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INVESTOR PROTECTION: THE NEED TO PROTECT INVESTORS FROM THE GOVERNMENT

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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INVESTOR PROTECTION: THE NEED TO PROTECT INVESTORS FROM THE GOVERNMENT

Thursday, June 7, 2012

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 2:34 p.m., in room 2128, Rayburn House Office Building, Hon. Scott Garrett [chairman of the subcommittee] presiding.

Members present: Representatives Garrett, Schweikert, Lucas, Neugebauer, Pearce, Posey, Hayworth, Hurt, Grimm, Stivers, Dold; Waters, Miller of North Carolina, Maloney, Donnelly, Carson, Himes, Peters, Green, and Ellison.

Chairman GARRETT. Good afternoon. This hearing of the Subcommittee on Capital Markets and Government Sponsored Enterprises is called to order. Today's hearing is entitled, "Investor Protection: The Need to Protect Investors from the Government."

I thank the panel for being here. We are on a little bit of a schedule, since we are starting 34 minutes late, so I will be pretty exacting with the time for each of the witnesses and also the members of the subcommittee. We will begin with opening statements, and I will yield myself about 5 minutes for my remarks.

As I indicated, today we are holding a hearing to further examine a number of measures advocated for by the Obama Administration that have basically negatively impacted a wide variety of U.S. investors, including pension funds, 401k plans, university endowments, mutual funds, insurance companies, foundations, and municipal entities.

Specifically, the Administration has taken a variety of actions where they have sided with the bigger banks, deadbeat foreign governments that we know of, and big labor, all at the expense of our own U.S. investors.

These actions include, first, the recent National Mortgage Settlement Agreement. In this instance, the Administration worked out an agreement with the Nation's four largest servicers in the wake of the robo-signing controversy, where the banks agree to pay a significant penalty but with funds purportedly going to help homeowners. As part of the agreement, the Administration allows the banks to get credit on what they owe by literally taking money out

of securitization trusts owned by private investors, including again, pension funds, 401k plans, university endowments, and the like.

So in this case, we actually have the Administration advocating policies that directly take money from the investors who committed absolutely no wrong whatsoever in order to pay, at least partially, for the problems admitted to by the banks. To ensure that this terrible outcome doesn't occur again, I offered an amendment to the Fiscal Year 2013 Department of Justice's appropriations bill to block the use of any funds by the Justice Department from entering into similar agreements or settlements in the future, where money is forcibly removed from residential mortgage-backed securitization trusts. This amendment passed, and it is my hope that it will remain in the final fiscal year funding bill.

Next, we have the Argentina default issue. In 2001, Argentina was the third largest economy in South America. Now, it is the largest sovereign debt default in history, with hundreds of U.S. investors taking billions of dollars in losses, despite Argentina having the money to pay the bill.

Since the 2001 announcement, U.S. and other foreign creditors have won more than 100 judgments against the Argentine government and it has continued to ignore these judgments, despite its promise to respect U.S. law. In February, the U.S. District Court for the Southern District of New York handed U.S. investors that they had still not settled a significant victory by agreeing that Argentina violated a key provision of the bond agreement and that it should treat obligation to all the bondholders, at least equally to the obligation of others. Argentina then appealed the decision to the U.S. Court of Appeals for the Second Circuit.

This now is where the Administration could not resist intervening against U.S. investors. On April 4th, at its own discretion, without being asked by the Court, this Administration submitted an amicus brief weighing in on the side of Argentina and against U.S. investors. So I hope to learn more today from our panel as to why the Administration felt that they had to interfere, as opposed to just allowing the matter to go through the courts impartially.

Finally, let us turn to the crisis-secured bondholder write-down. In 2009, the Administration took the unprecedented action of forcing secure creditors to take a backseat to unsecured labor unions. Regardless of how someone feels about the appropriateness of the Federal Government bailing out the big auto companies, at the very least, there would be some agreement that secured bondholders, who have a legal priority, should not have their claims superseded by those who may be politically connected—the unsecured labor unions.

This breaking of private contracts and the harming of secured investors is really a blow then to the rule of law in this country and it has set a dangerous precedent, a political intervention on behalf of politically favored constituencies. Investor protection, therefore, is tantamount to ensuring healthy and well-functioning capital markets. The Administration should be working to protect the investors, not harm them.

It is unfortunate that I have yet to hear a peep of concern after any of these actions from any of the usual groups that claim to cherish the role and importance of protecting investors, but we

haven't. I guess, from their perspective, it is only bad when investors get harmed by the private sector and not by the government. I, however, fail to see the difference. In fact, because the government is usually perceived by many people to be on their side, I feel that it is even more incumbent upon the government to go that extra mile to ensure that none of the actions are negatively impacting the American investor.

Also, it is important to recognize the severe negative effect these various actions will have on investors and these markets going forward. We are now introducing a new type of risk to the U.S. investment market decision. Usually, investors have to determine a narrow set of risks, such as credit and interest rates. Now, we are adding an additional layer—government risk.

Unfortunately, over the last several years during this Administration, we have seen a dramatic rise in crony capitalism, where the government picks the winners and the losers, based on political connections. This must end.

With that, at this time, when our economy continues to be sluggish, it will be appropriate among the savings to last through those golden years, this Administration should be taking actions to protect these investors and savers, not taking actions to harm them and making them worse off.

And with that, I will now yield to Mr. Peters for 2½ minutes.

Mr. PETERS. Thank you, Mr. Chairman. As we sit here today, we have had 27 straight months of private sector job growth, with the auto sector leading the way, adding more than 231,000 new jobs since General Motors and Chrysler emerged from bankruptcy. Yet here we are 3 years later and we are debating the bipartisan effort undertaken by both the Bush and Obama Administrations to help General Motors and Chrysler restructure.

Let us put aside for the moment that the auto rescue saved hundreds of thousands of jobs. Let us put aside that the bankruptcy was far more successful than anyone would have expected. And let us take a moment to ask what investors were actually harmed by the government's actions.

Here are the facts. Chrysler's debt was trading at about 30 cents on the dollar prior to bankruptcy, which is about what the creditors received. And 90 percent of Chrysler's creditors agreed to the bankruptcy sale. Critics of the auto rescue offered no facts to demonstrate that GM or Chrysler's investors were actually harmed. Instead, they alleged the company's workers received a bailout. Nothing could be further from the truth.

The UAW sacrificed billions of dollars in earned benefits. Workers accepted a 50 percent pay cut for newly hired employees and thousands lost their jobs as a result of plant closures. Most importantly, there was no private financing available to fund the bankruptcies of General Motors and Chrysler. Had the government not intervened, they would have been liquidated and this would have had a devastating impact on the economy, causing widespread failures in the supply base and resulting in major losses to investors.

The government's decision to intervene was designed to avoid this nightmare scenario. The money that went to the UAW was not taken from investors. It was money designed to ensure that General Motors and Chrysler had a workforce. Giving the investors

anything beyond what they would have received or recovered through liquidation would have amounted to a bailout and it would have been a windfall for those who had purchased their investments for pennies on the dollar.

