DeLeo, Wanda

From:DeLeo, Wanda
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To:Taylor, Mary Ellen;Chris Katopis ((b)(6) @the-ami.org);Scholz, Elizabeth;Stauffer, Lawrence;Newell, Jamie;Fishman, Robert;Ackerman, Lauren;Singh, Manoj;Lawler, Patrick;Kuhl, Janice;Thompson, Sandra;Burns, Meg; (b)(6) @fanniemae.com';Giammarinaro, Matthew;Seiler, Robin; (b)(6) @freddiemac.com;Fernandez, Maria;PL Plaza Conference Room 1-201; (b)(6) @freddiemac.com; (b)(6) @fanniemae.com;Prendergast, Joseph;Opsahl, Michael
Cc:Harrington, Joan
Subject:Additional Attachments for AMI Meeting at 4:00
Attachments:AMI House Fin Svs Committee Written Statement_April_24_2013_final.pdf, Essential Elements for GSE Restructuring table.pdf, Mortgage Credit Is Still Falling.pdf, Mortgage Infrastructure Necessary Modernization.pdf, Mortgage Market Needs Diverse Capital Sources.pdf, Privatization of GSEs one-pager.pdf, Selected Quotes on Mortgage Availability 2013.pdf, Swagel_THP_15WaysFedBudget_Prop13 (022613).pdf.pdf, Trust Indenture Act adapted to MBS Act v2-20-2013.pdf, Trust Indenture Act for MBS two-pager 4-2013.pdf

Some additional copies will be available at the meeting.

WRITTEN STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
FINANCIAL SERVICES COMMITTEE ON

Building a Sustainable Housing Finance System:

Examining Regulatory Impediments to Private Investment Capital

APRIL 24, 2013

by CHRIS J. KATOPIS,
EXECUTIVE DIRECTOR

Introduction

Mr. Chairman, Ranking Member Waters, and distinguished members of the Committee, thank you for the opportunity for the Association of Mortgage Investors (AMI) to testify today. Our statement will focus on the issues and concepts regarding the current impediments for private capital in the housing finance system, the concerns of investors, and some proposed legislative solutions. A key goal of the system is the flow of mortgage credit and capital from investors to the borrower – and then back again. At its essence, the present situation limits the availability of housing credit and the reach of the American Dream of home ownership. In response, AMI would like to discuss how some common-sense legislation can impact the critically important topic of returning private capital to the U.S. mortgage market.

The Association of Mortgage Investors (AMI) commends you and your House colleagues for your leadership in pursuing responsible and effective oversight and vigilance to enhance the health and effectiveness of the U.S. financial markets, and in particular, the U.S. housing finance system. The renewed investment of private capital returning into the U.S. housing finance system and increasing future investor demand in the mortgage market will require addressing a number of current market problems which are presently obstacles for private label securitization. As AMI has previously testified, the current mortgage investors suffers from market opacity, an asymmetry of information between investors and originators or, it can be said, a thorough lack of transparency. Moreover there are:

- Poor underwriting standards;
- A lack of standardization and uniformity concerning the transaction documents;
- Numerous conflicts-of-interest among servicers and their affiliates;
- Antiquated, defective, and improper mortgage servicing practices;
- An absence of effective legal remedies to investors for violations of RMBS contractual obligations and other rights arising under state and federal law; and,

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- Unwarranted federal and state government intervention in the mortgage market (*e.g.*, the use of eminent domain as a foreclosure mitigation tool).

Accordingly, we commend the Chairman and your colleagues for acknowledging these issues facing investors and our public institution partners, as well as, your efforts toward developing solutions. Given the following testimony regarding problems obstructing the reemergence of private capital in the U.S. housing finance market, we would like to work with you and your colleagues in developing legislation and solutions.

I. Background

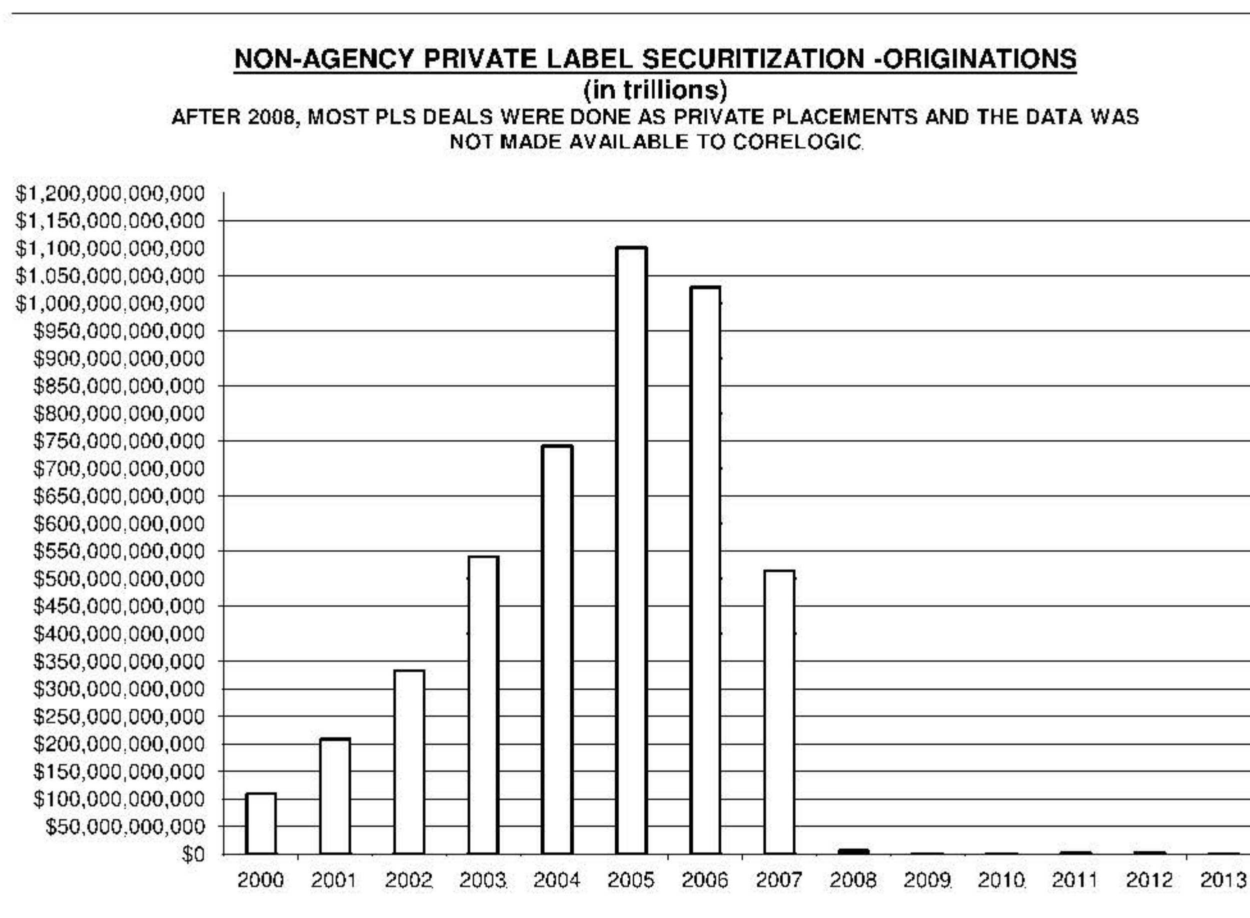
The AMI was formed to become the primary trade association representing investors in mortgage-backed securities (MBS), along with life insurance companies, and state pension and retirement systems, university endowments. It has become the sole unconflicted buy-side investor group and developed a set of policy priorities that we believe contribute to achieving the goal of restoring private market securitization. AMI was founded to play a primary role in the analysis, development, and implementation of mortgage and housing policy that keep homeowners in their homes and provide a sound framework that promotes continued home purchasing. In practice, only three sources of residential mortgage capital exist in the United States: (1) balance sheets of financial institutions such as banks; (2) the government (currently including Fannie Mae, Freddie Mac and FHA); and, finally (3) private securitization, which is effectively shut down for the reasons described herein.

