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H.R. _____, THE PRIVATE MORTGAGE MARKET INVESTMENT ACT, PART 2

HEARING

BEFORE THE

SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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H.R. _____, THE PRIVATE MORTGAGE MARKET INVESTMENT ACT, PART 2

Wednesday, December 7, 2011

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS AND
GOVERNMENT SPONSORED ENTERPRISES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:08 a.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Schweikert, Biggert, Hensarling, Neugebauer, Campbell, McCotter, McCarthy of California, Pearce, Posey, Hayworth, Hurt, Grimm, Stivers, Dold; Waters, Sherman, Lynch, Miller of North Carolina, Maloney, Donnelly, and Green.

Ex officio present: Representative Frank.

Chairman GARRETT. Good morning. The Subcommittee on Capital Markets and Government Sponsored Enterprises is called to order. For this hearing, as previously agreed to with the ranking member, each side will have 10 minutes for the purpose of making opening statements. And now, we will begin that.

I recognize myself for 2½ minutes as we begin this hearing on the Private Mortgage Market Insurance Act, Part 2.

Today, the subcommittee is holding a second legislative hearing on the Private Mortgage Market Investment Act. The subcommittee held a hearing on this bill on November 3rd. Since then, I have been actively reaching out to and working with regulators and market participants and other members of this subcommittee to make improvements to the bill. I understand this is a very complex issue and I welcome another opportunity to hear from the public on the merits of this bill.

Currently, the Federal Government is guaranteeing or insuring over 90 percent of the U.S. mortgage market. Everyone on both sides of the aisle and all market participants claim that they support efforts, then, to bring additional private capital back into the secondary mortgage market.

There are two things that must be done to have private capital brought into this space: first, we must begin to roll back the government's involvement in the housing market; and second, we must take actions to facilitate and increase investors' interest in the secondary mortgage market. By facilitating continued standardization and uniformity within the marketplace, and increasing transparency and disclosure and providing legal certainty through the

clear rule of law, there will be a robust investor participation in the housing market without—and this is important—exposing the American taxpayer to trillions of dollars of additional risk. So the legislation we are discussing today essentially sets up a new qualified securitization market.

The FHFA is tasked with establishing a number of categories and mortgages using traditional underwriting standards that have different levels of credit risk associated with each one of the categories. Also, they are responsible for creating standardized securitization agreements in this marketplace. So these securitization agreements will standardize the servicing contracts, modification process, and reps and warrants, all things that provide the investors the ability to put back nonqualifying loans.

The legislation also removes one of the biggest regulatory impediments to private capital reentering the market by striking the risk retention provision under the current law. Now, I do agree that risk retention does have benefits, but the way it is currently being implemented will create a multitude of negative unintended consequences, we have been told.

So to bring private investment back to our mortgage market, it is essential that the rule of law is clear, specific, and upheld; investor rights and contracts must be honored; and by facilitating the adjudication of disagreements between investors and issuers, clarifying the rules around the rights of first lien holders and preventing government-enforced loan modifications that could negatively impair investor returns, investors will return and have the certainty they need to reenter the marketplace and invest in our Nation's housing market.

Finally, in regard to additional transparency and disclosure, investors should be empowered and enabled to do their own analysis of the assets underlying the securities that they invest in. So by disclosing more detailed loan-level data, while protecting the privacy of borrowers, and by allowing more time for investors to study that information, investors will be able to conduct more due diligence and less reliance on the rating agencies.

With all that being said, I look forward to today's hearing and a panel engaging in a very productive debate with other members of this committee as we try to seek a solution to this very most important problem facing the country.

With that, I will yield 4 minutes to the gentleman at the end of the row from Massachusetts.

Mr. FRANK. The subject is obviously of great importance because any doubts about the centrality of a healthy housing market to our economy or at least—not the centrality but its being an important element has clearly been reinforced, and so we should be moving forward. And there are some elements of this bill where there will be some agreement, but there are a couple of things that I wanted to focus on that concern me.

In particular, I am opposed to the notion of a complete repeal of a risk retention requirement. All the studies of the problems that led us to the crisis of 2007 and 2008 focused on the ability of people to originate loans without any real concern for the repayment rate, and to then pass them along to securitizers who also were not on the hook for failures.

The bill does empower the Federal Housing Finance Administration in effect to replace that with a series of fairly elaborate requirements and it is an interesting increase in the regulatory role for the FHFA. Mr. DeMarco has commented that it would require a FHFA very much like the current one, even if there was to be a complete abolition of the GSEs. But I don't think that is an adequate substitute for risk retention. It is a reliance on government regulation, which has a role, but I still believe that the risk retention method is the best because it gives a market incentive to the direct participants. It is in the statute as a responsibility for the securitizer, with the securitizer legally allowed to work that out with the originator.

I particularly note—and maybe I misread the bill—that what it seems to me the bill does is to repeal risk retention for all asset-backed securities, but proposes a substitute form of safety only for residential mortgages, so that asset-backed securities not dealing with residential mortgages are back to where we were.

And as I read, whether it is Gillian Tett in "Fool's Gold," or "The Big Short" by Michael Lewis, that troubles me. I do not think a system in which people can make loans—and I will give you an example of a nonmortgage situation. Henry Kravis told me publicly at a meeting, that a few years before we had talked, he wanted to get some bank loans so he could buy a company. Obviously, he didn't want to advertise it for too long; he didn't want to bring in a lot of competitors, as I have noted. I think the favorite spectator sport of most American businesses is competition; they very much like to watch other people engage in it. As to being a player, sometimes that makes them a little nervous. But Mr. Kravis asked a group of banks on Friday afternoon—he told me to let him know by Tuesday if they would participate in this loan. He thought he was giving them too little time, but by Sunday, he was oversubscribed. He said, not wanting to look a gift horse in the mouth, he had asked one friend who had offered him a loan how he could have possibly done the diligence between Friday afternoon and Sunday to tell him that he would subscribe to the loan? And the answer was, "Oh, I just had to ask one question. I called in my people and asked them if we could sell the loan, and when they told me we could sell the loan, that is all the diligence I had to do." Now, we will go back to that situation if we repeal risk retention entirely and put nothing in its place.

We do have, it seems to me, an overreliance on the ability of the FHFA to do it, but at least there is a potential or proposed substitute for it there. But doing away with risk retention entirely in matters unrelated to residential mortgages and leaving no protection against that kind of risk-free lending seems to me to be a grave error.

Chairman GARRETT. The gentleman yields back.

The gentleman from Arizona is recognized for 1½ minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman. I first want to give a gigantic thank you to my chairman for jumping in, wading into this. It is like the gigantic onion. Every time we peel one layer back, we find out there are dozens underneath it with more and more complications and details.

One thing I will particularly ask the panel to do is as you look at the Garrett bill in the outline, details, mechanics—and when providing those details a little less of here is how we used to do it, you know; in 2006, this is what the TBA market did, how it functioned; this is how correspondent lending worked.

It is what do you believe that type of market is going to look like in the coming years. I am reading a number of articles where correspondent lending may shrink down dramatically. The mechanics of what would a to-be-announced market really look like if you and I were trying to create the design of future mortgage lending and securitization and keeping a safe, protected system working.

So much of what my minute-and-a-half here is to ask all of you to reach into your thoughts, and provide us as much detail as you can so we can craft as quality a piece of legislation as possible. I yield back, Mr. Chairman.

Chairman GARRETT. And the gentleman yields back.

The gentlelady from California is recognized for 3 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman. As you know and as you said, this is the second hearing we have had on your discussion draft to reform the private mortgage-backed securities market. I appreciate that this hearing is another opportunity to hear from stakeholders, particularly since the first hearing we had on this draft didn't include the full range of industry perspectives.

As I said at our last hearing a month ago, I believe that bringing certainty and uniformity to how mortgage-backed securities are underwritten, securitized, and sold is a useful goal. Again, I am also pleased that you recognize that government should have a large role in creating clear rules of the road for this market. Specifically, I appreciate that this bill includes reforms to the mortgage servicing industry, something I have been advocating for quite a long period of time. Servicer conflicts of interest clearly need to be prohibited.

I also think that some of the disclosure requirements in this bill will be very useful in creating transparency, thus bringing confidence and certainty to the market. Such provisions, if they had been implemented earlier, could have prevented much of the litigation we see today between mortgage investors and entities that securitized and originated mortgages.

However, with that said, I would like to reiterate my concern and disagreement with you, Mr. Chairman, on your goal of repealing the risk retention requirements in Dodd-Frank provisions included in this bill. More than that, I would like to again express my concern about how this bill fits with the larger context of GSE reform. The bill does not address whether or when Fannie Mae and Freddie Mac should be wound down. It says nothing about the transition to the new system. It is silent on all of the tough questions that Congress should be wrestling with.

Mr. Chairman, do we even know if this bill will ever be marked up in full committee, or will it languish in subcommittee like the other housing finance bills we have considered?

I raise these questions because I am concerned about how the Congress will move forward on this issue. I think we need to stop pursuing GSE reform in a piecemeal fashion. Currently, there are three comprehensive reform bills that have been introduced in the

Congress: one comprehensive GSE privatization bill from Representative Hensarling; and two bipartisan reform bills from my colleagues in California—one from Representative Miller and the other one from Representative Campbell.

Clearly, if Representative Garrett's bill were adopted, at least one of those comprehensive reform bills would need to supplement it in order for the country to transition to a new housing finance system.

It is my belief that in addition to the reforms to private labor mortgage-backed securities contemplated in Representative Garrett's bill, there should be some government role assuring liquidity for access to our mortgage market. So I would urge my colleagues to consider a bipartisan, comprehensive approach along those lines rather than continuing to pursue piecemeal reform.

With that, I thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman GARRETT. And the gentlelady yields back.

We turn now to the gentleman from New York for 1½ minutes.

Mr. GRIMM. Good morning, everyone. Thank you, Chairman Garrett, for holding this hearing, and thank you to the witnesses for being here to testify.

I think we can all agree that the current situation in the mortgage market is not sustainable over the long run. Currently, the United States underwrites or guarantees in one form or another over 90 percent of new mortgages. And while this could arguably have been necessary over the last several years in the wake of the financial crisis and the obvious withdrawal of private capital from the mortgage market, it is a situation that cannot continue indefinitely.

It is of vital importance that we take seriously the need to create a workable framework where private capital will feel secure in returning to the U.S. mortgage market. I think we can all agree that the need to clarify issues surrounding underwriting standards and representations and warranties is critical in regaining that confidence in both the originators of mortgage securities as well as mortgage investors.

However, I do acknowledge that there remain many differences of opinion on how to best go about achieving this goal, while realizing that the process of reducing the government's role in housing finance is one that cannot be taken lightly. For example, in my hometown of New York City, real estate and related industries account for 25 percent of the economy. A sudden shock to an already battered real estate market would do great harm to that local economy.

That is why I look forward to hearing our witnesses' views on the legislation. And I do believe that your views will, when shared with us, aid us in the process of shaping a comprehensive solution going forward. And again, I thank you. I yield back.

Chairman GARRETT. The gentleman yields back.

The gentlelady from New York is recognized for 3 minutes.

Mrs. MALONEY. Thank you. Thank you, Mr. Chairman. And welcome to the witnesses. I respect Chairman Garrett's hard work, but on this bill, I do not support it and I have significant concerns.

An effort to restart the private securitization market is an important one, especially since we can't continue to have 90 percent of the mortgages guaranteed by the government. I do support some parts of the bill, such as standardized documentation and mortgage servicing standards, but I am completely opposed to any repeal of the risk retention requirements of Dodd-Frank. The bill repeals all of the risk retention requirements for all securities, not just mortgages, which is the topic of the bill.

Section 941 of Dodd-Frank would be repealed without providing any alternative other than giving discretion to the regulators. And that is exactly what happened leading up to the crisis of the "Great Recession." Repealing 941 would remove the market mechanism in Dodd-Frank to make sure that securitizers don't swindle investors, and it would return to us the attitudes and actions that led to the recession. At that time, no one cared about the quality of the loans they were making. That is how we got no-doc loans, how we got no information, no downpayment. The joke in New York was if you can't afford your rent, go out and buy a house; it is so easy, they don't ask you anything. They will sell you the house and turn around the next day and securitize the loan with no skin in the game. And it led us up to the crisis that we are now trying to recover from.

I really do believe that risk retention is a key safety and soundness principle which, if anything, we should make stronger not delete, as this bill does.

I also question why the FHFA is the regulator, and not the SEC. The SEC oversees securities and the bill exempts mortgage-backed securities from oversight, but does not replicate the SEC's investor protections. If anything, Dodd-Frank directed the SEC to strengthen the MBS market. I don't see how this bill provides any equivalent protections.

So I look forward to the testimony and I do think we need to look at ways that we can reform the whole GSE process, but we should not do it in a way that weakens safety and soundness. I yield back.

Chairman GARRETT. Mr. Dold is recognized for 1½ minutes.

Mr. DOLD. Thank you, Mr. Chairman, and I certainly want to commend you for your hard work and leadership on this issue which I believe is so very important for our economy and for American families.

So far, the GSE losses have amounted to nearly $200 billion, and American taxpayers are already stuck with that bill. Things are likely, in my opinion, to get even worse. On top of that nearly $200 billion in existing and indefinite losses, taxpayers are also effectively responsible for all the losses that will ultimately arise from over $5 trillion in existing total mortgage debt that the GSEs now own or guarantee.

And even with taxpayers remaining exposed to this enormous and unsustainable liability, our housing market remains severely challenged. Private sector investors and lenders have been driven completely out of the market. Consequently, families struggle to get new mortgages to buy a home. Homeowners frequently can't sell or refinance their homes, and house values continually decline. This situation is plainly unsustainable for taxpayers, for homeowners, for home buyers and, I would, argue for our economy as well.

Clearly, our mortgage financing system is badly broken, and I believe it must be fixed. Instead of a mortgage market dominated by the Federal Government and taxpayer guarantees, we need bold new solutions that will create the conditions for the private sector's return to the mortgage financing market without the taxpayer guarantee. To create those private sector conditions, we need a legal framework that establishes and enforces uniform standards, transparency, and legal certainty for the private sector lenders and investors.

So I look forward to hearing from our witnesses today and working with my Democratic and Republican colleagues to effectively address what I believe is a critical problem for our country. Thank you, and I yield back.

Chairman GARRETT. The gentleman yields back.

The gentleman from Texas is recognized for 1½ minutes.

Mr. HENSARLING. Thank you, Mr. Chairman. I would like to applaud you for your work on the Private Mortgage Market Investment Act, which is obviously designed to stimulate private investment in our mortgage market.

We all know that today the status quo of government domination is totally unworkable and totally unsustainable. When we have 90 percent of all originations and roughly 99 percent of all securitizations that are government-guaranteed, this cannot remain. It is an unacceptable risk for the American taxpayer at a time when their Nation is, unfortunately and regrettably, on the road to bankruptcy.

Clearly, the private market cannot compete with government guarantees. It can't be done. Even the Obama Administration has agreed and said, "Private markets should be the primary source of mortgage credit and bear the burden for losses."

So with the losses in Fannie Mae and Freddie Mac tipping the scales at roughly $200 billion, it is now time to begin winding down this financial commitment so the taxpayers are protected and private markets can begin to compete. Eliminating the government-sanctioned duopoly of Fannie and Freddie is only part of the solution. We also have to cultivate the private mortgage market, and that is why this Act is a very important first step.

The legislation also would repeal the risk retention provisions of Dodd-Frank, which are at odds with our attempts to reduce the government footprint in the housing market and have been universally panned as completely unworkable.

I look forward to working with the witnesses, and I yield back the balance of my time.

Chairman GARRETT. The gentleman yields back.

We have two more speakers, for 45 seconds each. The gentleman from California is recognized for 45 seconds.

Mr. MCCARTHY OF CALIFORNIA. Thank you, Mr. Chairman. I will therefore make it brief. It has been said that there are things about this bill on which there is agreement and things on this bill on which there is not. But I think the greater question is: Is this bill the solution to our housing finance crisis, and is this the comprehensive solution? I think the answer is clearly no; that bits of it may be a part, but that there is a lot more that needs to be done. And I will be interested in hearing from the panel on that point,

as I think you have heard other people say, is that there will be a lot more that needs to be done if we are to fix housing finance and thereby housing and thereby the economy. I yield back.

Chairman GARRETT. The gentleman yields back.

The gentlelady from New York for 45 seconds.

Dr. HAYWORTH. I thank the chairman and I thank him especially for his work on this crucial issue. I note the presence of Peter Wallison here, whose dissent from the FDIC I recommend to everyone who may not have read it. The marvelous concept we are honoring here is that we are endeavoring as expeditiously as possible to remove the moral hazard that is implicit in a Federal guarantee of the mortgage marketplace. So by whatever means we can accomplish that crucial goal and put responsibility and trust back in the hands of those who confer mortgages and those who create securities, we will advance the prosperity of the American people.

I look forward to your comments, and I think it is crucial that we continue this work with all due speed. Thank you, Mr. Chairman.

Chairman GARRETT. That concludes the opening statements.

And now, we will hear from the panel. Again, as I said before, thank you very much to the entire panel for coming here and sharing with us your two cents and answering any questions that will follow. You will each be recognized for 5 minutes. Your complete written statements will be made a part of the record. You can summarize your statement, hopefully, within 5 minutes.

We will begin with Mr. Katopis from the Association of Mortgage Investors.

STATEMENT OF CHRIS J. KATOPIS, EXECUTIVE DIRECTOR, ASSOCIATION OF MORTGAGE INVESTORS (AMI)

Mr. KATOPIS. Thank you, Chairman Garrett. Good morning, Ranking Member Waters, and distinguished members of the subcommittee. Thank you for the opportunity for the Association of Mortgage Investors to testify on these important concepts and the proposed draft legislation.

To make sure everyone is on the same page, let me briefly summarize some facts about the mortgage market that was. The U.S. mortgage market is awesome, $11 trillion of mortgage loans arising from three—and only three—sources; bank balance sheets which we know are full and stressed; the GSEs; and private capital through securitization.

At its height, 60 percent of the mortgage loans were securitized. Today, that has ground to a halt. It is not our choice. Representative Schweikert runs around Arizona saying Mortgage Investors are on strike. We have billions we would like to put into the mortgage market, but we can't for the reasons that are the purpose of today's hearing.

I just want to note for everyone's benefit who Mortgage Investors really is. We are not just a bunch of investment companies; we partner with public institutions like pension funds, retirement systems, university endowments, unions, and life insurance companies. So we are working with Main Street to put money into the mortgage market. When we can't, that hampers returns. It also

hurts people in your district like seniors, first responders, and others. So we are eager to work with you on solutions.

We also feel it is abused by some of the big box servicers, as some people in your district. And we want to work with you on solutions to addressing elements of the mortgage crisis, and how to help distressed borrowers.

So with that, let me talk about the bill and the text and I want to start by first sincerely commending you, Chairman Garrett, for acknowledging the issues facing Mortgage Investors. We are very humble that it seems you read our White Paper and took many of the issues from our White Paper and put those concepts into the legislative draft that we are looking at today. We would like to work with you on fine-tuning those concepts.

As AMI has testified before, we testified in September, there are a number of issues that face investors, including the servicer conflict of interest, and the breakdown around reps and warranties. Our written testimony details extensively the problems investors are having with trustees whom we believe are not honoring their contractual obligations under the PSAs. They are not abiding by their common law obligations. So there are a number of concepts you touch on. We would like to work with you. The truth is, investors price risk; we cannot price the unknown. So to get back into the market, we need the clear rules of the road that were alluded to. We need certainty, transparency, and uniformity. We need the execution of contracts, rule of law. So we appreciate all the work the committee is doing.

I want to say that the Investors do appreciate a role of government in the mortgage market to be a prudent regulator, to set standards, systems, and structures to move forward. We do not want to see government burden taxpayers with the liability around the unsound mortgages, so we appreciate your work in that respect, your work in leveling the playing field, and we also want to mention the work that you have done regarding leveling the playing field by eliminating the government subsidy and raising G fees with bills such as H.R. 1222. That is appreciated.

But the staff has also encouraged me to drill down on some concepts that we would like to see fine-tuned in the bill. I just want to mention that we last year joined a number of financial services trade associations praising the FCC's Reg AB, which did a number of things, including providing a cooling-off period, and enhanced disclosure, things that are included in this bill.

In terms of skin in the game, in terms of protecting investors, one thing we would like to see is some entity policing the trusts. You have touched on that concept in this draft. Page 11 provides for an independent third party. We would like to work with you to refine that, among other things. I just wanted to highlight that.

The SEC proposed something called the credit risk manager, which is sort of a supertrustee. We think that is a more robust regime to police trusts. So I would like to continue this dialogue with you at the appropriate time and work with you on a number of concepts to bring Mortgage Investors back to the crowd in private capital, including working on enhancing the plumbing of the mortgage finance system as well as fixing things like the national note recordation system, maybe a MERS II one day.

Thank you, and I am happy to answer any questions and take any comments.

[The prepared statement of Mr. Katopis can be found on page 59 of the appendix.]

Chairman GARRETT. I thank you, and I appreciate the detail of your testimony in the past, and that you have provided to the committee today as well.

Moving on—Dr. Calabria, welcome once again to the committee.

STATEMENT OF MARK A. CALABRIA, PH.D., DIRECTOR, FINANCIAL REGULATION STUDIES, CATO INSTITUTE

Mr. CALABRIA. Thank you, Chairman Garrett, Ranking Member Waters, and distinguished members of the subcommittee. Thank you for the invitation to appear at today's hearing. I also want to commend the chairman for his efforts.

While I believe we cannot replace our current mortgage system completely with private-label mortgage securities, I do believe the draft legislation before the committee is an important step. I would also prefer to see much quicker efforts to eliminate Fannie and Freddie. I do believe fostering alternatives in the interim is much better than doing nothing at all. I think we should bear in mind that as long as the heavy hand of subsidized government is tilting the scales, any private market solution is going to be hobbled.

My testimony will focus on the discussion draft before the subcommittee. But I want to make some specific comments, that we should bear in mind that you can have too much standardization and too much uniformity. I like to have a little variety in the marketplace. I think we should have a diversity of options. I think one objective of our Federal mortgage policy should be to have a wide variety of options available to borrowers without unduly advantaging any particular product.

The approach of Title I of the draft is that of standardizing mortgage pools by risk, and allowing those standardized pools to have an exemption from the registration requirements under the 1933 Securities Act. I believe this is a reasonable approach to fostering a liquid market for private-label securities.

And while I do question the expertise of the Federal Housing Finance Agency in the area of securities disclosure, I would prefer the SEC. With that said, I believe the structure of Title I and the involvement of FHFA is a reasonable interim step. Perhaps to keep it as an interim step, the subcommittee could include a reasonable sunset provision for the authorities under Title I. I would suggest something like 6 years.

But moving on to what I think is maybe the most contentious, but certainly the most important part of Title I, is the repeal risk retention provisions of Dodd-Frank contained in section 1 or 2 of the discussion draft. I believe this is one of the more crucial provisions of the draft, and I strongly encourage its inclusion. I say this with all due respect to the effort that was put in by the Members, and the statements of the Members this morning, but I think that is built upon a false premise, which is that various participants did not obtain sufficient risk. For instance, the bulk of losses that Fannie Mae and Freddie Mac suffered are from the credit guarantees of their MBS. If Freddie and Fannie had not obtained that

credit risk, and instead flowed to the holders of the mortgage-backed securities, the taxpayer would be better off today.

The same holds with the various off-balance sheet entities used by the largest commercial investment banks. The primary problem with these special investment vehicles was that the sponsoring bank did retain the credit risk rather than transfer it.

So to summarize, one of the problems of our existing securitization model is it too often allows for securitization without the actual transfer of risk. I will also note that 100 percent retention of the credit risk did not prevent the S&L crisis. So, again, you can have all sorts of credit risk retention, but I don't think that is a fix. Again, I would mention as well, if credit risk retention is such a great thing, why do we exempt FHA? If it is terrific, it should be for everybody, in my opinion.

Moving on to Title II disclosure requirements for non-exempted securities, I quite frankly prefer to have these standards drafted by private market participants. As many of these ongoing private sector initiatives were mentioned at the previous hearing, I am not going to repeat them today, but I would only suggest that since these private efforts are currently under way, I believe Title II could be absolutely deleted completely without an adverse impact to the bill.

Moving on to Title III, while the presence of a second lien is undoubtedly a risk factor, I have concerns about section 301(a) and 301(b) as they would, in my opinion, rewrite existing contracts, something which I believe is always and everywhere harmful and destructive to the trust in our markets. I will note it does not matter whether a rewriting of a contract is meant to benefit the borrower or lender. For instance, I read section 301(a) as essentially a forced transfer from borrowers to servicers. So I would argue for deleting those sections.

Regarding 302, while there are clearly substantial conflicts of interest to servicers of a second lien themselves or holders of a junior lien, I think a blanket prohibition on future interest by mortgage servicers is much too broad. There may well be situations where a junior interest held by servicers is beneficial to both junior and senior lien holder. So I think you need to rethink some modification to section 302.