So what is the real purpose of this hearing today? A cynic might argue that it is nothing more than a partisan attempt to discredit one of President Obama's greatest economic success stories in order to harm his chances at being reelected. I look forward to testimony of the witnesses today to see if there is any evidence presented that would lead to a less cynical conclusion.

Thank you.

Chairman GARRETT. The gentleman yields back time. I don't believe we have any on our side right now.

So, Mr. Donnelly for 2½ minutes.

Mr. DONNELLY. Thank you, Mr. Chairman.

At the height of the recent economic crisis, our Nation's auto industry faced serious financial problems, putting the jobs of more than 3 million hard-working Americans in jeopardy. The failure of the domestic automobile industry would have had a devastating impact on Indiana's economy, America's economy, and the American workforce.

The potential failure of Chrysler and General Motors threatened the jobs of nearly 150,000 Hoosiers, from transmission workers in Kokomo to parts suppliers and dealers from the Ohio River to Lake Michigan. The threat to our auto industry wasn't just a threat to Hoosier jobs. It was a threat to our way of life and would have plunged Indiana into a depression.

In December 2008 and January 2009, the Bush Administration stood behind our automakers and their financial arms, providing temporary assistance and arguing that not providing any assistance to companies like Chrysler would make the recession even worse. When the new Administration took office in 2009, they built on that precedent to keep the industry alive, working to secure Chrysler's first lien creditors a greater return than they would have ever received under the liquidation, while keeping Chrysler and the thousands of Hoosier jobs that support it alive. Shortly after, the Chrysler Group began repaying those funds and reinvesting in the American auto industry and our Nation's communities.

Chrysler Group has since paid back all obligated loans to the government. At a time when private capital is scarce, I strongly supported this temporary assistance, as did the Democratic Administration and the Republican Administration. Chrysler's spring 2009 sale to Fiat prevented the company from facing total collapse, an action which would have been devastating to an already fragile economy. This was not an easy decision, but it was a necessary one.

I saw a clear choice: to either bet on American automobile workers, American industry, and American investors; or to bet against them. We bet on American workers and we will continue to do so every single time we are presented with that choice.

Today, we know we made the right decision, which was upheld at every stage by our Federal courts, to stand behind American workers and families because Chrysler and the American auto-

motive industry have bounced back from near collapse. In 2011, the sales of Chrysler vehicles worldwide increased by 22 percent. Chrysler Group's U.S. market share rose 10.5 percent, up from 9.2 percent a year prior. This was driven by a 43 percent increase in U.S. retail sales. Most recently, Chrysler Group reported a 30 percent increase in sales from May of 2012 over sales from May of last year. These are the best sales since 2007.

We will continue to stand with our American automobile industry today, now, and long into the future. And we will also stand with American investors and American workers. This was an extraordinary success story.

Chairman GARRETT. That is fine. The gentlelady from California for 2½ minutes.

Ms. WATERS. Thank you, Mr. Chairman.

I think that there are likely some areas where we will agree today, and I appreciate your holding this hearing. But before I get into the substance of my remarks, I must say that the title of this hearing—"The Need to Protect Investors from the Government"—does cause me some concern. I think that the overwhelming message of the financial crisis 4 years ago was that investors need more legal protections and more enforcement from our regulators, not less. That is why we devoted all of Title IX of the Dodd-Frank Act to investing in protection and the regulation of securities.

Additionally, Mr. Chairman, I think that we agree that we both have concerns with the joint Federal and State settlement with the five largest mortgage servicers. But before we get into that, I think it is important not just to focus on the government role in negotiating the settlement, but to remember that investors also obviously need protection from the servicers that caused this problem to begin with.

I have been following this issue for quite some time. When I chaired the Housing Subcommittee, I held the first hearing in the House on the issue of robo-signing and chain-of-title problems. In fact, Professor Levitin, who is here today, testified at that hearing almost 2 years ago.

And while we have achieved some important victories, most notably, the standup of the Consumer Financial Protection Bureau, I am afraid that we still haven't adequately responded to the systemic mortgage servicing fraud that has taken place in recent years on the consumer side. I think the settlement will help too few borrowers and won't help them deeply enough.

And on a related point, I am concerned that the OCC and the Federal Reserve allowed servicers to hire their own investigators under their consent orders. I also understand the concerns of investors that servicers can satisfy a portion of the settlement through a system that gives them credit for writing down loans that they service on behalf of others. While I am a supporter of the principal write-downs, it doesn't make good sense that servicers should satisfy the robo-signing and other claims against them through actions that don't cost them anything or that they should be doing away with.

On the other two issues we will discuss today—the auto rescues and litigation involving Argentine sovereign debt—I think that the Administration generally acted in a way that was consistent with

the law on both of these issues. In fact, the Administration continued policies that had been established by the Bush Administration.

And specifically in the case of the auto rescue, I think the Administration did the best they could to save a critical U.S. industry in the midst of an historic financial crisis. Also, I should note that the structure of those rescues has been upheld in the courts.

I sincerely thank you. I yield back the balance of my time.

Chairman GARRETT. And the gentlelady yields back the balance of her time. The gentleman from Connecticut is recognized for 2½ minutes.

Mr. HIMES. Thank you, Mr. Chairman. Mr. Chairman, the title of this hearing today caught my eye. This premise that investors need protection from the government is interesting for two reasons. One, it is a novel concept. Centuries of experience with bubbles and crashes have shown us the need for smart regulation—how important that is to well-functioning markets.

But also, in my 3 years here, I have watched as the Republican Majority has seized each and every opportunity to remove and erode every protection that is there in the law for our investors as well as to damage the SEC and ECFTC to reducing their budgets. And so I ask myself, why are we here?

We are obviously here for political reasons. If you read the summary of this testimony, this is all about pinning these couple of purportedly and allegedly dastardly acts on President Obama. So let us evaluate the claims on the merits. Let us ask two questions: who are the investors that we are talking about here; and how have all American investors fared during the Obama Administration?

Now, who are the investors in Venezuelan sovereign bonds and in Chrysler's senior debt? The answer of course is tremendously sophisticated institutional investors in private funds who, in law, are deemed to not require the kind of oversight that retail investors have. I pulled the offering circular for the Venezuela offering and it yielded 11 and 12 percent interest. Why? Of course, because these are enormously risky investments that should not be undertaken other than by sophisticated people.

Page one of this offering circular reads, "Argentina is a foreign sovereign state. Consequently, it may be difficult for you to obtain or realize upon judgments of courts in the United States against Argentina. In no way do I wish to imply that the investors deserved what happened to them, but they were the swashbucklers of the investment world who knew what they were getting into, which brings me to the question—and if I will bring the committee's attention to the graphic on the wall right now. How have investors in this country fared over the Obama Administration? Let us add up the maximum possible loss of three of the investors or the investor categories in the session today. And you get something on the outside, around $100 billion.

Since March 2009, shortly after the President took office, the stock market alone has restored $7.2 trillion in household wealth to U.S. investors. The amount of money we are talking about today is less than 2 percent of that restoration. Now, because I care about logic, I am not going to offer 100 percent of the credit for that to the President of the United States. But if I can watch the Repub-

lican Majority blame gas prices entirely on the President, and the slow job growth numbers on the President, I would ask anyone in the Republican Majority if there is a good reason why we should not give entire credit for this $7.2 trillion gain on the part of 121 million American investors entirely to President Obama?

