Case No. 13-684

IN THE

Supreme Court of the United States

LARRY D. JESINOSKI, ET UX.,
Petitioners,

v.

COUNTRYWIDE HOME LOANS, INC., ET AL.,
Respondents.

On Writ of Certiorari To The
United States Court Of Appeals
For The Eighth Circuit

BRIEF FOR *AMICUS CURIAE* STRUCTURED FINANCE INDUSTRY GROUP, INC. IN SUPPORT OF RESPONDENTS

Frank A. Hirsch, Jr.
Counsel of Record
Scott D. Samlin
Matthew D. Montaigne
Richard A. McAvoy
Alston & Bird LLP
4721 Emperor Blvd., Suite 400
Durham, North Carolina 27703
frank.hirsch@alston.com
(919) 862-2200
Attorneys for Amicus Curiae

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

INTERESTS OF THE *AMICUS CURIAE*[1]

The Structured Finance Industry Group, Inc. ("SFIG") is a member-based trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market. SFIG has over 250 members from all sectors of the securitization market, including investors, issuers, financial intermediaries, accounting, law, and technology firms, rating agencies, servicers, and trustees. SFIG was established with the core mission of supporting a robust and liquid securitization market, recognizing that securitization is an essential source of core funding for the real economy.

Regulations governing residential mortgages have a significant impact on the structured finance and securitization market. In fact, over 60% of the home mortgages originated in the United States are securitized. The interpretation of Section 1635 of the Truth in Lending Act ("TILA") espoused by Petitioners and certain other *amici* would have a destabilizing impact on the market for private label residential mortgage-backed securities ("RMBS")

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[1] No counsel for a party or a party to this proceeding authored this brief, in whole or in part, and no counsel for a party or party to this proceeding made a monetary contribution intended to fund either the preparation or the submission of this brief. No person other than *Amicus Curiae*, their members, or their counsel made a monetary contribution to the preparation or submission of this brief. Petitioners and Respondents have filed with this Court blanket consents to the filing of *amicus* briefs.

and, in turn, the residential mortgage market more generally.

Although SFIG's members' participation in the securitization market gives them a unique interest in the outcome of this case, the impact that residential mortgage regulations have on securitization markets are not only felt by those parties directly involved with mortgage-backed securities, but rather, are borne by *all participants*—borrowers included. A vibrant environment for private label RMBS infuses additional capital into the residential mortgage market, thus making it easier for all borrowers to obtain mortgages at a favorable interest rate and reducing the burden of taxpayers currently bearing the cost of government-sponsored residential mortgage securitization, which now represents a substantial majority of funding provided for residential mortgages.[2]

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[2] There are generally two types of RMBS based on the issuer of the security: RMBS issued or guaranteed by government-sponsored enterprises ("GSEs"), such as Fannie Mae, Freddie Mac, and Ginnie Mae, and private label RMBS issued by market participants such as banks or other entities. The securitization process described herein, *see infra* Part I.A.1, is specific to private label RMBS.

Because they do not typically have to meet the same requirements as the GSEs, issuers of private label RMBS have more flexibility with respect to the loans they may securitize. Thus, private label RMBS will typically contain different or specialized types of mortgage loan pools that do not qualify for agency RMBS, including loans with balances that exceed the amount that the GSEs are allowed to purchase by statute. Private label RMBS, under the right market conditions, can infuse more capital into the markets, reduce the governmental

The United States Court of Appeals for the Eighth Circuit was correct when it ruled that where a lender disputes the existence of a right to rescind, a borrower cannot unilaterally void his mortgage merely by notifying the creditor of his intent to do so. SFIG believes that reversing the Eighth Circuit's ruling (or agreeing with Petitioners) would have a detrimental impact on the mortgage lending market, private label RMBS liquidity, and the U.S. economy.

In particular, SFIG and its constituents are concerned that a reversal of the ruling would call into question representations and warranties ("R&Ws") contained in RMBS transactions regarding mortgage loans, which would result in a significant number of repurchases and pointless repurchase demands, and create the potential for a significant increase in litigation and liability—in a market which has borne the brunt of a never-ending stream of litigation over the past few years. Also, to the extent that post-rescission-notice mortgage loans remain in the trust, SFIG is interested in making certain that participants in private label RMBS transactions can be confident in the enforceability of creditors' security interests in the property acting as collateral for the securitized pool of mortgages. SFIG is concerned about the implications of a statutory interpretation that would allow a borrower to instantly and unilaterally terminate a creditor's security interest, even where the borrower's right to do so is disputed. SFIG is also concerned that a ruling for Petitioners would force its members to

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footprint in the mortgage market, and decrease taxpayer risk—an important goal for the Administration.

litigate every single notice of rescission, even if the claim is patently without merit. The cost of eradicating a single rescission claim is substantial and would add significantly to the cost of servicing the assets.

SUMMARY OF ARGUMENT

The Truth in Lending Act provides borrowers with "the right to rescind [certain home mortgage transactions] until midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms required under this section . . ., whichever is later." 15 U.S.C. § 1635(a). Thus, if a borrower gives notice within the first three days, his right to rescind is unconditional; the borrower may seek rescission for any reason. Where the borrower seeks to rescind after the first three days, however, defective TILA disclosures are a condition-precedent. Regardless of whether the required disclosures were made, "an obligor's right of rescission shall expire three years after the date of consummation of the transaction . . . ." 15 U.S.C. § 1635(f).