I again want to emphasize, I commend the chairman for his efforts. I think much of the modification of this bill would make it something that would work and a lot of sense. I also emphasize I can't think of an issue that I think should be higher up on the priorities of the committee and the subcommittee than reform of our mortgage finance system.

I would emphasize as well that I have worked on a number of pieces of legislation in my time, and read a number of pieces of legislation in my time, but I have yet to see a perfect bill. So I don't think my criticisms should be taken to say we should not move forward. I do think the effort merits considerable consideration.

[The prepared statement of Dr. Calabria can be found on page 42 of the appendix.]

Chairman GARRETT. I thank you for your testimony. I also thank you for that last comment because I was getting a little worried as you were going along there.

Mr. Fleming, we appreciate you being with us today. You are recognized for 5 minutes.

STATEMENT OF MARK FLEMING, PH.D., CHIEF ECONOMIST, CORELOGIC

Mr. FLEMING. Chairman Garrett, Ranking Member Waters, and distinguished members of the Subcommittee on Capital Markets and Government Sponsored Enterprises, CoreLogic appreciates the opportunity to submit its testimony regarding Congressman Garrett's proposed bill addressing our country's residential mortgage securitization market, the Private Mortgage Market Investment Act.

My name is Mark Fleming, and I am chief economist of CoreLogic. CoreLogic is a leading provider of consumer, financial, and property information, analytics and services to business and government. Our company combines public, contributory, and proprietary data to develop predictive decision analytics, provide business services that bring dynamic insight to our customers in the residential mortgage origination, securitization, and servicing markets, as well as other private sector institutions in government.

CoreLogic's information resources include over 500 million historical real property and mortgage transaction records; monthly performance information on the vast majority of conforming as well as private-label securitized loans; insight in a majority of loan applications being originated today; and the Nation's largest contributory mortgage fraud database.

CoreLogic is supportive of the return of robust loan origination servicing, trading, and securitization markets as over 1 million users rely on CoreLogic to assess risk, support underwriting, make investment and marketing decisions, prevent fraud, and improve their business performance.

Unfortunately, many of our customers are being severely impacted by the lack of liquidity that has pervaded the non-agency residential mortgage-backed securities market for several years. The housing market is beset by headwinds. The shadow inventory is currently 1.6 million units, or a 5-month supply. While down 16 percent over a year ago, this is primarily driven by the declining rate of serious delinquencies.

There are 22.1 percent, or 10.7 million mortgage households underwater in the third quarter, down from 23 percent in the second quarter, but primarily due to foreclosures as opposed to house price gains. There are 22 million, approaching half of all mortgaged households, who have either insufficient or negative equity; that is, greater than 80 percent current combined loan-to-value ratio. And many have well above current market interest rates. Negative equity will persist for years to come, taking more than 10 years in some markets for the average underwater borrower to regain positive equity.

No one single policy or prescription can heal the housing market, but regulatory certainty, establishing underwriting uniformity, standardization of legal documents, and transparency is critical to the future of efficient allocation of private capital to finance mortgage assets.

Any resolution will require that the Private Mortgage Market Investment Act identifies as crucial: uniformity of underwriting standards of securitized assets; standardization of the securitization process; and granular loan-level understanding of the credit risk associated with residential mortgage-backed securitizations.

The return of private capital to the residential mortgage market hinges on the return of liquidity, which in turn is dependent on at least four elements: trust in what is being offered; understanding of the product; sufficient information upon which risk-adjusted pricing can be agreed upon; and monitoring of the investments and purchases made.

One of the greatest failures of the RMBS market was the mistaken belief that an upfront outlay for appropriate loan diligence was not worth the cost; that the ever-rising house price market would cover any deficiencies that may have existed in the loan underwriting process.

Empowering investors with the necessary data to use the many solutions available today to better measure credit risk and perform appropriate levels of due diligence—that is, trust but verify—is critical to regaining the trust and understanding of what is being offered in the RMBS security.

Had RMBS transaction participants employed even a few of the available diligence tools at the time of securitization, we believe substantial losses could have been avoided.

Data and analytics providers to the securitization industry are actively making comprehensive information more available than ever before. With gains and technology in data mining and the incorporation of scientifically validated methodologies, these analytics will not only uncover deficiencies at the time of origination or securitization, but during the life of the loan and the security within which it resides.

The ability of third parties and investors to independently assess the accuracy of issuer-provided information creates a framework for issuers that we believe can enhance the goal of skin in the game.

CoreLogic is thankful to Congressman Garrett for his efforts in promoting rational securitization practices through his introduction of the Private Mortgage Market Investment Act. As provider of the transparency-based information that PMMIA calls for, we are encouraged by the recognition of how data and analytics can help lead the way toward the restoration of a liquid residential mortgage-backed securities market.

Thank you. I will be glad to answer your questions.

[The prepared statement of Dr. Fleming can be found on page 52 of the appendix.]

Chairman GARRETT. I thank you as well.

Mr. Stevens, good morning and welcome.

STATEMENT OF DAVID H. STEVENS, PRESIDENT AND CEO, MORTGAGE BANKERS ASSOCIATION (MBA)

Mr. STEVENS. Good morning. Thank you, Chairman Garrett and Ranking Member Waters.

While my written statement is far more comprehensive, I would like to open with some brief comments. The proposed Private Mort-

gage Market Investment Act is aimed at achieving our shared goal of opening a pathway to a sustainable real estate finance system. As the MBA has consistently stated, the current environment in which the Federal Government owns, securitizes, or guarantees nearly every mortgage is both unsustainable and undesirable. I am pleased that we agree on the most important fundamental point: Private capital must be at risk, bearing the first loss, and private capital must be the primary source of liquidity for the mortgage market.

I would also like to mention other features that MBA's recommendations share with the legislation we are discussing this morning. For instance, we agree that the secondary market needs common standards, consistency, and transparency for all market participants in order to attract private capital. Your bill, Mr. Chairman, offers a way to accomplish these goals.

By facilitating predictability and reliability, standardization helps investors measure the risk exposure, particularly in the TBA market. MBA also appreciates that the bill provides for the establishment of different classes of standardized mortgage properties. Safe, well-defined product standards help consumers compare financing options. For investors, the core market will establish performance standards for pricing purposes.

I also want to comment on the bill's repeal of Dodd-Frank's risk retention requirements. A key issue for our residential and commercial members is this particular provision. Risk retention is a well-intended means for better aligning the interests of mortgage market participants, and the MBA was a leading advocate for establishing an exemption for safer Qualified Residential Mortgages, or QRM. Regrettably, the proposed rule with its QRM definition and creation of a premium capture cash reserve account, loan-to-value requirements, and debt-to-income ratios is so deeply flawed that we seriously question whether it reflects congressional intent or can ever be successfully implemented. Until we see a final rule, it may be premature to call for repealing this provision, though I fear that day may not be far away.

In my remaining time, Mr. Chairman, I want to turn my attention to the broader issue of GSE reform. Your legislation helps build a bridge to a future housing finance system, but determining what that system will look like is also of paramount importance. We believe the financial crisis proved that some form of government support is required to keep the mortgage market open during times of severe distress.

The current dearth of activity outside of government-supported liquidity channels exemplifies the transient nature of private capital. When the market becomes unstable, private investors will exit and will be less apt to buy assets, even in good times, if they doubt their ability to sell them in bad times.

To be clear, MBA believes the government's role should be to promote liquidity for mortgage finance, not to provide the capital for it or absorb all the risk itself.

MBA has proposed an FDIC-type insurance structure, fully funded by private capital, from risk-based fees on market participants, and limited to core mortgage products. As with the FDIC, taxpayer funds would only come into play if the capital of the securitizing

entity and the insurance fund were both exhausted. Again, like the FDIC, taxpayer funds would be returned as the fund is replenished.

It is important to note that the absence of a guarantee does not mean that the government will not be forced to step in during a crisis. In fact, GSE securities have always stated they are not backed by the government. The most recent crisis has shown the government's willingness to support even institutions that lacked an explicit guarantee. The taxpayer is better protected and the market will operate more efficiently if the rules of the road are clearly stated upfront, and government guarantees are clearly delineated and paid for before the crisis occurs.

I want to conclude by mentioning that even though a new housing finance system may be years away, the steps we take today will influence the system's ultimate design. With that in mind, it would be inefficient, if not downright wasteful, to dismantle portions of the existing infrastructure before a proven new structure is in place. The existing system, market practices, and human capital are the result of decades of effort, public investment, and billions of dollars of private capital. Retaining these assets through an orderly transition is in all of our best interests and will promote a smoother economic recovery. Thank you.

[The prepared statement of Mr. Stevens can be found on page 94 of the appendix.]

Chairman GARRETT. Mr. Salomone?

STATEMENT OF TOM SALOMONE, 2012 DIRECTOR, REALTOR® PARTY ACTIVITIES, NATIONAL ASSOCIATION OF REALTORS® (NAR)

Mr. SALOMONE. Good morning, members of the Capital Markets Subcommittee. On behalf of the 1.1 million members of the National Association of REALTORS®, thank you for holding this important hearing on increasing private capital participation in the secondary mortgage market.

My name is Tom Salomone of Coral Springs, Florida. I am NAR's committee liaison for the issues of mobilization, political involvement, and REALTOR® political action committees.

I have been a REALTOR® for more than 33 years, and I am the owner of Real Estate II and Real Estate II of Margate, both in Florida. The firm specializes in residential real estate. As with many of my colleagues who have testified before this committee in the past, my life, my passion, is real estate.

REALTORS® agree with Chairman Garrett that greater transparency is needed in the trading of mortgage-backed securities. We believe that concepts within this legislation are a good attempt to bring stability and confidence back to the housing finance sector. The concept as posed in this legislation that focuses on standards and uniformity and transparency dovetail nicely within with NAR's first principle for second mortgage market reform that states: An efficient and adequately regulated secondary mortgage market is essential to providing affordable mortgages to consumers.

Also, REALTORS® agree an increase in private capital to the secondary mortgage market will help reduce the need for large-scale government involvement in this portion of the housing fi-

nance sector. However, we do believe that even with the influx of private capital, it remains a role for the government and the conventional conforming space. Therefore, to restore confidence in the market, improve the efficiency and effectiveness of the housing finance system going forward, and to ensure the continued availability of mortgage capital under all economic conditions, concepts from this proposed legislation must be coupled with the comprehensive strategy for reforming the entire secondary mortgage market, including Fannie Mae and Freddie Mac.

REALTORS® believe examples of bills that this legislation could be paired with are H.R. 2413, introduced by Representatives Gary Miller of California and Carolyn McCarthy of New York; and H.R. 1859, introduced by Representatives John Campbell of California and Gary Peters of Michigan.

REALTORS® believe that the secondary mortgage market should be reformed to strengthen it for the long term. In fact, we agree with lawmakers in the Administration that taxpayers should be protected, private capital must return to the housing finance market, and that the size of government participation in the housing sector should decrease if the market is to function properly. Those who advocate for constraining or removing entirely government participation from the secondary mortgage market need only to look to the current minuscule activity in the jumbo and manufactured housing mortgage markets to understand the implications of private capital as the sole participant in the secondary mortgage market. The result of this is a tightening of credit that has prohibited well-qualified borrowers from accessing funds required to purchase a home.

Unique to the U.S. housing finance sector is the availability of long-term fixed mortgages like the 30-year fixed-rate mortgage. We believe that full privatization of the secondary mortgage market, even with the rules put in place by the Private Mortgage Market Investment Act, could foster mortgage products that are not adequately aligned with the needs and in the best interests of the Nation's housing consumer.

Ultimately, REALTORS® believe that moving to a fully private secondary mortgage market could make the affordable 30-year fixed-rate mortgage disappear. In fact, early NAR survey data shows that consumers who are now above the new lower GSE loan limit are experiencing significantly higher interest rates and the need for substantially larger downpayments in order to receive scarce mortgage funding. This is leading to a loss of interest in real estate.

Finally, REALTORS® fear that in times of economic upheaval, a fully private secondary mortgage market will largely cease to exist, as has occurred in the jumbo and commercial mortgage markets. This would be fatal to the entire economy because the disappearance of affordable, predictable long-term mortgage funding would no longer be available, which would cripple the wide variety of industry supported by the residential housing market.

In conclusion, the National Association of REALTORS® applauds Chairman Garrett's efforts to bring back stability and confidence in the private-label mortgage securities market space. Again, we believe that this bill will be most effective if coupled with the legisla-

tion that supports the secondary mortgage market model that includes some level of government participation, while protecting the taxpayer and ensuring that all creditworthy customers have reasonable access to mortgage capital.

Thank you for this opportunity to present our thoughts on the Private Mortgage Market Investment Act. The National Association of REALTORS® is anxious to work with the chairman and our industry partners on this thoughtful piece of legislation, which is an excellent first step toward finding a solution that best meets the needs of the U.S. housing consumer and the desire for homeownership. And I thank you.

[The prepared statement of Mr. Salomone can be found on page 86 of the appendix.]

Mr. SCHWEIKERT [presiding]. Thank you.

Dr. Poole?

STATEMENT OF WILLIAM POOLE, PH.D., DISTINGUISHED SCHOLAR IN RESIDENCE, UNIVERSITY OF DELAWARE

Mr. POOLE. Mr. Chairman, and members of the subcommittee, I apologize for being so late. Allowing an extra 75 minutes was simply not enough for driving here from my home.

Mr. SCHWEIKERT. Dr. Poole, may I beg of you to pull the microphone just a bit closer?

Mr. POOLE. I am sorry?

Mr. SCHWEIKERT. Pull the microphone closer if you can.

Mr. POOLE. Is that better? Okay.

I confess I am also a bit discombobulated from being in the traffic and the rain, even though I lived here for quite a while and should be used to that, but you get away from it after awhile and you forget just what it can be.

Okay. I have a fuller set of comments for the record and those will be submitted. Probably the most relevant part of my background for this discussion is that for 10 years, I was President and CEO of the Federal Reserve Bank of St. Louis, and of course we had a lot of responsibilities not only for monetary policy, but for monitoring developments in the financial markets.

I believe that the way that we ought to go is to move toward a fully privatized market in mortgage finance. I didn't hear everyone here, obviously. I disagree with the position that says that we need to have a large government role. There are many capital markets that work just fine without a government role. Examples would be: automobile lending, another asset market; corporate finance; and mortgage markets in other countries. And what we are seeing today is the residue, the very unsatisfactory residue of decades of heavy Federal involvement. It is exceedingly strange that we talk about the need to have a Federal backstop when it was exactly the Federal backstop that created so much of the current problem, the financial crisis.

The detailed specification that is in the draft bill, I quite frankly believe is the wrong way to go. It seems to me that is trying to design complicated products in Washington. I do not believe that Washington would try to design a computer or cell phone or a piece of complicated software, and I don't understand why you should ex-

pect that you would be able to design a mortgage instrument correctly and keep up with the times, which change.

Moreover, here is the result: This is what I had in my latest refinancing of my mortgage. So this is the consequence: this document, pages and pages of fine print. It is a consequence of Federal involvement and State of Maryland involvement in the mortgage business. And as I read this draft bill it would deepen that—it would make this kind of document larger, and I don't think that is the way we ought to be going.

Let me also make just a few comments on Fannie Mae and Freddie Mac, and of course we have other GSEs to worry about in the housing space, as we put it, the 12 Federal Home Loan Banks, the FHA.

Let me concentrate on Fannie Mae and Freddie Mac. What I believe ought to be done with those firms is to phase them out altogether. They ought to become artifacts of history and should no longer be active firms. It is not hard to design a process that will accomplish that end. Two things need to be done: first, the conforming loan limit needs to be phased down, not all at once, but over a period of years; and second, the securitization fees need to be on a schedule of increase.

I would urge you to go that route, and I would also urge you to put those—phasing schedule into the law, rather than have it at the discretion of regulators. The discretion of regulators is very likely to be on the way. Some reason to stop—in fact, we have seen that already because there was a scheduled reduction in conforming loan limits. That has been suspended at least for the time being.

Let me finish with a comment about the scale of the subsidies that have gone into housing. Those subsidies are very large.

The way we ought to look at all the elements of our Federal budget is to ask whether we would be willing to ask Social Security recipients to accept a 10 percent reduction, let's say, in their benefits, including current recipients. It has been 70 years since the attack on Pearl Harbor occurred. I have no doubt what the answer would have been 70 years ago. And in fact, we know that an enormous number of our citizens volunteered, and gave their lives in that cause.

Do we really believe that subsidies for housing, for ethanol, for high-speed rail and so forth are—would we ask our citizens to give up Social Security benefits for those things? I don't think so.

Mr. SCHWEIKERT. Dr. Poole, I let you go over about a minute-and-a-half; I am sorry.

[The prepared statement of Dr. Poole can be found on page 81 of the appendix.]

Mr. SCHWEIKERT. Should we start with a few questions just to sort of get our heads around the variety of information here?

Mr. Fleming, from CoreLogic—with some of the discussions we have been having, everything from the risk retention to how do you make sure—if the underlying reason for risk retention is ultimately that we don't want someone to not be able to keep their home, that we don't want bad paper, ultimately, to be moving through the system, and ultimately the holder of the bond to be holding impaired paper.

CoreLogic's ability to analyze data—we have had discussions of whether ratings on bonds are really the quality stamp for the bond investor, for the pension system, for the retiree who is going to buy the bond, or should we almost put a data field that is actually at the loan level that would allow risk analysis up and down, and how public should that data be? For someone like CoreLogic, you can demand that data be copy-written, be proprietary; or can we actually, through legislation, say here is the base field that you are going to have to disclose, and you may sell the algorithm. Give me your comments.

Mr. FLEMING. Sure. I think there are two levels to it. One is the concept of risk retention in many ways is sort of trying to address the principal agent problem; that is, that we want to incent the appropriate behavior, the risk transfer behavior between principals and agents, and that is an important factor there.

But we also believe that through the use of data and analytics that are available today and that have been available for a number of years, one can measure more dynamically through monitoring or surveillance types of techniques the performance of bonds, and let market forces drive pricing, right? It becomes a very straightforward process, where if a bond starts to perform away from expectations based upon the data, then the market can reprice that bond and sort of there is an enforcing mechanism in the pricing of those bonds and the recognition of the quality of the securitizers, the counterparty issuing those bonds, sort of counterparty risk rating kinds of programs can be done by investors.

So that is why we believe strongly in the idea of the concept of the transparency of the data and it being something that is used to allow the markets to really drive pricing behavior and enforce good transparent risk management techniques. We already know and we do today use loan-level modeling and analytics. A lot of the loans that are in these securities are tied at the loan level and can be modeled and measured that way. So we believe in the idea of modeling those and having that data be available.

In many ways, it is like the credit score that is attached to the loan application that passes its way through the process and is always a valuable piece of information throughout. The data and analytics that are attached to the loan at origination can be passed to the different parties along the way.

There is the sort of information asymmetry problem that we had in the market of the past, which was that at each level of transfer, less and less information was being passed, right? And when you have markets—

Mr. SCHWEIKERT. That is part of the discussion we keep having up here, is literally, do you create a number of data fields in a standardized format that are attached at the loan level and are always moving through? They are just there. So if you are the California Teachers Retirement System and you are considering buying into this bond, you can run your own risk analysis and it is actually at loan level. Am I going in the right direction?

Mr. FLEMING. Yes. It exists today. So it is already out there and can be used and is used by market participants.

Mr. SCHWEIKERT. Forgive me if I mispronounce it, Mr. "Katopis?"

Mr. KATOPIS. "Katopis."

Mr. SCHWEIKERT. Give me your understanding from your Association, from your view, the current QRM rules, risk retention, what do you think that—how that changes both your business and the availability for future homeowners to find credit?

Mr. KATOPIS. Certainly, risk retention is a concept related to skin in the game. We do believe the best skin in the game is an effective reps and warranty regime that can be enforced.

Mr. SCHWEIKERT. Could we stop right there? To that point, could I get a couple of comments of how many of you believe that a well-designed reps and warrants mechanics is also every bit as important, or maybe even more effective? I just thought we would do a quick rundown. Yes? No?

Mr. FLEMING. Yes.

Mr. STEVENS. Absolutely.

Mr. POOLE. I am sorry; I didn't catch the question.

Mr. SCHWEIKERT. A quick discussion of the reps and warrants mechanics actually in many ways provides as much quality coverage as a QRM or risk retention.

Mr. Poole, would you turn on your microphone, please?

Mr. POOLE. My view is that the government ought not to be in the business of designing this product, and I said that before. The market makes those judgments all the time, and I would not see a role for the government to force it down a particular direction.

Mr. SCHWEIKERT. Mr. Katopis, I am sorry. One last, and then I am way over my time.

Mr. KATOPIS. We think an effective reps and warranty regime would not necessarily rely on government enforcers, but you would have private—you would have all the pension funds. You would have CalPERS, the Carpenters Union, whoever runs your TSP, trying to make sure that there are economically viable mortgages in the trust.

Mr. SCHWEIKERT. Thank you.

Ms. Waters?

Ms. WATERS. Thank you very much.

I am going to call on Mr. Fleming again. Recently, I read an article from BankThink authored by you, "Mortgage Principal Can Be Cut Without Moral Hazard," and you discuss quite thoroughly the possibility of principal mortgage deduction, which is a very controversial concept with some. And I notice, of course, in this legislation Chairman Garrett in one section here says, "Prevention of forced principal writedowns with respect to a securitized mortgage loan: No Federal department or agency, including the Board of Governors of the Federal Reserve System and the Bureau of Consumer Financial Protection, may require reduction in the principal amount owed on such mortgage loan."

I have been discussing with my staff, and you discuss somewhat in this article, the advantages of principal writedown and how they can be done in a creative way so as to reduce the cost to the banks and the taxpayers. I have also been discussing with my staff recent information about how Fannie Mae's financial statements show that they are selling their REOs for around 55 percent of the unpaid principal balance of the mortgage. So isn't it possible to reduce principal in a way that both helps the borrowers and reduces loss

to the taxpayers? I would like to hear your thoughts on that, Mr. Fleming.

Mr. FLEMING. Sure. As you said, with the losses that the GSEs are suffering on foreclosures, foreclosure is a very expensive proposition from a loss perspective to the mortgage industry. And the concept of principal reduction is slightly different from, say, a cramdown concept of forcing it. It is the idea that it can be and should be considered as one of the many choices, and using the idea of sort of the net present-value testing of the value of a loan. It is consistently a choice that can be net present-value beneficial amongst all the other ones that are out there, other forms of modification, refinancing, short sales, all of these alternatives that are out there. Appropriately structured principal reduction can be a net present-value benefit, and therefore would be something that would be of value that would reduce losses to the investor in those loans. If it was a GSE loan, it would be the GSEs.

So it is not that it should be forced, but it can be considered as one of the many options. The important aspect to take into account there is to address the moral hazard risk. And the best way to think about that is, we do it all day long in our daily lives with our auto insurance and our health insurance. They have moral hazard clauses in those contracts, too, and they address them through things like deductibles.

So the key with doing principal reductions in the mortgage space is to have some kind of equivalent to the deductible concept to incent the appropriate behavior and mitigate or moderate the moral hazard. Something like a shared appreciation mortgage is one of the ones that is out there today being used effectively to do that.

Ms. WATERS. And we are thinking about looking at that possibility with the shared appreciation. We think that makes a lot of sense.

What about, again, the REOs? As I said, they are selling these REOs for about 55 percent of the unpaid principal balance of the mortgage. Should we not have anything in law that would prevent principal writedowns, allow them perhaps not to be forced but to be considered as a possibility? Because while there are some good things in Mr. Garrett's bill, this section would prevent forced principal writedowns altogether.

Mr. FLEMING. I think that gets more to the concept of honoring the contracts that are out there and making sure that the industry, particularly the private market, is going to enter an industry only when they can be assured that the contracts that are negotiated are withheld—or are held up.

So, as I said, it is one of those ones where it is an option amongst many that, if done appropriately and objectively, can be of value. Any legislating or forcing one way or another gets away from the idea of letting the markets use the data and the analytic information that they have at their disposal to make the best decisions.

Ms. WATERS. Yes, but there is so much discussion about how this crisis in our housing market is continuing to cause us so much economic displacement, and that if we are to revitalize this economy, we have to do something about the housing market. Wouldn't principal writedown help us to stimulate the economy in some way?

Mr. FLEMING. Yes. I think in terms of, if you address the moral hazard risk and do it using these net present-value type of tests or models, yes, because negative equity is a significant drag on the housing economy and the economy as a whole today, and that is one of the fastest ways, if you will, to get rid of that negative equity risk.

Negative equity reduces turnover, mobility. It reduces household sales demand. Currently, at the moment, it is locking people into their mortgages at higher interest rates, so it is not freeing up on their household balance sheet money that they could spend and consume otherwise.