I yield back the balance of my time.

Chairman GARRETT. And the gentleman yields back the balance of his time. I will yield myself 2 minutes just to respond to a couple of those points.

First, the gentleman makes some sort of references as far as cuts or reductions—regulators—

I know of no data to show of any cuts to regulators. In fact, the facts of the matter are, you would see year over year increases in the regulators' budget.

Secondly, to the gentleman's point that these type of investments are risky investments, they may well be, but now, thanks to legislation out of past years' legislation and this Administration, add one other factor of risk to it. Not only the risk that this is a South American country that may have some variables down there, but now, you have the added risk of political cronyism, as this Administration gets involved in it.

So an added risk—we talked about liquidity risk, credit market risk, and the other risks involved there, as the gentleman from Connecticut just cited. Now, you have the risk of the Federal Government—getting involved with it. That was not the intention of the Federal Government, being able to involve itself in this matter.

Thirdly, to your chart which is now gone. How do you argue in a counter-factual? Your point being—creditors did a lot better under the situation where the Federal Government got involved with the auto company bailouts.

If you want to do a true apples-to-apples comparison, as opposed to your chart, which I guess is an apples-to-oranges comparison, your chart basically says—on the one hand, this is where—what—when the Federal Government gets involved and spends taxpayers' money to pick its winners and pick its losers, under your scenario that the creditors did better than under the second scenario where no taxpayer dollars would have gone into a bankruptcy proceedings. That is not really a fair comparison.

If you wanted to do a fair comparison, one would be putting taxpayer dollars into both situations—into the situation that occurred (a)—where the government picked winners and losers; or (b) into a bankruptcy scenario. Had you done that, I would assume that the honest creditors would have actually done better. They would have then known what the rule of law would be. And those parties who had no secured interest whatsoever in this matter—namely, the unions—would not be represented on your chart whatsoever.

So let us be fair about it. Let us compare apples-to-apples, as opposed to apples-to-oranges. And let us also be fair to the investors, and remember who the investors are. The investors are not some big Wall Street conglomerate or those sophisticated people that you are talking about, making these swashbuckling risky investments. The investors are the people down the street—the pension funds, the university funds, the 401k plans. It is the retirees down in Florida. Those are the investors who have been harmed in each one

of these cases, not by the investment per se, but by the involvement of the Federal Government.

With that, I yield back the balance of my time. And I believe all time has expired. So with that, we now look to our panel. And again, we are on a hard deadline here.

I would like to welcome the panel. Mr. Fiorillo, you will be first up. And for all the witnesses who are here today, we thank you for being a member of our panel. We thank you for your complete testimony, which will be made a part of the record. You will be recognized for 5 minutes, of course. And I will say this once, although I will probably say it one, two, three, four, five more times: make sure you push your button on your microphone and make sure you pull it as close as you possibly can so that people like me can hear you.

Good afternoon. You are recognized for 5 minutes.

STATEMENT OF VINCENT A. FIORILLO, TRADING/PORTFOLIO MANAGER, DOUBLELINE CAPITAL, LP, ON BEHALF OF THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

Mr. FIORILLO. Chairman Garrett, Ranking Member Waters, and distinguished members of the subcommittee, thank you for the opportunity to testify.

My name is Vincent Fiorillo and I am a 35-year veteran of the housing, finance, and mortgage securities industry. Currently, I serve as a portfolio manager at Doubleline Capital in Los Angeles. However, in my testimony, I am representing the Association of Mortgage Investors. The AMI represents the managers of mutual funds, long-term investors for State and local pensions, and retirement funds for a range of institutions, including unions, teachers, and first responders.

In truth, many of you and your constituents are probably mortgage investors through your 401ks and other retirement savings, such as the TSP program. For decades, the system for private financial mortgages worked very, very well, in part because this system relied on the rule of law, execution of contracts, and the understanding that borrowers would repay their mortgages.

In recent years, these concepts have been challenged by some government actions, including and then being introduced into the markets. We attribute these government policies to a lack of understanding of what the system requires to remain vibrant. For decades, fixed-income investing in mortgage securities was one of the safest and most secure vehicles for long-term retirement savings. Likewise, it brought private capital to the mortgage market, and it thus enabled people to get credit and expanded opportunities for homeownership.

Today, the U.S. mortgage market operates at a drastically reduced level. And this privately financed mortgage market has largely ground to a halt, as a result of actions taken over the last 4 years. These changes now require investors to quantify and assess a political risk premium to the purchase of mortgages.

Please let me emphasize that AMI members are fiduciaries for their clients, such as pensions and retirement funds. Mortgage investors understand that many hard-working middle-class Americans were economically harmed by the financial crisis. We have

thus strived to work with all parties on long-term effective solutions to the mortgage crisis. AMI is on record for supporting many kinds of relief for responsible borrowers and providing a helping hand, including things like cash for keys, fees in lieu, and, when appropriate, principal reduction. The settlement, unfortunately, has the potential to be a retirement tax, a 401k tax, because it will place a portion of the cost of the settlement on the public who are victims of the alleged robo-signing and anti-consumer activities.

Further, investors were not a participant in any of the negotiations. It is incomprehensible that the mortgage servicers receive credit for modifying mortgages held by third parties, which are often pension plans, 401ks, and endowments at Main Streets. This is why many of the left and the right are looking at this as a bank bailout. As it stands, it will damage the RMVS market further by adding yet another risk premium due to government intervention. It will further restrict the ability of deserving Americans to obtain credit for homes for generations to come.

Please understand we are not saying no to modifications. Servicers have the right and obligation to make modifications to mortgages they service. They should do so, irrespective of an AG settlement. But they certainly should not be able to reduce the cost of their settlement by modifying mortgages they service but don't own.

Our hope was that the final settlement would be designed to address such alleged wrongdoing while not settling with the money of innocent parties. The retirement security of innocent parties will be impacted by this settlement as it is currently filed. The final settlement is now the responsibility of the Oversight Committee for the next 3½ years.

AMI asks for the following four changes to be made on behalf of all stakeholders, including retirees and the public at large. Number one, transparency. The net present value model incorporated into the settlement must consider all of the borrowers' debts, including mortgage debt, credit card debt, and student loan debt. A borrower's total debt-to-income ratio is a significant factor in the analysis.

Two, monetary caps to protect public institutions. As intended, this settlement causes financial loss for the abusers—the bank servicers and their affiliates. Unfortunately, the settlement is expected to also draw billions of dollars from innocent parties including public institutions, unions, and individual investors, rather than to servicers. It places first and second lien priority in conflict with its original construct, thereby increasing future homeowner mortgage credit costs.

Number three, public reporting. We ask that the settlement administrator be required to make reports public and available on a monthly basis, reporting progress on clearly defined benchmarks and detailing on both a dollar and percentage basis, whether the mortgages modified are owned by mortgage servicers or the general public.

And fourth, investors stakeholder participation. Our clients and the general public are important stakeholders of this settlement, yet we were excluded from the negotiation. Investors must be included in any further negotiation with additional servicers in the

future. The consequences and the mechanisms underlying this settlement greatly concern investors, including the establishment of a precedent that condones the bad deeds of others being paid by innocent responsible parties. And this settlement will undo contractual obligations that have second liens treated in a pari passu matter with other senior debt.