At its height, today's U.S. mortgage market consisted of approximately $11 trillion in outstanding mortgages. Of that $11 trillion, approximately one-half -- $5.4 trillion -- are held on the books of the GSEs as agency mortgage-backed securities (issued by one of the agencies) or in whole loan form. Another $4.0 trillion are on the bank balance sheets as whole loans or securities in their portfolios, of which $1 trillion are second liens (*i.e.*, home equity loans/lines of credit or closed end second mortgages). Of the $1.1 trillion outstanding second mortgages, only about 3-4% of the total (or approximately $40

billion) is held by private investors in securitized form. The remaining $ 985 billion in first lien mortgages reside in private label mortgage-backed securities (MBS). AMI's members hold a significant portion of these mortgages through our investments.

The following analyst chart illustrates this point, namely that the PLS market, and private capital, has virtually left the U.S. mortgage market. This trend is uncontested. The future is likely to reflect a similar situation unless the Congress establishes the necessary systems, structures, and standards for private capital to return.

Chart 1



Source: Data provided by RBS and CoreLogic.

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Investors are prepared to invest private capital into the mortgage market and, hence increase housing availability and affordability. However, we seek the government's development and deployment of these enhanced securitization standards and safeguards to restart the virtuous circle of private capital into the market and to borrowers. . These will promote the certainty, transparency, uniformity, enforcement, recourse, and other criteria that will contribute to improving the functioning of capital markets for all investment asset classes, especially those pertaining to a necessity of life, namely housing. Your work will contribute to helping to keep Americans in their homes, making credit available, and the development of effective tools against in this challenging housing and foreclosure environment.

Mortgage investors share your frustration with the slow restoration of the housing market and the need to assist homeowners that are truly hurting. . In fact, the markets for Residential Mortgage Backed Securities (RMBS) securitization have virtually ground to a halt since the financial crisis for reasons that we will enumerate.[1] We are hopeful that meaningful solutions can be implemented more quickly, and we believe that our interests are aligned with responsible homeowners. As difficult as it may be to believe, many of the most sophisticated investors were as victimized and abused by the servicers and their affiliates as were many consumers. Investors are essential in order to rebuild the private mortgage market. However, investors and their private capital will only return to a market which is transparent, has non-conflicted stakeholders, and the protection of contract law.

[1] The exceptions to this include a small number of PLS securitizations which are very limited in size and scale. *See, e.g.*, http://www.bloomberg.com/news/2012-09-10/redwood-to-sell-securities-backed-by-313-2-million-of-mortgages.html.

II. The Role of Mortgage Investors in the Marketplace

Mortgage investors, through securitization, have for decades contributed to the affordability of housing, made credit less expensive, and made other benefits available to consumers. Today, however, as one can see on the below chart, mortgage investors are continuing to exit the market. As illustrated by the chart below, the government's dominant market share -- as shown in yellow -- can only be transitioned back to the private sector as shown by blue and green -- by fixing the asymmetry of information, poor underwriting, conflicts-of -interest by key parties in the securitization process, as well as, the inability to enforce rights arising under contracts, securities and other laws. This list is by no means intended to be exhaustive. Accordingly, the U.S. economy at-large is hurt by the decreasing availability of mortgage credit.

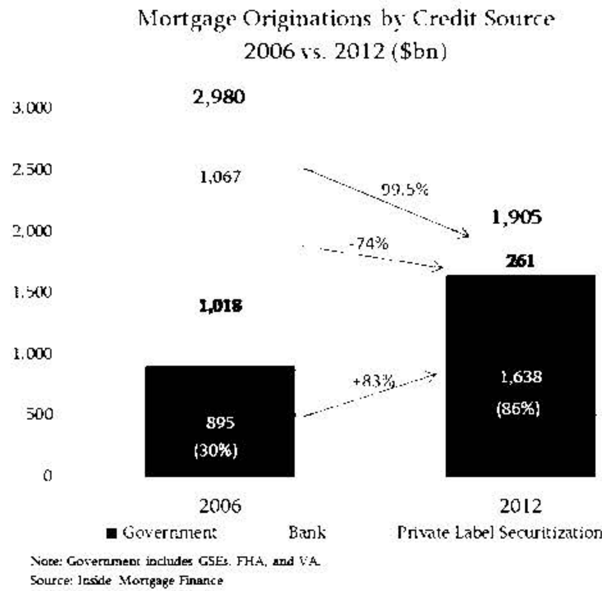
Chart 2

The Mortgage Market Needs Diverse Capital Sources

Source: Federal Reserve Board.

