduct at issue, and the maximum penalty for the most serious violation is $2,000,000. The 2008 Act also adds criminal penalties of up to $1,000,000 and five years' imprisonment for any person who, while subject to an effective removal or prohibition order and without the prior written approval of the FHFA, knowingly participates, directly or indirectly, in any manner in the conduct of the affairs of any regulated entity.

Subpoena Authority

The 2008 Act also provides the FHFA with subpoena power and empowers the FHFA to bring actions on its own behalf rather than having to request the Department of Justice to act on its behalf, as had been the case with the 1992 Act.

Other Provisions Relating to Regulated Entities

Creation of Federal Housing Finance Oversight Board

The 2008 Act also creates the Federal Housing Finance Oversight Board (the ''Oversight Board'') consisting of the Treasury Secretary, the HUD Secretary, the Chairman of the Securities and Exchange Commission and the FHFA Director, and provides that the FHFA Director will act as chairperson of the Oversight Board. The 2008 Act requires that the Oversight Board meet no less frequently than on a quarterly basis and testify annually before the Congress regarding—

(1) the safety and soundness of the regulated entities,

(2) any material deficiencies in the conduct of the operations of the regulated entities,

(3) the overall operational status of the regulated entities,

(4) an evaluation of the performance of the regulated entities in carrying out their respective missions,

(5) an evaluation of the performance of the FHFA, and

(6) such other matters relating to the FHFA and its fulfillment of its mission as the Oversight Board determines appropriate.

Consultation with Federal Reserve Board Chairman

The 2008 Act requires the FHFA Director to consult with and consider the views of the Chairman of the Board of Governors of the Federal Reserve System (the ''Federal Reserve Board Chairman''), with respect to the risks posed by the regulated entities to the financial system, prior to the FHFA's issuing any proposed or final regulations, orders, and guidelines regarding management and operations standards and capital requirements and portfolio standards applicable to the regulated entities. The FHFA Director is also required to consult with the Federal Reserve Board Chairman regarding any decision to place a regulated entity into conservatorship or receivership. The consultation requirements expire on December 31, 2009.

Registration of Securities

The 2008 Act provides that no class of equity securities of either enterprise will be treated as an exempted security for purposes of Section 12, 13, 14 or 16 of the Securities Exchange Act of 1934 (the ''Exchange Act''). Accordingly, the enterprises' equity securities will be subject to the registration and reporting requirements of the Exchange Act and related provisions. However, the enterprises had previously registered their common stock and subjected themselves to the reporting requirements of the Exchange Act on a voluntary basis. Consequently, the 2008 Act will likely result in the registration of only certain limited classes of the enterprises' securities (such as preferred stock).

Moreover, the 2008 Act requires each FHLB to register a class of its common stock under section 12(g) of the Exchange Act within 120 days and provides that each FHLB will be treated for purposes of the Exchange Act as an ''issuer,'' the securities of which are required to be registered under section 12 of the Exchange Act.

Federal Home Loan Banks

In addition to the provisions described above, the 2008 Act also contains various provisions affecting the FHLBs, most notably—

(1) changing the size of each FHLB's board of directors from 14 to 13, eliminating the 6 directors formerly appointed by the Federal Housing Finance Board, and requiring that at least 6 directors be independent directors,

(2) establishing various housing goals for the FHLBs, and

(3) exempting the FHLBs from compliance with certain securities laws, including those relating to (a) transactions in the common stock among member banks and (b) share repurchases by the FHLBs.

Reporting of Fraudulent Loans

Each regulated entity is required to submit a timely report to the FHFA upon discovery by the regulated entity that it has purchased or sold a fraudulent loan or financial instrument, or suspects a possible fraud relating to the purchase or sale of any loan or financial instrument. The FHFA is charged with requiring each regulated entity to establish and maintain procedures designed to discover any such transactions. The 2008 Act also protects the regulated entities from liability under law or contract for any report or failure to make a report.