And lastly, we wish to thank Chairman Garrett and his House colleagues for his recent appropriations amendment, which passed the full U.S. House of Representatives last month. We believe that the dual goals of protecting seniors and savers across this country and providing relief to responsible distressed homeowners are bipartisan and these efforts on a Federal level should be bipartisan as well.

And again, we thank you for the opportunity to testify.

[The prepared statement of Mr. Fiorillo can be found on page 42 of the appendix.]

Chairman GARRETT. Great. Thank you, Mr. Fiorillo.

Ms. Goodman, welcome to the panel today. You are recognized for 5 minutes.

STATEMENT OF LAURIE S. GOODMAN, SENIOR MANAGING DIRECTOR, AMHERST SECURITIES GROUP, L.P., ON BEHALF OF THE ASSOCIATION OF INSTITUTIONAL INVESTORS

Ms. GOODMAN. Thank you very much, Chairman Garrett, and members of the subcommittee. I thank you for your invitation to testify today. My name is Laurie Goodman, and I am a senior managing director at Amherst Securities Group, a leading broker/dealer specializing in the trading of residential and commercial mortgage-backed securities.

I am testifying on behalf of the Association of Institutional INVESTORS. Collectively, the members of this Association, all long-term investors, manage investments on behalf of more than 100 million American workers and retirees. Thus, the concerns I express are not just those of a group of institutional investors. They are also those of the 100 million individuals they ultimately serve.

I will focus on the mortgage market, discussing three specific topics where the government has taken action contrary to the interests of investors with no investor input—the State Attorney General settlement, the treatment of second liens mortgage modifications, and the unwillingness of the government to recognize that the cost of delay in the foreclosure process are borne by investors, not the servicers that were responsible.

To reiterate the points made by Congresswoman Waters and Vince Fiorillo, the $25 billion settlement between the State Attorneys General and the five largest servicers allowed the servicers to use investor funds to pay for servicer wrongdoings. Out of this $25 billion, at least $10 billion must be used for principal reductions. With servicers receiving a dollar of credit for each dollar of portfolio loans written down, 45 cents of credit for each dollar of private label securities is written down.

We believe principal reduction is the most effective form of modification, but are concerned about the potential for abuse under the terms of the settlement. In particular, if the affected servicers are unable to economically modify a sufficient number of portfolio loans

to meet their targets, they might choose to more aggressively write down principal on investor loans. For example, they may have to do a larger write-down when a smaller write-down would be sufficient.

Speaking on behalf of the Association of Institutional INVESTORS, we recognize the settlement is done, but have three pragmatic requests. First, servicers should provide investors with information on modification activity performed on loans and private label securities under the settlement. We have included the information request in our written testimony. This should not be too much of a burden, as investors have been assured that most banks intend to rely exclusively on principal reduction on portfolio loans to meet their settlement targets.

Second, going forward, servicers should be unable to use investor money to settle charges of servicer wrongdoing. We understand there is discussion on other mortgage settlements and want to ensure investors are protected. We are vocal supporters of the Garrett amendment to the DOJ appropriations bill. Thank you, Mr. Garrett.

And third, provide transparency to investors on servicing fees during foreclosure delinquency, mirroring the disclosure to borrowers under the terms of the AG settlement. This is especially critical as some bank servicers own pieces of the foreclosure process such as forced place insurance and property preservation services.

When investors purchased private label securities, they assumed lien priority would be respected. The second lien would be written off before the first lien suffered any diminution of cash flows. HAMP was originally designed by Treasury, aided by servicer input, with no input from investors. It required only the first lien to be modified. This reflected the fact that banks often own the second lien and service the investor-owned first lien. Modifying the first lien increase the value of the second lien.

In response to investor outrage, the 2MP program was introduced, which requires that the modification on the first and second lien be done in a proportionate manner, essentially making the liens pari passu. This treatment shows a flagrant disregard for the legal concept of lien priority.

Neither borrowers nor investors want to see foreclosure. However, some foreclosures are inevitable and quick resolution is in the interest of both parties. The government has shown no recognition that there is a real cost to investors of needless delay in the foreclosure process. In particular, investors must pay taxes, insurance, and maintenance on the property, or accept a lower sales process if not maintained.

The timelines have extended considerably. The average loan is now 26 months delinquent at the time of liquidation, up from 16 months 3 years ago. This increase was initially due to the banks' struggles to implement HAMP. Then, the robo-signing issue emerged, further extending timelines. And we fear the AG settlement will extend timelines still more.

Members of the Association of Institutional INVESTORS have a fiduciary duty to the organizations and individuals whose money they manage to strive for the highest risk-adjusted returns. Governmental realignment of the risk will force institutional asset

managers to either demand higher returns for those risks or reduce mortgage holdings, which entail credit risk. These governmental actions certainly make it more difficult to bring private capital back to the mortgage market.

It is therefore critical that the government explicitly acknowledge the role of investors as a very important group of stakeholders in the mortgage market and ensure their interests are addressed.

I appreciate the opportunity to share the Association of Institutional INVESTORS' views and I am happy to answer any questions. Thank you.

[The prepared statement of Ms. Goodman can be found on page 47 of the appendix.]

Chairman GARRETT. And I thank you as well.

Mr. Levitin, welcome to the panel.

STATEMENT OF ADAM J. LEVITIN, PROFESSOR OF LAW, GEORGETOWN UNIVERSITY LAW CENTER

Mr. LEVITIN. Chairman Garrett, Ranking Member Waters, and members of the subcommittee, good afternoon. My name is Adam Levitin. I am a professor of law at Georgetown University, where I teach courses in financial regulation and bankruptcy.

The three episodes highlighted by this hearing are entirely unconnected and in no way indicate an anti-investor bias from the Obama Administration. Rather, two of them—the Chrysler bankruptcy and the filing of an amicus brief in the Argentine debt litigation—are consistent with reasoned, responsible stewardship of the State.

The third episode—the mortgage servicing settlement—is problematic. But it is indicative of the Administration being held hostage by the too-big-to-fail banks, rather than evincing animus toward mortgage investors.

Let me address each of these episodes in turn. There are four points to be made in regard to the Chrysler bankruptcy. First, the Chrysler bankruptcy was done according to law. The asset sale underwent significant judicial review, all the way to the Supreme Court, and was found to be kosher, while the plan of liquidation was overwhelmingly approved by Chrysler's creditors and by the bankruptcy court.

Second, it is unfair to claim that the UAW received a greater return than Chrysler's senior lien holders. In the formal bankruptcy distribution itself, the lien holders received 29 cents on the dollar and the UAW got nothing. If we want to account for the UAW receiving an ownership stake in new Chrysler, we must broaden our view to include events outside the formal bankruptcy distribution. If we do so, however, there is no reason not to account for the fact that many Chrysler senior lien holders bought their claims at a discount in the secondary market for less than 29 cents on the dollar or for the UAW's pre-bankruptcy concessions.