At issue in this case is what steps must be taken by the borrower within the three-year repose period prescribed by 15 U.S.C. § 1635(f). An analysis of the necessary implications of Petitioners' position and the basis for the remedy of rescission demonstrate the falsity of the underlying premise of Petitioners' position—that mere notice is sufficient to effect the result. A ruling that rescission is effectuated upon mere notice from the borrower, when the underlying right to rescind is disputed by

the creditor, would have a detrimental effect on the residential mortgage market and private label RMBS securitization. Consumers would face little to no risk to send notices of intention to rescind, which would likely drastically increase, leading to more litigation and, inevitably, higher costs for residential mortgage financing and more disputes amongst transaction parties to a securitization.

Petitioners' position would have serious implications for the private label RMBS market, as it would call into question standard R&Ws regarding pooled mortgages and the validity of the security interest in the underlying collateral.[3] The RMBS market is finally on the path to rebuilding, but it needs predictability to recover to healthy levels and to lessen the burden on the taxpayer. In 2005, private label mortgage securities infused over $1,120 billion in capital into the mortgage market. In 2013, as a result of diminished investor confidence and an increase in expenses for participants, that number

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3 For mortgage loans included in a recent publicly registered RMBS, the percentage of mortgage loans in that deal which could have been subject to TILA rescission—refinance mortgage loans—was over 50%-similar to other transactions. For example, in Sequoia Mortgage Trust 2013-8, the disclosed percentage of mortgage loans which were refinance mortgage loans at the time of the closing of the transaction was 62.22%. Prospectus Supplement dated June 12, 2013 (To Prospectus dated April 24, 2013) *available at* http://www.sec.gov/Archives/edgar/data/1176320/000114420413034658/v347661_424b5.htm. TILA rescission could also apply to mortgage loans other than refinance loans which also may be securitized.

dropped to less than $16 billion, a decrease of nearly 99%. A determination that a creditor's security interest is voided immediately upon notice may make many of these mortgage loans ineligible for securitization, if they have not been contributed to an RMBS, or if already included in an RMBS, will impose additional costs and burdens on originators, issuers, trustees, servicers and ratings agencies, thereby causing further trepidation among investors. The end result will inevitably have a negative impact on the private label RMBS market, an essential source of core funding for the economy.[4]

Petitioners' position also presents a panoply of uncertainties for participants in the RMBS market. For example, are trustees required to treat a notice of intention to rescind as a breach of the R&Ws and pursue remedies to remove that loan from the RMBS pool? What if there is no repurchase remedy for a loan in the trust? Will the RMBS be downgraded? Will bank holders of private label RMBS be required to adjust their capital requirements as a result of a downgrade? Are servicers required to notify trustees, and trustees required to notify sellers and investors in RMBS as soon as a borrower provides notice of intent to rescind? Moreover, how would the loan be serviced if it is determined that it is no

4 Petitioners' position could also have a negative impact on mortgage loans sold to GSEs for securitization as well as other mortgage originators that may have loans in their portfolio i.e., on their balance sheet. Mortgage participants typically engage in a "best execution" analysis to determine if securitization through the private label securities market, holding loans on balance sheet, or selling loans to the GSEs is the best option.

longer secured by real property? Which is "the most relevant statute of limitations from state law," Br. for Petitioners at 43, and how will the application of common law defenses such as laches, waiver, and estoppel vary by state? How should investors value a residential mortgage loan or an RMBS containing loans from a state with a one-year statute of limitations compared to loans from a state with a six-year statute of limitations, and how will those differences in valuations impact the availability of financing in different states? These ambiguities would cast a cloud over the entire residential mortgage market.

Petitioners' erroneous position will dramatically increase legal disputes. In addition to the inevitable litigation that will arise out of the questions discussed above, Petitioners' underlying premise will force servicers to litigate every single notice of intention to rescind, no matter how untenable and unsubstantiated. The risks associated with the mortgage loan becoming unsecured are dramatic, as are the costs associated with the potential of providing, in essence, an interest-free loan.

This Court's recent discussion regarding the nature of statutes of repose confirms that when a borrower seeks to rescind his mortgage loan and the lender disputes the borrower's right to rescind, the borrower must bring a suit for rescission within the three-year period provided by 15 U.S.C. § 1635(f). Any claims brought under § 1635 after the three-year repose period, no matter how they are crafted,

are improperly seeking an award of rescission on the basis of a right that no longer exists.

Enacted in 1974 to combat the uncertainty created by unexpired rights of rescission, 15 U.S.C. § 1635(f) provides that the right "shall expire" three years after consummation of the loan. 15 U.S.C. § 1635(f). By enacting § 1635(f), Congress struck a balance between consumer protection and the need for certainty in the residential mortgage and real estate markets: Consumers are entitled to rescind in certain circumstances for up to three years, but after that date a lender can be confident in its secured creditor status.[5] The position espoused by Petitioners would upset this balance and largely defeat the purpose of § 1635(f).