I think one of the benefits of the HARP II program will be that borrowers are being put into lower interest rates and that money is flowing back out through consumption expenditures. It doesn't actually do anything significantly with regard to the housing market in terms of reducing equity risk or anything like that, but it is an economic stimulus in many ways. So ways to address reducing negative equity more quickly than time would do on its own, certainly would benefit.

Ms. WATERS. Thank you. I would like to talk with you further about shared appreciation, because we are going to try and get our colleagues to agree to something.

Thank you very much. I yield back the balance of my time. I am sorry; I have no more time.

Mr. SCHWEIKERT. Mr. Grimm? And if we go fast enough, we will hopefully get a second round.

Mr. GRIMM. Thank you, Mr. Chairman. Again, thank you to those testifying today. We we do appreciate it.

Mr. Stevens, I believe your testimony notes that the alternative QRM proposal, which would require a 10 percent downpayment, would be as bad or even worse than the original 20 percent requirement. Obviously, that seems a bit counterintuitive. Why would reducing a downpayment requirement to 10 percent be worse? Could you please explain?

Mr. STEVENS. First and foremost, I think the most critical variable we all have to pay attention to is the enormous role that the FHA is playing in the purchase market today, and that is singly driven by the fact that downpayment is the single biggest barrier to homeownership today. If you put the downpayment requirement at 20 percent, that guarantees, quite frankly, an outcome that we are going to have more mortgages using a government-subsidized outcome, as opposed to allowing any opportunity for private capital to come back into the markets. And it will make it very difficult for borrowers to have access to anything except a government-subsidized finance system.

By reducing the downpayment to 10 percent, which is the alternative option, our concerns have to do with how capital markets' execution will occur. In other words, a smaller market with only a 10 percent downpayment requirement would leave a much smaller liquid market available to trade in the private market space.

To put it another way and try to put it more simply, if the downpayment level was set at 10 percent, it means that anybody with less than 10 percent would have a difficult time getting any market execution, other than going to FHA, which would ultimately then

be under even greater pressure to do more purchase volume because it would be an illiquid market in that remaining space.

So our view is that we don't support a downpayment requirement in either proportion in the QRM rule. While respecting much of what is good in QRM, the concerns about putting these bright-line underwriting standards may ultimately become a barrier to engaging private capital back into the mortgage markets. And that is one of the things that I think we need to consider as we look at that rule.

Mr. GRIMM. Continuing on that, given the uncertainty regarding the GSEs—I think you have stated it, but I want to make it clear what your opinion is. Is now the right time to change the structure of servicing compensation?

Mr. STEVENS. We have looked at the proposed servicing standards that FHFA has put out for comment. We do not believe now is the time to change servicing compensation. And particularly to your question with the uncertainty in the housing finance system and the uncertainty in the housing recovery, changing servicing standards before we have even established servicing compensation, before we determine what servicing standards are, seems to me to be in reverse order.

I think we first need to determine what are the servicing obligations going to be of the industry going forward, and then determine what compensation should be in accordance with that. To change that right now could even disrupt further the availability of mortgage credit to consumers across the country.

Mr. GRIMM. Thank you. And I will open this up to the panel. We have just under 2 minutes.

In your opinion, are we going down the same road, possibly, of some of the things we did with Dodd-Frank in the sense that we are giving too much authority to the regulators? FHFA, right now, you are talking about reps and warranties, credit and quality standards, underwriting standards. We can go on and on and on. Is there not enough definition, not enough clarity, and we are going to make the same mistake again? And I will open that up to the panel.

Mr. KATOPIS. Congressman, let me make one comment on behalf of the investors who share the goal of crowding in private capital. Today with the contracts, the PSAs, we have 300 kinds of contracts out there with one commonality: They don't really work. There needs to be standardization. And the conversation about whether FHA versus SEC is the better organization to create those standards is an open dialogue, but I think it is different than relating it to the Dodd-Frank experience.

Mr. CALABRIA. I would say as an overall point, we are absolutely making the same mistakes that we seem to make after every housing boom and bust. You can go back and look at the things that were done after the savings and loan crisis, and in many ways they mirror what was done, with one exception: At least, we did have sort of a prompt, corrective authority regime that was put in, in the 1990s that tried to reduce forbearance, because one of the problems in the marketplace today is we seem to be unwilling to shut banks when they need to be shut down. So this sort of extend-and-pretend that dominates the markets, we didn't learn from that.

But I would say in many ways you really do need to limit some of the discretion of what the regulators can do. They had tons of discretion before the crisis and that simply did not work then. So I am very much concerned that we are repeating some of the same mistakes.

Mr. FLEMING. I would just say I think we never really know for sure where we draw the line of balance between regulation or setting of standards, which is sort of the government role versus allowing the private market. And it is good that we can have the debate here to try and find those lines and know that probably, invariably, we get it wrong, and times change and it always needs to be revamped.

Mr. GRIMM. I am going to yield back, and the Chair can decide.

Mr. SCHWEIKERT. Thank you, Mr. Grimm.

Mr. Frank?

Mr. FRANK. Thank you. First, let me follow up with Mr. Katopis. You say you would prefer to leave the authority to the SEC rather than the FHFA; is that correct?

Mr. KATOPIS. No, Ranking Member Frank. We share the goal of standardization—

Mr. FRANK. I didn't ask that. I am sorry, but we only have 5 minutes. You say here you would rather have the SEC, we believe the SEC responded. So did I misread this?

Mr. Katopis. No, no. I think you are misconstruing it. We have supported the Reg AB proposal in the past. We like what the SEC put out in the past in terms of moving forward on the standardized reps and warranties. It is an open question. We have not decided whether—

Mr. FRANK. So it is an open question for you.

Let me ask Mr. Calabria. You lament the legislation restricting—to require the government to insist that people use the rating agencies. Remember, we don't say people can't use them on their own. I was a little surprised that Cato was in favor of the government insisting that private parties use it rather than leave it up to themselves.

But having said that, let me ask you, would you evaluate the rating agencies' role in rating these things in the past; and do we have any reason, if you don't think that they did a good job, why they would be better?

Mr. CALABRIA. I will reiterate, as I say in my written testimony, that ultimately we should be moving toward a world where we have far less reliance on the rating agencies. However, we are stuck in a bad world—

Mr. FRANK. Okay. But answer my question, please. Again, I will repeat. I was struck that Cato is saying, "Hey, government, make them do it," rather than what I thought—

Mr. CALABRIA. With all due respect, I don't believe anywhere in the testimony I say—

Mr. FRANK. No. What we did was to say not that people couldn't use the rating agencies, but that the government couldn't require them to. And I would have thought Cato would have been with us in saying it is up to you; if you want to use the ratings agencies, use them, but the government can't order you to do it.

Mr. CALABRIA. Nowhere in my testimony do I say that the government should require people to use—

Mr. FRANK. I thought that is what—

Mr. CALABRIA. What I talk about is there is the section in Dodd-Frank that the current—was it 4-something G that exempts rating agencies from Section 11 liability, and then once you have that, the ABS market shut down because—

Mr. FRANK. So you don't object to the part of the bill that says that no government agency should require people to use the rating agencies?

Mr. CALABRIA. I absolutely agree with that part. We are on the same page.

Mr. FRANK. Okay. I misread that. As to the rating agencies, how would you evaluate their past performance?

Mr. CALABRIA. The rating agencies?

Mr. FRANK. Yes.

Mr. CALABRIA. Not good.

Mr. FRANK. What reason do we have to think they will get any better? Is there any reason to think that, absent any government intervention, they will get any better?

Mr. CALABRIA. Again, I want to move to a world where we have—

Mr. FRANK. I am sorry, Mr. Calabria. That is a fairly straightforward question. Do you have any reason to think they will get better, absent some outside intervention?

Mr. CALABRIA. I think if we don't bring competition to that market, no.

Mr. FRANK. Okay, thank you.

Mr. Stevens, I know you don't want to use downpayments and my letter—also no bright lines about debt-to-income or loan-to-value. Let me ask you, looking back at the way residential mortgages used to be used, what in that system would you change? That is, how would you have us going forward be different than the way they were 3 years ago? It is a very specific question.

Mr. STEVENS. Yes. I think what you put in—

Mr. FRANK. No, no. How would you change it?

Mr. STEVENS. We support what is in QRM that eliminates negative amortizing loans, interest only, balloons, extended loan terms, prepayment penalties—

Mr. FRANK. You would get rid of the bad stuff.

Mr. STEVENS. —understated income, no income verification, points and fee caps. You have owner-occupied restrictions.

Mr. FRANK. Let me just ask, those all are in there to say that you need to comply with that to have a qualified mortgage. So from your standpoint, there should be no difference between the qualified mortgage and the Qualified Residential Mortgage. That is, if it meets the qualified test, then there should be no further restriction?

Mr. STEVENS. That is actually not necessarily correct.

Mr. FRANK. What is your position?

Mr. STEVENS. We wouldn't object necessarily if that was the outcome, but QRM—

Mr. FRANK. Tell me what your position is. I am glad you wouldn't object, but what would you be for?

Mr. STEVENS. A qualified mortgage allows second homes, investment properties, where QRM does not.

Mr. FRANK. Okay. But people in my business, when we say we do not object, that means we don't want to really tell you what we think, because "do not object" doesn't mean what I think. What do you favor in terms of—are there any restrictions you would put on mortgages to qualify for no-risk retention, other than simply meeting the basic qualified mortgage test?

Mr. STEVENS. I don't consider the list of provisions that Congress passed in Dodd-Frank on the QRM standard is a small list. It is a significant—

Mr. FRANK. No, I didn't ask you that. So the answer is no, in effect?

Mr. STEVENS. No, we support everything that—

Mr. FRANK. No. If it meets the qualified mortgage test, then it would automatically get a QRM test as well? That is not a hard question.

Mr. STEVENS. The QRM test, the qualified mortgage extends beyond that.

Mr. FRANK. So I think saying that you don't have any requirement to avoid risk retention or debt-to-income, loan-to-value, or downpayment, is really asking us for further trouble.

Thank you, Mr. Chairman.

Mr. SCHWEIKERT. Thank you, Mr. Frank.

Mr. Dold?

Mr. DOLD. Thank you, Mr. Chairman.

Dr. Calabria, just starting with you, do you believe that the government should play any role in preserving the availability of credit during times of stress; and, if so, can the government do this through other means besides Fannie and Freddie?

Mr. CALABRIA. I would say, ultimately, no. I do think we need to recognize that the Federal Reserve has set a precedent of buying $1 trillion-plus in mortgage-backed securities. The ECB has bought almost half a trillion in covered bonds. You have a catastrophic backstop in place both here and in Europe, so we shouldn't deny that fact. But ultimately, I would want to even limit those abilities as well.

Mr. DOLD. Can you just talk to me for a second about why it isn't desirable to have a mortgage market where 90-plus percent of all the mortgages have some form of government support?

Mr. CALABRIA. I think you lessen the incentive. Again, the whole structure of sort of risk retention and all these things is try to align incentives properly. But if you don't have the downside, and you only have the upside and the taxpayer takes the downside, you have eliminated those incentives for proper underwriting.

The way markets should work is mismanagement, bad products, should all go out of business. Companies should fail. They should get weeded out. Instead, when we save them and we keep them around indefinitely, you propagate and sustain bad practices.

So certainly, part of the need for all of this regulation is because we continue to have a massive safety net for the financial system. We need to get rid of that safety net so these bad firms go out of business.

Mr. DOLD. So you also believe that the GSEs underprice risk?

Mr. CALABRIA. Absolutely. And I think the fact that they have close to $160 billion in losses is proof enough.

Mr. DOLD. Mr. Fleming, would you also agree that the GSEs underprice credit risk?

Mr. FLEMING. I think that one of the reasons that private capital is not coming back into the marketplace is because the underpricing of risk makes it non-economically feasible for it.

Mr. DOLD. And as we look at how big this is right now, Mr. Fleming, and the way to get around this, how do we best bring private capital back into the marketplace? How would you best do it?

Mr. FLEMING. A lot of the things that are being talked about today are certainly there, the things I mentioned in my testimony: the creation of trusts; the honoring of contracts; the creation of some more standardization. I think there is a very clear benefit the GSEs provided to the mortgage market that is not really obvious in direct financial markets, and that is the creation of a very standardized and efficient process for origination of the loan all the way through to securitization.

In principle, those concepts can be applied to the private marketplace to also create that level of efficiency which brings liquidity, which as we note today and have known even in a well-functioning housing market, the GSEs brought a lot of liquidity. And that is the key to what we are looking for in the private market.

Mr. DOLD. Mr. Stevens, you have said, or at least you have written in your testimony, that you believe the necessary tools, materials, and expertise currently exist to begin building a bridge towards a more sustainable real estate finance system. What are those tools and why aren't they currently being used?

Mr. STEVENS. I think there are three interesting requirements that we continue to struggle with as we talk about the recovery, the housing finance system, and bringing finance into the marketplace.

The first is to make sure that we have standardization in terms of the marketplace understanding what those standardized terms would look like. That exists currently in the TBA market in the securities issued by the GSEs. It also exists in Congressman Garrett's bill. That is one of the provisions he is trying to protect, the expertise to design that. What is in that credit box for standardization clearly exists in the industry today. That can be defined through Congressman Garret's bill, as it is with GSE production.

The second is liquidity, to make sure there is enough capital coming into the system to create tradable currency, a security that markets will buy into. I think that comes a bit from standardization. And by creating large enough pools of standardized products, you can create liquidity.

I can give you a detailed version of that. Fannie Mae MBS, which is trading $70 billion roughly per day, is right now trading a full point through Freddie Mac mortgage-backed securities because they trade such lower volumes of currency, it is a less liquid security today. We are already seeing price differential because of large liquid pools.

Congressman Garrett's bill could potentially ultimately resolve in testing whether we can create enough liquidity to have pricing power into that market.

The third then ends up being the backstop: Who has the capital markets' guarantee behind the provision? We have traditionally—today, we rely on the government to give that triple A guarantee behind the security. That is what creates investors coming into the market.

The question will be, under the provisions that are created in this proposed legislation, will there be investors willing to come in? Because the counterparty backstop won't be the U.S. Government in that structure; it will be individual companies that have created those mortgages. And I think that is going to be the most interesting part about testing the viability of what is in this proposed legislation, if it ultimately comes to market, is can you bring the liquidity in simply based on having standardization in mortgage pools.

Without question, the expertise exists in the housing finance system to help design those structures. The question will be, will the capital come into the market? And I think that is something that everybody here would be interested in finding out.

Mr. DOLD. Thank you. I yield back.

Mr. SCHWEIKERT. Mr. Lynch?

Mr. LYNCH. Thank you, Mr. Chairman, and I want to thank all of the witnesses for coming and testifying and helping this committee with its work.

For starters, I have to address Mr. Stevens, representing the Mortgage Bankers Association. I have a matter in my district, and I just need to put you on notice on this. Originally, Ms. Debra Still was supposed to testify in your stead. She is the new incoming chairman of the board of directors, as I understand, for the Mortgage Bankers Association. She is the principal for Pulte Homes.

I have a couple of Pulte Homes projects in my district, a very bad situation where a number of carpenters, about 59 to 60 carpenters were hired on those projects, a number of them with questionable immigration status, by Pulte Homes through a subcontractor, Nunez Construction.

To make a long story short, Nunez Construction, after the project was completed, skipped town. I think they may have gone back to Brazil, leaving about 60 carpenters in my district without pay 3 weeks before Christmas. They are owed a total of about $150,000 in wages. I hate to lay this on you, it is not your doing, but I have a feeling that the original witness was changed because I was going to confront her with this dilemma that I have.

So, while it is not your matter, it is a reflection on the Mortgage Bankers Association, because she is the new Chair coming in. I have this, I am confronted with this, like I say, less than 3 weeks before Christmas, and I have all these folks owed a lot of money for wages and benefits. So that being what it is, I just want to put you on notice on that.

With respect to the Private Mortgage Market Investment Act, I do want to just reiterate my concern about the elimination of risk retention. I think that if we go to a standard where we have warranties and representation clauses as our insurance in this matter, we are going to end up with a system that creates very well-written representations and warranty clauses. We won't end up with

very well-constructed, asset-backed securities and mortgage-backed securities. That is my concern.

And the reason that these bad toxic securities, mortgage-backed securities, went viral was because the way they were constructed and the way we have the law, it allowed people to escape liability if they just pushed them out the door. Just get them out. It doesn't matter if they are exploding, just get them out the door. Once you get them out the door and they are in somebody else's hands and they blow up, it is okay. You make your money, you push the product out the door.

We can't go back to that type of system. That is the concern that I have. And I don't think that going to the representations and warranties standards, if you will, will cure that.

I think we do have some common interest in the definition or the standard, the rule being proposed for QRMs, the Qualified Residential Mortgage. I think a 20 percent downpayment is too high. We are going to squeeze a lot of people out of that market, and we have to figure out a better combination, a better set of standards that brings people back in the market, allows the private market to take a much, much, bigger role, and moves the GSEs out to a more historic level with their involvement.

But I think absent the elimination of risk retention, that is a bad idea. And we have to figure out a way to make sure people have skin in the game. Otherwise, we are going to go back to the bad old days.

But on this other matter of how do you get that exemption, what are the standards for a QRM that give you that exemption, we have to make that much more realistic, much more workable in terms of how we get there. I agree that a 20 percent downpayment is too high. I like the idea of an 80 percent loan-to-value ratio. I think that creates a buffer so that we are not going into a negative position if we have a little dip in the real estate valuation market. There has to be a better way to do that.

But Mr. Stevens, with respect to the risk retention argument, what are your proposals in terms of making sure that people do have that skin in the game going forward?

Mr. STEVENS. So, very briefly, given the time constraints, I would say this: If you go back—I have been in this industry for 30 years. We did 5 percent downpayment transactions back in the 1970s for owner-occupied, primary residence, fully documented, safe and sound, fully amortizing mortgages. You protect all of those provisions in the Dodd-Frank QRM rule, which we support.

When you throw in the downpayment provision, either 10 or 20 percent, all that ends ends up doing is drawing a line that will directly impact first-time homebuyers, borrowers of color in this country, just the way the demographics work, and it draws a barrier that doesn't necessarily reflect performance.

And the one variable I would ask everybody to look at is the Freddie Mac and Fannie Mae owner-occupied, 30-year fixed-rate, primary residence, fully documented mortgage portfolio. The cumulative default rate on that portfolio is still in the very low single digits. It is the other stuff, the neg ams, the piggybacks, the subprimes. Those products ended up creating these 20-plus percent

default rates, which Freddie Mac and Fannie Mae also bought in their portfolios.

You have done a great job, Members of Congress have, to create boundaries without drawing this arbitrary line in the sand that says 10 percent. So if you are a first-time homebuyer or you are a family without large inherited wealth, you are going to have to go to FHA, and we will have this separate but equal finance system as a result.

So I think what Congress did in Dodd-Frank was outstanding as it relates to QRMs. It is what ultimately came out in the proposed rule from the six regulators that we take significant issue with, because we think that creates barriers that are unnecessary in this housing society.

Mr. LYNCH. Thank you, Mr. Chairman. I yield back.

Mr. SCHWEIKERT. Thank you.

Ms. Hayworth?

Dr. HAYWORTH. Thank you, Mr. Chairman.

A question, and Mr. Stevens, I apologize if this is redundant, but regarding the alternative QRM proposal for a 10 percent downpayment being as bad or even worse than the 20 percent, can you just explain the negatives of that? It seems to be a little counterintuitive otherwise.

Mr. STEVENS. Sure. It is interesting, Dr. Poole actually made a very good point, which is we are designing very technical products through a political process, which makes this very complicated. But here is the essential premise: If you fully document a borrower for sustainability, the risk of default won't vary with a 5 percent downpayment, or a 10 or a 20 percent downpayment.

What happens is in the event something disrupts their lifestyle—job loss, etc.—your default risk then increases with a low downpayment because you don't have enough equity to get out of a home.

Those performance differences are actually fairly marginal. So if you look at actual performance with a 5 percent down loan or a 20 percent loan, protecting for all the other provisions in Dodd-Frank, you actually get pretty good performing loans in both categories. The reality is the private sector has always underwritten these loans.

So a 5 percent down loan, with mortgage insurance, has always had much tighter qualifying ratios required by the mortgage insurance companies, longer histories of job stability, higher credit score requirements, even sometimes restrictions on the type of property in order to ensure performance. Bigger downpayments get more flexibility. That is always handled on sort of a natural risk scale, the way underwriting has been done by the private sector.

What QRM does is put just an arbitrary line in the sand that everybody gets treated the same. It takes away this nuance that really makes the credit markets work in this country for housing finance.

Dr. HAYWORTH. Right. And what you are talking about fundamentally is bringing rational analytics back into the process, as opposed to a laudable but fiscally irresponsible, unfortunately, social goal which has ill-served our public.

Dr. Calabria, was it you in January who testified as a member of a panel about the mortgage marketplace crisis at that time, and

I think—was it you I asked a question about the contribution of the GSE debacle to our national unemployment rate? I think it was you who said it contributed about 1 percentage point because people were underwater and couldn't be mobile.

Mr. CALABRIA. There is a fair amount of literature that says the higher your homeownership rate, the higher your structural unemployment. And this has been looked at across the country, and this has been looked at across States.

And I want to emphasize it is not simply Freddie and Fannie. It is the broader array of things that we did to get higher homeownership rates and locks people in.

Dr. HAYWORTH. Absolutely. I appreciate your argument, Mr. Stevens. It makes sense, and it really reflects back into the risk retention piece as well. If we put the trust and the responsibility in the hands of those who are conferring the loan or are making the investment, we will have more sense and more opportunity ultimately. Is that something that, as a principle, the panel would accept, and any specific comments?

Mr. STEVENS. If I could, the one thing I would just caveat is what we have seen in this search for profit at any return without tested modeling, we have seen risks that occurred from the 2005, 2006, 2007, and 2008 books where a lot of new products that had been untested with models were passed into the system and rated at levels that were clearly not appropriate with the sustainability factor. I think what CoreLogic and other companies bring to the table is if we can get more data and more transparency, we will do it better, with a better ability to price and evaluate risk in the marketplace.

Dr. HAYWORTH. No question. And part of that is the ratings for government-backed securities were higher than was justified. Isn't that a big part of the problem as well, fundamentally?

Mr. CALABRIA. If I can make a point that I think is important to keep in mind—it doesn't matter whether it is the market, it doesn't matter whether it is government. We don't know ahead of time everything we think we know. For instance, I helped draft, with many people in the room, the American Dream Down Payment. We put lots of provisions in there where we thought we could give downpayment assistance and it would perform well. It did not perform well. Sometimes, you just learn these things after the fact.

My point here is that I do worry about having too much rigidity to the standards, because then you stick them in place, when you only later learn that they weren't really the right standards that you wanted anyhow. So there has to be flexibility in the system.

Dr. HAYWORTH. And you put unjustified faith in them, and that leads to a whole cavalcade of consequences.

I know my time has expired. Thank you, Mr. Chairman. Thank you, panel.

Mr. SCHWEIKERT. Mr. Miller?

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

One issue on which I have introduced legislation that is also an issue covered in Mr. Garrett's legislation is servicers of mortgages in securitized pools, the beneficial owners are Mr. Katopis' clients but not the servicer. But then the servicer is an affiliate of a bank that has second mortgages, second liens on the same property. And

that is an area that Mr. Garrett has said he would work with me on.

I have asked before a panel of servicers, what is the advantage, if any, of being affiliated with a bank that might have second mortgages on the same property? And they kind of drew a blank. I think they eventually said something like, "Some people like to deal with just one bank for servicing their first mortgage and their second mortgage and their credit cards and everything else," which did not seem like the most persuasive argument I have heard.

Mr. Katopis, do you see any necessary—anything that requires the servicers to be affiliates of banks? Is there any reason the servicers should not—that the banks should not be required to spin off their servicing affiliates?

Mr. KATOPIS. Thank you for that question, Congressman. I don't know if you heard my opening statement. I was lavishing praise on some of the Members. Certainly, you are at the top of the list for being thoughtful about private—

Mr. MILLER OF NORTH CAROLINA. You can repeat all that if you would like.

Mr. KATOPIS. You got that? But let me say that we appreciated your legislation, and I cannot see a reason why these conflicts should continue. In fact, to the degree Members care about modifications and other issues in the housing ecosystem, it does seem odd. I think it would be very worthwhile for this committee or GAO to look at the mod rates when a servicer owns both the first and the second, rather than otherwise.

So there are a number of conflicts. We think this is hurting private capital, it is hurting investors, and we appreciate yours and Chairman Garrett's interests in this issue.

Mr. MILLER OF NORTH CAROLINA. A second issue, one that Mr. Fleming talked about earlier in answer to questions, and it may have been covered in the opening statements as well, and also that Mr. Grimm discussed in his questions, is that the Garrett bill gives the FHFA pretty broad authority to develop servicing standards and loss mitigation procedures. But the FHFA has been reflexively against principal reductions to reduce loss, even in the face of studies that pretty clearly show, and Mr. Fleming said his analysis pretty clearly shows that there are many instances in which it would be far better; the loss would be far less if there was a principal modification, a principal reduction, rather than a foreclosure.