The UAW had previously accepted a 40 percent reduction in this pension retiree benefit claim, as well as made enormous concessions in its contract going forward, namely reducing the cost of all future workers by over 50 percent and eliminating pension and retiree health care provisions for those workers. Taking a larger view

then, the senior bondholders came out of Chrysler's restructuring substantially better than the UAW.

Third, the UAW's pension obligations were not funded by the senior lien holders in the bankruptcy, but by the United States and Canadian Governments in fiat. While one can question this funding decision, its only effect on investors was positive. Absent the funding of the UAW Viva, there would not have been a sale of Chrysler's good assets because there was no other bid. Chrysler shopped the company for a year and the bidding window was held open for 3 weeks in the bankruptcy court. No other bidder emerged. Chrysler is an example of the free market, not the government, at work.

Fourth, absent the funding of the UAW Viva, Chrysler would have been liquidated. This would have resulted in a lower return for Chrysler's bondholders and the likely failure not only of Chrysler but of GM, Ford, and most of the U.S. auto industry. As it happens, Chrysler has been a success story post-bankruptcy. And there are hundreds of thousands of your constituents who owe their continued employment to the Obama Administration's responsible support for the auto industry.

Moving on, the fact that the United States filed an amicus brief in the Argentine sovereign debt litigation is hardly novel or evidence of an anti-investor bias. The Bush Administration filed a substantially similar amicus brief in 2004, supporting Argentina's position. Moreover, the Obama Administration has done more to help American investors collect on Argentine debt than the Bush Administration ever did. The Obama Administration imposed trade sanctions on Argentina for its failure to pay a judgment regarding its debt.

Whatever one thinks of the substantive arguments about the Argentine debt litigation, it is entirely reasonable for the United States to have filed an amicus brief, given that the case has implications for the stability of global financial markets and for the ability for the United States to enjoy sovereign immunity abroad. To characterize this amicus brief as the coddling of a deadbeat state is risible.

Finally, there is little to like about the mortgage servicing settlement. It was concluded without any real investigation, despite over a year-and-a-half of dithering. The settlement provides too little relief for too few homeowners. It will not clear housing markets. It will not deter future consumer fraud by the too-big-to-fail banks. It does not even force the banks to disgorge their wrongful profits. And then, there is the possibility that the cost of the settlement will be borne largely by mortgage investors.

The Administration has boasted that $20 billion in homeowner relief required under the settlement will actually result in $32 billion of relief. This amplification is premised on the assumption that the banks will write down principal only on mortgages that they service for others and not on the mortgages they own themselves.

It is hard to square this boast with the Administration's insistence that the settlement will not result in harm to mortgage investors. It is possible that the Administration's claims are merely spin to make the settlement look more meaningful. If the Administration's boasts are correct, however, then either the servicers will get settlement credit for modifying mortgages they were already obli-

gated to modify or servicers will get credit for modifying mortgages that they are contractually prohibited from modifying. Either way, the settlement is a sham. Either no additional modifications are being required or the cost of the additional modifications is being shifted to investors who have not engaged in any wrongdoing and who are not even at the negotiating table.

That said, framing the Obama Administration's actions as anti-investor misses the real problem, namely that the Administration is hostage to the big-to-fail banks. The Administration was forced to take action in the wake of the robo-signing scandal, but it knew it could not impose a serious and proper penalty on the too-big-to-fail banks. The only possibility was the sham settlement of one form or another.

Too-big-to-fail tied the Administration's hands. And while it may be convenient in an election season to frame the issue otherwise, the only way investors will avoid being shafted again by the big banks' misbehavior is by eliminating too-big-to-fail.

I look forward to your questions. Thank you.

[The prepared statement of Professor Levitin can be found on page 59 of the appendix.]

Chairman GARRETT. Thank you, Mr. Levitin.

Dr. Lubben, welcome.

STATEMENT OF STEPHEN J. LUBBEN, HARVEY WASHINGTON WILEY CHAIR IN CORPORATE GOVERNANCE & BUSINESS ETHICS, SETON HALL UNIVERSITY SCHOOL OF LAW

Mr. LUBBEN. Thank you, Chairman Garrett, and distinguished members of the subcommittee. I am the Harvey Washington Wiley Chair in Corporate Governance & Business Ethics at Seton Hall University School of Law in Newark, New Jersey. I was asked to address two issues: Argentina; and the automotive bankruptcy cases.

First, with Argentina. At heart, Argentina's bonds, and the interpretation thereof, are a matter of New York State contract law, not really a matter of Federal law. It is pretty clear—and I think we all have to concede—that Argentina has breached its obligations under those bonds.

Nonetheless, we have this issue that when you buy sovereign debt, you also buy the issue of sovereign immunity. Knowing all this, the holdout bondholders nonetheless decided to decline Argentina's restructuring offer earlier on and take their chances with a litigation strategy. But in the process of implementing this strategy, they have advanced an interpretation of the pari passu clause in those—in that debt instrument that is inconsistent with the understanding of that clause in both corporate and sovereign context under New York State law.

A pari passu clause basically reaffirms the idea that the unsecured debt is not subordinated. In a corporate context, this is obviously extremely important because, while it is a corporation's issue—subordinated debt.

It is quite clear, however, in the corporate context, that the pari passu clause does not protect bondholders from preferential payment of other equally ranked creditors. The only protection against preferential payment of other equally ranked creditors comes under

the Federal Bankruptcy Code. There is no such protection under State contract law. Obviously, there is no Federal bankruptcy system that is applicable in the sovereign debt context.

So what we have here in this litigation strategy is an attempt to convert the pari passu clause from a rule of rank into basically a rule of equality. The problem is that is going to have some serious implications even outside of the sovereign debt context. I have concerns that it will make it very hard to do out-of-court workouts and out-of-court debt restructurings in the corporate context, because I have no idea how you can cabin their proffered interpretation of the pari passu clause to solely the sovereign debt context.

So given that background, it seems to me entirely appropriate for the Obama Administration to intervene in the Second Circuit case and alert the Second Circuit to this state of affairs.

Turning to the bankruptcy cases, the automotive cases—these cases involved a quick sale of the debtor's assets under Section 363 of the Bankruptcy Code. This would have been a novel deal structure. When I graduated from law school—but, of course, e-mail was novel at that time, too—it really has become quite routine in most large corporate bankruptcy cases. Nevertheless, we still have several commentators who continue to argue that Chrysler, in particular, was defective because senior creditors received partial payment, while the unions and former employees received a greater payment.

Importantly, these payments happen outside of the bankruptcy process. So there isn't any real connection, as Professor Levitin has already noted, between those payments and what happened in the bankruptcy process.

It is not even clear that it was a bailout, per se, because it is quite common for senior creditors to pay junior creditors as part of a Section 363 sale to basically ensure peace following the sale. They buy the assets and want to make sure that those assets retain their value. It is not uncommon to pay certain trade creditors that you need. And it is also not uncommon to pay employees, because they also contribute a lot to the value of the assets.

In the absence of any bidder interested in buying either of these automotive companies, the argument that any of the funds going to the unions amounts to a bailout really means that the government should have overpaid for the debtors' assets, or provided a bailout to the secured creditors. That is not really a question of bankruptcy law that results in a violation of the rule of law.