According to Petitioners' interpretation, a borrower need only provide notice of an intent to rescind within three years of consummation of the mortgage and, if the transaction happens to have occurred within the state of Minnesota (as in the instant case), the borrower has *another* six years to bring a suit for rescission. That's nine years in total (in stark contrast with the one-year statute of limitation provided by Section 1640 for damages for other violations of TILA). Further, Petitioners argue that the actual rescission itself, including the voiding of the creditor's security interest in the underlying property, is effective *immediately* upon the borrower's notice. Even when the right of rescission is disputed by the lender, mere notice could relegate

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[5] Consumers also lose the right to rescind if their loan is paid off or the property is sold. 15 U.S.C. § 1635(f).

the creditor to unsecured status, and potentially provides the borrower with an interest-free loan retroactive to consummation up until the matter is litigated. Many lower courts have wisely recognized that this is an "untenable proposition." *See Large v. Conseco Fin. Servicing Corp.*, 292 F.3d 49, 54-55 (1st Cir. 2002).

Petitioners' position conflicts with this Court's recognition that § 1635(f) is a statute of repose, *see Beach v. Ocwen Fed. Bank*, 523 U.S. 410, 417-18 (1998), and disregards the purpose of statutes of repose. As this Court recently noted, "[l]ike a discharge in bankruptcy, a statute of repose can be said to provide a fresh start or freedom from liability." *CTS Corp. v. Waldburger*, 189 L. Ed. 2d 62, 72-73 (2014). The creation of a protracted, and perhaps indefinite, period in which a borrower may bring a rescission suit would defeat Congress's intent to provide lenders with "freedom from liability" after three years.[6]

For the reasons summarized above and discussed below, SFIG respectfully asks the Court to affirm the majority rule and find that where a borrower's right to rescind is disputed, he must bring a suit for rescission within the three-year repose period set forth in 15 U.S.C. § 1635(f).

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[6] This Court recognized that Congress's concern for commercial certainty led it to establish the fixed and limited repose period of § 1635(f). *See Beach*, 523 U.S. at 418 ("when Congress amended the Act in 1995 . . . it took care to provide that any such liberality was subject to the three year time period provided in subsection (f)").

ARGUMENT

Respondents argue that where the borrower's right to rescind is contested, the borrower must sue for rescission within TILA's three-year statute of repose. To that end, SFIG agrees in full with Respondents that the Petitioners' rescission claim is time-barred.

I. WHERE A BORROWER'S RIGHT OF RESCISSION IS DISPUTED BY HIS CREDITOR, MERE NOTICE OF A BORROWER'S INTENT TO RESCIND DOES NOT AUTOMATICALLY RESCIND THE MORTGAGE.

Petitioners' argument is based on the false premise that under § 1635, a borrower's mere notification to the creditor is sufficient to effectuate a rescission, even when the existence of a condition-precedent (deficient disclosures) of the underlying right of rescission is disputed. The Court should reject this position for three reasons. First, the necessary implications are so absurd that Congress could not have intended such a scenario. Second, it would result in increased litigation, straining our already overburdened federal courts and increasing the costs of obtaining residential financing. And third, it is inconsistent with the equitable remedy of rescission and corollary equitable principles such as clean hands.

A. Petitioners' Position Has Serious Negative Implications On The

Private Label RMBS Market As Well As The Residential Real Estate Market More Generally.

Petitioners' position is based on the dangerous assumption that where required TILA disclosures are alleged to have been deficient, a rescission is effective immediately at the time a borrower provides his creditor with notice of an intent to rescind. Notice alone is sufficient so long as it is made within three years after consummation, regardless of whether the right of rescission is disputed by the lender. This could not have been Congress's intent. *In re Chapman*, 166 U.S. 661, 667 (1897) ("nothing is better settled than that statutes should receive a sensible construction, such as will effectuate the legislative intention, and, if possible, so as to avoid an unjust or an absurd conclusion").

If a rescission is held to be immediately effective upon mere notice of a borrower's intent to rescind, then a creditor's status as a secured party is likewise placed in jeopardy upon mere notice of a borrower's one-sided intent. *See* 15 U.S.C. § 1635(b). Indeed, Petitioners acknowledge this result. *See Petitioners' Petition for Writ of Cert.* at 21 ("upon such a rescission that a borrower exercises by notifying his creditor, any security interest becomes void") (internal quotations omitted). In light of the hyper-technical nature of TILA, *see, e.g. Handy v. Anchor Mortgage Corp.*, 464 F.3d 760, 764 (7th Cir. 2006) ("TILA does not easily forgive 'technical' errors."), it would be difficult for creditors to confidently conclude whether or not the borrower

has a valid right of rescission upon receipt of the notice and, in turn, whether its security interest is still valid. This secured-creditor-limbo has the potential to have a severe impact on the private label RMBS market and a heightened impact on the residential mortgage market more generally.[7]

1. Overview of the RMBS securitization process.

In order to fully appreciate the impact that Petitioners' position would have on the residential mortgage market, it is essential to have an understanding of the structure of, and parties involved in, the private label RMBS securitization process.

The life of a mortgage loan begins at origination. An "originator", or lender, is the entity that actually makes a mortgage loan. An originator also processes a borrower's loan application and is responsible for making the required TILA disclosures. In exchange for making the loan, the originator receives a mortgage from the borrower, which provides the originator with a security interest in the borrower's property.