I have introduced legislation that is modeled on the former Mac procedures that provides standards and requires principal modification when a mortgage is in trouble.

Mr. Katopis or Mr. Fleming, have you looked at those standards? My understanding from the people I have talked to in Farm Credit is that they work fine. It is not a problem. It doesn't create moral hazards. People don't strategically—farmers don't strategically default. They only get modified if they truly are in trouble. Should there be some standard in the statute, or should it be given to the discretion of the FHFA? Mr. Katopis?

Mr. KATOPIS. Let me just start by saying that investors believe in a couple of things, including the truth and math. So to the degree that a writedown, a haircut, is a 30 percent loss versus a 60 percent loss, we favor principal reduction in our work with the

AGs. We have talked about principal reduction. I think it needs to be done correctly. We have to do it on a case-by-case basis. You have to look at the borrower's entire debt scenario.

So while we have not reviewed your legislation, I will go back to our members and look at it. It is part of a solution, from what you are describing, but it has to be done correctly and mindful of many facts: the right discount rate; the MPV modeling has to be transparent. There are a lot of issues that go into that kind of analysis.

Mr. FLEMING. I would just add, we have models and tools that do that math at the loan level, looking at the borrower's whole credit history, assessing their willingness, assessing their capacity, and using the net present-value testing framework where the user can change the dial so that it is very transparent to do all of that, to make those decisions, to come up with the conclusion that a foreclosure 2 years from now is going to cost me "X" in losses but a short sale is going to cost me "Y," and a principal modification or a principal reduction of this amount today will cost me "Z." And "Z" is the lowest number, so therefore we should do it.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Mr. SCHWEIKERT. Mrs. Maloney?

Mrs. MALONEY. Thank you so much, Mr. Chairman.

I would like to ask Mr. Salomone to follow up on what Mr. Lynch's question was with the contractors not being paid, the carpenters. In New York, you are required to have a performance bond that would cover this. I know it wasn't your company, but do you know if the company had a performance bond?

Mr. STEVENS. Yes, the Pulte situation I am well aware of with Mr. Lynch, and we have tried to facilitate conversations. The woman, by the way, was not scheduled to testify today at all. But nevertheless, the issue is something that we are aware of.

Mrs. MALONEY. But did they have a performance bond? That would cover it, wouldn't it?

Mr. STEVENS. Our member only runs a mortgage subsidiary. She is not on the board and did not work for the builder directly. This is a Pulte home builder issue in Massachusetts, as I understand it, and we are trying to facilitate as many conversations as we can between Congressman Lynch's office and the Pulte Company.

Mrs. MALONEY. Thanks. Listen, I want to go back to the whole risk retention deal and ask anyone on the panel who would like to comment on what would happen if it was totally repealed, if they repeal Section 941 without providing an alternative other than enhanced underwriting standards. It it would be just a narrow slice of the mortgage market.

What do you see as the consequences of eliminating risk retention across-the-board, and how would the consequences vary, or would they vary with asset types? Anyone?

Mr. POOLE. Let me jump in here very quickly. I am always in favor of reducing and getting rid of regulation, so I would support that.

Mrs. MALONEY. I would like to ask Mr. Salomone, do you support repealing 941?

Mr. SALOMONE. We don't really have a position. But if it does remain, we would be in favor of—

Mr. SCHWEIKERT. Could I beg of you to do me a favor? You might have to either turn the microphone on or pull it closer.

Mr. SALOMONE. I apologize. Like I said, we don't really have a position on that, but if it did remain, we would be in support of Senator Isakson's efforts around a Qualified Residential Mortgage exemption.

Mrs. MALONEY. Mr. Stevens?

Mr. STEVENS. This is a difficult subject. We believe actually what was approved in Dodd-Frank in Section 941 by Congress as it relates to protecting against—not requiring risk retention for certain loan features had merit. We think that the regulators went above and beyond what the legislation called for, and that is where the issues concern us directly about the availability of mortgage finance capital, particularly for first-time homebuyers and people who have less wealth in this country, and forcing them to an only solution being FHA or a government-sponsored program.

So we have not called for the elimination of 941. In fact, we helped work on the language in supporting from a technical standpoint many, many months ago.

Mrs. MALONEY. Dodd-Frank precluded from QRM loans risky characteristics such as balloon payments, negative amortization, and the like. And the Act leaves it to the discretion of the FHFA Director to decide. So how important are these loan features such as balloon payments, negative amortization, whether and how soon after origination the interest rate adjustments and prepayment penalties are in determining the default risk of loans? Are they important? Mr. Fleming?

Mr. FLEMING. Yes. The features have had a variety of different names associated with them, but the features of those loan terms certainly add risk. And I think one of the biggest realizations for those who do the modeling of credit risk in the mortgage space today is that the layering of those risks actually was one of the reasons for the surprises of the delinquency rates; that each one alone may not be particularly risky, but the combinations of them together became significantly risky.

There is a place and a time for many of these features in certain situations. For example, Alt A loans were a classic loan given to high-net-worth borrowers when they were first designed and originated, and it played a valuable role in the mortgage industry as a product. How they eventually became used is very different.

Mrs. MALONEY. Thank you. I would also like to ask about the exemption that is provided for certain mortgage-backed securities from the SEC registration and oversight; but it does not, the draft bill, replicate the SEC's investor protections. What are your comments on that? Are there any ways that they provide equivalent protections for investor protections? That is a serious thing to me, that they are repealing that requirement and yet not replacing it in any way. Is that not a concern, or is that a concern of the panelists?

Mr. FLEMING. I would yield to other panelists here today on those comments.

Mr. CALABRIA. While I think parts of Title I try to include provisions to replicate much of securities law, this is one reason why I do think that ultimately these provisions should be at the SEC.

But again I emphasize, I think having it at the FHFA for a number of years is a reasonable interim step to getting it to the SEC at some point.

Mrs. MALONEY. Okay, my time has expired. Thank you.

Chairman GARRETT. Thank you. And since I am back, I thank the panel.

So I understand one of the issues has been the risk retention aspect, and I guess there is maybe unanimity, just as we are trying to get some degree of unanimity with regard to the legislation as well, as far as standardization and the underwriting and also on securitization.

On this issue, it sounds to me from the testimony that maybe we have some sort of agreement on this as well. And that is to say that the risk retention piece that we currently have in current law of Dodd-Frank may not be the best way to provide for that assurance, and instead what we do here is by having specific and enforceable reps and warrants that you can replicate, if you will, that through this legislation. I think this may have been done, but since I wasn't here and I am the chairman, I can do it again.

I am going to run down the panel and just get your two cents on that piece.

Mr. KATOPIS. The two-cent answer is yes. The best skin in the game is reps and warranties, and I can elaborate.

Mr. CALABRIA. First of all, I would emphasize there was risk retention beforehand, so before this rule was ever put in place. The 5 percent is arbitrary. I think leaving it to the marketplace to determine the appropriate risk retention on a product-by-product basis is a far better way to go.

Mr. FLEMING. I would just add that monitoring, surveillance, dynamically updating the performance of the pools, basically bring market forces that can address some of the components of what risk retention is after.

Mr. STEVENS. We understand the desire to have safe and sound mortgage underwriting. That is the thing we have to correct for. Our concern about the current way the risk-retention rules are provided, both with the qualified mortgage that the concept of rebuttable presumption will actually eliminate access to mortgage finance in the private sector for those that we are trying to protect through this process, and in the Qualified Residential Mortgage, we think that rule goes too far in eliminating capital even further.

There is absolutely value in reps and warrants and repurchase risk, which institutions hold today, which is significant from a cost standpoint to institutions. There is a way to ultimately get to a safe and sound system without overregulating to a point where we eliminate access to capital for the consumers we are trying to protect.

Mr. SALOMONE. As I mentioned before, if it is repealed we are okay with it, but we really have no position on it. But if it does remain in Dodd-Frank, then we will continue to support Senator Isakson's efforts around the Qualified Residential Mortgage exemption.

Mr. POOLE. We need to distinguish between two different aspects of stabilizing the financial system. One is designing the instruments, and I have already said where I come out on that.

The second is the constraints on the institutions, and let them design the instruments that they think work best in their business environment and their own customer base. We need stiffer capital requirements and so forth on the institutions. If we can stabilize the institutions, if we can do away with "too-big-to-fail," we will solve most of the problems we have been talking about.

Chairman GARRETT. Thank you. Mr. Katopis, did you want to chime in for a second?

Mr. KATOPIS. Again, investors can price risk, but they can't price the unknown. So it is not just the reps and warranties, it is also having that information accurate at the issuance level through the life of the security, through the wind-down, and have it enforceable. I think it is an important tool, because it doesn't just help investors, but also our Main Street projects, whether it is CalPERS, the Carpenters Union. If people see there are defects in the mortgage pools and want to make sure there are returns for retirees, first responders, union people, then they have an extra tool to get back that skin in the game.

Chairman GARRETT. Thanks. And the gentlelady from New York said that this bill would do away with the investor protection elements, equity protection elements with regards to the SEC. I would suggest that is not the case, that this bill would replicate them in the legislation. I see somebody nodding their head.

Mr. CALABRIA. I would agree. I think you have added within Title I most of the provisions that would replicate the security protections.

Chairman GARRETT. So, right now you have them over at the SEC. This would put them in the same protections here.

Mr. STEVENS. I was going to say your bill clearly outlines standards for servicing and reporting, standards for modifications, standards for documentation. A lot of that is replicated.

Chairman GARRETT. Great. The last question is for you, Mr. Stevens. Can you expound on your comments in your testimony about the need to ensure a safe harbor with regard to the QM, and if the rebuttal presumption option is selected, could that basically have a chilling effect on the whole mortgage market?

Mr. STEVENS. Yes. I think the greatest challenge we have here with this particular rule on the qualified mortgage now is that without having a clear bright line that gives safe harbor to the industry, to the financial services industry to provide mortgage finance, we are going to see credit actually retreat even further from the private sector, leaving even more dependency on government programs such as FHA to fill that gap. There has to be a bright line in the QM rule for safe harbor. Rebuttable presumption will not be enough to get private capital back into those markets.

Chairman GARRETT. That is a very important point. I thank the entire panel.

Mr. Green is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witnesses for appearing.

Mr. Poole, you have made your position quite clear. You oppose any sort of government backstop; is this true? If you will kindly say yes, it would be appreciated.

Mr. POOLE. I do not favor a backstop in the form of Fannie Mae, Freddie Mac, and other such agencies.

Mr. GREEN. Excuse me, I am sorry, I misunderstood you. What type are you inclined to support?

Mr. POOLE. I believe that it is the responsibility of the Federal Reserve to maintain financial stability and liquid markets, and that should be a generalized responsibility, not market by market by market.

Mr. GREEN. I see. Mr. Stevens, it is my belief that you differ with Mr. Poole. Is that a fair statement?

Mr. STEVENS. That is correct.

Mr. GREEN. Can you kindly explain why you differ with him in terms of the role of the government, please?

Mr. STEVENS. The most simple way I can describe this is private capital is opportunistic. They will come into markets when they are strong, and they will exit markets when there is weakness. Our economy goes through cycles, and the role of the government backstop, outside of this enormous disruption that we just had over in the 2000 timeframe, has been to make sure that there is a continuous availability of mortgage capital in the United States for housing.

So to have that backstop there has been extremely important to the housing system of this country. Clearly not at the size it is today; it has to shrink dramatically, and we need to work on those provisions and bring private capital back in. But to eliminate it in its entirety we believe would be unnecessarily and actually extraordinarily disruptive to access to housing.

Mr. GREEN. What type of impact—and I will come to you in just a moment, sir—would it have on the product that would be made available if we do not have a role for the government?

Mr. STEVENS. This is a debate that goes on. I spent the first 20 years of my career working for a depository that held loans, did not sell them into the GSEs. We offered 30-year fixed-rate mortgages. We didn't lock the rate for the consumer until typically a day before closing, so they couldn't lock their interest rate in advance before buying a home. We obviously charged more for that product and required larger downpayments and prepayment penalties on those loans back in the day. The availability to have a fully prepayable 30-year fixed loan, while people may debate its merit over the last several decades when rates went from roughly 20 percent in 1980 to 4 percent today, may not have been as valuable as the period going forward when rates are going to 4 percent and rise over the next many years as the economy recovers. I think that is where the program may be actually more needed in this society.

So the question is, can you safely offer a 30-year fixed-rate, or a long-term interest-rate-lock mortgage for consumers without some sort of organized finance system behind it? And I believe that is actually at the crux of much of the debate today.

Mr. GREEN. Mr. Poole, out of fairness to you, I would like to give you an opportunity to respond, and then I will go to the others. But I would like to be fair to you.

Mr. POOLE. I think the issue is very simple here. Yes, it is not a viable product in the market to offer a 30-year mortgage with no prepayment penalties, because it is very symmetric against the

lender. So if you charge the appropriate fees and if the consumer is willing to pay those fees, the interest rate, then that product will exist in the market.

Mr. GREEN. I think you want to weigh in, Mr. Salomone?

Mr. SALOMONE. Yes, it is kind of fun sitting between these two. Specifically, I would say that the impact on consumers is going to be higher rates, larger downpayments, and less financing choices. And I would agree with Mr. Stevens in the comments he made as well.

Mr. GREEN. Hold on just a second, Mr. Poole. I am sorry. There was one other person who tried to get my attention. It seems that I have created a little bit of a concern here. Yes, sir, if you would?

Mr. CALABRIA. I appreciate your commitment. I want to parse out something that Mr. Stevens was talking about, which is the picture he painted was the markets come in, fine, everything is great. And then boom, we get some bad shocks, something bad happens, and the market falls apart, and you need a backstop there.

And I think what Dr. Poole is getting at: To what extent does the backstop help inflate the bubble to begin with? So if you have these backstops in place, particularly if they are there all the time, you run the risk of the bubble itself is higher, which means the bust itself is worse. So if you go to a system, as Dr. Poole suggested, where the Fed comes in, the Fed only comes in worst-case scenario, and they are not feeding the bubble. I think the very hard question to answer is, how do you structure a backstop that doesn't add to the craziness and frenzy of the bubble in the first place?

Mr. GREEN. Mr. Stevens?

Mr. STEVENS. The only thing I would say in the few seconds you can actually speak in this context, is that the bubble that was created from the 2001–2007 period was in many ways contributed to by the private markets initially, with subprime mortgages, stated income loans, option ARMs, etc.

The GSEs ultimately obviously participated in that, and that is because in the pursuit of shareholder value and the lack of oversight in terms of what they were able to do, had they been constrained to doing owner-occupied primary residence, 30-year fixed-rate loans—which was always in their tradition—there would have been much less fuel provided to the private capital markets to put these products in the market in the first place.

Mr. GREEN. I have to yield back the time I no longer have, but thank you very much, Mr. Chairman.

Chairman GARRETT. The gentleman yields back after a great discussion. The gentleman from California is recognized for 5 minutes.

Mr. SHERMAN. Yes, I think we have focused effectively on the history here. Real estate values were bid up to unsustainable rates by a new wave of effective demand. That is to say, not only could people who could afford to buy houses, buying houses; but people financed with subprime loans who were invited to overstate their income or not state their income at all, were invited to also bid on those homes. The prices went up and then the credit rating agencies said, since the prices are going up, nobody could possibly lose any money making these loans, because if somebody can't afford their mortgage, they will simply sell the property at a profit. Therefore, we are going to give Triple A to Alt A. And, here we are.

What we can't really allow in this economy is a sudden additional decline in the value of homes that will happen if some big piece of effective demand is removed.

I would like to ask Mr. Salomone if—I would assume that if the buyers are told they can't get 30-year fixed-rate mortgages, there will be a big chunk of demand that goes away.

Mr. SALOMONE. I am glad you got to the point of buyers, because we have been talking about a lot of things, but not the individual buyer out there. I have had the opportunity to sit across the table for 33 years from buyers and sellers. I think one of the things that is really important, and Ranking Member Waters talked about it earlier when she was discussing the whole concept of reduction in principal, is the confidence that our American people have in the housing market today or the lack thereof.

People today—I sit across from everyday people, and they want stability, they want security, and they want something that they know is going to be a constant, i.e., their mortgage payment. That 30-year fixed-rate mortgage is so important in this country right now, and I can't emphasize that enough. If that goes away, you are just—you think we have a problem now. If that 30-year fixed-rate mortgage goes away, we are going to be in a lot worse shape.

And if I may, Ranking Member Waters, one of the things that we obviously as REALTORS® care about is keeping homeowners in their homes. I think that one of the things that we haven't talked about today enough, or at all, is the confidence of the American people in the housing industry today.

One of the questions that individuals have is, someone loses a job, and they have a payment on a property that is now underwater, and you talked about principal reduction. It is so frustrating for that homeowner to call his or her bank, get no good conversation going and say, hey, if we can just reduce by this little bit—and it doesn't happen. And then, they find out that their house is sold in foreclosure for a third of what it would have been.

Now, I don't need to be a rocket scientist—and you can talk about all the data all day long—but those numbers just don't make sense. So I think you are going down the right path, Ranking Member Waters.

Mr. SHERMAN. My next question is for Mr. Stevens. If I understand you correctly, you think there are a lot of favorable provisions in the bill that we are discussing here, the current draft. Are there any concerns that you have, or what potential improvements would you suggest?

Mr. STEVENS. I actually believe that the chairman's bill is very thoughtful, and it is something that is interesting from an industry perspective, because it could theoretically create a pathway for private capital to engage in the market. If we are going to talk about getting private capital back in, we believe strongly that before we talk about moving the support much more from Freddie Mac, Fannie Mae, FHA, etc., we need to find a pathway to get private capital to reengage. And to that degree, we applaud the nature of this bill.

There are questions about the role of the FHFA; about some of the servicing standard provisions that we would love to give more thoughtful response to; about how the oversight isn't involved from

a regulatory standpoint. And I could parse through each of those. It would take too much time for this particular meeting, but I would be glad to give a follow-up with a more thorough review.

Mr. SHERMAN. I will end with the comment that a lot of us are concerned about the Federal deficit. Some are concerned about the role that government plays. But I would like to point out that if we see a decline, a further decline in real estate values that hits the economy hard, and which drives up the deficit, it will obviously reduce tax collections. But then, we should remember that, like it or not, we own Fannie and Freddie. We are the insurers of many trillions of dollars of mortgages, and a decline in real estate values could cost the Federal Government many hundreds of billions of dollars. With that I yield back.

Chairman GARRETT. The gentleman yields back. And that brings us to the conclusion of today's hearing. Again, as I said in the very beginning, I really do appreciate everyone who came out to the hearing today.

The Chair notes that some Members may have additional questions for the panel which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

Inasmuch as a number of you said you had additional insights into the weak sort of aspects to this legislation as we go forward, I would suggest if you haven't already—and I know a lot of you have—that you talk to our staff members, zip any of your ideas over to us, and we will be glad to take a look at them. And with that, this hearing is adjourned.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

A P P E N D I X

December 7, 2011

Testimony of Mark A. Calabria, Ph.D.

Director, Financial Regulation Studies, Cato Institute

Before the

Subcommittee on Capital Markets & Government Sponsored Enterprises

House Committee on Financial Services

On "H.R. _____, the Private Mortgage Market Investment Act, Part 2"

December 7, 2011

Mark A. Calabria, Ph.D. is Director of Financial Regulation Studies at the Cato Institute. Before joining Cato in 2009, he spent seven years as a member of the senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs. In that position, he handled issues related to housing, mortgage finance, economics, banking and insurance. Prior to his service on Capitol Hill, Calabria served as Deputy Assistant Secretary for Regulatory Affairs at the U.S. Department of Housing and Urban Development, and also held a variety of positions at Harvard University's Joint Center for Housing Studies, the National Association of Home Builders and the National Association of Realtors. He has also been a Research Associate with the U.S. Census Bureau's Center for Economic Studies. He holds a doctorate in economics from George Mason University.
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Chairman Garrett, Ranking Member Waters, and distinguished members of the Subcommittee, I thank you for the invitation to appear at today's important hearing. I am Mark Calabria, Director of Financial Regulation Studies at the Cato Institute, a nonprofit, non-partisan public policy research institute located here in Washington, DC. Before I begin my testimony, I would like to make clear that my comments are solely my own and do not represent any official positions of the Cato Institute. In addition, outside of my interest as a citizen, homeowner and taxpayer, I have no direct financial interest in the subject matter before the Committee today, nor do I represent any entities that do.

Need for Reform

It should be beyond dispute that our Nation's system of residential mortgage finance is badly broken. A few tweaks here and there will not suffice. Major structural reform is needed. Never again should the taxpayer be forced to pay tens of billions to bail-out the mortgage finance

industry. It is well worth remembering that the most recent bailout is not the first. The Savings and Loan crisis of the 1980s was essentially a taxpayer financed bail-out of the mortgage-finance and housing sectors. We cannot leave the taxpayer holding the bag the next time the housing market goes boom and bust, which it will. We have not ended either the business cycle or the related housing cycle. If anything our current system has made those booms and busts worse.

Rebuilding the Private Label Mortgage-Backed Securities Market

I commend the Chairman for his efforts constructing the "Private Mortgage Market Investment Act." While I believe we cannot completely replace our current system solely with private label securities, for instance returning to a structure based more on deposit-funded portfolio lending should be key to any reform, the draft legislation before the Committee represents an important step in the process. And while I would prefer to see quicker efforts to shrink and ultimately eliminate Fannie Mae and Freddie Mac, fostering alternatives in the interim is far better than doing nothing at all. We should bear in mind that as long as the heavy hand of subsidized government is tilting the scales, any private market solution will be hobbled.

My testimony will focus on the discussion draft before the Subcommittee. None of my comments should be construed as supporting any taxpayer guarantee of the mortgage market. Our ultimate objective should be a market where those taking risks bear both the up-side and down-side of those risks. Neither lenders nor borrowers should be able to keep gains while sticking the taxpayer with losses. If lenders or borrowers wish to have "insurance" against extreme market events, then they should purchase such insurance on the open market like any other good. In addition, any efforts to "standardize" the mortgage market should be temporary.

Ultimately the free and voluntary choices of market participants, and not the coercive force of government, should determine the structure of our mortgage market.

As the discussion draft was only recently circulated my comments should be viewed as preliminary and intended more to generate discussion and analysis than to settle any outstanding questions.

Title I – Standardization and Uniformity

Before making specific comments as to the legislative language in the draft, I believe the Subcommittee should bear in mind that it is possible to have too much standardization and uniformity. In fact one of the central flaws of our current system is the dominance of a particular model – government sponsored enterprise securitization. Dodd-Frank, particularly the Qualified Residential Mortgage construct, falls into this same mode of limiting consumer choice and innovation. One of the objectives of our federal mortgage policies should be to have a wide variety of options available to borrowers without unduly advantaging any particular product. No product choice should be either favored or disfavored by Washington. Of course the risks inherent in any particular mortgage product should be borne by the contracting parties and not the taxpayer.

The approach of Title I is that of standardizing mortgage pools by risk and then allowing those standardized pools to have an exemption from the registration requirements under the 1933 Securities Act. I believe this is a reasonable interim approach to moving towards a more private mortgage market. This is particularly important given the exemption of Fannie Mae and Freddie Mac debt/MBS from the registration requirements of the 1933 Act.

While I do question the expertise of the Federal Housing Finance Agency (FHFA) in the area of securities disclosure, I would ultimately move the responsibilities under Title I to the Securities and Exchange Commission, I again believe the structure of Title I and the involvement of FHFA is a reasonable interim step. Perhaps to insure that this is an interim step, the Subcommittee should consider including a reasonable sunset provision for FHFA authority in Title I. Something like five or six years should suffice. None of this should be taken to question the current performance of FHFA. Acting Director DeMarco has done an outstanding job given the complexities and pressures he has faced.

If Congress were to choose to either now or in the future move the authorities under Title I to the SEC, then such authorities should be broadened to include all asset-backed securities (ABS) and not simply mortgage-backed securities. One of the problems of the approach in the discussion draft, and likely an unavoidable one presently, is the continued "special" treatment of mortgages as an asset class. Ultimately the MBS market should look a lot more like the rest of ABS market. I will remind the Subcommittee that although auto loans and credit cards, for instance, both have default rates that rival mortgages, neither of these loan types, both of which are heavily securitized, were behind the financial crisis.

I have some concerns as to the competitive effects of Section 101(f) which directs FHFA to set standards for "qualified sponsors" of mortgage securitization. In addition to questioning FHFA's ability to gauge the quality of different sponsors, the most likely impact of 101(f) would be to reduce the number of sponsors with little overall impact on mortgage quality. As long as the identity of the sponsor is attached to the pool I believe that should be sufficient for market participants to distinguish, and price, across sponsors. I would suggest Section 101(f) be deleted from the draft. I make this suggestion with full appreciation of the provisions of Section

101(f)(3) on review and revocation of qualified status, which are in part indeed to reduce the extent to which 101(f) would act as a barrier to entry.