I think we also need to note that 90 percent of the creditors in this case did approve the Chrysler sale. And at heart, Chapter 11 is always about a negotiated deal. And furthermore, that the Indiana funds in this case bought into a syndicated loan agreement. Every single syndicated loan agreement that I have ever seen has a majority rule provision. That is what happened in this case; 90 percent of the creditors agreed to go with it. They were bound by the terms of the instrument they invested in. And I see no reason why that shouldn't be so.

The government stepped in, in these cases, to provide needed financing when none was available. It is sometimes argued that some could have been available in some hypothetical world. I will just, as my final point, note that General Motors had a DIP loan

of about $30 billion. That is more than 4 times larger than any privately organized DIP loan ever. And that wasn't in the middle of a financial crisis.

Thank you.

[The prepared statement of Dr. Lubben can be found on page 72 of the appendix.]

Chairman GARRETT. Thank you. Mr. Olson, I would like to recognize you and welcome you to the committee.

STATEMENT OF THE HONORABLE THEODORE B. OLSON, PARTNER, GIBSON, DUNN & CRUTCHER LLP, ON BEHALF OF THE AMERICAN TASK FORCE ARGENTINA

Mr. OLSON. Thank you, Chairman Garrett, Ranking Member Waters, and members of the subcommittee for having a hearing on an issue of great importance to American investors.

My firm and I represent NML Capital Limited, which is one of many investors that has won substantial judgments from U.S. courts against the Republic of Argentina. NML is part of a family of funds that manages capital for dozens of U.S.-based organizations including colleges, universities, hospitals, and pension funds. My firm and I have also recently represented victims of Hamas-orchestrated and Iranian-supported terror against the government of Iran.

In these representations, I have been troubled by our government's eagerness to side with lawless nations against the interests of Americans. For example, just last month our government filed a brief in the United States Supreme Court supporting the position of the government of Iran that it can refuse to disclose to American victims of Iranian-sponsored terror the location of Iranian assets needed to satisfy victims' judgments.

I have been particularly troubled by positions our government has taken recently against investors in U.S. markets. For example, the government recently intervened in an appeal in favor of Argentina, in a case where the trial court had ruled that Argentina must abide by a contractual obligation to treat one set of bondholders no less favorably than another. Dr. Lubben has mentioned that that is a question of New York law, and the United States intervened without being asked to by the court to express an opinion on State law, not Federal Government law.

The government intervened voluntarily without any invitation from the court, and the issues primarily, as I said, involved New York law. Not only did the government gratuitously intervene, but it also did so after showing no interest in this case for a year-and-a-half after the trial court was considering these important issues.

In the appeals court, it largely repeated Argentina's arguments, adding only unsubstantiated and vague allegations and assertions about U.S. policy. The brief was signed by top officers of the Treasury Department, the Justice Department, and the State Department. Just 1 year ago, the United States Court of Appeals for the District of Columbia Circuit admonished the government that the gratuitous, last-minute filing of such a brief in an appellate court was patently unfair to the litigants and disrespectful to the district judge.

The broader context of the Argentina case raises grave concerns and grave questions about why our government should repeatedly choose to side with Argentina, and this is not the first time. And it is not specifically limited to this Administration. I hasten to make that point. It has happened before, but in different circumstances. But it seems to be happening with increasing frequency. It has involved support for the government of Iran, support for the government of the Congo, support for the government of Argentina—lawless nations that do not abide by the rule of law.

In this case, Argentina unquestionably has the ability to pay its investors. It is sitting on $47 billion in foreign currency reserves in a Swiss bank. Yet, it refuses to pay and has used every means imaginable to avoid paying its judgments and paying the judgments of the United States Court and has spirited its assets out of the United States. It has declared it will never pay a single penny on these debts. A Federal judge who heard this case said, what is going on between the Republic of Argentina and the Federal court system is an exercise of sheer willful defiance of the Republic to honor the obligations and judgments of a Federal court.

Our government's decision to invest taxpayer resources in supporting such defiance—when the courts have not even asked for its views—is disappointing, to say the least. It is all the more disappointing in light of Argentina's recent actions. Nationalizing an oil company, defying international arbitral awards, inciting tensions with Great Britain—these actions have drawn the rightful condemnation of the international community. Yet, when the United States filed its brief in support of Argentina, the Argentine finance secretary celebrated the filing of our government's brief, declaring that it validated the arguments used by Argentina and the general strategy of the Argentine government against American investors.

The time has come for our government to concern itself with the rights of American investors, the rule of law, thoughtfully drawn congressional limits on sovereign immunity, and the enforceability of contracts under U.S. laws voluntarily entered into by foreign sovereigns to induce investments by our citizens. These considerations should not be overridden by vague, inarticulate, and expedient concepts of foreign policy. The lawful contractual and statutory rights of our citizens should be paramount over the unlawful defiance of our laws by governments that have no respect for the rule of law or the laws of nations.

[The prepared statement of Mr. Olson can be found on page 79 of the appendix.]

Chairman GARRETT. I thank the gentleman. Mr. Skeel, welcome to the committee.

STATEMENT OF DAVID A. SKEEL, JR., S. SAMUEL ARSHT PROFESSOR OF CORPORATE LAW, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

Mr. SKEEL. Thank you. And thank you for the opportunity to testify before you today on investor protection. I have had the privilege of coming here for hearings like this one from time to time, and I must say it gives me goose bumps every time I walk into this building. It is a real thrill to be here.

Chairman GARRETT. We will adjust the temperature.

Mr. SKEEL. We'll see if that works. I suspect I won't give you goose bumps with what I have to say.

The past few years have been an extraordinary time, and the government has taken a variety of extraordinary actions. Like many Americans, I believe that some of these actions have been essential, while others have been deeply mistaken.

I would be happy to share my views on these issues—I am after all a law professor and we share our views about everything—and about the substance of these decisions. But that is not what I would like to talk about today. What I would like to focus on today is what I believe is a very dangerous pattern that has emerged during the crisis. And that is the undermining of basic rule of law principles in ways that have injected uncertainty into the markets.

In my initial remarks, I would like to briefly discuss two of the most egregious examples of this: the Chrysler bailout; and the recent national mortgage settlement. I would also be happy to give other illustrations of what I see as a very dangerous pattern or to talk about the Argentine litigation, if you all are interested.

In Chrysler, the Obama Administration commandeered the bankruptcy process so that it could decide which creditors got paid and which didn't. As you can see, I have a slight difference of opinion on this from Professors Lubben and Levitin.

Rather than use the ordinary reorganization process, the Administration structured the transaction as a sale of all of Chrysler's assets—all its good assets—to a new company that looked suspiciously like the old company, except that some investors were invited to participate in the new Chrysler and others were not. Now as Professor Lubben said, sales of assets as an alternative to using the normal reorganization process, have been a problem in Chapter 11. Not everybody loves them. Professor Lubben himself has criticized the common use of the sale of assets, rather than ordinary reorganization.

But whatever you think about sales of assets in many current Chapter 11 cases, the Chrysler bankruptcy was highly irregular and highly unusual. It was not like other cases. It was structured so that new Chrysler—the shell company that the assets were being sold to—and any potential competing bidder were essentially required by the terms of the transaction agreement and by the bidding rules in the bankruptcy case, to make the same deal that the government did—to protect the creditors that the government wanted to protect and not to protect other creditors.