After origination, an originator may choose to retain the mortgage loan on its balance sheet, to pool it with other mortgage loans in an RMBS, or to sell

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[7] *See Yamamoto v. Bank of New York*, 329 F.3d 1167, 1172 (9th Cir. 2003) ("[I]t cannot be that the security interest vanishes immediately upon the giving of notice. Otherwise, a borrower could get out from under a secured loan simply by claiming TILA violations.").

the mortgage loan to a third-party, who may either retain the mortgage loan or pool it with other mortgage loans in its own RMBS. If the mortgage loan is securitized in an RMBS, it is sold by the party initiating the securitization (typically referred to as the "sponsor") to a special purpose entity called the "depositor," pursuant to a mortgage loan purchase agreement ("MLPA"). In the MLPA, the sponsor makes various R&Ws about various features of the mortgage loans. The rights of the depositor with respect to the MLPA are then assigned to the securitization trust, or "issuer", which issues the RMBS. The RMBS is backed by payments on the pool of mortgage loans. A "trustee" is then appointed to handle various tasks with respect to the pool of loans contained in the trust.

After securitization, an "underwriter" purchases the RMBS from the trust to resell to investors. Before resale, the RMBS generally receives a credit rating from a rating agency. The rating agency gives an RMBS its rating based on an evaluation of data on each loan held by the trust (e.g., principal amount, location of the property, credit history of the borrower, ratio of the loan amount to the value of the underlying collateral, and lien priority) and the R&Ws, among other things. The rating agency is required to compare the R&Ws against their stated criteria and to file a report showing the differences, if any, between the R&Ws made by the sponsor and its standard R&Ws. Credit ratings inform investors about which RMBS are most appropriate given their respective tolerances for risk.

Another important entity in the RMBS process is the "servicer." The relationship between the trustee and servicer is generally governed by a "pooling and servicing agreement" ("PSA"). The servicer is responsible for processing payments and interacting with borrowers, implementing the collection measures prescribed by the PSA and, if needed, liquidating the collateral in the event of default. After a servicer processes payments, the proceeds are forwarded to the trustee, who distributes them to the investors. As part of its duties, under accepted servicing practices, the servicer in an RMBS would be required to attend to rescission claims from borrowers in a manner consistent with customary standards of the jurisdiction in which the mortgaged property is located.

Through the RMBS process, all investors, from institutional investors to individuals, have access to the residential mortgage market. In turn, this collection of private capital provides lenders with additional funds for their mortgage lending divisions and much-needed liquidity to the market, making financing more available to homeowners nationwide.[8] The private capital infused by the

[8] Without private capital, banks are dependent on their deposit base for funding of non-GSE conforming mortgages. These same deposits fund other assets such as credit card receivables and auto loans. The return on competing assets may be greater than mortgages, creating an economic disincentive to funding mortgages. Furthermore, the deposit base may shrink at any time. As such, certain originators are dependent upon private capital to fund originations, and private capital provides much needed liquidity to the residential mortgage market.

secondary market for RMBS is particularly important for non-agency borrowers, who may not qualify within the parameters of a GSE-backed mortgage loan. Indeed, originators often make mortgage loans fully anticipating that they are not eligible for purchase by a GSE and will ultimately be part of a private label RMBS transaction.

2. Petitioners' position would have a chilling effect on the private label RMBS market.

A determination that mere notice is sufficient to effect a rescission would reverberate through all segments of the RMBS market, creating significant hurdles for originators, issuers, ratings agencies, servicers, and trustees alike, while breeding doubt among investors regarding the value of future and already-issued private label RMBS.

As previously discussed, the R&Ws are important elements of the securitization process. The quality and extent of an originator's R&Ws provide issuers and investors with confidence in the value of the security and have a significant impact on the RMBS's credit rating. Specifically, ratings agencies seek R&Ws that provide assurances regarding the origination and underwriting quality of the pool of loans. For example, one rating agency expects to see the following R&Ws, among others, when rating RMBS securities:

> The mortgage is a valid, subsisting and enforceable first lien on the property therein described and, except as noted in the

> mortgage loan schedule, the mortgaged property is free and clear of all encumbrances and liens having priority over the lien of the mortgage . . . .
>
> At the time of origination or, if subsequently modified, the effective date of the modification, each mortgage loan complied in all material respects with all then-applicable federal, state and local laws including, without limitation, truth-in-lending, real estate settlement procedures, consumer credit protection, equal credit opportunity, predatory and abusive lending laws and disclosure laws . . . .
>
> No mortgage note or mortgage is subject to any right of rescission, set-off, counterclaim or defense . . . .

Representations and Warranties Criteria for U.S. RMBS Transactions, DBRS, May 2014, *available at* http://www.dbrs.com/research/267566/representations-and-warranties-criteria-for-u-s-rmbs-transactions.pdf. Thus, where a borrower provides an originator with notice of an intent to rescind after the three-day rescission period but before the originator has sold the mortgage to an issuer—no matter how untenable or unsubstantiated the purported right to rescind may be—the loan would be ineligible for securitization, as it would violate these standard representations.

For a mortgage loan which has already been included in an RMBS, it would be expected that the servicer, upon being provided a notice of intention to

rescind, would inform the trustee. Thereafter, the purported rescission could be treated as a breach of the R&Ws and a repurchase remedy would be sought. A sponsor might be eager to repurchase the loan for reputational reasons, and it may also want to remove the loan from the trust to defend the notice of intention to rescind more effectively. Regardless, rescission or attempted rescission would have serious ramifications for the securitization, as the various parties thereto would have to analyze a complex and difficult situation, with significant litigation risk. *See supra*, pp. 15-16. All of these issues would arise even if the trigger was an untenable and unsubstantiated notice of rescission.