Studies and Reports with respect to Guarantee Fees and Default Risk Evaluation

Under the 2008 Act, the FHFA is required to (1) conduct an ongoing study of fees charged by the enterprises for guaranteeing mortgage loans and annually submit a report to Congress on the results of the study and (2)(a) conduct a study of ways to improve the overall default risk evaluation used with respect to residential mortgage loans and (b) submit a report on the study to the applicable Congressional committees no later than July 30, 2009.

Diversity

The 2008 Act applies the provisions of the 1992 Act regarding minority outreach in contracting to the FHLBs and adds provisions regarding inclusion of women and minorities in the FHFA workforce. Furthermore, the 2008 Act requires each regulated entity to develop and implement standards and procedures to ensure, to the maximum extent possible, the inclusion and utilization of minorities and women, and minority- and women-owned businesses (including financial institutions, investment banking firms, mortgage banking firms, asset management firms, broker-dealers, financial services firms, underwriters, accountants, brokers, investment consultants, and providers of legal services) in all business and activities of the regulated entity at all levels, including in contracts for the issuance or guarantee of any debt, equity, or mortgage-related securities, the management of its mortgage and securities portfolios, the making of its equity investments, the purchase, sale and servicing of single- and multi-family mortgage loans, and the implementation of its affordable housing plan and initiatives. The 2008 Act requires each regulated entity to include in its annual reports to Congress detailed information describing the actions taken by the entity pursuant to the foregoing diversity provisions, which report is required to include a statement of the total amounts paid by the entity to third-party contractors and the percentage paid to minority- and women-owned businesses.

Housing Goals; Reporting; Public Use Database; Enforcement

The 2008 Act amends the housing goals for the enterprises, requires annual reporting by the enterprises to Congress regarding their progress in achieving those goals, and provides for a public use database for certain information reported by the enterprises. The 2008 Act also empowers the FHFA to issue cease and desist orders and assess monetary penalties against an enterprise in certain circumstances involving the failure of that enterprise to meet its goals.

Affordable Housing Allocations; Financial Education and Counseling

The 2008 Act requires that each enterprise set aside an amount equal to 4.2 basis points for each dollar of the unpaid principal balance of its total new business purchases and allocate 65 percent of those amounts to a new housing trust fund and 35 percent of those amounts to a capital magnet fund. However, the FHFA is empowered to suspend those allocations if they are negatively affecting the financial stability or capitalization of an enterprise. Amounts deposited in the housing trust fund will generally be distributed to states and state-designated entities to be used to promote various housing goals. Amounts deposited in the capital magnet fund are to be used by the Treasury Secretary to attract private capital for and increase investment in affordable housing, economic development activities and community service facilities in certain areas.

Notwithstanding the foregoing allocations, during the existence of the HOPE Program described below, 25 percent of the affordable housing allocations described above are to be deposited into a reserve fund for the HOPE Program, and with respect to the remaining 75 percent, in fiscal years 2009, 2010 and 2011, 100 percent, 50 percent and 25 percent of that remainder will be used to reimburse the Treasury for payments made under the HOPE Program. The balance of the remainder from 2010 and 2011, together with any unused allocations for the HOPE Program, will be directed to the housing trust fund and capital magnet fund as originally intended.

The FHFA is required to publish regulations prohibiting the enterprises from passing the costs of the affordable housing allocations on to mortgage originators.

The 2008 Act also requires the Treasury Secretary to make grants and approve a certain number of pilot projects to promote financial education and counseling services for prospective homebuyers and other related services to improve the financial stability and economic condition of low- and moderate-income and low-wealth individuals. The money for the grants and pilot projects is to come from future appropriations.

Elimination of Presidentially-Appointed Directors of Enterprises

The 2008 Act also reduced the size of the board of directors of each enterprise from 18 to 13 and eliminated the five directors of each that are to be appointed by the President.