Defenders of the transaction have argued that if another bidder came along, it would not have had to do what the government wanted it to do, but this is not accurate. There were bidding rules in the case that essentially required any bidder to do the same things for the UAW and for Chrysler's trade debt that the government wanted to do.

As far as the point that Professor Lubben made that payments to the UAW and to trade creditors were made outside of the bankruptcy process, that is not accurate either. They were required as conditions of the sale agreement. The sale agreement had these as terms of the sale.

I have one last thing to say about Chrysler, which is that a number of people have made the comment that the Chrysler transaction was approved by every court that looked at it. That is not accurate either. I think this misconception has stemmed from op eds that Steve Ratner, the former car czar, has written, which have included this mistake. Actually, the Supreme Court threw out the appellate court decision in Chrysler, vacated the opinion, but decided not to go further because it felt that it was too late to do anything. So it is not true to say every court blessed this transaction.

Very quickly on the mortgage settlement, I believe that the settlement is an abuse of the litigation process and a usurpation of the proper role of the legislature—that it is a legislative action masquerading as a litigation settlement. The basis for the mortgage litigation was robo-signing and related abuses. The settlement has almost nothing to do with robo-signing. What the settlement is, is a way to try to deal with the mortgage crisis a little bit—a very badly structured way to try to deal with the mortgage crisis and a small bailout to the States. And that is the way the States have been treating it.

I believe that these examples and other examples like them reflect a serious erosion of the rule of law in this country, and that it is a threat to our markets. It is also a threat to the recovery that we are all hoping to see.

[The prepared statement of Professor Skeel can be found on page 87 of the appendix.]

Chairman GARRETT. Thank you.

And with that, I thank the panel for all of their testimony and their comments and their opinions. We will now turn to questions. And I will recognize myself for an initial 5 minutes.

The first question will go to, I guess, Mr. Fiorello, and Ms. Goodman, if you want to chime in as well, or any members of the panel.

Political risk with regard to the issues that we are talking about here—this is an additional component now of two investors and how will that affect the price of bonds?

Mr. FIORILLO. I will go first, and Laurie will follow up.

Chairman GARRETT. Okay.

Mr. FIORILLO. Basically, when we look at bonds—when we look at mortgage bonds—we have some assumptions we have to make: how many folks will default; how many folks will not default; how many will pay on time; and how many will be late. And we take all that information and we put it into a yield table, if you will, or calculate what the return should be.

Now, not only do we have to do that, we have to understand that the Federal Government could stand up and say, I am disallowing something that we have been relying on several years—maybe 30 years or so. And they are going to change the rules in the middle of the game.

Changing the rules in the middle of the game adds basis points to the individual borrower. And if it is a small change, it is 20 basis points. If it is a big change, it is 100 basis points. But your constituents pay more for their mortgages. And I think that is what you need to hear.

Chairman GARRETT. Ms. Goodman?

Ms. GOODMAN. Yes, and it influences not only the mortgages that are outstanding, because the recovery is going to be lower, there is some probability of principal write-downs of what is necessary. But it also affects the mortgages going forward, because it builds in the possibility that the government can change the rules of the game going forward. So there is an extra risk premium on mortgages that haven't yet been made.

Chairman GARRETT. Mr. Skeel made a comment about the lack of the rule of law—the uncertainty of the rule of law. This is something I heard repeatedly during each one of these cases going through when I talked to stakeholders. And stakeholders are simply investors and investors are simply pension funds and charities and municipalities and the rest, from the lowest level to the most sophisticated level. They are all saying, "I don't know what the rule is going to be anymore." So what you are saying is, "When you don't know what the rules are of the road anymore, how do you drive?" I use that analogy—you drive slower. Okay. And maybe you don't invest in much at said cost.

Now, on the Argentine situation, I guess I will address this to Mr. Olson. I understand that Argentina's economy minister is coming here to D.C. next week to hold a press conference. And supposedly it is to help the fact about—as you gave in your testimony—that there is a refusal to pay U.S. investors.

When I heard about that, I said that is sort of an undiplomatic thing to do on the first front—to come to our country and say, hey, we are doing something that is going to hurt U.S. investors and we are proud about that. But what doubly gets to me is that this is part and parcel because the Administration became involved in this suit. And you said this is maybe some involved in past Administrations, though, as well. But clearly, it is—but they have—Argentina has been emboldened. Is that the correct way to look at it in this situation?

Mr. OLSON. They say so. I would say that this official is coming 1 week too late, Mr. Chairman. Because if he would have come this week instead of next week, he could have been here today to answer your questions about—

Chairman GARRETT. There you go.

Mr. OLSON. —this very thing. And I would—

Chairman GARRETT. It would have been interesting.

Mr. OLSON. Maybe you can invite him to testify and answer these questions. If he wants to tell American investors what Argentina is doing to American investors, he ought to tell them under oath before this committee.

The fact is that Argentina lured American investors into buying their bonds by waiving sovereign immunity, submitting to the jurisdiction of New York courts, promising to pay obligations on an equal basis among all of its unsubordinated bondholders. They have offered 27 cents on the dollar and then said, they passed a law saying that anybody who didn't accept that 27 cents on the dollar would never be paid.

Argentina is now defying the judgments of U.S. courts. It has spirited money out of the United States. It has all the money it needs to pay the judgments of United States courts and it is

defying the United States courts and the rule of law. They should answer those questions about why they are doing that.

Chairman GARRETT. Yes, I agree with you. I don't know whether they would come to the panel, but I guess we could ask them sometime.

I will close with a question to Mr. Levitin. In your written testimony, you state that the Obama Administration is not anti-investor, because "actions that are unfavorable to one set of investors are frequently favorable to another set. In at least two of the episodes involved, the Administration's actions were favorable to many more investors than they were unfavorable."

I think that goes to the question that we are raising today. And that goes to the political nature of the investment, if you will, by the Federal Government. That you are picking one set of investors to be more favorably treated than another set of investors. And that goes to Mr. Skeel's comment that coming into it as an investor, I have no idea which way the government is going to happen to come down on the situation; whereas, you would know it in a bankruptcy.

Mr. LEVITIN. I think it is important to know why the Administration chose particular sets of investors. It is not because the Administration liked one group of investors or another. I think it would be very wrong to characterize this as some sort of a crony deal.

Instead, I think that in both the Chrysler case and the Argentine bond litigation, you have the Administration looking out for a larger interest than any group of investors. In Chrysler, you have the Administration looking out for the entire country, trying to make sure that the United States did not lose its industrial base.

In the Argentine situation, the Administration has an interest in ensuring that we can have workouts of sovereign debt, so that we don't have problems like what is going on in Greece right now.

Chairman GARRETT. Thank you. I see my time has expired. The gentlelady from California?

Ms. WATERS. Thank you very much, Mr. Chairman.

I have a question for Mr. Levitin. When you testified in front of my Housing Subcommittee nearly 2 years ago, you were one of the early commentators to point out the real scale of the abuse that is happening in servicing and securitization. The major mortgage servicers at that time—at that same hearing—downplayed all of the allegations being made, even though they had initiated a voluntary foreclosure moratorium because of press reports about their foreclosure practices. Months later, of course, we finally saw a settlement emerge over these practices.