Note: Other includes life insurance companies, finance companies, real estate investment companies, private pension funds, state and local government retirement funds, households and nonprofit institutions, and non financial corporate and non corporate businesses.

Chart 3



MORTGAGE CREDIT IS STILL FALLING

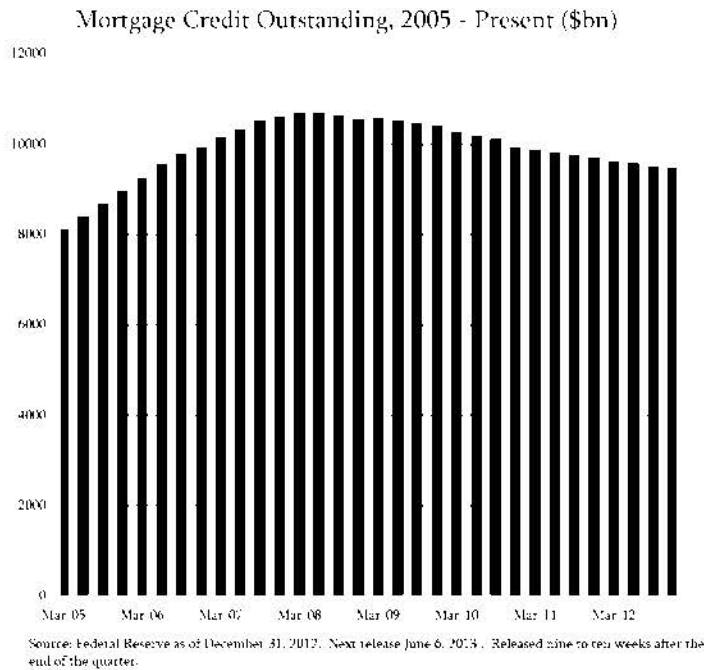


Chart 4, above, represents the decreasing amount of mortgage credit since the financial crisis.

A. Mortgage Investors' Interests Align with Responsible Borrowers

Mortgage investors are aligned with both homeowners and the government in our shared goals of keeping responsible Americans, including low and middle-income families, in their homes and rebuilding and maintaining a vibrant real estate market. The benefits of securitization are widely known.[2]
In fact, the maintenance of a healthy securitization market is a vital source of access to private capital for mortgages as well as autos and credit cards. Moreover, an efficient securitization market provides more capital and at a cheaper cost to mortgage loan originators, which allows them to make more loans to additional qualified borrowers. The use of private mortgage-backed securities as a funding source has many benefits, including:

- expanding the availability of housing finance opportunities for low- and middle-income families;
- reducing the cost of credit;
- equitably distributing risk in the mortgage finance industry; and,
- preventing a build-up of specific geographic risk.

In sum, these features and many others are those of a market which makes access to capital cheaper and thus spurs more mortgage lending. .

Mortgage investors seek effective, long-term sustainable solutions for responsible homeowners seeking to stay in their homes. . We are pleased to report that mortgage investors, primarily the first lien holders, do not object to modifications as part of a solution. We strive for additional remedies to assist homeowners. Likewise, if a borrower is speculating in the housing market, engaging in a strategic default or paying only their second-lien mortgages, then they should not be eligible for receiving subsidized first lien interest rates. Potential structural changes that should be examined include: full recourse, blockage

[2] *See e.g.*, *Securitization and Federal Regulation of Mortgages for Safety and Soundness*, CRS REPORT FOR CONGRESS at 2 (RS-22722, Oct. 21, 2008). ("This *securitization* of mortgages increased the supply of funds available for mortgage lending).

of interest payments on second lien debt if the first lien is in default, prohibitions on second lien debt above a specified loan-to-value (LTV). With a restored, vital and healthy securities market, we will be able to attract more private capital into mortgage investments and, in turn, provide more affordable mortgages for potential qualified home buyers.

III. Obstacles to the Return of Private Mortgage Capital

The current legal and regulatory landscape presents numerous obstacles for private capital returning to the mortgage market and RMBS in particular. In essence, mortgage investors simply seek the salient facts underlying a mortgage transaction in order to price the risk to their capital. AMI has offered a number of policy solutions which are described in its *Reforming the Asset-Backed Securities Market White Paper* (March 2010).[3] Just as with traditionally chartered bank-servicers, the vast majority of capital market investors have many options as to where to deploy their capital -- they do not have to fund mortgages, and they will only do so if it makes sense on a risk-vs-return basis. In the case of mortgages, they look at known returns vs. perceived risks.

A. *Inability to Compete with the Government*

Presently, the government subsidizes mortgage rates by keeping the cost of credit low by charging insufficient amounts through its "g-fee" at the time it creates a GSE securitization product. Although these fees are rising, they are still insufficiently low for the private label securitization product to compete in the market. It is natural that money is attracted to a product where the government guarantees risk at subsidized rates versus a private market with no guarantee or one with private insurance. Raising g-fees to market levels will help attract private capital through crowding in. This is necessary-- but not sufficient -- to get private capital into the market in greater size than it is right now.

With respect to risks, because investors (a) got badly burned on mortgage-backed securities during the financial crisis and (b) had their legal and economic rights trampled on in the aftermath to the

[3] http://the-ami.org/2010/03/22/ami-white-paper-reforming-asset-backed-securities-market/

crisis, in legal battles with various parties and some "help homeowners" initiatives, there is much that the Congress can do from here to lower perceived risks to investing in mortgages. Congress can encourage private-sector competition and create clear "rules of the road" so the mortgage market is restored. This is absolutely essential.

B. Competition, Crowding Out and Making the GSEs Truly Private

In terms of competition, private investors in mortgage-backed securities right now are "crowded out" by the government to a large degree. Between quantitative easing and government pressure for lower lending rates to spur economic growth, private capital simply cannot compete at these credit spreads.

Even if FHFA as conservator of the GSEs were to raise g-fees to market levels by regulatory order, this would not solve the problem. Fannie Mae and Freddie Mac are in the same business as private mortgage investors and mortgage insurers, bearing credit risk in exchange for financial compensation, and they should not have the low-funding-cost and other advantages of government sponsorship. Congress should prepare a transition plan to end government sponsorship and the credit-risk-bearing functions of these entities must be fully privatized, to ensure a level competitive playing field.