HOPE for Homeowners Act

HOPE Program

One section of the 2008 Act is designated as the HOPE for Homeowners Act of 2008 (the ''HOPE for Homeowners Act''). The HOPE for Homeowners Act amends the National Housing Act (the ''NHA'') to establish, in the Federal Housing Administration (the ''FHA''), the HOPE for Homeowners Program (the ''HOPE Program''), under which the FHA is to provide insurance to lenders on eligible refinanced mortgage loans made to distressed borrowers. Participation in the HOPE Program is voluntary on the part of borrowers and holders of existing mortgage loans. The HOPE for Homeowners Act creates a Board of Directors of the HOPE Program (the ''HOPE Board''), consisting of the HUD Secretary, the Treasury Secretary, the Federal Reserve Board Chairman and the Chairperson of the Board of Directors of the Federal Deposit Insurance Corporation, or their designees. The HOPE Board is charged with establishing requirements and standards for the HOPE Program and prescribing regulations and providing guidance to implement the HOPE Program requirements and standards.

In order for a refinanced mortgage loan to be eligible for HOPE Program insurance, a number of conditions must be satisfied, including, among others:

(1) the borrower must certify that he or she had not intentionally defaulted on the existing mortgage loan or on ''any other debt'' and had not knowingly, or willfully and with actual knowledge, furnished material information known to be false for the purpose of obtaining the existing mortgage loan;

(2) the new loan must be refinanced from a mortgage loan that was originated on or before January 1, 2008 and as to which the borrower (a) occupies the related property as his or her principal residence and (b) cannot, within the limits of the debt-to-income ratio set forth below and certain other standards to be established, afford his or her mortgage loan payments;

(3) as of March 1, 2008, the borrower's debt-to-income ratio (taking into consideration all of the borrower's then-existing mortgage loans) must have exceeded 31 percent (or such higher amount as the HOPE Board determines is appropriate);

(4) the principal balance of the new loan may not exceed 90 percent of the appraised value of the mortgaged property;

(5) all prepayment penalties, together with all fees relating to default or delinquency, on the existing mortgage loan, must be waived or forgiven;

(6) the holders of existing liens on the mortgaged property must have agreed, voluntarily, to accept the proceeds of the new loan as payment in full of the indebtedness under the existing mortgage loans, and all encumbrances related to the existing loans must have been removed;

(7) the refinanced mortgage loan (a) must bear a fixed rate of interest for the entire term of the loan, (b) must have a maturity of at least 30 years from the date on which amortization of the loan begins and (c) must have a principal balance not exceeding 132 percent of the 2007 Freddie Mac conforming loan limit for a mortgaged property of the applicable size;

(8) with certain exceptions, no second lien may be granted on the mortgaged property during the first five years following the origination of the new loan;

(9) appraisals of the mortgaged property (a) must be based on the ''current value'' of the property, (b) must be completed by an appraiser who satisfies certain competency and independence requirements and (c) must satisfy certain additional specified requirements;

(10) the borrower's income must be documented and verified;

(11) the borrower must not have been convicted under federal or state law for fraud during the 10-year period ending with the date on which the mortgage loan is insured; and

(12) the borrower must document that the mortgaged property is occupied by the borrower as his or her primary residence and that the property is the only residence in which the borrower has any present ownership interest.

In addition, the ''underwriter'' of the refinanced loan will be required to provide such representations and warranties as the HOPE Board considers necessary or appropriate. The 2008 Act provides that no insurance benefits will be payable to any lender that violates the underwriter's representations and warranties or in any case in which the borrower fails to make the first payment on the refinanced loan. It is unclear at this time whether a breach of representation or warranty made by an underwriter would necessarily result in the unavailability of insurance benefits to a subsequent holder of a mortgage loan. The HOPE for Homeowners Act contemplates the possible adoption of additional standards and policies to protect against adverse selection of mortgage loans to be insured, including possibly requiring higher-risk refinanced loans to demonstrate payment performance for some period of time before they may become eligible to be insured under the HOPE Program.

At the time a refinanced loan is insured, the FHA must be paid a single premium equal to three percent of the refinanced loan's original principal balance. The premium is to be paid out of the proceeds of the refinanced loan, and those proceeds, as so reduced, are to serve to retire in full the existing indebtedness. An additional premium of 1.5 percent must be paid annually to the FHA on the remaining principal balance of the refinanced mortgage loan.