Representation and warranty disputes have been significant after the credit crisis and an adverse ruling would have the potential to exacerbate disagreements. These disputes have led to considerable uncertainty in the market and have adversely affected the flow of private capital. SFIG has previously filed letters with the Treasury Department addressing some of these issues.[9] In addition, SFIG is currently attempting to address these issues through its RMBS 3.0 project, which involves a large group of securitization transaction parties, including issuers and investors, working together to create a new paradigm for the resolution of disputes concerning representations and warranties.[10] Also, the SEC in its recent release

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9 *See* Letter from SFIG to U.S. Department of Treasury (Aug. 11, 2014), *available at* http://www.regulations.gov/#!document Detail ;D=TREAS-DO-2014-0005-0028.

10 *See id.*

regarding Regulation AB mandated another paradigm for the resolution of representation and warranty disputes for publicly registered securitizations.[11] All of these efforts to create a new and viable market could be thrown into jeopardy by Petitioners' position, due to the likelihood that it would generate an increased number of alleged breaches of representations and warranties and create additional repurchase disputes between transaction parties.

Relatedly, the possibility that a rescission has already been effected by a borrower's mere notice will increase the due diligence costs to issuers of RMBS. Investors and ratings agencies understandably place significant due diligence requirements on issuers to ensure the value of the RMBS. The burden and expense of proving, loan-by-loan, that a borrower has not provided a notice of rescission (which, under Petitioners' position, would be necessary to have any confidence in the enforceability of the security interest) could have a substantial impact on profitability and incentive for issuing RMBS. *See Arizona Free Enter. Club's Freedom Club PAC v. Bennett*, 131 S. Ct. 2806, 2823 (2011) ("it is never easy to prove a negative").

The process of evaluating breaches of R&Ws places additional costs on trustees, decreases the incentive for originators to make loans they would not otherwise make and, if such loans are included

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11 *See* Asset-Backed Securities Disclosure and Registration (adopted on Sept. 4, 2014) (to be codified at 17 C.F.R. pts. 229, 230, 232, 239, 240, 243, and 249), *available at* http://www.sec.gov/rules/final/2014/33-9638.pdf.

in private label RMBS, increases the likelihood of litigation between originators, issuers, trustees, and investors. Because of the serious implications of an instantaneous cancellation of a security interest, these consequences would arise from any and all notices of intent to rescind, including ones without true merit.

Under Respondents' interpretation (and the holding of the Eighth Circuit) wherein a borrower's notice of intent to rescind does not immediately effect a rescission where the underlying right of rescission is disputed, trustees can wait to enforce a repurchase agreement until after the servicer either agrees with the borrower's intended rescission or, if the right of rescission is disputed, a determination is made by an appropriate court. This prudent interpretation of § 1635 ensures that a potentially frivolous assertion of a right to rescind neither diminishes the value of mortgage loans nor exposes RMBS participants to expensive and unnecessary put-back claims.

3. Petitioners' position could have a significant adverse impact on the risk-based capital treatment of RMBS.

In addition to the chilling effect that it would have on the residential real estate market's access to private capital more broadly, Petitioners' position has the potential to adversely affect investment in RMBS. The treatment of RMBS held by banks for regulatory capital purposes is sensitive to the ratings of such RMBS. In the event that RMBS are

downgraded as a result of borrower's resorting to a rash of notices of intention to rescind, the amount of capital that banks would be required to hold against RMBS held in portfolio could be increased. *See* 12 C.F.R. pt. 3, app. A, § 4 (3)(1). This would be in addition to the substantial increase in capital required for residential mortgage loans held in whole loan format, which would increase from 50% to 100%. *Compare* 12 C.F.R. pt. 3, app. A, § 3 (a)(3)(iii) (providing a 50 percent risk weight to loans secured by certain first mortgages on one-to-four family residential properties) *with* 12 C.F.R. pt. 3, app. A, § 3 (a)(4) (applying a 100 percent risk weight to all other assets).

The impact of a ruling that recognizes immediate rescission upon notice, regardless of whether the right to rescind is disputed, will be felt by all participants in the RMBS market:[12]

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[12] The *Amici* States argue that "the potential for rescission also gives the secondary mortgage market strong incentives to police loan originators to prevent threshold TILA violations." Br. for the State of New York, et al., at 21. This is unrealistic. It would be exceedingly difficult and expensive for participants in the secondary mortgage market to investigate as to each loan the adequacy of the TILA disclosures in its portfolio of RMBS. Indeed, even the *Amici* States recognize the "exceedingly difficult" task of discovering a TILA violation on the face of the loan disclosure statements. *Id*. Furthermore, the *Amici* States' suggestion that secondary market participants "police" originators misses the point. Under Petitioners' position, it does not matter to an investor whether a rescission is valid, and thus whether an originator actually acted appropriately. The *mere risk* of a frivolous notice of intention to rescind is too great and will inevitably result in repurchase demands on the trustee and litigation.

Originators will be unable to include in a pool any mortgage for which a notice of intention to rescind was received no matter how frivolous and will have less confidence that the loans it originates will ultimately be resold to an issuer; trustees will be burdened with increased expenses associated with mortgage loan repurchase claims; and servicers will be confronted with the expense of determining on a loan-by-loan basis whether a borrower provided a notice of intention to rescind, and, if so, whether the borrower actually possessed a right to rescind. However, given the recent deluge of R&Ws-related litigation and the severe risks of becoming an unsecured creditor, participants in the RMBS market cannot afford to wait for rulings on the declaratory judgment actions proposed by Petitioners, but must act under the possibility that the notice of rescission is valid. Petitioners' position would have negative implications on other participants in the residential real estate market as well. For example, potential purchasers would shy away from buying homes through non-judicial foreclosure where a frivolous right of rescission may remain un-litigated. *See Beach v. Ocwen Fed. Bank*, 523 U.S. 410, 418 (1998) ("a statutory right of rescission could cloud a bank's title on foreclosure").