It is an indisputable fact of the financial markets today that banks, mortgage insurers and private capital market investors simply cannot – they do not have enough capital to – support the $10 trillion U.S. mortgage market without the credit-risk-bearing functions of Fannie Mae and Freddie Mac. This is point is graphically illustrated by the multi-color chart of mortgage capital sources, above at page six. Accordingly it must be noted:

- Commercial banks do not provide more than 20% of the nation's outstanding mortgage capital, and adding thrifts and credit unions does not get them above 30%.
- Mortgage insurers fit into the "other" category on the chart, and at only a few billion in mortgage capital are insignificant in terms of U.S. mortgage funding needs.
- Private-label mortgage-backed securities at the height of the recent boom were never more than 20% of the market themselves and it will take a lot of work (see below) to get back to this level going forward any time soon.

While simply wiping out Fannie Mae and Freddie Mac would be good for investors from a competitive standpoint, the effects this would have on mortgage availability would be disastrous, seriously wounding the now-recovering housing market and causing losses to mortgage lenders, insurers and investors on outstanding loans.

Besides, wiping out Fannie Mae and Freddie Mac would put even more mortgage market power into the hands of the nation's largest banks, which is not and should not be a government goal.
The easiest and most direct way to have less government capital and more private capital in the mortgage market is for the government to sell its stakes in genuinely transformed GSEs into the capital markets and get taxpayers paid back. While Fannie Mae and Freddie Mac's debt-fueled purchase of low-quality MBS and insufficient equity capital were what got them into trouble before conservatorship, Congress can put their portfolios into run-off, pay off the debt, and ban them from buying MBS going forward, without wiping out their core guarantee businesses on high-quality mortgages which were never a problem. Subprime and other low-quality loans could be left to financial institutions and investors that are not systemically important.

After restructuring the companies to prevent problems of the recent past: (a) limiting them by charter to high-quality guarantees without allowing debt-fueled MBS portfolios; (b) ensuring sound regulation with appropriate equity capital; (c) severing government sponsorship and entity-level backstops; and, (d) imposing appropriate political limitations, the core mortgage guarantee businesses can be sold into the private markets with no government backstop, and the funds realized can repay the government for its assistance as with AIG. In bearing mortgage credit risk, the new privatized companies should compete on an equal footing with banks, mortgage insurers and private-label MBS -- with market-based costs of capital, g-fee rates and no special privileges.

C. Trust Indenture Act: Investor Bill of Rights and Bank Quality Control

Another useful source of inspiration for solving the issues at hand may be found in the Trust Indenture Act. As history teaches us, the 1929 financial crisis resulted in a crash of the stock (equities) markets. Yet, it is less well-known that the 1929 crisis also resulted in a bond industry crash as well. In response, in 1934, Congress tasked the Securities and Exchange Commission (SEC) to explore solutions for re-vitalizing the corporate bond market. The SEC prepared a report authored by the Commissioners, including future U.S. Supreme Court justices William Douglas and Abe Fortas.[4]

i. The 1936 SEC Commission Report's Finding

The 1936 SEC report on the problems surrounding the corporate bond market bears striking similarities to the issues facing the RMBS investment space at present. The report reads as if torn from recent financial news headlines:

> *The basic problem is to refashion the trust indenture [a corporate bond] for the purpose of according greater protection to investors. That entails prescribing a minimum standard specifications for the conduct of trustee and issue thereunder. . . . This means a more proper balance between the interests of investors and requirements of issuers ... where its failure to take swift and positive action leave the investors without effective protection of their interests . . . In this situation the inherent incompatibility of interest arises, common to all creditors and debtors""*

Accordingly, the SEC report catalogs a number of the resulting problems from the lack of appropriate investment standards, systems, and safeguards present up until Congress' enactment of the Trust Indenture Act (TIA). In particular, the TIA addressed the following defects of the bond industry of the early 20th century, and as well, any forthcoming new bill should also address these issues in the RMBS space:

- The eligibility and duties of a Trustee;
- The Trustees' duties in connection with breaches of representations and warranties;
- Transparency and periodic reporting;
- Creditor rights; and,
- Registration before the federal regulators pursuant to the Securities laws.

These parallel the issues that mortgage investors have noted before Congress and in our other advocacy.

[4] The full report may be found on the AMI website at: http://the-ami.org/2012/04/27/the-sec-tia-report-to-the-senate-banking-committee/

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ii. The 1936 SEC Commission Report's Results

The result of the 1936 SEC report was Congress' enactment of the Trust Indenture Act (TIA). This landmark legislation has enabled the corporate bond market with the standards and structures necessary for its efficient operation – so much so that investors do not even realizes that it is in effect.

Today, in 2013, we believe that the Congressional enactment of a new, explicit parallel to the TIA for the residential mortgage-backed securities industry would have dramatic, positive effects for the return of private capital to the U.S. mortgage market. Further, such TIA legislation would benefit many demographics of borrowers, including first-time home borrowers, low- and middle-income borrowers. The drafting of such a TIA-RMBS bill can be accomplished in several ways. . AMI has developed a draft version of the TIA-RMBS bill which we are happy to share with the Committee. Further, we appreciated and supported Chairman Garrett's 2010 legislation, the "Private Market Enforcement Act," H.R. 3644, as well as similar legislation offered by Congressman Brad Miller.

We believe that the recommendations below, which are detailed in depth in the AMI white paper, support healthy and efficient securitization and mortgage finance markets, with more information made more widely available to participants, regulators, and observers; incentivize positive economic behavior among market participants; reduce information asymmetries that distort markets and are entirely consistent with the government's traditional roles of standard-setting in capital markets.
This process resulted in a report to Congress on how underwriters sold bad corporate bonds into the market, the legal documents were weak, trustees didn't protect bondholders, investors had few rights and no real remedies to enforce the rights they did have.

- In response, Congress passed the Trust Indenture Act of 1939, which mandates that bonds sold into the financial markets have to have legal structures and documents that work for investors. This statute has worked for almost 75 years without an overhaul, and now we don't worry about the bond market blowing up because of bad legal structures the way the mortgage markets did.
- The problems we see in the MBS market today are almost exactly the same as we saw in the bond market after the 1929 crash. This argues for the same solution, mandatory

> standards and legal structures – a solution from Congress which the corporate bond market has successfully lived with for the past seventy years. Of the thousands of financial professionals trading corporate bonds in the US market today, few know what the Trust Indenture Act is, but all see that it works.