The HOPE Board is empowered to establish reasonable limits on origination fees for refinanced mortgage loans insured under the HOPE Program and to establish procedures to ensure that the rates on such loans are commensurate with market interest rates for similar types of loans.

After a distressed loan has been refinanced and insured under the HOPE Program, any future appreciation realized from a sale of the mortgaged property is to be allocated equally between HUD and the borrower. Any such realized future appreciation allocated to HUD is to be shared with the holders of the liens that were subordinate to the first lien of the originally distressed mortgage loan under standards and policies to be developed by the HOPE Board.

Refinanced mortgage loans are insurable under the HOPE Program during the three-year period beginning on October 1, 2008 and ending on September 30, 2011. The aggregate original principal balance of mortgage loans to be insured under the HOPE Program may not exceed $300 billion. This amount also equals the additional authority granted under the HOPE for Homeowners Act to the Government National Mortgage Association to enter into new commitments to issue guarantees of securities based on or backed by pools of mortgage loans insured under the HOPE Program.

Clarification of Duties of Mortgage Loan Servicers

The HOPE for Homeowners Act also amends the Truth in Lending Act to add a new Section 129A titled ''Fiduciary Duty of Servicers of Pooled Residential Mortgages.'' Section 129A provides that, except as may be established in an ''investment contract'' between a servicer of pooled residential mortgage loans and ''an investor'' (presumably the trust or other vehicle that owns the mortgage loans),

(1) any duty owed by the servicer to maximize the net present value of the pooled mortgage loans is owed to all investors and parties having a direct or indirect interest in the pool and not to any individual party or group of parties; and

(2) the servicer will be deemed to act in the best interests of all such investors and parties if it agrees to or implements a modification or workout plan (including any modification or refinancing undertaken pursuant to the HOPE Program) for a residential mortgage loan or class of residential mortgage loans constituting part or all of the mortgage loans in the pool, so long as any mortgage loan that is so modified meets the following criteria:

(a) default on the payment of a mortgage loan has occurred or is reasonably foreseeable;

(b) the property securing the mortgage loan is occupied by the borrower; and

(c) the anticipated recovery in the principal balance of the mortgage loan under the modification or workout plan exceeds, on a net present value basis, the anticipated recovery of the principal balance of the mortgage loan through foreclosure.

Before the 2008 Act was adopted, questions frequently arose as to a mortgage loan servicer's right under a pooling and servicing agreement to modify distressed mortgage loans in a securitization. The provisions cited in the preceding paragraph would appear to lend support to the argument that, absent a contrary provision in the pooling and servicing agreement, a servicer that agrees to such modifications has not, in so doing, breached its contractual obligation to the securitization's investors.

In addition, it is generally anticipated that if a servicer modified a mortgage loan in a securitization in order to take advantage of a HOPE Program refinancing of that loan outside the securitization, the result would be a prepayment of the securitized loan to the extent of the net proceeds of the new loan.

SAFE Mortgage Licensing Act

Also included in the 2008 Act were provisions collectively labeled as the ''Secure and Fair Enforcement for Mortgage Licensing Act of 2008'' (the ''SAFE Mortgage Licensing Act''). Those provisions were adopted to promote the establishment, by the states, of a

Nationwide Mortgage Licensing System and Registry. The 2008 Act's objectives for the registry include, among others—

(1) providing uniform license applications and reporting requirements for state-licensed loan originators,

(2) providing a comprehensive licensing and supervisory database,

(3) providing consumers with free, easily accessible information concerning the employment history of, and publicly adjudicated disciplinary and enforcement actions against, loan originators,

(4) facilitating responsible behavior in the subprime mortgage loan marketplace and providing comprehensive training and examination requirements related to subprime mortgage lending, and

(5) facilitating the collection and disbursement of consumer complaints on behalf of State and federal mortgage regulators.

The SAFE Mortgage Licensing Act defines a ''loan originator'' to be, generally, an individual who takes a residential mortgage loan application and offers or negotiates terms of a residential mortgage loan for compensation or gain.