The securitization of mortgages infuses additional capital into the residential mortgage market, making it easier for borrowers to obtain financing on favorable terms. Should the market for private label RMBS become impeded by uncertainty, issuers will have fewer potential purchasers and less of an incentive to originate, raising additional

barriers to credit for consumers in a market in which lending standards are already strict and out of reach for many first time homebuyers, the under-employed, those with damaged credit, and low- and moderate-income borrowers. The uncertainty that may arise if Petitioners' position is accepted adds another cost and hurdle in the form of threatened litigation, which could ultimately drive originators away from the recovering market.

B. Petitioners' Position Would Dramatically Increase The Amount of TILA Rescission-Related Litigation.

An interpretation that rescission may be had by naked notice, even when the right to rescission is disputed by the lender, will inevitably lead to a dramatic increase in the amount of TILA rescission-related litigation. Under Petitioners' interpretation, lenders and servicers will be forced to litigate every notice of rescission, lest they run the risk of the loan becoming unsecured (*see supra* Part I.A.), or to avoid the risk of providing the borrower with an indefinite (or at least extended) interest-free loan.

15 U.S.C. § 1635(b) provides that "within 20 days after receipt of a notice of rescission, the creditor shall return to the obligor any money or property given as earnest money, down-payment, or otherwise." Even where the borrower has not been harmed by the failure to make all necessary disclosures, the borrower is entitled to a return of all interest payments made prior to rescission. *See, e.g., In re Regan*, 439 B.R. 522, 534 (Bankr. D. Kan. 2010)

(holding that borrower was entitled to payments even where TILA violation "caused no harm or prejudice to Debtors."). Thus, rescission provides the potential for significant pecuniary gain on the part of a borrower. However, TILA is at heart a consumer *notice* statute intended to provide uniform data about the loan transaction and the true cost of the credit being extended. TILA is technical and can be easily violated, hence the $35 tolerance rule in TILA for *de minimis* computation errors. *See* 15 U.S.C.A. § 1635(i). It is incompatible with TILA's disclosure focus and tolerance for mistakes unlikely to have impacted the consumer decision, to interpret TILA as calling for windfall damage awards to borrowers.[13]

In fact, Congress opted to alleviate creditors of the financial risks associated with an indefinite right of rescission when it enacted § 1635(f) and its three-year statute of repose. Allowing a borrower to effect a rescission by mere notice, and to then bring a "declaratory suit", *see* Br. for Petitioners at 40, many years after the right to rescind has expired, creates a strong incentive for *all borrowers* to send a notice of

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[13] An extreme example would be a borrower that sent a rescission letter within three years but did not bring a rescission suit until the conclusion of his 30-year mortgage. For a $300,000 mortgage at 10%, the borrower will have paid $647,777.30 in interest over the 30 years on top of the $300,000 of principal. If the borrower is successful in its rescission action, the creditor would be forced to return the $647,777.30 to the borrower, thus having provided the borrower with a 30-year interest free loan. This reality demonstrates why TILA rescission has been referred to as the "most draconian remedy." 141 Cong. Rec. S14566, 14567 (statement of Senator D'Amato).

rescission just prior to the expiration of the three-year statute of repose, in the hopes that he or she may have an interest-free loan.

Of course, this potential windfall to borrowers creates a corresponding risk to creditors with little risk or cost to the borrower. *See Sherzer v. Homestar Mortgage Servs.*, 707 F.3d 255, 267 (3d Cir. 2013) ("permitting obligors to rescind by written notice could potentially impose additional costs on banks, as it costs little for an obligor to send a letter to the lender"). Creditors will likely find that the possibility of providing a borrower with an interest-free loan for many years, when paired with the unsecured creditor complications and R&Ws-related litigation risks discussed above, renders the risk of an outstanding and un-litigated notice of rescission too great to reasonably accept, no matter how confident they are that the borrower lacks the right to rescind, leading to unnecessary litigation. In addition to the significant strain that these cases place on our over-burdened federal courts, the costs of additional litigation will only make residential mortgages more expensive. *Id.* ("This may, in turn, be more costly for borrowers insofar as lenders—like all businesses—pass along costs occasioned by regulation or taxation to their customers.").

Conversely, should the Court agree with Respondents that mere notice of an intent to rescind does not effectuate a rescission, there is little risk that a creditor will try to "outwait" the three-year repose period of § 1635(f). As acknowledged by the CFPB, "[a]n obligor may sue for damages under Section 1640 for a creditor's failure to follow the

unwinding procedures of Section 1635(b)". Br. for United States at 14.

C. Petitioners' Position Is Inconsistent With The Common Law Remedy Of Rescission.

The United States of America, as *amicus curiae*, argues for immediate rescission upon notice by drawing an analogy between the right of rescission provided under § 1635 and the common law doctrine of rescission at law. This analogy backfires. Unlike the right of rescission provided by TILA, the remedy of rescission at law requires tender by the borrower ***at the time he provides his notice of rescission***. This is no small distinction.