In response to critics who oppose *"let the private market figure this out if it's so important, why does the government need to step in?"* -- private investors are here to tell Congress that there is no negotiation of the fundamental non-economic terms of mortgage-backed securities. Hence certain important national goals are not achieved. Underwriters do not negotiate with smart investors or even average investors, they write legal documents and make selective disclosures to sell deals to the marginal investor, the one who doesn't read the papers and doesn't know or understand what he or she is buying. These are the MBS that are sold into the capital markets, and that more sophisticated investors have to research and trade.

This dynamic leads to the classic "race to the bottom" -- minimal disclosures as to the mortgages securitized, no effective enforcement of representations and warranties that investors rely on, and weak legal structures that don't protect investors in practice. This is what led to the illiquidity in the markets and investor losses in the financial crisis, and private capital will not come back in size to fund mortgages if investors think this could happen again.

We need to mandate systems, standards and structures, to get data on the underlying mortgages out into the market so credit risk can be priced and compensated for appropriately. We need to have third parties – investor representatives -- enforcing representations and warranties, instead of servicers protecting their affiliates that would be liable, so underwriters give accurate data to investors and stand behind their financial products. If investors understand and can control the credit risks they are taking, they will be fairly compensated for the occasional losses they agreed to bear.

A Trust Indenture Act (TIA) for Mortgage-Backed Securities would include, among other things:

- real-time public loan-level information available to all investors, not just ratings agencies, both at the time of underwriting and as loan performance emerges;
- "cooling off" periods when MBS are offered so investors have a real opportunity to analyze what they are being offered;
- public deal documents for all MBS for investors, other market participants and regulators;

- standard pooling and servicing agreements for all MBS, with enforceable, understandable, and non-waivable, standard representations and warranties going all the way back to loan originators, which R&W would be effectively enforced by third parties with the minimum cost and litigation;
- clear and standard definitions, including for fundamental mortgage concepts like "delinquency" and "default";
- addressing conflicts of interest involving servicers (including second liens and third-party services like force-placed insurance) to make sure they manage the mortgage pools in the best interests of investors;
- protection for investors against servicers settling their legal liabilities to third parties with trust property (*i.e.* robosigning settlements that allow servicers to making modifications on investor-owned loans as consideration) and against local governments seizing their mortgage loans under eminent domain;
- simplified MBS pool structures and governance structures, for greater secondary market liquidity and effective investor supervision of trustees and servicers; and,
- better credit ratings for MBS investors, based on the same detailed data that the investors should get and updated continuously over time.

The quality-control functions essential to the proper functioning of MBS trusts must be mandated by the government and paid for by the economics of mortgage securitization transactions – as we have seen over the last several years, these functions will simply not be performed otherwise. Transactions that depend on dumping bad loans on investors for their economics to work should not be brought to market, period.

Congress should put a single regulator with appropriate experience in charge of all mortgage-backed securities, who can work with the CFPB to ensure mortgage servicing standards address the needs of investors as well as homeowners. We should make sure that servicer compensation is properly structured to accommodate different housing market conditions. We need uniform accounting and reporting policies for MBS pools and uniform procedures for loan servicing and restructuring known to all parties up front and not changed ad hoc in response to political demands.

To deal with the conflicts of interest between first-lien loans and second-lien loans, there needs to be a new inter-creditor regime for securitized mortgages. Owners of first-lien loans should have consent rights over second lien loans that lead to unsustainable loan-to-value (LTV) levels, should get paid before the owners of second-lien loans are paid by the same borrowers, and should control any modification or restructuring process. Property-level losses should be allocated properly among creditors based on legal priority and junior creditors should be impaired before more senior creditors.

If investors get a fair deal going forward, Congress can end the "putback wars" that have paralyzed loan origination. This will allow banks to limit their legal exposure the next time the market turns down, cutting off the "tail risk" that they will have to buy back defaulted loans -- so long as they meet new required market standards for data completeness, timeliness and integrity and appropriate protection of investors.

D. *Mortgage Market Infrastructure*

Beyond securitization, we need to reform and modernize the mortgage market infrastructure. To this end, Congress should consider:

- Facilitating a single national Internet database of mortgages – perhaps for real estate ownership as well that tracks, validates and clarifies mortgage loan ownership, putting to rest troublesome issues that have dogged the legal system since the foreclosure crisis began;
- Mortgage servicing standards that address needs of investors as well as those of borrowers;
- A single national uniform foreclosure law, non-judicial but still ensuring important homeowner protections, to govern enforcement of security interests in real property exactly the way Article 9 of the Uniform Commercial Code handles security interests in personal property; and,
- It is hard for investors to charge the lower interest rates normally associated with secured lending, when the difficulties of foreclosing in property in many jurisdictions makes the capital we have invested effectively unsecured.

Recent experience has shown us all that our mortgage market is national in scope. Congress should not be afraid to use pre-emption and model uniform state laws to bring about consistency among states in dealing with these important mortgage-related issues that affect investors not only nationwide, but around the world.

E. *Political Risk of Eminent Domain*

Another serious impediment to private capital arises from the government's intervention in the housing market which results in uncertainty and the possibility of severe loss. Investors characterize this as the new "political risk premium" surrounding our activity. Recently, we witnessed such harmful

activity in the mortgage space with both the National Mortgage Settlement[5] and the proposed use of eminent domain as a foreclosure mitigation tool.

We fully concur with the mainstream concerns of many, including the Federal Housing Finance Agency (FHFA) and think tanks across the spectrum,[6] regarding the use of eminent domain, including its dubious constitutionality, the potential to limit consumer credit and harm communities economically, the impact on securities and other institutional holdings, and the ultimate losses imposed upon tax-payers due to alterations to the Government Sponsored Enterprise's (Freddie Mac and Fannie Mae) securities holdings. We further wish to emphasize that among the consequences of this use of eminent domain is the likely further curtailment of access to the thirty-year fixed mortgage, an integral part of the American Dream, and additional harm to tax-payers that are holders of the Enterprise and Private Label Securities (PLS) through their public or private pensions, 401Ks and/or mutual funds.