One of the more important portions of Title I is the repeal of the credit risk retention provisions of Dodd-Frank, contained in Section 102 of the discussion draft. I believe this is one of the more crucial provisions of the draft and strongly encourage its inclusion. Like all too many provisions of Dodd-Frank the risk retention requirements were based upon a false premise, that various market participants did not retain sufficient risk. The truth is much different. For instance the bulk of losses to Fannie Mae and Freddie Mac are from their credit guarantees of their MBS. If Fannie Mae and Freddie Mac had not retained that credit risk, and it instead flowed to the holder of the MBS, the taxpayer, and the economy, would be far better off today. The same holds with the various off-balance sheet entities used by the largest commercial and investment banks. The primary problem with these special investment vehicles was that the sponsoring bank ***did*** retain the risk, rather than truly transferring it. To summarize, one of the problems of our existing securitization model is that too often it allows for securitization without the actual transfer of risk. The appearance of securitization without the substance. Risk becomes far harder to manage in our financial system when it is pieced out to various parties rather than held by a single responsible party. If the Dodd-Frank risk retention provisions are kept, we will end up creating a "tragedy of the commons" in the context of credit risk.

Sections 104, 105, 106, 107 and 108 appear to be reasonable reproductions of securities law provisions that would be in place had Title I been placed under the authority of the SEC rather than FHFA. Along with the remainder of Title I, I would suggest these provisions have a sunset at which time Congress can consider whether such authorities should transfer to the SEC.

Title II – Transparency

While disclosure if often a good thing, it is possible to have too much of a good thing. In order to minimize disruptions to the mortgage market and to allow some room for experimentation, I suggest that all the provisions of Title II be limited to exempted securities as defined under Section 101(b)(4) of the discussion draft. If instead the exemption for qualified securities in Section 201(c) is retained, then I would suggest deleting Section 201. What information is made available to market participants for "non-qualified" securities should be driven by market conventions and not by statute.

Title III – Ensuring the Rule of Law

Regarding Section 301, it is not clear from the draft whether these provisions would apply to 1) all existing mortgages, 2) any new mortgage, or 3) mortgages in exempted securities as defined in Section 101(b)(4) of the discussion draft. The language suggests to me that these provisions would cover all existing and future residential mortgages. While the presence of a second lien is undoubtedly a risk factor, Sections 301(a) and 301(b) would re-write existing contracts, something which I believe is always and everywhere harmful and destructive to trust in our markets. It should not matter whether such a "re-writing" benefits/harms the borrower or the lender. I do not see the role of Congress as either remedying flaws in existing contracts, which should be left to the Courts, or simply changing the terms of an agreed-upon contract to benefit one party over another. Section 301(a) reads as little more than a forced transfer from borrowers to servicers. Accordingly, I urge the Subcommittee to **delete** Sections 301(a) and 301(b) or to at least limit its application to future mortgages covered in Section 101(b)(4).

Again recognizing that the securing of a junior lien will generally increase the default risk of a senior lien, how that risk is handled should be left to negotiation by the contracting parties. Current law (I believe it is within the Garn-St.Germain Depository Institutions Act of 1982), which prohibits the exercise of due-on-sale clauses in residential mortgages, should be repealed so that borrowers and lenders are free to address this issue without having a solution forced upon them.

To the extent that Section 301(c) prohibiting forced principal reductions is intended to respect existing contracts and limit the ability of regulators to coerce modifications, I believe that section should remain. Language could be added allowing principal writedowns where both the lender and the borrower agree and there is no involvement of the regulators. It is vital to the integrity of our regulatory system that our financial regulators behave in a manner that is neutral and arms-length. It should not the role of either Congress or our regulators to pick sides in private disputes.

Regarding Section 302, there have clearly been substantial conflicts of interests when servicers of a senior lien themselves are holders of a junior lien, however a blanket prohibition on future junior interests by mortgage servicers I believe is much too broad. There may well be situations where a junior interest, held by the servicer, is beneficial to the junior and senior lien-holders, as well as the borrower. At a minimum Section 302 should be limited to mortgages covered by Section 101(b)(4).

Section 303 is a reasonable approach to both protecting the consumer and providing a degree of legal certainty to originators. Section 303 should be retained largely as is. Ultimately I suggest the repeal of the entire Qualified Mortgage construct of Dodd-Frank. A re-working of

the Truth-In-Lending Law, as badly needed as that is, however likely remains beyond the scope of the discussion draft.

An exception I would make to re-visiting TILA-HOEPA at a later date is the Federal Reserve's 2008 changes to HOEPA. Besides having little, if any basis, in statute (I recognize that has rarely stopped the Federal Reserve), the 2008 definitions of "higher cost" mortgage mean with today's interest rates any mortgage over 5.5%, quite low by historical standards, is considered higher costs. Given both the reputational and legal risks that come with higher costs mortgages, I believe the 2008 HOEPA changes have contributed to a drastic reduction in mortgage availability to higher risk borrowers. In 2005, 22 percent of the market was "higher-cost" according to HMDA data. By 2010 that share had fallen to 2.4 percent. Yes the housing bubble and credit crisis would have shrunk that market, but by almost 90 percent? And yes, many of those loans we do not want to come back, but many we do. At a minimum I would urge Congress to investigate the effect of the 2008 HOEPA changes on mortgage availability. A preferred approach would be to repeal those changes.

Role of the Rating Agencies - Repeal Dodd-Frank Section 939G

As much as I wish to see our capital markets less reliant on the credit rating agencies, it is difficult for me to envision in the current environment a vibrant private label MBS market without the use of rating agencies. As the Subcommittee is well aware Dodd-Frank's Section 939G has already had a tremendous negative impact on our capital markets, so much so that the SEC has effectively voided the provision. This Section, 939G, repeals SEC rule 436(g), which had exempted NRSROs from being deemed part of a security's registration statement. Rule 436(g) had protected NRSROs from liability under Section 11 of the 1933 Securities Act. This

protection actually increased the flow and quality of information received by investors by encouraging the use of ratings in offering statements. Dodd-Frank's repeal of Rule 436(g) effectively shut down the new offerings market for asset-backed securities and corporate debt. It was only the issuance of a "no-action" letter from the SEC to Ford Motor Credit Company that allowed this market to function. However this no-action letter is temporary in effect leaving considerable uncertainty as to how our debt markets will function in the absence of Rule 436(g), at least until such time the markets evolve beyond the regular use of credit ratings. In order to encourage a vibrant private label MBS market, Congress should consider not only repeal of Section 939G but also placing the original exemptions contained in rule 436(g) into statute. While of lesser importance the Committee should also consider repeal of Dodd-Frank's Section 939B, the ban of the rating agency exemption from Regulation FD, covering "fair disclosure".

Conclusions

Again I commend the Chairman for his efforts and thank all members of the Subcommittee for their attention and consideration of my remarks. Quite frankly there should be no higher priority for this Subcommittee than the reform of our broken mortgage finance system. Continued delay adds to market uncertainty and hobbles the development of private market solutions. Delay also adds to the increasing taxpayer cost of bailing out our mortgage finance system. Whether in concern with other needed reforms, or alone, the discussion draft circulated by the Chair merits consideration. Thank you and I look forward to your comments and questions.

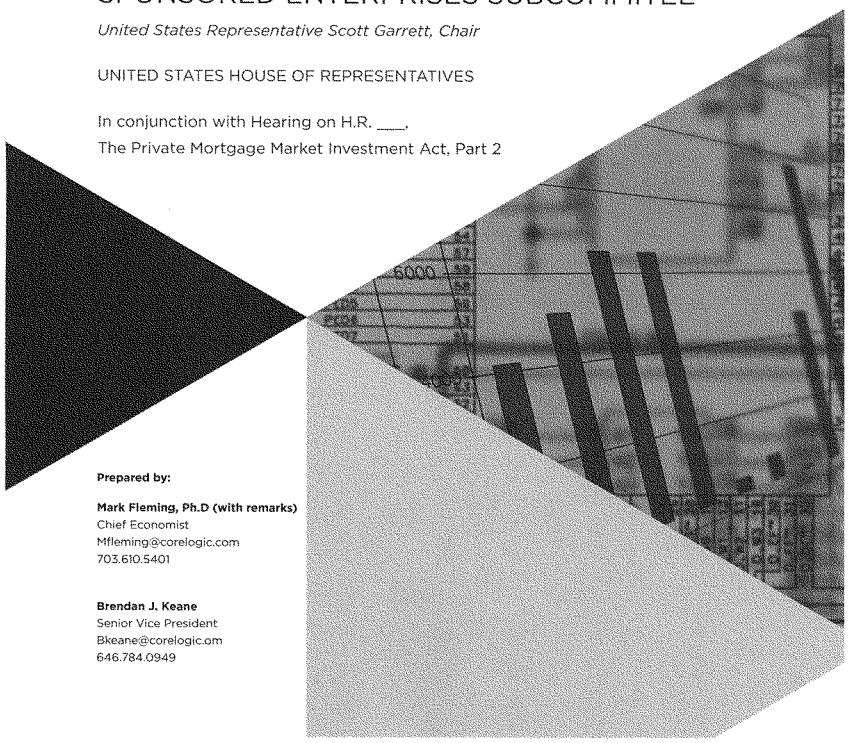
December 7, 2011

TESTIMONY TO
THE COMMITTEE ON FINANCIAL SERVICES
CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES SUBCOMMITEE

United States Representative Scott Garrett, Chair

UNITED STATES HOUSE OF REPRESENTATIVES

In conjunction with Hearing on H.R. ____,
The Private Mortgage Market Investment Act, Part 2



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INTRODUCTION & OVERVIEW

Chairman Garrett, Ranking Member Waters, distinguished members of the Subcommittee on Capital Markets and Government Sponsored Enterprises: CoreLogic appreciates the opportunity to submit this testimony regarding Congressman Garrett's proposed bill addressing our country's residential mortgage securitization market, the *Private Mortgage Market Investment Act (PMMIA)*.

CoreLogic is a leading global provider of consumer, financial, and property information, analytics and services to business and government. Our company combines public, contributory, and proprietary data to develop predictive decision analytics and provide business services that bring insights to our customers in the residential mortgage origination and servicing markets as well as other private sector institutions and government. We support residential mortgage trading, securitization, and investing through a variety of loan and securities performance databases, reporting, analytics, and advisory services.[1]

CoreLogic supports the return of robust loan origination, servicing, trading, and securitization markets for the over one million users that rely on CoreLogic to assess risk, support underwriting, make investment and marketing decisions, prevent fraud, and improve their business performance. Many of our customers have been severely hurt by the lack of liquidity that has pervaded the non-agency residential mortgage backed securities market for several years.

Below we highlight some of the challenges now facing the U.S. housing market and review specific provisions in the discussion draft of the bill. We are hoping that this legislation will align the many consumer, lender, investor, and regulatory interests that collectively can lead a recovery of the securitization market. Clearly, something must be done to alleviate the extraordinary pain that has been inflicted across the U.S. housing sector. We believe that investment of private capital through the return of rational mortgage securitization can play a significant role.

I. U.S. Housing Market Issues Continue

U.S. economic growth remains fragile but positive. Most economists believe the risk of a double-dip recession has faded from the heights reached this past summer. While the economy seems to have avoided stalling all together, growth is not yet strong enough to drive job growth and reduce unemployment substantially. Private sector jobs are being created but fiscally constrained state and local governments are shrinking their labor forces. Additionally, participation in the labor market is falling as job seekers give up, one of the main reasons for this November's decline in the unemployment rate. Recovering from the economic recession ignited by the financial crisis is proving to be very challenging.

Because of excess capacity in the labor market, income growth will struggle for some time, yet it is hard to see house prices rising in the long run without income growth driving it. The housing market is beset by headwinds. Specifically, the persistence of negative equity and the shadow inventory are likely to drag down any gains in housing for a number of years to come. The shadow inventory is currently 1.6 million units--five months' supply--down 16% from a year ago, primarily due to the declining rate of serious delinquencies. The distressed assets in the inventory will take some time to move through disposition. Almost half the shadow inventory is delinquent but not yet foreclosed and the foreclosure process and timeline can vary dramatically from state to state. For example, while California and Florida have shared similar home price appreciation and depreciation paths over the past 10 years, California, a non-judicial foreclosure state, and Florida, a judicial foreclosure state, are having very different experiences with their stock of distressed assets. The California foreclosure inventory is currently 2.5% of all active loans, down 18% from a year ago--12 months' supply given the prevailing pace of REO sales in California. The Florida foreclosure inventory is currently 12% of all active loans, unchanged from a year ago--61 months' supply given the prevailing pace of REO sales in Florida. The housing market benefits in the short run from the slow pace of asset disposition, but in the long run the impact of continuing distressed asset sale discounts will be a persistent negative influence.

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1 CoreLogic, Inc. (NYSE: CLGX; www.corelogic.com). Our information resources include:

- Property-specific data covering approximately 99% of U.S. residential properties;
- Over 93 million mortgage applications;
- 87% of mortgage loan servicing performance information;
- 97% of loan-level, non-agency mortgage-backed securities;
- Over 700 million historical (real property and mortgage) transaction records;
- We believe we own the nation's largest contributory mortgage fraud database; and
- More than 88% of the nation's property parcels digitally mapped.

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Negative equity--22% of all mortgage households in Q3; 10.7 million households--is down from 23% in Q2 but its decline is primarily due to foreclosures rather than house price gains. More than 6 million underwater borrowers have no junior liens, a sign of less leveraging behavior on the part of borrowers. More than half of all underwater households are in only five states (Nevada, Arizona, Florida, Michigan, or Georgia). At the current rate of decline, negative equity will persist and remain a market factor for years to come, with average underwater borrowers taking more than 10 years in some markets to regain positive equity. Furthermore--22 million households--approaching half of all mortgage households, have either insufficient or negative equity (defined as greater than 80% current CLTV) and many are paying above-market interest rates. The availability of credit to these individuals is limited both by insufficient equity and by the smaller set of mortgage financing providers. Apart from the GSE's and FHA, very little mortgage lending is now being done. If borrowers do not fit GSE or FHA underwriting criteria, they are unlikely to receive reasonably priced financing. Restricted access to credit perpetuates the significant risk of future default and curtails current consumption.

While most analyses of HARP2 suggest it will facilitate between one million and two million additional refinancing opportunities over the next two years that otherwise would not occur (and provide discretionary income for borrowers), the program will not significantly reduce negative equity or help those already in distress. Instead, it will facilitate consumption expenditures that will be welcomed by industries associated with mortgage originations and local economies where incremental consumption occurs.

Housing is a durable good and therefore purchase decisions can be timed and substitution products found (rental housing), with decisions strongly influenced by sentiment. Demand is low for all the reasons stated above and because of deflationary expectations and a lack of economic certainty. House prices are declining again, down 3.9% year-over-year as of this October. Excluding distressed, REO and short sales, prices are only down 0.5% year-over-year as of October. But the non-distressed segment of the housing market is fairing much better than the distressed segment. Overall, prices are not expected to return to positive year-over-year growth rates until 2013.

No one single policy or prescription can heal the housing market. Economic certainty, job security in particular, is critical to the future success of the housing market. While principal reductions can quickly reduce negative equity, doing so increases moral hazard risk—as recognized by Congressman Garrett's bill leaving that option to the private sector and not permitting regulators to force mortgage principal write-downs. However, other efforts can play significant roles. Standardizing foreclosure processes would improve servicer efficiency, speed up distressed asset resolution, reduce shadow inventory, and provide greater certainty and benefit to investors and borrowers. In addition, regulation promoting consistent loan underwriting, standardization of legal documentation, and transparency is critical to the future allocation of capital to efficiently finance mortgage assets.

II. Enhancing Private Solutions to Address Public Issues: The Need for the Return of Private-Label Mortgage-Backed Securitization

Alleviating the housing crisis and revitalizing the market will require a series of integrated solutions across origination, servicing, and risk management programs for residential mortgages. As a result, over the last several years, market participants have offered best practice and regulatory solutions to resolve the current predicament and enable a liquid, functioning market for newly originated mortgages, but with limited success. In our view, what has been missing so far is what PMMIA identifies as crucial: uniformity of underwriting standards and securitized assets, standardization of securitization processes, and granular, loan-level understanding of the credit risks associated with whole loan portfolios and residential mortgage-backed securitizations (RMBS).

We believe unequivocally that securitization is critical to the U.S. economy, as it can efficiently allocate private capital. This is true whether the assets securitized are consumer-based (credit cards, student loans, auto loans, et al.), commercial in nature (e.g., equipment leases, small business loans), or real estate-based. However, there is no market that needs this financial solution more than the residential mortgage market. The importance of private capital to the RMBS market cannot be overstated—we have witnessed the impact of disruption in mortgage credit available to the consumer and the continued pressure it brings to bear on the housing market. We feel strongly that the illiquidity of the new-issue, private-label RMBS market is a significant reason for the difficult economic and housing situation confronting our country today.

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III. Promoting Transparency Through PMMIA: Encouraging Private Solutions Available Today

The return of private capital to the residential mortgage market hinges on the return of liquidity—the free flowing exchange of financial resources between RMBS issuers and investors. Liquidity, in turn, depends on at least four elements:

- *Trust* in what is being offered;
- *Understanding* of what the product or investment contains;
- *Sufficient information* to enable agreement on a risk-adjusted price; and
- *Monitoring* of the investment or purchase

Fortunately, commercial solutions are readily available today that can facilitate each of the above requirements, corresponding to the ultimate goals of standardization and transparency as outlined in Congressman Garrett's legislation.

Prior to the collapse of our privately-financed real estate system, one of the greatest failures (particularly with sub-prime and "Alt. A" securities) was the mistaken belief that an upfront outlay for loan diligence was not worth the cost; that an ever-rising house price market would offset any deficiencies in the loan underwriting process.

Clearly, that approach did not work. It has already resulted in billions of dollars in securities losses and is a major cause of low investor confidence. Re-establishing market conviction is crucial and can be achieved only if investors are empowered with the necessary data and analytics to measure credit risk and perform due diligence--trust but verify. Consequently, we support Congressman Garrett's call for disclosure of "pertinent" loan-level information like borrower income and credit scores (with appropriate privacy safeguards) as well as property valuations.

IV. Empowering and Enabling Investors Through Life-of-Loan Transparency

Though it will apparently take federal legislation to push the private label market toward greater transparency, we are convinced that market participants can independently follow PMMIA's proposed directives in crafting cost-efficient strategies that employ currently available data and analytics. In fact, we have already witnessed a return to basic risk management approaches that include:

- Property valuations through the use of automated valuation models (AVM's) and comprehensive Home Price Indices (HPI)
- Assessments of borrower willingness and capacity to pay through comprehensive, scientifically-based scoring techniques
- Measurements of security performance trends by modeling loan-level expected cash flows supporting RMBS transactions, rather than pool level approaches that proved outdated and inaccurate
- Forensic reviews of representations and warranties in whole loan sales and RMBS transactions—retrospectively identifying potential breaches, particularly with respect to significant credit factors such as occupancy and loan-to-value (LTV)[2].

We are encouraged by those investors who are engaging in this "new diligence" approach to whole loan and securities investing. Data, analytics, and advisory service providers are delivering continuously refreshed information on an expedited basis to investors, residential mortgage originators and servicers who are actively deploying these tools before and after the closing of a loan. In addition to improving credit risk management, this can positively impact financial reporting, as balance sheet and income statements can accurately reflect the credit status and expected performance of loans and securities.

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2 For a discussion of these and related trends, see "Navigating the New Secondary Residential Mortgage Market," (CoreLogic May 2011 Whitepaper), available at corelogic.com.

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The securitization industry will directly benefit as investors and rating agencies employ this updated information to execute more accurate valuation and pricing assessments. The savings from active surveillance of securities at the loan level--and the understanding of bond cash flows that result--can be significant.[3] Advances in modeling, computer, and analytical power have made such benefits far more tangible, realizable and economically efficient today than they were at the start of the RMBS crisis just a few years ago.

Indeed, had RMBS transaction participants employed even a few of the then-available diligence tools at the time of securitization, we believe substantial losses could have been avoided. For example, a recent study examining the non-agency RMBS market suggested that nearly 45% of loans in a benchmark sub-prime securities index (consisting of 20 transactions containing over 150,000 loans) overstated property values by at least 10%. Further, nearly 30% of properties listed as owner-occupied demonstrated potentially inconsistent representations. The study concluded that credit losses were higher on loans with likely deficiencies than those without.[4]

Data and analytics providers to the securitization industry are more actively making comprehensive information available than ever before. These analytics can uncover deficiencies at the time of origination or securitization, as well as during the life of a loan and the security within which it resides. With gains in technology and the incorporation of scientifically validated methodologies, security holders can now, in seconds, more accurately gauge the estimated, cumulative LTV of a mortgage in an RMBS pool through automated valuation and tools that aggregate all outstanding liens associated with the subject property.

These assessments provide investors with powerful, loan-level, risk management insight that offers sure guidance to independent pricing decisions for RMBS bonds. This comprehensive information can help define the standard underwriting criteria as outlined in PMMIA, as well as drive private-market credit risk scaling, without undermining the legislation's intent.

V. RMBS Issuers: Private Market Incentives Align with Transparency Needs of Investors

As currently drafted, PMMIA recognizes that issuer risk retention provisions (such as the 5% threshold under the Dodd-Frank Act) may make private-label securitization uneconomic. On the other hand, many market participants want issuers of private-label RMBS to have "skin in the game", ensuring that loans supporting securities have been prudently underwritten.

We would hope that a consensus solution can be reached that incorporates the positive impact that data and analytics can contribute. Indeed, the power of the data sets currently available to all market participants has increased the importance of issuer-provided representations and warranties in RMBS offering documents and agreements. That third parties and investors can now easily, affordably, and independently assess the accuracy of issuer-provided information ensures issuer "reps and warrants" have more teeth because they can be more actively monitored and enforced. This, in turn, forces RMBS issuers to have more skin in the game as the risk of deficient loans and securities being "put back" to them increases.

The ongoing pricing power of the marketplace can also force issuers to have more of their own capital tied to the performance of RMBS transactions they issue. Investors who employ dynamic diligence and surveillance will quickly recognize shortcomings in an RMBS issuer's disclosures of what is contained in the underlying loan portfolio, affirming the elements of truth and understanding through sufficient information and monitoring as highlighted above. Consequently, those investors can drive up the interest rates paid by issuers, impacting that issuer over the life of the transaction and subsequent deals they offer to the market.

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3 See "How Loan-Level Insight Can Lead the Way to Resolving the RMBS Crisis," *The Journal of Structured Finance*, (Brendan J. Keane, Fall 2011, Vol. 17, No.3), available at www.iijsf.com.

4 CoreLogic Case Study, January 2011; as updated with data through June 30, 2011 (unpublished) and referenced in *The Journal of Structured Finance* (Keane, Fall 2011, Vol. 17, No.3) www.iijsf.com.

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VI. Private Solutions for What Continues to be a Public Problem

We believe that the tools necessary to assess, measure and execute transactions based on residential mortgage risk are abundantly available today throughout the industry. We further believe that that the lessons learned from the recent crisis will resonate for years to come, with cautious investors determining what information they will require to make investment decisions. To restore a truly private RMBS marketplace, laws and regulations should act as guideposts for standardization, uniformity and legal clarity, while leaving decision makers free to choose from market-created risk alternatives and privately-available sources of information to make their own informed investments.

The development of new and improved data and analytics tools to provide that information has come through significant private enterprise investment. Having improved through multiple generations, these tools maximize public domain availability, granular transparency, comprehensive data depth, and cost-efficient availability. Similar governmental initiatives introduced now or in the future would be unnecessarily burdensome and redundant, directing resources away from rapidly advancing private enterprise risk management efforts to improve transparency across the RMBS and capital markets. We support Congressman Garrett's PMMIA as currently proposed--and subsequently refined--to the extent that it does not call for any such additional governmental action.

CONCLUSION

Along with other stakeholders in the residential mortgage and securitization markets, CoreLogic is thankful to Congressman Garrett for his efforts in promoting rational securitization practices through his introduction of the Private Mortgage Market Investment Act. As a provider of the transparency-based information that PMMIA calls for, we are encouraged by the recognition of how data and analytics can help lead the way toward the restoration of a liquid residential mortgage-backed securities market, one driven by the investment and ingenuity of private enterprise to resolve public challenges such as those facing our country's residential mortgage finance system.