The remedy of rescission cannot be had without the balanced scales of equity. *See Rosenfield v. HSBC Bank, USA*, 681 F.3d 1172, 1184 (10th Cir. 2012) ("Rescission in its most basic form is an equitable remedy designed to return the parties to the status quo prevailing before the existence of an underlying contract."). Thus the maxim, "he who seeks equity must do equity." *Koster v. (Am.) Lumbermens Mut. Cas. Co.*, 330 U.S. 518, 522 (1947). Under the remedy of rescission, if a borrower would like the mortgage loan transaction to be unwound and the lien voided, then he must pay back the borrowed funds.

In fact, several of the cases cited by the United States specifically acknowledge the necessity of a tender to effectuate a rescission at law. *Douglass v. Nationwide Mut. Ins. Co.*, 913 S.W.2d

277, 282 (Ark. 1996) ("In Arkansas, rescission of a contract at law is accomplished by *the rescinding party's tendering the benefits received to the contracting party*, and the courts have nothing to do with the repudiated transaction.") (emphasis added); *Peterson v. Highland Music, Inc.*, 140 F.3d 1313, 1322 (9th Cir. 1998) ("Under California law, a party to a contract can rescind it and such rescission can be accomplished by the rescinding party by giving notice of the rescission *and offering to restore everything of value which the rescinding party has received*.") (emphasis added); *Griggs v. E.I. DuPont de Nemours & Co.*, 385 F.3d 440, 445 (4th Cir. 2004) ("A rescission is an avoidance of a transaction . . . . Except as the parties might agree to the contrary, *rescission will normally be accompanied by restitution on both sides*.") (emphasis added); *see also Maumelle Co. v. Eskola*, 865 S.W.2d 272, 274 (Ark. 1993) ("rescission at law is accomplished when one party to a contract tenders or returns to the other party the benefits received under the contract"). The doctrine of rescission at law seeks to return the parties to their respective positions *ex ante*. Because TILA does not require an immediate tender at the time the borrower provides his notice of intention to rescind, it makes perfect sense that a rescission is not automatic where the right to rescind is disputed. An interpretation to the contrary would leave the borrower with the loan proceeds and the creditor with no security interest—hardly a reset to the parties' original positions.

In fact, an interpretation of § 1635 that does not provide for rescission upon mere notice resolves

other tender-related issues that would arise under Petitioners' position. For example, if rescission is immediate upon mere notice even where the right to rescind is disputed, what happens to the creditor's security interest if the borrower fails to tender? Does it immediately go back into existence? What happens to other creditors that gain a security interest in the same property after the borrower provided a notice of intention to rescind, but before the borrower failed to tender? Are they junior or senior to the original creditor? These are real concerns, not mere speculation. Creditors have already been confronted with suits filed many years after the borrower provided notice of rescission. *See Nix v. Option One Mortg. Corp.*, No. Civ. 05-03685, 2006 U.S. Dist. LEXIS 2289, at *2-3 (D.N.J. Jan 19, 2006) (borrower provided notice of rescission in 1998 but did not file a lawsuit until 2005). Some courts have remedied this issue by requiring that borrowers prove an ability to tender before granting rescission.[14] Petitioners' position of immediate rescission upon notice would eliminate the ability of courts to take such an action because under their analysis any post-notice suit is merely a suit for

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[14] *See, e.g., Yamamoto v. Bank of New York* 329 F.3d 1167, 1170 (9th Cir.2003) (acknowledging that "rescission *should be* conditioned on repayment of the amounts advanced by the lender") (emphasis in original); *Williams v. Homestake Mortgage Co.*, 968 F.2d 1137, 1142 (11th Cir. 1992) ("In deciding whether or not to impose conditions upon [the borrower], the district court should consider traditional equitable notions, including such factors as the severity of [the creditor's] TILA violations and whether [the borrower] has the ability to repay the principal amount.").

declaratory judgment, and the rescission—and the concomitant voiding of the creditor's security interest—has already been effected.[15]

II. SECTION 1635(F) IS A STATUTE OF REPOSE THAT BARS ALL ACTIONS PREMISED ON A BORROWER'S RIGHT TO RESCIND AFTER THREE YEARS.

This Court has previously recognized that § 1635(f) is not merely a statute of limitations, *see Beach v. Ocwen Fed. Bank*, 523 U.S. 410, 417 (1998), but is a statute of repose that by its "plain language" states that a borrower's right to rescind shall not be "'***enforceable in any event*** after the prescribed time.'" *Id.* at 416 (emphasis added) (quoting *Midstate Horticultural Co. v. Pennsylvania R. Co.*, 320 U.S. 356, 360 (1943)). And as a statute of repose, "Section 1635(f) . . . takes us beyond any question whether it limits more than the time for bringing a suit, *by* governing the life of the underlying right as well." *Beach*, 523 U.S. at 417. As a rescission cannot be had by mere notice where

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[15] Congress clearly intended that courts would play an active role in the rescission process. Section 1635(b), which includes the provision that "any security interest given by the obligor, including any such interest arising by operation of law, becomes void upon such a rescission", also states that "the procedures prescribed by this subsection shall apply except when otherwise ordered by a court." A determination that rescission is had immediately upon notice from the borrower conflicts with Congress's grant of judicial discretion. In fact, many courts have held that "[v]oiding a security interest is one of the procedures that may be modified to effect rescission." *See In re Regan*, 439 B.R. 522, 534 (Bankr. D. Kan. 2010).

the right to rescind is disputed by the lender (*see supra* Part I), any action under 1635 ***must*** be an action for rescission, and thus barred if brought more than three years after consummation. Likewise, even if this Court were to find that mere notice does immediately result in rescission, any suit would still be an action to enforce a right of rescission—a right that no longer exists after 1635(f)'s three-year statute of repose has run.