The use of eminent domain to restructure residential loans is a controversial, untried, and likely an unconstitutional use of government power.[7] The use of such government power is an extremely blunt instrument; the burden on its proprietary and the justification for its use must reside with its advocates. While some would claim that it is a last resort, there are no indications that this is true or that, in the case of performing mortgages, said borrowers should be entitled to relief. Either way, it appears that the negative consequences will always outweigh the purported benefits. Even though AMI is extremely sympathetic to the problems surrounding the housing sector and borrowers for the past six years, the case has not been satisfactorily made for the use of eminent domain, particularly given all of the programs available to troubled borrowers, some of which are too new to have fully registered their potential.

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[5] http://www.nationalmortgagesettlement.com/

[6] Think tanks and NGOs across the political spectrum question the use of eminent domain in this context. See, e.g., the Progressive Policy Institute (PPI)'s report: http://www.progressivepolicy.org/wp-content/uploads/2012/07/07.2012-Gold_Can-Eminent-Domain-Help-Underwater-Homeowners.pdf

[7] Cornell Law Professor Robert C. Hockett, a key architect, spokesman for the eminent domain proposal and past MRP consultant has conceded that this plan is untried and legally unverified. "In an interview Wednesday, Hockett conceded that the eminent domain seizure of a mortgage loan has apparently not been tested explicitly in court." http://newsandinsight.thomsonreuters.com/Legal/News/2012/07_-_July/Eminent_domain,_MBS_and_the_U_S__Constitution__a_one-sided_fight_/

Further, housing analyst and government data suggest that after a six-year housing crisis, many indicia, including home prices and relief for borrowers, are showing consistent improvement.

In sum, the risk of the use of eminent domain in this manner poses more risks to the housing markets, communities, and the availability of credit, than any advantages portrayed by those who seek its financial gain. . We are pleased that when the concept is reviewed in its entirety and the facts come to bear, communities are rejecting eminent domain in this context. For these reasons, AMI supported those efforts to protect investments from government takings, as with the last session's introduced bill, "The Defending American Taxpayers from Abusive Government Takings Act," H.R. 6397.

IV. **Conclusion**

Today, more than half a decade after the financial crisis, mortgage funding through the capital markets remains in a weakened state on government life support. The landmark Dodd-Frank Act did not address at all the many serious issues discussed in this testimony, and mortgage investors now ask that Congress step in to help restore and strengthen the private market, through establishing standards, systems, and rights. There are tremendous gains the government can make in improving competition and decreasing risk, and therefore increasing the participation of private capital.

Mortgage investors believe that the vibrancy and effectiveness of the U.S. capital markets can be restored, in part, by enhancing the transparency around fundamental regulatory structures, standards, and systems. Toward this goal, the government has a role – not through the heavy-hand of big government, but rather, the light touch of a prudent standard-setter and facilitator. With appropriate standards and rights for the holders of asset-backed securities, securitization would achieve the goals sought by many – the more efficient funding of capital markets, lessening volatility, and the resulting better economic activity. In the absence of transparency, the future of the U.S. housing finance system will remain dark, hurting America's global competiveness and our domestic health. The results will include less home

lending, more expensive credit, and fewer housing options and less opportunity for working class Americans. These are the reasons that we need solutions providing for more transparent systems and restarting our capital markets. Hopefully we can all look forward to a mortgage funding market that is larger, more private, and more systemically sound than the one we have now.

Thank you for the opportunity to share the views of the Association of Mortgage Investors with the Committee. Please do not hesitate to use the AMI as a resource in your continued oversight and crafting legislative solutions concerning the many issues under review. We welcome any questions that you might have about securitization, representations and warranties, or other mortgage industry topics.

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Statement for the Record

On behalf of the

American Bankers Association

For the Hearing

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

Before the

Financial Services Committee

United States House of Representatives

American
Bankers
Association

Statement for the Record

On behalf of the

American Bankers Association

before the

Financial Services Committee
United States House of Representatives

July 18, 2013

The American Bankers Association appreciates this opportunity to submit comments for the record regarding the Protecting American Taxpayers and Homeowners Act of 2013 (PATH Act). We commend House Financial Services Committee Chairman Jeb Hensarling for crafting this legislation which includes provisions addressing a wide range of issues confronting our nation's housing finance system.

The ABA supports a number of the provisions of this legislation, which are sorely needed to return some balance to the regulatory environment facing mortgage lenders. We also applaud the Chairman's efforts to begin serious debate over the reform of the Federal Housing Administration (FHA) and the termination of the conservatorship of the housing Government Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac. We do, however, have concerns with the approach taken in the bill with regard to both the GSEs and the FHA, and note at the outset that the bill differs markedly from longstanding, banker developed, positions advocated by the ABA. We will detail these concerns below.

BACKGROUND

Congress, the Bush and Obama Administrations, and the regulators have all taken a number of actions since the financial crisis to address problems in the housing finance system and to stabilize that system. These have included the passage of stringent and complex new regulations included in the Dodd-Frank Act, establishment and exercise of authority to place the GSEs into conservatorship, and the vast expansion of FHA as a resource to help make mortgage credit available. The end result is a housing finance system that is dominated by federal-controlled entities, with FHA and Fannie Mae and Freddie Mac backed loans accounting for the vast majority of the current secondary mortgage market. Such a system may have been a necessary short-term

expedient, but we agree is not sustainable or desirable for the longer-term, nor for the American taxpayers. It is also a system that has been radically transformed by underwriting and lending changes, many undertaken by the market in response to the crisis, and many more having been mandated by Dodd-Frank. The Dodd-Frank changes, including new Ability to Repay and Qualified Mortgage rules, and the still pending Qualified Residential Mortgage (QRM), have the potential to permanently alter who will qualify for a mortgage and reduce credit availability going forward. There is no doubt that some potential borrowers, despite being good credit risks, will find themselves unable to qualify or afford a mortgage as a result of unintended effects of the new regulations. Therefore, it is essential that we begin the process of reforming the housing finance system, putting it on a sustainable foundation not primarily dependent on taxpayer backstops, and correcting features of the new regulatory structure likely to decrease availability of credit and increase cost to consumers.