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WRITTEN STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
FINANCIAL SERVICES SUBCOMMITTEE ON
CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

THE PRIVATE MORTGAGE MARKET INVESTMENT ACT

DECEMEMBER 7, 2011

by CHRIS J. KATOPIS.
EXECUTIVE DIRECTOR

Introduction

Chairman Garrett, Ranking Member Waters, and distinguished members of the Subcommittee, thank you for the opportunity for the Association of Mortgage Investors (AMI) to testify today. Our comments will focus on issues and concepts relating to the present draft legislative proposal, the "Private Mortgage Market Investment Act," and how its provisions impact the critically important topic of returning private capital to the U.S. mortgage market and restoring our markets.

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. Facilitating future investor demand in the mortgage market will require addressing a number of current market problems which are presently obstacles for private capital returning to the securitization space. As AMI has previously testified, the current mortgage investors suffer from a number of problems in the securitization space including:

- Market opacity, an asymmetry of information, and a thorough lack of transparency;
- 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; and,
- Investors lack effective legal remedies for violations of RMBS contractual obligations and other rights arising under state and federal law.

Accordingly, we commend Chairman Garrett and your colleagues for acknowledging these issues facing investors and our public institution partners and your efforts toward developing a solution. While we do not presently take an association position on the current draft, this proposal is an important step

forward and fosters a healthy discussion of key issues and concepts. In light of the following testimony regarding problems obstructing the reemergence of private capital returning to the U.S. mortgage market, we would like to work with you and your colleagues in perfecting the legislation as it moves forward.

I. Background

The AMI was formed to become the primary trade association representing investors in mortgage-backed securities (MBS), along with life insurance companies, state pension and retirement systems, university endowments, and pension funds. It has developed a set of policy priorities that we believe can contribute to achieving this goal. It 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) the bank balance sheets- which are arguably stressed and by themselves are not enough to support a mortgage market of the size that U.S. homeowners have come to rely on; (2) the government (Fannie Mae, Freddie Mac, FHA); and, finally, (3) securitization, which is effectively shutdown 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).[1] Of the $1.1 trillion outstanding second mortgages, only 3.7% of the total (or $41 billion) is held by private investors in securitized form. The remaining $1.2 trillion in first lien mortgages reside in

[1] Observers note that while PLS represents approximately 12.8 percent of the first lien market, they represent 40% of the loans that are currently 60+ days delinquent.

private label mortgage-backed securities (MBS). AMI's members hold a significant proportion of these investments; AMI members have approximately $300 billion of assets under management.

Investors seek the government's development of enhanced structures, standards, and safeguards. 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 the foreclosure crisis.

Mortgage investors share your frustration with the slow restoration of the housing market, relief for homeowners, and finally offering the capital markets and homeowners that are truly in need meaningful and permanent relief. 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.[2] 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.

[2] The exceptions are three recent securitizations by Redwood Trust.

a. The Role of Mortgage Investors in the Marketplace

Mortgage investors, through securitization, have for decades contributed to the affordability of housing, making credit more inexpensive, and making other benefits available to consumers. Today, however, mortgage investors face enormous challenges in the capital markets due to opacity, an asymmetry of information, poor underwriting, conflicts-of -interests 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, investors, average Americans, and the U.S. economy at-large are harmed.

b. The History and Rise of MBS Securitization

It is important to note that securitization as a mortgage finance tool has been instrumental in reducing housing costs and helping citizens achieve the American dream of homeownership. In the 1970s, the mortgage finance industry was in its infancy. In fact, then the market consisted solely of two products – those backed by Ginnie Mae and Freddie Mac. The advent of the mortgage-backed securities market resulted in de-regionalizing or nationalizing real estate investment risk, increasing liquidity to mortgage originators, and lowering barriers to home ownership. Securitization was a key factor in improving regional real estate markets. New York State is a case in point. In the 1970s, most New York depositories were flush with cash but had a hard interest rate limit on mortgages. The result was a flow of California mortgages to New York and a flow of dollars to California. New York was an unattractive and non-competitive local market. With securitization, the New York market, as well as other markets became national markets; and hence, mortgage funds were more readily available. Since the 1970s, mortgage-backed securities have increased lending levels, with even state housing agencies benefiting

from the mortgage-backed securities' structuring techniques. The benefits of securitization are widely known.[3]

II. 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 in their homes and rebuilding and maintaining a vibrant real estate market. 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 and cheaper capital to originators, which allows them to issue more loans to additional qualified borrowers. The use of mortgage-backed securities equitably distributes risk in the mortgage finance industry, and prevents a build-up of specific geographic risk. 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 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 of interest payments on second lien debt if the first lien is in default, prohibitions on the second lien debt above a specified loan-to-value (LTV).

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[3] *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).

Those "private label" (non-Federal agency) securities are put together by a variety of entities (*e.g.,* investment banks) that pool the mortgages into a trust. The trust is built around a document called a Pooling and Servicing Agreement (PSA) that provides investors the rights and protections relating to the mortgages that make up the securitization and the terms and duties that are owed to the investors by the trustee of the security and the servicer of the individual mortgages. Within this Agreement, numerous representations and warranties exist regarding the quality of the mortgages that are included in the trust and the lending practices that were followed in the mortgage origination process. It is important to note that, historically, investment in these mortgage products have been attractive, in part, because they are governed by binding contracts that lend the stability and to the predictability investors desire. Like any purchaser, investors expected the sellers of mortgage securities (which were often large banks) to stand behind their promises. Similarly, the GSEs, the Federal Reserve Bank of New York, and others confront the same challenges. Unfortunately, this critical component of mortgage securities market has broken down, harming mortgage investors including state pension and retirement systems.

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.

a. Problems Arising from Improper Servicing

As Congress reviews this area and considers solutions for enhancing securitization, it may wish to review solutions across all asset classes. We wish to highlight that the housing space and MBS have been devastated by the practices and events of the last few years. Accordingly, we urge lawmakers that it is necessary to treat MBS separately from other asset classes in an effort to restore the U.S. housing sector and help American families pursue home ownership. The problems impacting investors by the malfeasance of servicers and their affiliates are numerous. We wish to highlight the following points:

- **Many Servicers are Conflicted; They May not be Servicing Mortgages Properly.** Very often they are harming the interests of both investors' and homeowners' interests. This has a negative impact on private investor demand for mortgages and limits housing opportunities;[4]

- **Originators and Issuers May not be Honoring their Contractual Representations** about what they sold into securitizations. The past is prologue and there are no assurances that they will not repeat these practices in the future; and,

- **The Market in General Lacks Sufficient Tools for First Lien Mortgage Holders**, such as: recourse to the homeowner on a uniform, national basis (to avoid strategic defaults) and efficient ways to dismiss the 2nd lien (to allow for more effective workouts with the homeowner on the first lien).

[4] An example of this conflict is as follows. Consider the case when the servicer and the master servicer are the same entity. In such a case, a lack of effective oversight exists when the enforcement entity is owned by the same parent as the servicer. For example, in certain deals the Master Servicer has "default oversight" over the servicer therefore certain loss mitigation cannot be accomplished. Hence certain critics observe that when both are owned by the same parent entity, with the identical priorities and culture, no effective oversight is possible.

b. The Failure of RMBS Trustees in the Securitization Process

AMI and its members have experienced first-hand how the insufficient legal protections and failure of protecting investors' rights have harmed the public institutions with which we partner (*e.g.*, unions and pension funds) and caused private capital to leave mortgage investing. The most serious problems surround the role of the securitization trust (RMBS) Trustee failing to undertake the duties required by the common law and its contractual obligations pursuant to a PSA.

RMBS Trustees have certain important duties with respect to the Trusts they oversee – duties that are critical to preserving the core contractual rights afforded to investors under the relevant PSAs. These include (i) ascertaining pertinent facts regarding the underlying collateral and notifying all parties upon discovery of a breach of any party's obligations; (ii) providing investors with reasonable access to information regarding their investments; and, (iii) remedying servicer Events of Default and enforcing the cure, substitution, or repurchase of loans that breach representations and warranties. The following constitutes evidence that the parties to RMBS Trust agreements are engaging in substantial breaches of their contractual obligations, and notice that such breaches have gone largely unaddressed by RMBS Trustees. These examples are divided into two sections:

1. Evidence of the egregious underwriting deficiencies that have been discovered across residential mortgage securitizations issued in the years leading up to the 2008 financial crisis; and,
2. Evidence of servicer breaches of their obligations to service loans in RMBS Trusts in compliance with their servicing agreements and the best interests of Certificateholders.

Given the evidence detailed herein, AMI considers the Trustee to be on notice of serious threats to the assets and contractual rights underlying its RMBS Trusts.

i. Breaches of Representations and Warranties

The sale of loans into RMBS Trusts is typically governed by mortgage loan purchase agreements, which contain representations ("reps") and warranties made by the seller regarding the quality, underwriting process, payment history, and other fundamental characteristics of each loan. These reps

and warranties were incorporated into the PSAs for the benefit of the Certificateholders. Pursuant to most PSAs, the seller must cure, substitute, or repurchase any loan that is found to contain a breach of reps and warranties that materially and adversely affects the value of the loan or Certificateholders' interest therein. The Trustee has an obligation to provide access to loan files, deal documents, and other pertinent information to investors upon receiving a request pursuant to the relevant terms of the PSA. Further, upon discovering or being notified of any such breach, it is the Trustee's duty under most PSAs to notify the responsible party and to "undertake commercially reasonable efforts to enforce the obligations" of the responsible party to cure, substitute, or repurchase such defective loans.

It is these important contractual provisions that provided investors with comfort regarding the quality of the loans that would serve as the collateral for their investments in RMBS. While investors were prepared to accept certain risk with respect to this collateral—these reps and warranties constituted investors' fundamental protection against the risk of misrepresentation, fraud, and abject underwriting failures in the underlying mortgage loans—risks that were entirely within the control of the originators and sellers of these loans. For this reason, the following evidence regarding pervasive breaches of reps and warranties, and the Trustees' failure to enforce the same, is particularly troubling.

The following findings are but a few examples of the egregious underwriting deficiencies that have been discovered across RMBS pools from the years leading up to the 2008 financial crisis. In April 2011, the United States Senate Permanent Subcommittee on Investigations released a bipartisan report detailing the findings of its two-year investigation into the causes of the crisis.[5] The Senate Subcommittee focused on Washington Mutual Bank ("WaMu") as a case study of lender conduct during this time, and concluded that WaMu had engaged extensively in improper loan underwriting practices,

[5] "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse," United States Senate Permanent Subcommittee on Investigations, April 13, 2011, *available at* http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf.

including steering borrowers into riskier loans than those they could afford; failing to verify borrower income or enforce compliance with its own underwriting guidelines; authorizing loans with multiple layers of risk, underwriting exceptions, and/or erroneous or fraudulent borrower information; and incentivizing loan personnel to quickly generate large volumes of higher risk loans without regard for loan quality.[6] The Senate Subcommittee concluded that,

> *unacceptable lending and securitization practices were not restricted to Washington Mutual, but were present at a host of financial institutions that originated, sold, and securitized billions of dollars in high risk, poor quality home loans that inundated U.S. financial markets...These lenders were not the victims of the financial crisis; the high risk loans they issued were the fuel that ignited the financial crisis.*[7]

Consistent with these findings, several bond insurers have reported discovering widespread breaches of reps and warranties in RMBS loan pools from the years leading up to the financial crisis. In a review of approximately 15,500 defaulted first lien loans and 37,500 defaulted second lien loans, Assured Guaranty found that 14,500 (93%) and 33,100 (88%), respectively, breached reps and warranties.[8] Ambac Assurance Corp. conducted a review of 6,309 loans securitized by Bear Stearns and found that 5,724 (91%) breached reps and warranties; Ambac reports that out of the loans found to have breaches, Bear Stearns has agreed to date to repurchase only 52 (less than 1%), and has in fact not repurchased a single one.[9] In separate lawsuits against Countrywide and Bank of America, MBIA Insurance Corp. reports having found that nearly 90%[10] and approximately 91%[11] of the defaulted or delinquent loans in Countrywide securitizations show material discrepancies from Countrywide's reps and warranties.

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[6] *Id.* at 3.

[7] *Id.* at 4.

[8] Assured Guaranty Ltd., Annual Report (Form 10-K), at 105 (March 1, 2011).

[9] *Ambac Assurance Corp. v. EMC, et al.*, Case No. 08-CV-9464 (S.D.N.Y. 2008) (First Amended Complaint ¶28).

[10] *MBIA Ins. Corp. v. Countrywide Home Loans, et al.,* Case No. 08602825 (N.Y. Sup. Ct. 2008) (Complaint ¶59).

Other findings from across the industry suggest extensive underwriting deficiencies throughout RMBS Trusts. In 2007, Fitch Ratings conducted a review of subprime underwriting practices, in which it found that,

> *[i]n many instances, misrepresentations and altered documentation are evident in the physical files... Often, loans containing misrepresentations have multiple problems that can be detected through a strong validation and reverification process.*[12]

In particular, Fitch analyzed 45 loans with early payment defaults and found the results "disconcerting at best, as there was the appearance of fraud or misrepresentation in almost every file." In 2009, the Federal Home Loan Banks conducted a study of subprime and Alt-A loans in which they found that 54.5% of 2007-vintage loans, 49.1% of 2006-vintage loans, and 43.2% of 2005-vintage loans were eligible for repurchase based on breaches of reps and warranties.[13] Due diligence or forensic loan auditing firms have noted similar findings, with the Barrent Group reporting that 69.9% of Alt-A loans reviewed from the 2006-07 period contained breaches of the underwriting guidelines while Recovco Management, LLC has found that over half of the several thousand loans reviewed from the 2006-07 period contained material breaches of reps and warranties.

As the holder of the Trust fund for the benefit of Certificateholders, the Trustee has a duty under most PSAs to exercise reasonable care in "ascertaining the pertinent facts." As the Custodian of the

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[11] *MBIA Ins. Corp. v. Bank of America Corp., et al.*, Case No. BC417572 (Cal. Super. Ct. 2009) (Complaint ¶80)

[12] M. Diane Pendley, et al., "The Impact of Poor Underwriting Practices and Fraud in Subprime RMBS Performance," *Fitch Ratings US Residential Mortgage Special Report*, Nov. 28, 2007, at 4-6, *available at* http://www.mortgagebankers.org/files/News/InternalResource/58467_TheImpactofPoorUnderwritingPracticesandFraudinSubprimeRMBSPerformance.pdf.

[13] Chris Gamaitoni, Jason Stewart and Mike Turner, "Mortgage Repurchases Part II: Private Label RMBS Investors Take Aim - Quantifying the Risks," *Compass Point Research & Trading*, August 17, 2010, *available at* http://api.ning.com/files/fiCVZyzNTkoAzUdzhSWYNuHv33*Ur5ZYBh3S08zo*phyT79SFi0TOpPG7kIHe3h8RXKKyphNZqqytZrXQKbMxv4R3F6fN5dI/36431113MortgageFinanceRepurchasesPrivateLabel08172010.pdf.

relevant trust documents and loan files in many deals, or the as the party with the authority to direct the Custodian, the Trustee has an obligation to provide investors with reasonable access rights to information regarding their investments. The Trustee also has a duty to enforce the cure, substitution, and repurchase obligations of the parties to the PSA within the prescribed cure period when it becomes aware or should become aware of a material breach of reps and warranties. Pursuant to these contractual provisions, the repurchase price for any loans repurchased should include amounts for accrued interest and advances, and such repurchase amounts should be included in the remit provided to investors (requirements with which investors are seeing inconsistent compliance, at best). The Trustee may incur liability should it fail to comply with these duties, or act in a negligent manner in carrying out these duties. Given the significant evidence that material breaches are prevalent within RMBS Trusts, and that Trustees have rarely exercised their duties to ascertain these facts or enforce repurchase obligations, these liabilities are potentially extensive.

ii. Servicing Breaches

The conduct of mortgage servicers is governed by servicing agreements, which require these entities to service securitized mortgage loans in the best interests of the ultimate Certificateholders. However, many of the largest servicers are affiliates of the lenders that originated the loans at issue. These prior origination activities have created significant conflicts of interest for mortgage servicers, encouraging them to enrich their own interests over those of the Certificateholders they are contractually obligated to protect. For example, where a servicer controls the servicing for a borrower's first and second lien loans, but only owns the second lien, this creates conflicts that encourage the servicer to maximize the value of the second lien at the expense of the first. A study published by the National Bureau of Economic Research found that a modification program implemented by Countrywide Financial Corporation as part of settlement with state Attorneys General resulted in a substantial increase in voluntary or "strategic" defaults by borrowers on first lien loans, without a corresponding increase in

strategic defaults on second lien loans.[14] As Countrywide no longer owns 88% of the first liens at issue, but holds a large majority of the second liens,[15] these findings suggest that Countrywide is encouraging delinquent borrowers to pay second liens *in lieu* of first liens, thereby protecting its interests at the expense of the interests of investors.

These conflicts and others have led to widespread servicer breaches of their obligations to service loans in RMBS Trusts in the interests of the ultimate Certificateholders. The following are just some examples of these breaches.

iii. Failure to Report Rep and Warranty Breaches

When servicers discover any material breach of a loan seller's reps and warranties, they are obligated by most PSAs to "give prompt notice thereof to the other parties." Servicers are also in the best position to determine whether there has been any such breaches because they regularly (i) interact with borrowers in collecting loan payments and are privy to borrower statements that may contradict information in their loan files; (ii) conduct in-depth reviews of loan files in the course of evaluating potential loan modifications; and, (iii) are put on notice of potential breaches by bond insurer and investor lawsuits, such as those discussed in this letter. Nevertheless, servicers have failed to give notice to Trustees or investors of any breaches, primarily because the servicers, as affiliates of the loan originators and/or sellers, would often be the ones required to buy back any deficient loans.[16] This conflict of interest has led to the failure

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[14] Chris Mayer, Ed Morrison, Tomasz Piskorski, and Arpit Gupta, "Mortgage Modification and Strategic Behavior: Evidence from a Legal Settlement with Countrywide," *National Bureau of Economic Research*, Working Paper No. 17065, May 9, 2011, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1836451.

[15] Alex Ulam, "The Bank of America Mortgage Settlement Fiasco," *The Nation*, October 13, 2010, http://www.thenation.com/article/155380/bank-america-mortgage-settlement-fiasco?page=0,1.

[16] *See, e.g.,* Letter from Kathy Patrick to Countrywide Home Loans Servicing and Bank of New York, October 18, 2010, *available at* http://www.businessinsider.com/bondholers-letter-to-bank-of-america--over-countrywide-loans-2010-10; *Deutsche Bank National Trust Co. v. FDIC, et al.*, 09-CV-1656-RMC (D.C.D.C. 2009) (Complaint ¶82); Laurie Goodman, Roger Ashworth, Brian Landy, and Liclan Yang, "The Elephant in the Room—Conflicts of Interest in Residential Mortgage Securitizations", *Amherst Mortgage Insight,* at 15, May 20, 2010 (only 37% of early payment defaults have been repurchased out of the trust).

by servicers to report findings of clear fraud and misrepresentation relating to mortgage loans held in securitization.[17]

This conflict is illustrated by the discrepancy between the manner in which servicers handle loans in their own portfolios and the manner in which they service loans on behalf of investors or Government Sponsored Enterprises ("GSEs"). For example, the OCC and OTS issued a Mortgage Metrics Report for the third quarter of 2009 that found that, "[s]ervicers continue to modify more loans held in their portfolios than they did [*sic*] for the GSEs, government-guaranteed loans, or for private investors. Loans serviced for the GSEs accounted for 18.7 percent of all modifications despite making up 63 percent of the servicing portfolio."[18] These findings demonstrate that banks are more willing to engage in loan modifications (especially principal loan modifications) when they hold loans in portfolio. In contrast, when they service loans for others, servicers earn higher servicing fees if loans remain in delinquency with higher principal balances, and are neither repurchased nor resolved.

The Trustee should not permit servicers to subordinate investors' interests to their own. If servicers discover breaches of reps and warranties in the portfolios they service for others, they can and should be reporting these breaches to the other parties to the PSA, just as they should be modifying loans in these portfolios, where appropriate. The Trustee must ensure that servicers comply with their obligations to service such loans in the best interests of Certificateholders, and should exercise its right to declare a servicer Event of Default and replace any servicer that is too conflicted to do so.

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[17] U.S. Representative Brad Miller, Letter to JPMorgan Chase Home Lending, June 17, 2010, at 2 n.4 (citing sources) (letter on file with AMI).

[18] U.S. Department of the Treasury, "OCC and OTS Mortgage Metrics Report: Disclosure of National Bank and Federal Thrift Mortgage Loan Data," December 2009, 25, *available at* http://www.occ.gov/publications/publications-by-type/other-publications/mortgage-metrics-q3-2009/mortgage-metrics-q3-2009-pdf.pdf.

iv. Improper Servicing of Delinquencies

Servicers encounter additional conflicts with their obligation to service in the best interests of Certificateholders when servicing delinquent mortgages. Servicers often earn more fees from foreclosing than they would from engaging in loan modifications, thereby creating incentives for servicers to foreclose on borrowers that might qualify for a workout.[19]

AMI supports effective, long-term solutions for responsible homeowners seeking to stay in their homes, including sustainable loan modifications, where appropriate. By all accounts, servicers are failing miserably in this capacity.

In April 2011, the U.S. Treasury announced that it was withholding incentive payments to three servicers – Bank of America, Wells Fargo, and JPMorgan Chase – based on noncompliance with the Making Home Affordable Program.[20] This decision stemmed from a report of the Treasury compliance team that found, among other things, that servicers were making income calculations errors (defined as a difference of at least 5% between the income calculated by the servicer and the Treasury compliance team) on a substantial percentage of modification assessments.[21] In particular, Bank of America was found to have made income calculation errors on 22% of assessments, Wells Fargo on 27% of assessments, JPMorgan on 31% of assessments, and Ocwen on 33% of assessments. These numbers suggest that servicers are not conducting their servicing duties in investors' best interests.

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[19] Kurt Eggert, "Limiting Abuse and Opportunism by Mortgage Servicers," 15 HOUSING POL'Y DEBATE 753, 757 (2004) *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=992095.

[20] "Obama Administration Releases May Housing Scorecard Featuring New Making Home Affordable Servicer Assessments," *U.S. Department of the Treasury*, press release, June 9, 2011, *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg1205.aspx.

[21] U.S. Department of the Treasury and the Department of Housing and Urban Development, "Making Home Affordable" Program Performance Report Through April 2011," June 9, 2011, at 16-36, *available at* http://www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/April%202011%20MHA%20Report%20FINAL.PDF.

Of course, if no arrangement can be made to recover delinquent payments and/or modify the loan, servicers have an obligation to use reasonable efforts to foreclose. Instead, as widely reported by research analysts, servicers are often keeping mortgages in delinquency for extended periods, which maximizes servicing fee proceeds.[22] Further, with respect to such delinquent loans, servicers have been increasingly disregarding their obligation to advance principal and interest payments to RMBS Trusts, despite the fact that these payments are recoverable from liquidation cash flows, borrower repayments upon cure, or deal cash flows in the case of workouts with principal and interest recapitalization. In general, the servicer should stop advancing payments on a loan only if it deems the loan in good faith to be "non-recoverable." However, since there is no clear definition of "non-recoverable" in most PSAs, servicers have begun to deviate from accepted and established servicing practices to limit their financing costs at the expense of investor interests. Indeed, stop advance rates have been steadily increasing over the past 12-18 months (particularly with respect to subprime mortgages), thereby depleting cash flows to investors, lengthening repayment timelines, and resulting in significant value destruction in RMBS.[23] Pursuant to governing PSAs, servicers must implement loss mitigation efforts, if appropriate, in a timely fashion, and must continue making servicing advances should loans remain in delinquency. Certificateholders are entitled to Trustee assistance to research and preserve these important contractual rights, and the failure to take such actions could lead to irreparable harm to the Trust and Certificateholders.

III. **Solutions Required by Mortgage Investors to Bring Back Private Capital**

The current legal and regulatory landscape presents numerous obstacles for the MBS securitization and restoring private capital, including a lack of the necessary transparency for the effective functioning of capital markets in connection with several fundamental aspects of the system. These problems are

[22] *See, e.g.*, "The Elephant in the Room," at 23.

[23] Barclays Capital, "Securitisation Research: Stop Advances – Trends and implications," June 3, 2011.

varied and numerous in the RMBS context. The lack of transparency in this context distorted markets and ultimately proved to impair the health and stability of our housing and mortgage markets. In essence, mortgage investors simply seek the salient facts underlying a transaction. In fact, recently, Mr. Edward DeMarco, Acting Director, Federal Housing Finance Administration (FHFA), testified before a House of Representatives Subcommittee and explained the following:

> *FHFA views enhanced, loan-level disclosures as necessary for investors to analyze and assess the potential risks associated with the collateral of asset-backed securities, including mortgages.*[24]

Accordingly two sets of consequences have arisen. First, the U.S. private mortgage-backed securities market has ground to a halt. Observers note that with two exceptions, no new RMBS securitizations have occurred since the financial crisis. Second, Americans suffer through reduced credit, more expensive mortgage rates, and fewer housing opportunities. In an effort to solve the problems facing the capital markets and the working class, AMI has offered a number of policy solutions which are described in its *Reforming the Asset-Backed Securities Market White Paper* (March 2010).