The SAFE Mortgage Licensing Act contemplates parallel registration regimes:

(1) one system for loan originators (referred to as ''registered loan originators'') who, in addition to meeting certain other requirements, are employees of—

(a) a depository institution (as defined in Section 3 of the Federal Deposit Insurance Act, and including credit unions),

(b) a subsidiary owned and controlled by a depository institution and regulated by a federal banking agency, or

(c) an institution regulated by the Farm Credit Administration, and

(2) another system for loan originators (referred to as ''state-licensed loan originators'') who, in addition to meeting certain other requirements, are not employees of any entity described in clause (1).

The SAFE Mortgage Licensing Act provides an individual may not engage in the business of a loan originator without, among other things, first obtaining (and maintaining annually) a registration as a registered loan originator or a license and registration as a state-licensed loan originator. In each case, the individual must be registered as a loan originator with the Nationwide Mortgage Licensing System and Registry. State-licensed loan originators must additionally be licensed by a state or by HUD pursuant to its backup authority, under the SAFE Mortgage Licensing Act, to establish a loan originator licensing and registration system for loan originators operating in a state as state-licensed loan originators, if, within a specified timeframe, the state in question fails to have in place, by law or regulation, an adequate system for licensing and registering loan originators, or the state does not participate in the Nationwide Mortgage Licensing System and Registry. Applicants for loan originator status will be subject to background checks and will be required to submit fingerprints to the FBI and related government agencies or entities.

State-licensed loan originators will be required to satisfy certain minimum licensing and registration standards, including, among others:

(1) no prior loan originator license revocations in any governmental jurisdiction,

(2) no convictions, or pleas of guilty or no contest, to any felony—

(a) at any time preceding the date of application for licensing and registration, if the felony involved an act of fraud, dishonesty, a breach of trust or money laundering, or

(b) otherwise, during the seven-year period preceding the date of application,

(3) demonstration of financial responsibility, character and general fitness such as to command the confidence of the community and to warrant a determination that the loan originator will operate honestly, fairly and efficiently within the purposes of the SAFE Mortgage Licensing Act,

(4) completion of pre-licensing education requirements,

(5) successful completion of a written test requirement, and

(6) satisfaction of a net worth or surety bond requirement.

State-licensed loan originators will be required to satisfy annual continuing education requirements as a condition to state license renewal.

The SAFE Mortgage Licensing Act requires the federal banking agencies, together with the Farm Credit Administration, to jointly develop and maintain a system for registering, as registered loan originators within the Nationwide Mortgage Licensing System and Registry, (1) employees of depository institutions, (2) employees of subsidiaries owned and controlled by depository institutions and regulated by a federal banking agency and (3) employees of institutions regulated by the Farm Credit Administration. That system must be implemented before July 30, 2009.

The SAFE Mortgage Licensing Act provides that, if at any time the HUD Secretary determines that the Nationwide Mortgage Licensing System and Registry has failed to meet the SAFE Mortgage Licensing Act's requirements and purposes, the HUD Secretary will be required to establish and maintain such a system to carry out those purposes and the effective registration and regulation of loan originators.

II. Foreclosure Prevention

The foreclosure prevention provisions of the 2008 Act, which are collectively designated as the Foreclosure Prevention Act of 2008, consist primarily of—

(1) modifications and amendments to the NHA,

(2) mortgage foreclosure and other protections for members of the Armed Forces (including (a) the extension of the foreclosure/sale bar and stay provisions under the Servicemembers Civil Relief Act from 90 days following the period of military service to nine months following the period of military service and (b) the extension of the six percent limit on mortgage interest rates during the period of military service through the one-year period following the period of military service, both of which extensions expire on December 31, 2010),

(3) the appropriation of funds for emergency assistance to state and local governments for the redevelopment of abandoned and foreclosed-upon homes

(4) the appropriation of funds for certain foreclosure mitigation activities involving the Neighborhood Reinvestment Corporation, including credit counseling and foreclosure prevention hotlines,

(5) modifications and amendments to the Truth in Lending Act, and

(6) measures to provide housing benefits and assistance to certain veterans, members of the Armed Forces and other eligible individuals.