GSE REFORM

The PATH Act would wind down Fannie Mae and Freddie Mac within five years, and would not provide for any federal guarantee on any loan in their absence. Instead, this legislation would authorize the creation of a "public utility" which would oversee the creation and maintenance of a single platform for the sale of mortgages by originators to investors who would then securitize the mortgages. The public utility would be charged with ensuring equitable access to the secondary market for participants regardless of size or geographic location.

This approach differs from ABA's longstanding policy positions. While ABA believes that the federal role in mortgage finance needs to be significantly reduced, we continue to support a fully priced and fully paid for guarantee by the federal government for a class of well underwritten loans within clearly defined and targeted loan limit boundaries. While we envision a transition to a marketplace with a large and perhaps predominate component that is not dependent on federal guarantees, a targeted federal role is essential to progress from the present reality toward that goal.

Furthermore, a carefully targeted federal role can contribute to market stability, more directly and assuredly maintain equitable market access for originators of all types, sizes and geographic locations, and provide a fully operational and effective "safety valve" for instances of market failure to ensure that mortgage credit remains available in all economic conditions. Though ABA regrets that progress toward resolving the GSE conservatorships was not made in a timely manner,

nevertheless the conservatorships played an essential role by providing a governmental guarantee in a time of crisis. While Fannie Mae and Freddie Mac engaged in policies and practices which precipitated their failure and contributed a large part to the overall financial crisis, the conservatorships played an important stabilizing role.

Although we differ with the PATH Act's complete phase out of federal involvement in the secondary mortgage market, we do agree with many of the reforms incorporated into the discussion draft. Specifically, ABA supports:

- Reducing the maximum mortgage amount eligible for sale to Fannie Mae and Freddie Mac.

- Efforts to review and revise guarantee fees to ensure that the federal government is being adequately compensated for the risk it is taking when providing a guarantee.

- Development of risk-sharing transactions including first loss agreements with private sector participants.

- Prohibiting the GSEs (or any successor) from purchasing or guaranteeing mortgages that are within a jurisdiction that has exercised eminent domain to seize a mortgage loan during the last 120 months.

ABA also supports the creation of a utility or other entity to operate a new securitization platform (such as the one currently being developed by the Federal Housing Finance Agency). This utility would be tasked with operating the securitization platform in an open access manner and would ensure that eligible loan originators, aggregators and issuers would have equitable access to the platform, regardless of size, geographic location or market served. In contrast with the position taken in the draft legislation, however, we maintain that such a utility or similar entity should also be the vehicle for providing a well-targeted and purposed federal guarantee that is fully priced and paid and maintains prudential standards and capital requirements for all market participants.

While a utility lacking a federal guarantee (such as that proposed in the PATH Act) could still be a mechanism for government intervention during a market failure or other crisis, it would be difficult at best to quickly implement any federal support under such a regime. Absent an ongoing role in the secondary market, it would be difficult for the government to intervene in a timely

manner, resulting in a potentially long period without secondary mortgage credit and the attendant harm to the overall economy.

A targeted federal guarantee provides the solution to this problem. It provides a mechanism to enforce the regulatory function, and a safety valve allowing necessary and limited (in both time and scope) governmental intervention in times of crisis or market failure. It must be fairly and appropriately priced to fully compensate taxpayers for the risk undertaken, and it must be limited only to a segment of the market targeted to ensure mortgage credit for low- and moderate-income borrowers not otherwise being served by FHA or other government programs.

FHA REFORM

The draft legislation would re-target FHA to serve first-time homebuyers and low- and moderate-income borrowers—goals that ABA strongly supports. We also believe that the allowance for FHA to be employed in markets experiencing counter-cyclical mortgage conditions and Presidentially-declared disaster areas is prudent. We support the intent of the draft legislation to revise the premium structure for FHA insurance and to create new risk sharing pilot programs.

The PATH Act discussion draft also would significantly alter the structure of the Federal Housing Administration, making it an independent entity outside of the Department of Housing and Urban Development. While the ABA has not advocated for such a sweeping change, we do believe the idea has merit and should be explored further.

One aspect of the discussion draft that is of concern is the proposed reduction of the FHA's mortgage insurance coverage to only 50 percent of the mortgage being insured. ABA continues to advocate for full coverage of the outstanding balance of a loan insured under FHA. It is our view that with appropriate down payment amounts, more prudential underwriting standards, and reasonable premiums for the insurance being provided, there is no reason not to continue full insurance coverage of FHA loans. Further, given the re-targeted role envisioned by the bill for FHA to be primarily targeted to first time and low- and moderate-income borrowers, it is appropriate for the program to provide full insurance coverage as a public policy matter to encourage lending to qualified borrowers in this market segment.

Finally, we have concerns with the draft legislation's repeal of the Home Equity Conversion Mortgage (HECM) program. The HECM program has experienced losses and must be reformed,

but it should remain available as a tool, with federal government oversight and regulation, for qualified homeowners with sufficient equity. An aging population will likely increase demand for such programs and improved federal regulation and insurance of such programs will protect consumers and lenders alike.

COVERED BONDS

Subtitle B of the draft bill, comprising Sections 351 through 356 would authorize the creation of a covered bond market in the United States. The ABA supports the creation of a covered bond market as one of several sources of liquidity for the mortgage market. Noting that covered bonds function in a similar fashion to the Federal Home Loan Banks, we would encourage the committee to make clear that in developing a covered bond market there should be no restrictions placed on use of either covered bonds or participation in Federal Home Loan Bank membership. Some have proposed limiting covered bonds to one segment of the market based upon asset size while restricting Federal Home Loan Bank membership as well. We would strongly oppose any such restrictions and would oppose any legislation which included such restrictions.

REGULATORY IMPROVEMENTS

Title IV of the PATH Act draft includes many provisions which ABA strongly supports. These provisions will help to rebalance the regulatory environment from regulatory overreach that occurred in response to the financial crisis and will help to ensure a more vibrant, safe and effective mortgage market. Specifically we support:

- Section 401 - the mandatory delay of Basel III implementation and study of Basel III impact;
- Section 402 - Basel III liquidity coverage ratio amendments;
- Section 403 - changes to the definition of points and fees under the Qualified Mortgage rule;
- Section 404 - the exclusion of asset-backed securities from the proposed definition of "covered funds" in which banks are restricted from investing;
- Section 405 - the suspension of the Security and Exchange Commission's Reg AB rulemaking regarding asset-backed securities;
- Section 406 - the extension of the implementation date of Dodd-Frank Act mortgage regulations for one year;

- Section 407 - the repeal of the Qualified Residential Mortgage and the Premium Capture Cash Reserve Account rulemaking, and
- Section 410 – the repeal of sections 1413, 1431 and 1432 of the Dodd-Frank Act.