We believe that the recommendations below, which are detailed in depth in the attached 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.

We are pleased that the current draft proposal acknowledges and reflect AMI's past concerns and recommendations. We are pleased that the following AMI recommendations to enhance transparency and best securitization practices within capital markets are reflected in the bill:

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[24] Hearing on *Transparency as an Alternative to the Federal Government's Regulation of Risk Retention*, before the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, May 11, 2011 (testimony of Acting Director Edward DeMarco).

- *Provide loan-level information that investors, ratings agencies and regulators can use to evaluate collateral and its expected economic performance, both at pool underwriting and continuously over the life of the securitization (Draft Bill, § 201).*
- *Require a "cooling off period" when asset-backed securities are offered so that investors have sufficient time to review and analyze loan-level information before making investment decisions. (Draft Bill, § 202).*
- *Make deal documents for all asset-backed securities and structured finance securities publicly available to market participants and regulators sufficiently in advance of investor decisions whether to purchase securities offered. (Draft Bill, §201).*
- *Develop, for each asset class, standard pooling and servicing agreements with model representations and warranties as a non-waivable industry minimum standard. (Draft Bill, § 101).*
- *Develop clear standard definitions for securitization markets. (Draft Bill, §101).*
- *Directly address conflicts of interests of servicers that have economic interests adverse to those of investors, by imposing direct fiduciary duties to investors and/or mandatory separation of those economic interests, and standardize servicer accounting and reporting for restructuring, modification or work-out of collateral assets. (Draft Bill, §101).*
- *Asset-backed securities should be explicitly made subject to private right of action provisions of anti-fraud statutes in securities law and to appropriate Sarbanes-Oxley disclosures and controls.*
- *Certain asset-backed securities can be simplified and standardized so as to encourage increased trading in the secondary market on venues, such as exchanges, where trading prices are more visible to investors and regulators. (Draft Bill, § 101).*
- *Ratings agencies need to use loan-level data on their initial ratings and to update their assumptions and ratings as market conditions evolve and collateral performance is reported. .*

a. Investors Require Additional Protections, such as those included in the SEC's Proposed Reg AB

In 2010, mortgage investors and a range of other organizations submitted comments to the S.E.C. in support of its proposed Reg AB.[25] As part of the discussion of the concepts in the draft legislation presently before the panel, we wish to provide the following feedback. We must restate and emphasize our support for concepts and solutions that the proposed Regulation AB provides. As we have explained, AMI members believe that much of the dysfunction in the ABS market can be traced to (1) a lack of transparency; (2) subjective representations and warranties which, compounded by weak remedy enforcement, unfairly limits sponsors' and loan sellers' liability; and, (3) the financial decoupling and misalignment of interests of sponsors, originators and depositors from the interests of investors through reducing and in many cases eliminating their financial interests in the performance of ABS pools. We believe that the S.E.C. correctly responded by proposing common-sense reform involving three broad areas:

- **Securities Act shelf registration reform** - significant improvements involving risk retention, new certifications and expanded investor review timelines;
- **Expanded disclosure requirements** – enhanced data requirements both at issuance and on a go-forward basis at the asset and pool level as well as the historical experience of sponsors and originators involving repurchase claims; in addition, requiring from issuers a common platform cash flow model; and,
- **144A and new disclosure provisions** – requiring issuers to make available similar disclosure information to that offered in public market ABS.

The present legislative draft proposes an independent third party to act on behalf of the interests of investors. While we appreciate the spirit and intent of this concept, it falls far short from the necessary investor protection mechanism envisioned by the Reg AB, a Credit Risk Manager ("CRM"). The need to appoint a CRM arises from the long-standing abuses and possible conflicts we have extensively described.

[25] AMI's Reg AB comment letter may be found online at www.the-ami.org.

A qualified CRM, selected by the issuer subject to, *inter alia*, a representation of its independence from other parties to the ABS trust, will represent the interests of all Certificateholders (bond-holders) in investigating and, if warranted, pursuing representation and warranty claims against responsible parties. Although the CRM would have the unilateral discretion to pursue such claims as a fiduciary to the Certificateholders, individual or collective investor interests could require the CRM to launch investigations on well-founded investor suspicions. Expanding on existing concepts of voting rights commonly found in existing pooling and servicing agreements, voting rights aggregating greater than 25% of such interests outstanding could impel the CRM investigation at the expense of the trust. Investors representing below 25% of aggregate voting rights could require such investigation, but only at the expense of the inquiring investor(s). In discharging its obligations as a compensated party to the pooling and servicing agreement, the CRM must have complete access to loan and servicing files in order to conduct a proper examination and effectively pursue resulting claims. We look forward to working with the Committee on addressing this concept in the current legislative draft, as well as the other expanded disclosure and legal mechanisms, to permit them to operate in a fashion that can truly protect investors from long-standing abuses (*i.e.,* conflicts of interest) and help us to bring private capital back into the mortgage market, restoring the mortgage and securitization "plumbing," and the national note recordation system.

IV. Conclusion

Mortgage investors believe that the vibrancy and effectiveness of the U.S. capital markets can be restored and private capital will return, 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.

Thank you for the opportunity to share the views of the Association of Mortgage Investors with the Subcommittee. 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. Please feel free to contact me directly at Chris Katopis, Executive Director, at 202-327-8100 or by email at katopis@the-ami.org. We welcome any questions that you might have about securitization, representations and warranties, or other mortgage industry topics.

Testimony
of
William Poole
Distinguished Scholar in Residence, University of Delaware

U.S. House of Representatives
Committee on Financial Services

Subcommittee
on
Capital Markets and Government Sponsored Enterprises
Hearings
December 7, 2011

Testimony of William Poole

Mr. Chairman, members of the Committee, I am pleased to be here this morning to comment on the Discussion Draft of a bill to increase standardization, transparency, and to ensure the rule of law in the mortgage-backed security system. My biographical information is in your hands—no need to add to that. For present purposes, the most relevant part of my career is my ten years as President and CEO of the Federal Reserve Bank of St. Louis.

The performance of the mortgage market is critical to the welfare of everyone in this country and to the stability of the financial system. Unfortunately, the Nation is still struggling today with failures, both public and private, in the functioning of the mortgage market. Those failures have left a stain on the economy, ruining many lives and the reducing the assets and security of many citizens. We are all aware—painfully aware—of what has happened and eager to create a better environment in the financial markets of the future.

I will speak in broad-brush terms. Should the Subcommittee or its staff want a more detailed contribution, I would be pleased to work with you.

The Case for Fully Private Mortgage Markets

The United States is the only country with mortgage intermediaries of the form of Fanny Mae and Freddie Mac, two very large government sponsored enterprises. We also have the 12 Federal Home Loan banks and the Federal Housing Administration to address.

Other countries with well-functioning mortgage markets do not have the mortgage intermediaries of the sort we do. There is no evidence of which I am aware that mortgage markets abroad function less well than ours. Indeed, the failure of Fannie Mae and Freddie Mac, at a taxpayer cost of about $150 billion so far, should be a clear warning to us. Moreover, the worldwide financial panic was a direct consequence of the bust in our subprime mortgage market. Quite frankly, any claim that our mortgage market serves us better than the markets abroad sounds pretty fishy to me.

Putting the mortgage market aside, U.S. capital markets are the envy of the world. Our markets are more liquid and more innovative than those elsewhere. We should be very careful not to kill innovation in the financial markets.

It is true that for some years Fannie and Freddie seemed to work well. They grew to an immense size, supported by the implicit federal guarantee of their liabilities. The guarantee meant that the U.S. taxpayer was providing insurance against failure, without charging an insurance premium. The guarantee permitted Fannie and Freddie to pursue portfolio policies that no purely private firm could. They grew and grew and their shareholders and especially senior managements enjoyed handsome returns. I regret that the Occupy Wall Street protesters have not taken aim at Fannie and Freddie, and even more that they were nowhere to be seen when the opportunity to reform these firms was a live issue five and more years ago.

It is absolutely essential to understand the importance of taxpayer subsidy of risk. A period without loss does not mean that there is no subsidy. If the federal government were to provide fire insurance on my house, there would not have been a loss over the years I have been a homeowner. I am careful and have never had a fire. I hope that I never do have a fire. Nevertheless, I do have homeowner's insurance. Everyone understands this point—I could explain to a fourth grader why it makes sense for me to have insurance and why the absence of loss to date does not mean that my purchase of insurance is unwise.

Pricing of insurance is complicated and fire insurance is much more complicated than life insurance. With a widely diversified group of policyholders, life insurance actuaries can project quite accurately loss experience in future years. Losses from fire insurance are much more episodic and the same is true of losses on mortgages. The essence of underwriting fire insurance is that the properties insured be highly diversified, so that a relatively few properties are insured in any one community to avoid conflagration risk.

Mortgage risk is unavoidably subject to conflagration risk, because the business cycle affects so many communities at the same time. Nevertheless, I urge you not accept industry arguments that the federal government must support the market because the presence of correlated business cycle risks means that private firms cannot handle the risk. The private market can handle the risk, as demonstrated by foreign experience and by U.S. experience over business cycles before this most recent one.

Comments on Discussion Draft Bill

In the context of standardizing mortgage products, Fannie Mae and Freddie Mac functioned more like private firms than they did in the accumulation of their portfolios. The issue at hand is whether we need a continuing federal presence in the design of mortgage products.

I am not an expert on many of the technical issues in the discussion draft. However, I confess that I read the draft bill with dismay. I understand, and am in complete sympathy with, the motivation to avoid another catastrophe of the sort we have been living through. Still, the bill reads as an effort to design a complicated product in Washington. Would you ever do the same thing for the design of a computer, or a smart phone, or a web site? I am quite sure not. Even if Washington could create a fine mortgage product today, could the product evolve over time as conditions change? I apologize for using strong language, but it is folly to design a complicated product in Washington and expect the product to remain current and innovative.

I recommend that the committee staff put together, with the assistance of the GSEs, a time line of changes in the major areas of the bill. I suspect that you will find an evolution over time in these provisions, and you should ask whether a federal regulatory framework is likely to be as responsive to changing conditions. I realize that is an argument for delegating many details to the Federal Housing Finance Agency.

However, the extensive delegation of power to the Director of the Federal Housing Finance Agency and the vagueness of the criteria that are supposed to guide his decisions worry me. If this product cannot be designed by this committee and its expert staff, why should it be any easier for the director to design? What this grant of authority to the director would do is to invite a never-ending process of industry pressure and complaint. What the industry does not achieve by direct influence on the director it would seek to achieve through the Congress, getting obscure provisions written into legislation. Why would we want to magnify the decidedly unpretty process under way today as regulators attempt to implement the Dodd-Frank legislation?

The financial crisis was not primarily a consequence of defective design of mortgages. Instead, banks (including investment banks) accumulated too many subprime backed securities while holding too little capital. Banks violated banking principles 101 from 150 years ago by holding risky assets financed with excessively short liabilities and much too little capital.

The problem was not that investors and rating agencies had too little data on the underlying mortgages. They just did not look for the information that was available. Michael Lewis in his very readable and informative book, *The Big Short*, makes clear that the data were

there for any portfolio manager who would dig a little. The few who did dig found what they needed.

Standards for securitization should be determined in the market and not by the federal government. Should a hedge fund, for example, want to get into the securitization business, perhaps in some innovative way, should it be blocked by legislation of this sort? Some, I know, would say absolutely yes. I simply disagree. We already have a plethora of rules against fraud, enforceable in the courts through private actions. We must not bog down the private economy with rules and regulations unless we have specific ills that can be addressed that way.

Reform Transition

I have long favored a death sentence for Fannie Mae and Freddie Mac. A pleasing and easy transition into history should not be difficult. Two simple things need to be done. One is to phase down the conforming mortgage limit and the second is to increase securitization fees, perhaps at the rate of 10 percent per year. Both should be legislated and not left to administrative discretion. The legislation might provide that both transitions would begin one year after the bill becomes law. Fannie and Freddie's portfolios should be frozen and the existing mortgages permitted to pay down in the normal course of business. There is no need to sell the existing portfolio—letting it run off will shrink the companies rapidly and they will be mostly gone in seven to ten years.

It is terribly important to put these provisions into statute law and not leave them to administrative discretion. That is the only way to provide reasonable certainty to potential private competitors that it is worth the investment to develop this market. Without that certainty, private competitors will be slow to enter the market and those who want to maintain the GSEs will be able to claim that the private market cannot handle the business.

If you will forgive me for challenging you, I cannot understand those who are defenders of the market in the abstract but are squeamish about starting this transition. I well remember Ronald Reagan's confidence that ending price controls on natural gas would end the shortages in that market, and the conservative doubts about the strategy. Reagan was right, and the evidence appeared in a matter of days.

GSE Reform and the Federal Budget

Fannie and Freddie have cost taxpayers $150 billion so far, and the tab is likely to continue to rise. It appears that the FHA will require taxpayer funds, as will the Pension Benefit Guarantee Corporation. These commitments are on the books and will have to be honored. At this point, all we can do is to avoid making the problems worse and learn from the experience.

For these programs, and dozens of others, I suggest the following criterion. Would you be willing to ask Social Security beneficiaries to accept a 10 percent reduction in benefits to continue housing subsidies? On this day 70 years ago, the United States suffered a terrible loss at Pearl Harbor. Citizens quickly rallied to the defense of the Nation, at great personal cost. Under similar circumstances today, citizens would eagerly volunteer to give up some of their Social Security benefits to pay for national defense.

We would sacrifice the same way for many other existential threats. But would we sacrifice to maintain housing subsidies? The question is almost absurd. I remind you that this country does face an existential threat in the form of insolvency of the United States Government. How can we be defending housing subsidies, and subsidies for windmills and solar panels and for high-speed rail and on and on in the face of this threat? I urge you to ask every

advocate of a special interest spending program or tax preference whether he or she believes that the issue is so important that Social Security beneficiaries should be asked to help pay for the program in question.

The answer will always be that we do not have to face that question—that the program or tax break should be financed some other way. So, I repeat the question this way, suppose hypothetically that a cut Social Security benefits were to be considered. Is your program more important? And I remind you of what the answer would have been on this day 70 years ago.

Maurice "Moe" Veissi
2012 President

Dale A. Stinton
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WRITTEN TESTIMONY OF

TOM SALOMONE
2012 DIRECTOR, REALTOR® PARTY ACTIVITIES
NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

UNITED STATES HOUSE OF REPRESENATIVES
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT-SPONSORED ENTERPRISES

HEARING REGARDING

THE PRIVATE MORTGAGE MARKET INVESTMENT ACT, PART II

DECEMBER 7, 2011

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INTRODUCTION

On behalf of the more than 1.1 million members of the National Association of REALTORS® (NAR), thank you for holding this important hearing examining the U.S. housing finance system.

My name is Tom Salomone, NAR's Committee Liaison for the Issues Mobilization, the Political Involvement and REALTOR® Political Action committees. I have been a REALTOR® for more than 31 years and am the owner of Real Estate II and Real Estate II of Margate, firms specializing in residential real estate. Currently, I serve as a member of NAR's Executive Committee and from 2000 to 2011 was a member of NAR's Board of Directors. As with many of my colleagues who have testified before this committee in the past, my life and passion is real estate. So, it is my honor to be here today to speak on behalf of NAR's 1.1 million members, and the millions of Americans who own a home, want to sell a home, or just provide rental opportunities to those who require a home.

Since the onset of the global financial crisis there have been relentless attacks on the U.S. housing finance system. The majority of these attacks were carried out by groups who are ideologically opposed to the existing system, which includes some government participation in the conventional conforming market. Of distinct interest to NAR as an advocate for the housing consumer is that this vocal minority is increasingly being told that the current guiding principles of the U.S.' existing housing finance system (e.g. long-term payment structures, reasonable down payment levels, and government participation), are appropriate and necessary. However, the American public and policy experts are saying that "we"—lenders, consumers, real estate professionals, regulators, and Congress—must be better stewards of the system if it is to effectively serve future American homebuyers and mortgage investors as it did prior to the recent financial market meltdown.

THE PRIVATE MORTGAGE MARKET INVESTMENT ACT

REALTORS® believe that the legislation proposed by Chairman Garrett (R-NJ), the "Private Mortgage Market Investment Act", is a good first step toward bringing stability, confidence and transparency to the private side of housing finance. REALTORS® are fervent believers in "free markets", and acknowledge the need for private capital to reduce the Federal government's role in this sector. The rules put-in-place by this legislation to: (1) create standards and uniformity, (2) provide investors with transparency, and (3) ensure legal certainty with regard to investors' rights could create the confidence required to reignite the private label securities market. Should growth in the private market space result from the implementation of this legislation, then ultimately the role the government plays in housing finance will be reduced, which is what we all desire. REALTORS® also believe that even when the government's role in the housing sector is reduced, there will still be a need for some government participation in the conventional conforming space.

Therefore, REALTORS® believe that this bill's approach cannot be viewed as a comprehensive solution to the housing finance sector's reform needs. If enacted, this proposed legislation must be coupled with comprehensive reform of the Government-Sponsored Enterprises (GSEs) if we are going to ensure that the housing finance system will work efficiently, and more importantly, effectively in the future. An example of a bill that this legislation could be coupled with is H.R 2413,

the Secondary Market Facility for Residential Mortgages, introduced by Representatives Gary Miller (R-CA) and Carolyn McCarthy (D-NY), which has a role for government participation in the conventional conforming portion of the secondary mortgage market.

REALTORS® believe the inclusion of government participation in the conventional conforming portion of the secondary mortgage market is necessary and appropriate because we understand that in extreme economic conditions private capital will retreat from the market, requiring the participation of an entity that will remain active in the marketplace regardless of economic conditions. A full shut-down of the conventional conforming portion of the secondary mortgage marketplace, means there would be very limited or no funding for middle class homeowners or homebuyers, which would be devastating to the national economy—possibly causing a catastrophic collapse. Presently, we continue to see the downward pressure that housing is having on the economy; therefore, tools that can be used to mitigate such effects, should be put-in-place and utilized to unsure viability of this extremely important economic sector.

The government-sponsored enterprises (GSEs) were created to support that specific mission within the secondary mortgage market. The future U.S. secondary mortgage market must include an entity with that purpose in order to ensure that creditworthy American families will always have access to affordable mortgage capital.

THE U.S. HOUSING FINANCE SYSTEM: THE REALTORS'® PERSPECTIVE

There are many systems of housing finance globally, and all have their merits for the countries they serve. REALTORS® believe that the U.S. housing finance system, which utilizes securitization to recapitalize mortgage lenders, works best for a nation of our size with our fervor for real property ownership. Mortgage products that offer the populace reasonable down payment requirements, as well as provide affordable access to the remaining capital required to close the property sale, are what REALTORS® believe is in the best interest of the American public. We do not believe that the underlying system, which until recently has afforded many qualified, middle and lower income American families the ability to purchase a home, should simply be scrapped.

Our belief in the existing U.S. housing finance system does not mean that REALTORS® do not believe that reforms cannot, or should not, be undertaken. Over the past 3 years, in testimony before the House Financial Services Committee, as well as the Senate Banking, Housing, and Urban Affairs Committee, REALTORS® have indicated the need for repairs to the U.S. housing finance structure (see Appendix A).

REALTORS® agree with lawmakers and the Administration that taxpayers should be protected, private capital must return to the housing finance market, and that the size of government participation in the housing sector should decrease if the market is to function properly. Those who advocate for legislation that constrains or removes government participation from the conventional mortgage market, and/or relies only on a purely private secondary mortgage market need only examine the current miniscule activity in the jumbo and manufactured housing mortgage markets in order to understand the implications of such a system. In both of these markets, mortgage capital became

nearly non-existent, which prohibited creditworthy borrowers from access to the funds required to purchase a home.

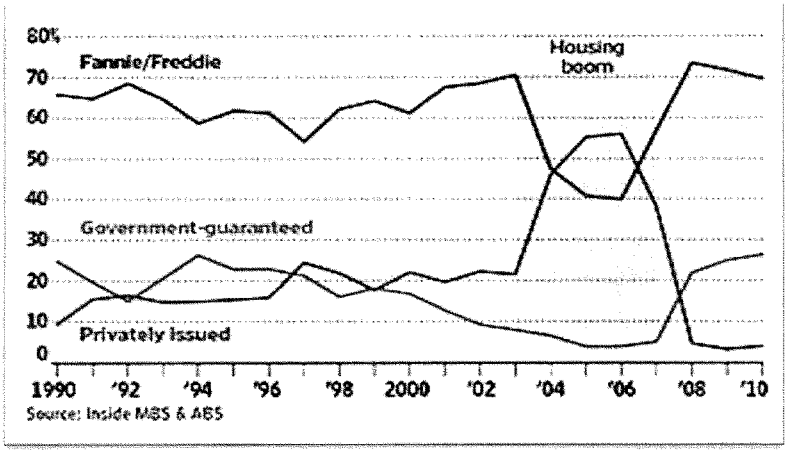
OUR NATION'S UNIQUE SECONDARY MORTGAGE MARKET

Congress chartered Fannie Mae and Freddie Mac to expand homeownership opportunities and provide a stable foundation for our nation's housing finance system. Unlike private secondary market investors, Fannie Mae and Freddie Mac remained in housing markets during past market downturns, and have used their federal ties to facilitate ongoing access to affordable mortgage finance when other players have left the market.

REALTORS® believe that the GSEs' housing mission, and the benefits that are derived from it (e.g. long-term fixed-rate mortgages), played a vital role in the success of our nation's housing system, and continue to play a key role today. Without these secondary mortgage market facilities providing affordable mortgage capital during the current market disruption, there would have been a much more serious disruption to the market.

As the market turmoil reached its peak in late 2008, it became apparent that the role of the GSEs, even in conservatorship, was of utmost importance to the viability of the housing market as private mortgage capital effectively fled the marketplace. As indicated in Table 1, below, if no government-backed conventional mortgage market facility entity (i.e. Fannie Mae and Freddie Mac) existed as private mortgage capital fled to the side lines, the housing market would have fallen even further and thrown our nation into a deeper recession, or even a depression.

Table 1: Share of Mortgage Securitization Market by Segment



THE 30-YEAR FIXED-RATE MORTGAGE

Unique to the U.S. housing finance sector is the availability of affordable, long-term fixed-rate mortgages. The 30-year fixed rate mortgage is the bedrock of the U.S housing finance system. And now, more than ever, consumers are seeking fixed rate 30-year loans because they are easily understood and offer a predictable payment schedule.

REALTORS® believe that full privatization is not an effective option for our secondary mortgage market because private firms' business strategies will focus on optimizing profits. This model would foster mortgage products that are more aligned with these business' goals than in the best interest of the nation's housing policy, or the consumer. We believe that this would lead to the elimination of long-term, fixed rate mortgage products (e.g. 30-year fixed-rate mortgage), and an increase in the costs of mortgages to consumers.

In fact, based on early data from a survey that NAR is conducting on the impact of the new, lower GSE loan limits, we are beginning to see signs of how the private market impacts consumers. Preliminary data indicates that consumers who are now above the new lower conventional conforming loan limit are experiencing significantly higher interest rates and the need for substantially larger down payments. According to data, this is leading to "a loss of interest" in real estate sales. (NAR will provide the committee with details from the full report once the data has been fully analyzed.) At a time when our economic recovery teeters on the edge of collapse, activities and reforms that force further constriction of economic activity should be resisted.

Furthermore, according to additional research by economist Dr. Susan Woodward, there is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without government urging. Dr. Woodward points out that a few developed countries have encouraged the use of amortizing long-term loans, but in all instances (save for Denmark) where they do exist, the loans have adjustable rates and recast every 5 years. She goes on to indicate that the United States is unique in having a residential mortgage that is long-term, amortizing, fixed-rate and pre-payable, and that Americans have come to view this product as one of their civil rights. Dr. Woodward points out that in early 2000, when Former Federal Reserve Chairman, Alan Greenspan, hinted at its abandonment, the public outcry was such that he eagerly abandoned that position.

The affordability and availability of the fixed-rate mortgage has yielded a US residential mortgage market that stands at approximately $11 trillion. Today, the GSEs own or guarantee $5 to $6 trillion of mortgage debt outstanding and provide capital that supports roughly 70% of new mortgage originations. REALTORS® believe that it is extremely unlikely that any secondary mortgage market structure that does not include securitization and have some government backing could support the existing mortgage funding needs of the United States housing sector, while making mortgages available in all markets under all economic conditions.

Lastly, REALTORS® fear that in times of economic upheaval, a fully private secondary mortgage market will largely cease to exist as has occurred in the jumbo mortgage, the commercial mortgage, and the manufactured housing mortgage markets. When the economy turns down, private capital

understandably flees the marketplace. Should that happen under a fully private secondary mortgage market model, the results for the entire economy would be fatal because affordable long-term fixed-rate mortgage funding would no longer be available, and the plethora of peripheral industries that support and benefit from the residential housing market would suffer.