Statutes of repose, such as § 1635(f), "effect a legislative judgment that a defendant should be free from liability after the legislatively determined period of time," *CTS Corp. v. Waldburger,* 134 S. Ct. at 2183 (internal citations omitted), and "embod[y] the idea that at some point a defendant should be able to put past events behind him." *Id.* (citing *Jones v. Thomas*, 491 U.S. 376, 392 (1989) (SCALIA, J., dissenting)). In seeking to avoid application of the statute of repose, Petitioners ignore the plain language of 1635(f) and this Court's analysis in *Beach*.

Section 1635(f) states that "[a]n obligor's right of rescission shall expire three years after the date of consummation." *Beach* recognized that this provision "governs the life of the . . . right." *Beach*, 523 U.S. at 417. Petitioners seek to avoid the plain language of 1635(f) and *Beach* by arguing that 1635(f) "makes no mention of a lawsuit and 'talks not of a suit's commencement but of a right's duration'". Br. for Petitioners at 40 (quoting *Beach*, 523 U.S. at 417). It is axiomatic, however, that there can be no viable claim where there is no underlying right.

If, as Petitioners assert, a suit brought after the borrower already provides notice is a "suit to enforce rescission", Br. for Petitioners at 46, it is barred when brought more than "three years after the date of consummation." As previously noted by this Court, § 1635(f) renders a borrower's right to rescind *"'**[un]enforceable*** in any event after the prescribed time.'" *Beach*, 523 U.S. at 417 (emphasis added) (quoting *Midstate*, 320 U.S. at 360). To allow a borrower to proceed with a "suit to enforce rescission" after the three-year period would completely ignore this Court's ruling in *Beach* as well as its recent analysis of the purposes of statutes of repose. *See CTS Corp.*, 134 S. Ct. at 2183 (stating that statutes of repose allow defendants "a fresh start" and allow them "to put past events behind him").[16]

Avoiding § 1635(f) by arguing that a borrower's post-notice suit merely seeks a declaratory judgment is equally as untenable and inconsistent with the limitations of declaratory judgment proceedings. Hypothetically, a court could decree that the loan was already rescinded and that the creditor's security interest was already void. However, a declaratory judgment may only state what *is*. A declaratory judgment may not order the

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[16] The United States focuses on alleged hardships that treating § 1635(f) as a limit for filing suit would have on borrowers. However, unlike statutes of limitation, which allow tolling when "extraordinary circumstance prevents [a plaintiff] from bringing a timely action," statutes of repose are defendant-facing and seek to "provide a fresh start or freedom from liability." *See CTS Corp.*, 134 S. Ct. at 2183.

borrower to tender the loan proceeds or order the creditor to "return any money or property given as earnest money, down-payment, or otherwise" or to "take any action necessary or appropriate to reflect the termination of any security interest created under the transaction." 15 U.S.C. § 1635(b); *see also King v. United States*, 390 F.2d 894, 904 (Ct. Cl. 1968) ("Since no performance by, or execution on, the defendant is sought in a prayer for declaratory relief, no further mechanism for the satisfaction of the plaintiff's claim is required when a court grants a declaration.") *rev'd on other grounds*, 395 U.S. 1 (1969). Such steps are part of the rescission process and embedded within the rescission remedy, which is terminated three years after consummation. The absurdity of a statutory scheme that allows for immediate cancellation of a security interest upon naked notice, while potentially exposing other aspects of the process to a repose period, is further evidence that Congress could not have intended that a rescission is effective immediately upon mere notice from the borrower where the underlying right to rescind is disputed.

Having already argued that § 1635(f) does not apply to their actions to "enforce" the right of rescission and recognizing the absurdity of an indefinite period during which a borrower may seek a rescission so long as notice was made during the first three years, Petitioners offer an alternative limitations period: Minnesota's six-year limitations period for suits "upon a liability created by statute" on the grounds that it is the most analogous statute of limitations under state law. Br. for Petitioners at

44 (quoting Minn. Stat. Ann. § 541.05, subd. 1(2)).[17] By claiming that the most analogous statute of limitations is one applicable to "a liability created by statute," Petitioners betray their own argument that a borrower's suit following notice is merely an action for a declaratory judgment, and is not covered by the 1635(f) statute of repose. Thus, no matter how an action to enforce the right to rescind is phrased, it is barred three years after consummation.

17 Using a six-year statute of limitations period means the lender may have to refund an additional six years' worth of interest payments.

CONCLUSION

For the reasons set forth above, SFIG respectfully requests that the Court reject the arguments of the Petitioners and affirm the ruling of the majority of courts holding that where a borrower's right of rescission is disputed by the creditor, a borrower must file an action for rescission within three years from the date of consummation of the mortgage transaction.

Respectfully submitted,

Frank A. Hirsch, Jr.
Counsel of Record
Scott D. Samlin
Matthew D. Montaigne
Richard A. McAvoy
Alston & Bird LLP
4721 Emperor Blvd., Suite 400
Durham, NC 27703
frank.hirsch@alston.com
(919) 862-2200
Attorneys for Amicus Curiae
Structured Finance
Industry Group, Inc.

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