The sections referenced above all provide significant needed relief, without which investments in the mortgage market and credit availability will be seriously constrained. With regard to Basel III, we continue to be concerned about the punitive restrictions that agencies have placed on bank mortgage servicing assets under the final Basel III capital rules. Such capital treatment of mortgage servicing will drive a wedge between mortgage borrowers and lenders, potentially pushing such activities into the nonbank sector. ABA pledges to work with the Committee on this and other capital issues arising from Basel III implementation that are expected to have adverse impacts on credit availability and would be pleased to work with you on expanding these provisions in the bill.

Section 403 includes changes to the points and fees definitions for the Qualified Mortgage rule which were also included in H.R 1077, introduced by Representative Bill Huizinga. We strongly support these changes which are of particular import to community banks who serve as mortgage brokers when serving their customers. Without the changes in this section, these banks will find it harder to make a Qualified Mortgage and to provide mortgage servicers to their local communities.

The extension of the implementation date of the Dodd-Frank Act mortgage regulations included in Section 406 is essential. These rules will dramatically refocus the entire lending process. Every participant in that process, from lenders to borrowers, and service providers, appraisers, escrow agents, title agents and all others will be impacted by the changes, and must come into compliance in the next six months. Between now and then banks must fully review all of the final rules, implement new systems, processes, and forms, train staff, and test changes for quality assurance, as well as work with all these other providers to ensure that they too are compliant. That effort is made even more complicated when factoring in the fact that to manage year-end regulatory and tax reporting requirements, many institutions have an information technology "freeze" between November and early January. Because it is not possible to test or revise the new mortgage compliance systems during the lock-down period, the compliance deadline is effectively November of 2013.

Regulatory implementation is further complicated by the fact that many banks commonly rely on vendors for software and system upgrades. Many banks report that their vendors are not yet

ready to provide the necessary updates to the individual institutions and some vendors may not do so until late summer or early fall. Given these time constraints, and the fact that CFPB continues to issue modifications to the rules, it will be virtually impossible for most lenders to achieve full compliance by January. That lack of confidence in the ability to comply will likely lead to a reduction of credit as lenders pull back from lending until such time as they have confidence in their ability to comply. It is a far better approach to delay implementation to ensure that the entire industry can comply than to meet an arbitrary deadline that will further disrupt the mortgage markets and harm credit availability.

In addition to the regulatory corrections made in the sections delineated above, we also strongly support Section 409 which exempts from the Dodd-Frank Act the ability to repay requirements those residential mortgage loans originated by a creditor and held in portfolio. Those provisions of Dodd-Frank were intended to reform the securitization process to prevent lenders from originating loans without consequence and then passing the loans through the securitization chain. Portfolio lenders, willing to make a loan to a borrower who they view as a reasonable credit risk and willing to hold those loans on their own books, should not be required to meet the Dodd-Frank requirements. A portfolio lender's own self interest in maintaining a safe and sound portfolio, along with safety and soundness regulation and supervision, provide adequate regulation in this area. Further, the imposition of the Dodd-Frank requirements on portfolio lenders will make it impossible to serve some otherwise creditworthy customers and will significantly harm certain borrowers and populations which would otherwise be well served by portfolio lenders.

As referenced above, we support Section 410 of the bill which would repeal three sections of the Dodd-Frank Act, including the defense to foreclosure provision. The defense to foreclosure provision has created a concern that prudential regulators will severely restrict the ability of banks to keep non-QM safe harbor loans in their portfolios. This would make QM the effective requirement for safety and soundness and risk mitigation purposes. Section 410 will help to ensure that lenders are able to offer mortgages to borrowers who do not meet all of the QM standards but who nevertheless have the ability to repay a mortgage loan.

ABA also strongly supports Section 412 which incorporates provisions of the Financial Institutions Examinations Fairness and Reform Act introduced by Representative Shelley Moore Capito. Our members are concerned that bank regulators are making decisions during the examination process that have effectively and unnecessarily reduced the amount of capital available

for lending—particularly to small businesses. These decisions hinder banks' ability to help local businesses grow and create jobs. The changes included in H.R. 1553 and incorporated into Section 412 of the PATH draft address this critical issue by establishing clear examination standards and creating an independent Examination Ombudsman to ensure the consistency of all examinations. These provisions would also ensure that financial institutions receive timely examination reports that include full documentation of the information the regulators used to make their determinations, and would create an expedited process for banks to appeal examination decisions without fear of reprisals.

ADDITIONAL AREAS OF CONCERN

In addition to the provisions we specifically support, there are provisions of the PATH Act draft which are of concern and which ABA cannot support in their current form. Specifically, we have concerns over Section 414 which would prohibit a mortgage servicer of a residential mortgage from holding an interest in any other security interest on the same dwelling. This provision would prohibit a lender who holds or services a mortgage loan from offering their customer a home equity loan or line of credit.

We also have concerns with Section 502 which incorporates provisions of H.R. 927, the Common Sense Economic Recovery Act. These provisions would permit certain current loans that would otherwise be treated as non-accrual loans as accrual loans. We are concerned about legislating changes in accounting standards, even if they are only intended to be for regulatory use. Banks are issuers of financial statements – upon which our investors rely – as well as heavy users of financial statements of our borrowers. We need to make sure that all parties can rely on the accuracy of financial statements. We appreciate the motivation behind this provision and support requiring the Financial Stability Oversight Council (FSOC) to conduct a study of how best to prevent contradictory guidance from federal banking agencies, but the other aspects of this provision should be reconsidered. We also believe that Section 412 provides a more effective and less disruptive means to address the objective of preventing classifications of performing loans.

CONCLUSION

We appreciate this opportunity to submit comments on the PATH Act discussion draft. We recognize that provisions of the bill may change and others may be added or altered. We hope that these comments are helpful in further refining this legislation and in moving the process forward and we again applaud Chairman Hensarling for crafting this important legislation to begin the process of reforming our nation's housing finance system.