CONCLUSION

The National Association of REALTORS® applauds Chairman Garrett's efforts to bring back stability and confidence in the private label mortgage securities market space. However, we believe that this bill will be most effective if coupled with legislation that supports a secondary mortgage market model that includes some level of government participation, while protecting the taxpayer and ensuring that all creditworthy consumers have reasonable access to mortgage capital so that they too may attain the American Dream: homeownership.

I thank you for this opportunity to present our thoughts on the Private Mortgage Market Act. The National Association of REALTORS® is anxious to work with the Chairman, and our industry partners, on this thoughtful piece of legislation which is an excellent first step toward finding a solution that best meets the needs of the U.S. housing consumer and their desire for homeownership.

APPENDIX A:
KEY GSE REFORM POINTS BASED ON NAR's PRINCIPLES

- An efficient and adequately regulated secondary market is essential to providing affordable mortgages to consumers. The secondary market, where mortgages are securitized and/or combined into bonds, is an important and reliable source of capital for lenders and therefore for consumers.

  Without a secondary market, mortgage interest rates would be unnecessarily higher and unaffordable for many Americans. In addition, an inadequate secondary market would impede both recovery in housing and the overall economic recovery.

- We cannot have a restoration of the old GSEs with private profits and taxpayer loss system. The current GSEs should be replaced with government chartered, non-shareholder owned entities that are subject to sufficient regulations on product, revenue generation and usage, and retained portfolio practices in a way that ensures they can accomplish their mission and protect the taxpayer.

- Government-chartered entities have a separate legal identity from the federal government but serve a public purpose (e.g. the Export-Import Bank). Unlike a federal agency, these new entities will have considerable political independence and be self-sustaining given the appropriate structure.

- The mission must be to ensure a strong, efficient financing environment for homeownership and rental housing, including access to mortgage financing for segments of the population that have the demonstrated ability to sustain homeownership. Middle class consumers need a steady flow of mortgage funding that only government backing can provide.

- The government must clearly, and explicitly, guarantee the issuances of the entities. Taxpayer risk would be mitigated through the use of mortgage insurance on loan products with a loan to value ratio of 80 percent or higher and guarantee or other fees paid to the government. This is essential to ensure borrowers have access to affordable mortgage credit. Without government backing, consumers will pay much higher mortgage rates and mortgages may at times not be readily available at all (as happened in jumbo and commercial real estate loans)

- The entities should guarantee or insure a wide range of safe, reliable mortgages products such as 30 and 15 year fixed rate loans, traditional ARMs, and other products that have stood the test of time and for which American homeowners have demonstrated a strong "ability to repay."

- For additional safety, sound and sensible underwriting standards must be established for loans purchased and securitized in MBSs, loans purchased for portfolio, and MBS purchases.

- The entities should price loan products or guarantees based on risk. The organization must set standards for the MBS they guarantee that establish transparency and verifiability for loans within the MBSs.

- Political independence of the entities is mandatory for successful operation (e.g. the CEOs will have fixed terms so they cannot be fired without cause, they should not be allowed to lobby, and the authorities should be self-funded—no ongoing appropriations).

- In order to increase the use of covered bonds, particularly in the commercial real estate arena, the entities should pilot their use in multifamily housing lending and explore their use as an additional way to provide more mortgage capital for owner-occupied housing. The entities should be allowed to pave the way for innovative or alternative finance mechanisms that meet safety criteria.

There must be strong oversight of the entities (for example, by the Federal Housing Finance Agency—FHFA or a successor agency), that includes the providing of timely reports to allow for continual evaluation of the entities' performance.

Testimony of David H. Stevens

President & CEO
Mortgage Bankers Association

Before the

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets and GSEs

Hearing on

"The Private Mortgage Market Investment Act, Part 2"

December 7, 2011

Chairman Garrett, Ranking Member Waters, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Mortgage Bankers Association (MBA) on the proposed Private Mortgage Market Investment Act (PMMIA). My name is David Stevens and I am MBA's President and Chief Executive Officer. Immediately prior to assuming this position, I served as Assistant Secretary for Housing at the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) Commissioner. My background prior to joining FHA includes experience as a senior executive in finance, sales, mortgage acquisitions and investments, risk management, and regulatory oversight. I started my professional career with sixteen years at World Savings Bank. I later served as Senior Vice President at Freddie Mac and as Executive Vice President at Wells Fargo. Prior to my confirmation as Commissioner of the FHA, I was President and Chief Operating Officer of Long and Foster Companies, the nation's largest, privately-held real estate firm.

The purpose of the PMMIA, as set forth in the draft bill, is "to increase standardization and transparency and ensure the rule of law in the mortgage-backed security (MBS) system." Without reservation, MBA supports these important objectives. The current real estate finance environment — with the federal government owning, securitizing or guaranteeing nearly 90 percent of single-family mortgages underwritten today — is untenable.

Without question, a new housing finance system must attract private capital. Key elements of the PMMIA — facilitating standardization, legal certainty, greater transparency and disclosure — are fundamental to mortgage markets that rely on robust private investment. We commend the chairman for taking steps toward this critical objective.

At the same time, we believe the necessary tools, materials and expertise currently exist to begin building a bridge toward a more sustainable real estate finance system. As the discussion on the future of housing finance continues, MBA recommends that policymakers carefully consider the path by which private capital is brought back into the system — a pathway that maintains market stability while establishing a framework that ensures ongoing liquidity.

Three years ago, MBA emerged as a thought leader on the fundamental components of a stable and liquid secondary market for the long term. We began by exploring the benefits and shortcomings of the current system featuring the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. The benefits from the GSE model include liquidity brought about by the government's support of the MBS issued by the GSEs, and the development of standardized products and practices that have facilitated a deep and liquid secondary market. In turn, this promoted access to mortgage finance for homebuyers and rental housing, regardless of market conditions.

A core disadvantage to the GSE model is that it fundamentally relied upon ambiguity regarding the extent of the government backstop in the conventional mortgage market — an ambiguity that in the end wound up harming the interests of borrowers, investors, and taxpayers. Because the government guarantee was implicit rather than explicit, it was provided at no charge to market participants. Another shortcoming of the GSE model is that Fannie Mae and Freddie Mac were permitted to amass sizeable risk through their retained portfolios that presented substantial systemic risk with limited benefit to anyone but their shareholders. Additionally, the fact that the GSEs were chartered by Congress meant their competition was limited.

Our evaluation of the current system led to the development of three principles that serve as the foundation of MBA's recommendations for the future of the secondary mortgage market.

The first principle, which is in agreement with the goals of the PMMIA, is that secondary mortgage market transactions should be funded with private capital. The second principle is that the importance of housing, whether owner-occupied or rental, to the nation's economic and social fabric warrants a federal government role in promoting liquidity and stability in the core mortgage market. This role should be in the form of an explicit credit guarantee on a class of MBS, and the guarantee should be paid for through risk-based fees. Third, taxpayers and the system itself should be protected through limits on the mortgage products covered, limitations on the types of activities undertaken, strong risk-based capital requirements, and actuarially fair payments into a federal insurance fund. MBA's recommendations were developed in a way that retains the benefits and avoids the shortcomings of the existing GSE framework.

I am pleased to say that there is considerable concurrence between MBA's recommendations and the draft PMMIA. MBA's testimony today will address the elements where commonalities exist between MBA's suggested framework and the PMMIA. Our testimony also will address topics not included in the PMMIA that merit consideration.

Private Capital

The most important common ground we share is that private capital should be the primary source of liquidity for the real estate finance system. Like MBA's proposal, the PMMIA also provides greater clarity on the government's role by establishing that private capital is in the first loss position.

Standardization

We agree that one way to foster a secondary market that attracts private capital is to provide standards, consistency and transparency for market participants. Features of

the PMMIA could help accomplish these goals. For example, the bill authorizes the Federal Housing Finance Agency (FHFA) to develop, adopt and publish standard form securitization agreements for certain classes of mortgages. This provision is important for a variety of reasons. For example, standard forms and terms facilitate predictability and the rapid flow of information. Standard securitization forms streamline the transportation of data and capital in the same way that standard gauge railroad tracks facilitate interstate commerce. MBA, through its subsidiary, the Mortgage Industry Standards Maintenance Organization, Inc. (MISMO®), has been and remains committed to industry-developed voluntary standards for data, forms, and other purposes, as such standardization increases efficiency and lowers costs for consumers and the entire market.

Predictability and consistency are also important because they help investors measure and manage their risk exposure. In fact, standardization is at the heart of the "To-Be-Announced" (TBA) securities market. As the name suggests, the defining feature of a TBA trade is that the underlying mortgage loans have not been identified and may not even have been originated on the trade date. Instead, participants agree only on a defined set of parameters of the securities to be delivered.

This contrasts sharply with non-TBA securities, whose loans are typically originated before trading. The TBA market also significantly lowers the transaction costs associated with originating, servicing, and refinancing a mortgage. In addition, the TBA market provides an efficient way for lenders to hedge the interest rate risk involved in offering borrowers the ability to lock-in a rate for 30 days while closing on a mortgage. TBA prices, which are publicly observable, serve as the basis for pricing and hedging a variety of mortgages that are not TBA-eligible. TBA trading is thus a key link between the primary and secondary mortgage market.

Market participants across the board and around the world value the liquidity and the structure of the TBA market. Any change to the mortgage system would need to retain this structure. It is less than clear, however, that this can be accomplished through either legislation or regulation. The system must be acceptable to originators, who provide the products, and to investors, who provide the funds. The TBA market was the creation of the private sector, although it certainly relies upon the liquidity and homogeneity that flow from government-backed securities.

Core Products

MBA appreciates that the PMMIA provides for the establishment of different classes of standard mortgage products. This provision is similar to MBA's recommendation for the establishment of a core residential mortgage market to set a benchmark for consumers, underwriters, investors and others. For consumers, the presence of well-defined core mortgage products will provide a standard against which other products

can be assessed. The core market will also provide considerable stability, ensuring that mortgage products of a known type will be available in all market conditions. For underwriters, the characteristics of the "well-documented, well-understood" mortgages of the core market will provide a known base for modeling and pricing risk. For investors, the core market will establish performance and pricing benchmarks for use in MBS investing, and against which other investment options can be judged.

30-Year Fixed Rate Mortgage

We appreciate that the bill gives consideration to preserving the 30-year fixed-rate mortgage. Homeowners in the United States have come to view this mortgage product as the industry standard. Payments are predictable and borrowers are protected from fluctuations in interest rates. From the borrower's perspective, it is the simplest mortgage product available. If rates rise, payments are unchanged. If rates decline, borrowers typically have the option to refinance at no explicit cost.

Although it is consumer friendly, from the standpoint of an investor, the 30-year, fixed-rate, self-amortizing, prepayable mortgage is actually a very complex product. Borrowers refinance when rates drop, transforming a loan with a nominal 30-year maturity to a short-term instrument. When rates increase, refinances disappear, extending the expected life of the loan. Banks and thrifts that fund themselves with deposits are not natural holders of 30-year, fixed-rate, prepayable loans, because they would inevitably be borrowing short and lending long. With the beginning of the nation's MBS market in the early 1970s, it was discovered that investors were willing to bear the prepayment risk associated with these loans, so long as they were protected from the credit risk. From that point to today, with a few exceptions, most investors either did not have the capacity or the willingness to take on the credit risk, particularly given the uncertainty involved with systemic credit events such as the one we just experienced.

MBA also appreciates that the bill does not attempt to standardize <u>all</u> real estate finance transactions. Instead, it provides room for market participants to negotiate alternative agreements according to their own risk appetites. This leaves open opportunities for innovation and further advancements.

Competition

MBA is grateful that the PMMIA attempts to address a fundamental flaw in the current statutory and regulatory framework regarding the statutory charters of the GSEs. Fannie Mae's and Freddie Mac's congressional charters give them a competitive advantage that no other private MBS issuer has – a government guarantee that at one point was implied, but was made explicit when they entered conservatorship. MBA believes transferring to a federal regulator the authority to charter additional

competitors, and approve and disapprove certain MBS, solves the problem of insufficient competition in the secondary market.

Disclosure and Securities Registration
The disclosure provisions of the PMMIA are generally consistent with MBA's support for efforts to increase the transparency and reliability of investment product information. MBA is mindful that the financial services system has witnessed a tremendous increase in the level of complexity and sophistication in financing options, investment products and liquidity channels. We believe it is vital for investors to have sufficient information so they can adequately assess whether a particular investment matches their level of risk appetite. At the same time, the secondary market is remarkably fluid. As a result additional securities registration requirements could cause unnecessary delays in MBS execution. Accordingly, we support the PMMIA's exemption for certain securities from securities registration requirements.

Clarification of Qualified Mortgage Exemption
MBA strongly supports efforts to clarify the "ability to repay" provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). Dodd-Frank authorizes the Bureau of Consumer Financial Protection (CFPB) to establish a "Qualified Mortgage" (QM) category of mortgages that will have been deemed to satisfy the law's "ability to repay" provisions. Some have expressed uncertainty regarding whether the QM category is a safe harbor or rebuttable presumption of compliance.

Having considered this issue carefully, MBA urges that adoption of a safe harbor with objective bright line standards serve as the best construct for the QM. Such an approach:

- Is clearly within the powers of the CFPB under the Truth in Lending Act as amended by Dodd-Frank;
- Will provide the strongest incentives for lenders to operate within its requirements, given the severe penalties resulting from non-compliance, and at the same time offer sustainable mortgage credit to the widest array of qualified consumers;
- Will allow efficient and less costly litigation to determine whether the safe harbor requirements have been met;
- Will prevent lenders who conscientiously meet the requirements from being dogged by endless and costly litigation including meritless claims that would be encouraged by anything less than a safe harbor;
- Will avoid saddling qualified borrowers with the costs of legal uncertainty in the form of lack of access to credit, or, if credit is made available, higher interest rates and fees (which is the only way the industry will be able to support the costs of litigation); and

- Will help maintain competition in the marketplace by reducing the burden on smaller lenders.

The rebuttable presumption of compliance, in contrast, would:

- Cause lenders to act more conservatively and potentially use the more restrictive "Qualified Residential Mortgage" (QRM) standards (under Dodd-Frank's risk retention section) as a "safe harbor";
- Result in the denial of credit at a higher rate and/or increase costs to many borrowers;
- Have the most serious effects on the availability and costs of credit for minority, low- to moderate-income and first-time borrowers who, though qualified, may present greater credit risks;
- Invite more extensive litigation than necessary, resulting in greater costs being borne by all borrowers;
- Eliminate competition from the marketplace by creating a level of risk makes compliance too costly for smaller lenders; and
- Diminish the recovery of the housing market and the nation's economy.

For these reasons, MBA believes it is imperative to unequivocally clarify that Dodd-Frank provides a bright line safe harbor for QM purposes.

Other Considerations

While there is much in the PMMIA that aligns with MBA's recommendations, we believe a properly designed real estate finance system must be capable of operating in times of extreme conditions. Unfortunately, we know all too well what can happen in a liquidity crisis. MBA believes the past few years have given us perspective on how to design a new system that addresses the current system's shortcomings while preserving its many benefits. We hope you will consider the following recommendations as you continue discussing the issue of housing finance reform.

The Federal Government's Role in Housing Finance

The financial crisis proved that some form of government support is necessary to keep the mortgage market operating during times of severe distress. The current dearth of activity outside of government-supported liquidity channels exemplifies the risk averse nature of private capital. Foreign investors are flocking to Ginnie Mae securities for the sole reason that they are backed by the full faith and credit of the United States.

More importantly, even in good times, investors will remember the experiences of the recent crisis. If they doubt their ability to sell mortgages during a crisis, they will be less apt to buy them outside of a crisis.

The size and scope of the nation's housing market means that, except in times of extreme duress, the federal government's secondary market role should be to promote liquidity for investor purchases of MBS, not to attempt to provide the capital for or absorb the risks itself.

Without a government backstop, the market will be limited to investors willing to take on catastrophic risk. While such investors may exist, they are much fewer in number than those who willingly trade more than $200 billion daily in the agency MBS market. Without these investors, the market is susceptible to a "run" during times of financial turmoil. Practically, this means that middle-income homebuyers seeking core products would lose access to the market during crises.

It is important to note that the absence of an explicit guarantee does not mean the government will not step in during a crisis. In fact, GSE securities have always been mandated to state that they are explicitly not backed by the government. The last crisis showed that the government will step in to support even institutions that were not perceived to have an implicit guarantee. The taxpayer is better protected, and the market will operate more efficiently, if the rules of the road are stated clearly upfront, and government guarantees are clearly delineated and paid for before the crisis occurs.

Securitization is an alternative liability structure for funding mortgages and as such is subject to the same volatility problems that have historically made bank deposits unstable and subject to bank runs. When depositors or security holders become concerned over the health of the assets supporting their investments and have imperfect information regarding the future performance of those assets, they want to liquidate their positions. In the case of banks, this is a run on deposits. For securitization, it is a panic sale of the securities with a large drop in price. It was the macroeconomic effects resulting from those bank runs that precipitated the Great Depression and lead to the creation of the Federal Deposit Insurance Corporation (FDIC) in 1933.

This FDIC-type liability insurance structure is essentially the system MBA recommends establishing for MBS. Except in extreme instances, the private capital of the insuring entities will be adequate to pay any losses on MBS. However, in order to mitigate the panic sale of MBS resulting from the imperfect information that always exists regarding asset quality, a back-up insurance structure should be established to pay any losses if the capital of a first-level insurance/guaranty entity proves inadequate. This is precisely how the FDIC fund works. Just as is the case with the FDIC, the support of the government and the potential exposure of the taxpayers would come into play only if the capital of the securitizing entity proved inadequate and the insurance fund was exhausted. As with the FDIC, however, taxpayers' funds would be returned as the insurance fund is replenished. The role of the regulator, therefore, would not be to oversee the pricing of the risk attributes of individual mortgages, any more than federal

bank regulators oversee the pricing of individual loans held by banks. Instead, the regulator will look at the capital, earnings and management of the guarantor entities with an eye toward overall risk to the insurance fund, just as regulators do for the overall health of banks.

Questions have been raised as to whether the government can price a guarantee correctly. Certainly the FDIC has mispriced the deposit guarantee in the past, with taxpayer funds needed to meet interim cash needs until the fund is replenished. The key point is that there exists within the FDIC structure a mechanism for repaying the taxpayers and correcting for any overpricing or underpricing. We expect a similar mechanism to be put in place with MBA's structure. Perhaps more important, the government is providing a backstop guarantee against the risk of an institution failing and is forced to price only that institutional guarantee, not guarantees on individual loans.

Transition
MBA believes it is important to provide for the careful execution of a transition from the current to the future state of the housing finance system and to retain as much of the public goods as possible. It is important that any action take place in a careful and deliberate manner. Ignoring the consequences of interim actions and the pace of economic recovery could shock a still-fragile housing market, severely constrain mortgage credit for American families, and expose taxpayers to unnecessary losses on loans the institutions already guarantee. During the transition, it is also important that the operations of Fannie Mae and Freddie Mac continue to serve the market and the American people, including retaining the human capital necessary to effectively run both institutions.

MBA believes it is inefficient, if not wasteful, to dismantle portions of the existing infrastructure, which are the result of decades of effort and public investment coupled with billions of dollars of private capital. Many aspects of this infrastructure (data, systems, market practices) are essentially public goods at this point and should be retained.

While a gradual transition to a new housing finance system is desirable, there are strong reasons to lay out a clearly defined future for mortgage finance as soon as possible. The uncertainty over the future policy environment is deterring the recovery by inhibiting the ability of businesses and investors to plan and move forward.

Regulatory Oversight
One of the strengths of MBA's model is that while all approved MBS issuers would have access to a government backstop for catastrophic insurance, they would have the ability to compete with respect to how they manage the first loss credit risk. For example, they

might set different parameters with respect to loan guidelines (within the proposed Dodd-Frank "ability to repay" rule's QM credit box). They might also have different risk sharing arrangements with originators, mortgage insurers, and other counterparties. Each approved issuer would make a tradeoff between the risk they retained and held capital against, versus sharing the risk and returns with counterparties. Competition along these dimensions would add choice and flexibility to the market place. It would also reduce systemic risk, as credit decisions would be dispersed, rather than concentrated, in the hands of just one regulator or two GSEs. MBA believes the concentration of risk within one regulator is an aspect of the PMMIA that should be addressed.

Risk Retention

MBA has mixed emotions with respect to the PMMIA's provision to eliminate Dodd-Frank's risk retention requirements. We firmly support and understand the goal of risk retention as a means to bolster accountability for real estate finance market participants. At the same time, we believe the current proposed regulations issued by federal regulators would do far more damage than good. Given the choice between a deeply flawed rule and no risk retention requirements, it is fair to say it would be better not to have them at all. On balance, therefore, MBA believes it would be better to eliminate Dodd-Frank's risk retention requirements than implementing the law in a poor or misguided fashion.

In particular, MBA advocates removing the proposed borrower debt-to-income (DTI) and loan-to-value (LTV) requirements from the "qualified residential mortgage" exemption from risk retention, in order to align it with the original intent of Congress. MBA also emphasizes that the alternative QRM proposal, mandating a 10 percent LTV, would be as bad or potentially even worse (in terms of negative impact for first-time homebuyers) than the 20 percent LTV requirement, as it would fracture liquidity in the market. The proposed Premium Capture Cash Reserve Account is likewise unworkable.

Even though the PMMIA would overturn Dodd-Frank's risk retention requirements, other provisions of the PMMIA could be interpreted as authorizing a similar framework, or worse. Specifically, PMMIA instructs FHFA to establish MBS risk classes and underwriting requirements, including DTI, LTV, borrower credit history and other elements similar to the QRM criteria. Moreover, the PMMIA bestows this authority on a single regulator rather than the six regulators authorized to establish risk retention requirements under Dodd-Frank. Apart from objecting to specific regulatory underwriting requirements, MBA questions whether a single regulator has the necessary expertise and capacity to undertake this initiative.

Mortgage Servicing
MBA is concerned about the mortgage servicing provisions of the PMMIA. As a result of the unprecedented volumes of non-performing loans during the current cycle, single-family mortgage servicers have experienced difficulties in their ability to adjust systems and work processes quickly to meet the ever-changing regulatory environment, including changes to loan modification programs, and the time required to hire and train employees for these new processes.

We believe a voluntary national residential mortgage servicing standard would be beneficial to streamline and eliminate overlapping requirements. A national servicing standard, however, must be truly national in scope and not simply another standard layered atop the already overwhelming number of servicer requirements.

In developing servicing standards, we must pay careful attention to the interdependence of servicing and the impact that changes to the system will have on the economics of mortgage servicing, tax and accounting rules and regulations, and the effect of the new requirements on Basel capital requirements and on the TBA market. Servicing does not operate in a vacuum; instead it is part of the broader ecosystem of the mortgage industry. When making changes to the current model we need to be mindful of unforeseen and unintended consequences that could result ultimately in higher costs for consumers and reduced access to credit.

While we support the development of a consensus set of national servicing standards, MBA believes the topic is sufficiently complex to merit its own separate discussion rather than as an adjunct to secondary market reform. Moreover, mortgage servicing is of such a dynamic nature that it could be seriously impaired by static statutory mandates.

National residential servicing standards should start with a full analysis of existing servicer requirements and efforts to standardize state laws on foreclosure. The new standards should be promulgated in a process that includes open dialogue with all stakeholders, including federal regulators, state regulators, consumer advocates, servicers, and investors in mortgages and MBS. MBA continues to welcome the opportunity to participate and play a constructive role in such a process.

Financial regulators and other enforcement authorities are engaged in separate efforts pertaining to national standards that address numerous mortgage servicing issues including customer service, the processing of payments, foreclosure processing, operational and internal controls, and servicer compensation and payment obligations. This effort is the proper venue to deal with servicing standards. Assuming a balanced approach is taken, this effort will ensure uniformity in application, reduce regulatory burden and risk for mortgage servicers, and provide certainty to the secondary market

while ultimately achieving the objective of comprehensive, consistent enforceable standards.

Multifamily Housing Finance
MBA wishes to underscore that the secondary mortgage market supports the financing of single-family and multifamily properties, and that both serve critically important roles in housing our nation. MBA's recommendations address both parts of the market. The same principles apply to the federal role in the core single-family and multifamily secondary mortgage markets, including the importance of the federal government guarantee in ensuring liquidity. Even though the multifamily market had much lower default rates and stronger performance than the single-family ownership market during the recent downturn, ensuring liquidity in this market would be equally important in a new real estate finance system.

Conclusion
I am pleased to reiterate that MBA agrees with many aspects of the Private Mortgage Market Investment Act, particularly its strong reliance on private capital. We look forward to assisting this subcommittee, the full Financial Services Committee, and other congressional leaders as this debate continues and you develop a framework that ensures liquidity and stability in the marketplace at all times.