In connection with the foregoing, the Foreclosure Prevention Act of 2008 calls for various studies to be conducted, and reports to be delivered, by the relevant administrative agencies.

The Foreclosure Prevention Act of 2008 also makes a number of minor to moderate changes to the NHA, including, without limitation, the following:

(1) with respect to mortgage loans that may be FHA-insured under Section 203 of the NHA (i.e., loans on one- to four-family residences)—

(a) after December 31, 2008, generally revises the upper limit on the principal balance of loans eligible for such insurance,

(b) revises the minimum cash down payment that must be made on such loans and prohibits funding of the down payment by the mortgaged property seller or certain other financially interested parties,

(c) increases the upper limit on the initial mortgage insurance premium payable by a borrower to HUD,

(d) expands the definition of "mortgage," and

(e) directs the HUD Secretary to carry out a pilot program to establish, and make available to mortgagees, an automated process for providing alternative credit rating information for borrowers and prospective borrowers who have insufficient credit histories for determining their creditworthiness,

(2) revises NHA provisions relating to the insurance of home equity conversion mortgage loans (i.e., reverse mortgage loans),

(3) directs the HUD Secretary to establish and conduct a demonstration program over a three-year period to test the effectiveness of alternative forms of pre-purchase homeownership counseling for first-time homebuyers who have been approved for residential mortgage loans with loan-to-value ratios between 97 percent and 98.5 percent,

(4) until October 1, 2009, limits HUD's ability to increase mortgage insurance premiums under NHA multifamily housing programs over the premium amounts in effect under such programs on October 1, 2006,

(5) during the 12-month period beginning on October 1, 2008, and notwithstanding notice of the planned implementation published in the Federal Register on May 13, 2008, prohibits HUD from taking any action to implement or carry out certain risk-based premiums relating to FHA insurance of mortgage loans on single-family residences, and

(6) with respect to manufactured housing loans that may be insured under the FHA's "title I" insurance program—

(a) conclusively establishes that any contract of insurance that is executed by the HUD Secretary for a financial institution with respect to loans, advances of credit or purchases in connection with a manufactured home, a lot on which a manufactured home is to be placed, or both, is evidence of the eligibility of the financial institution for such insurance,

(b) upwardly adjusts the loan limits for title I manufactured home loan insurance,

(c) establishes initial and annual insurance premiums to be paid by the borrower in the case of a loan, advance of credit or purchase relating to a manufactured home, a lot on which a manufactured home is to be placed, or both, and

(d) directs the HUD Secretary to establish manufactured housing loan underwriting criteria.

III. Tax-Related Provisions

The 2008 Act contained a number of tax-related provisions. Two particular provisions relating to housing finance are discussed below.

Tax Credit for First-Time Home Buyers

The 2008 Act provides a refundable tax credit for first-time homebuyers of a principal residence in the U.S. equal to the lesser of 10 percent of the purchase price of the residence and $7,500 ($3,750 for a married individual filing separately) for the tax year of the purchase. The credit is refunded by the taxpayer with no interest charge over 15 years in equal installments. The amount allowable as a credit is phased out for individual taxpayers with adjusted gross income (increased by amounts excluded from gross income under Section 911, 931, or 933) between $75,000 and $95,000 (or $150,000 and $170,000 for joint filers) for the year of purchase. The 2008 Act defines a first-time homebuyer as any individual if such individual (and if married, the individual's spouse) had no present ownership interest in a principal residence during the 3-year period ending on the date of the purchase of the principal residence. This provision applies to residences purchased on or after April 9, 2008, in taxable years ending on or after such date.

Increase in Standard Deduction for State and Local Taxes

The 2008 Act enables an individual taxpayer to increase its standard deduction for a taxable year by the lesser of (1) its allowable deduction for state and local real property taxes, and (2) $500 ($1,000 in the case of a joint return). This new deduction under the 2008 Act, however, does not apply to taxes that are deductible in computing adjusted gross income. This provision applies to taxable years beginning after December 31, 2007.