First, do we know if the settlement amount of $25 billion is a fair penalty? As I understand it, the Consumer Financial Protection Bureau (CFPB) came out with an analysis before the settlement, saying that servicers had saved $25 billion by deliberately underresourcing in their servicing. And we know that servicers can satisfy the settlement amount through all sorts of activities that might not actually cost them anything, including write-downs of investor-owned loans.

Can you talk about both the $25 billion overall number and the credit schedule that guides how servicers can comply with the settlement?

Mr. LEVITIN. It is, unfortunately, really impossible to figure out if the settlement figure is in any way fair, because there was no investigation done. We don't know if the Administration settled the case where it didn't know what it was settling. And that makes it very unlikely that we got to a reasonable settlement figure.

What we do know is that there was a CFPB analysis that was leaked, there was an internal document and that it showed, without showing the methodology, that the CFPB was estimating that servicers saved somewhere in the neighborhood of $25 billion through various corner-cutting in the foreclosure process. It is not clear exactly what was included there. And therefore, it could have actually been a much larger number, but the CFPB's estimate from a—and this is on PowerPoint deck that got—that somehow got leaked—was that there was $25 billion in savings.

So the best-case scenario here is that we have seen disgorgement of these wrongful—of these savings. I don't even think that is taking into account time value, which is considerable on $25 billion. So in the end, the banks were probably coming out ahead with this.

Ms. WATERS. Thank you. You described the national mortgage settlement as the conclusion to round one of an ongoing struggle for accountability and reparations for the enormous damage the housing bubble did to the United States.

You note that round two is marked by the creation of the residential mortgage-backed securities (RMBS) working group, which was announced in January of 2012 during the President's State of the Union. How would you assess the progress of the RMBS working group so far? Now that we have settled the servicing issue, should the public be confident that they are going to seriously investigate the securitization aspects of the recent financial crisis?

Mr. LEVITIN. Given what we know publicly about the workings of the RMBS fraud taskforce, we should not be encouraged. There are two things in particular that come to the Floor. First, is that there is no appropriation for this working group. The Administration has, in my understanding, proposed something in the range of a $55 appropriation, which strikes me as rather small, but that appropriation has not been made.

Secondly, there is the matter of the staffing of this taskforce. And at this point, it seems that a relatively small number of existing Federal employees have been detailed to this taskforce, such that its staffing is a fraction of the taskforce that existed to deal with fraud in the S&L crisis.

Ms. WATERS. Finally, I have been very concerned with the parallel effort going on at the OCC and the Federal Reserve under their mortgage servicing consent order process. How would you assess the credibility of that process?

Mr. LEVITIN. I think that process has very, very little credibility. The OCC never managed to actually find any problems with the servicing process until it was raised publicly. And somehow, its examiners entirely missed the process.

What I know of the OCC's internal investigation is that the OCC avoided asking many of the most important questions about the process. The supposedly independent outside consultants that have been hired by the servicers often have pre-existing relationships with those servicers and the conflicts have not been fully disclosed.

The disclosures of the contracts that the OCC have made have been heavily redacted. And in one case, actually, the OCC, after extreme pressure, finally announced that it was rescinding that independent consulting work for Allen Hill because of a conflict of interest.

In all, I think that we are unlikely to see any meaningful relief for homeowners coming out of either these consent orders or the servicing settlement. And I think that is a real shame.

Ms. WATERS. Thank you very much. I yield back.

Chairman GARRETT. The gentlelady yields back. The gentleman from New York is now recognized for 5 minutes.

Mr. GRIMM. I came into the hearing very interested in this subject matter. But as it progresses, I have gone from interested to extremely concerned. If we could just take a step back, Mr. Levitin, you had just mentioned that it is your belief that the President was making a decision in two areas in specific that were in the best interests of the country. He wasn't picking because he liked one group over another, but it was in the interest of the country.

Don't you think that undermines the separation of powers to some extent, especially when you are talking about court cases? Isn't that the court's decision to decide the law?

Mr. LEVITIN. I think it is the court's decision to decide the law, but I don't think that is what the President was doing. I don't think he was usurping the court's powers by filing an amicus brief. That is something that the United States does all the time.

And the concern of the United States in the Argentine debt litigation is that if Argentina is found not to have sovereign immunity in American courts, the United States might lose its sovereign immunity in foreign courts. So therefore, when someone brings a tort suit against the United States—

Mr. GRIMM. If I could just stop you there—but if the court decides that they did, in fact, waive their sovereign immunity, then that is the law. Is it not?

Mr. LEVITIN. Of course.

Mr. GRIMM. Even if it is bad for the United States. And sometimes things are bad for us. What makes us the United States and makes us great and gives us an innate advantage over most countries in the world is that rule of law.

I would submit to you that it absolutely undermines that, even if it is bad for us. And I am not saying you shouldn't want to protect—a parent wants to protect its child but they have to let them out into the world, as scared as they may be, or they are not doing their job as a parent.

Mr. LEVITIN. But the United States does have a right to express its opinion on judicial appeals and that is what this is—that if the Second Circuit or ultimately the Supreme Court says that Argentina doesn't have sovereign immunity, that is the law. And I don't think there is any indication that the Administration would disagree with it. It is simply the Administration saying that, at this point, it thinks that the district court has the issue wrong.

Mr. GRIMM. Okay. I was surprised to hear that there was this press conference. I was very, very surprised by that. I agree with the chairman. I don't think that is a diplomatic thing to do. I think that Argentina has been emboldened by this amicus brief.

I thought that it was odd that the United States would side with Argentina, which isn't a particularly poor country. Are they able to pay the investors? Do they have the means to pay the investors?

Mr. LEVITIN. Are you asking me, sir?

Mr. GRIMM. Sure, why not?

Mr. LEVITIN. I believe they do, but again, I don't think the issue—

Mr. GRIMM. It is a yes-or-no question. Do they have the means to pay the—

Mr. LEVITIN. Yes. I think they have the money, but I don't think that is the issue in the litigation

Mr. GRIMM. Okay. I didn't ask you what the issue was. I asked you if they have the means, counselor. Thank you. They choose not to. I have a couple of minutes left.

Let me ask—I can't see everyone's name from here—Mr. Olson. Do you know if the Administration considered the effect on the deficit of intervening in Argentina's side against U.S. investors, because my understanding is, if U.S. investors are given back the money that they are owed, they are going to pay more in taxes. Doing rough math, wouldn't it mean that the U.S. Treasury in tax revenue would receive close to a billion dollars if Argentina made good on the debt that it owes?

Mr. OLSON. I don't know whether the Administration took that into consideration or not. I think the most important thing is the rule of law. We have repeated judgments that Argentina is defying. They do have the money to pay it. They have $47 billion in reserve that they could use to pay these judgments of United States courts that have been rendered as a result of their submission to the United States courts as a part of inducing the people to invest.

The United States Government has a right to file a brief. There is no question about that. Although they did that in this one case without any request from the court and after 2 years after the litigation had been going on, and they allowed the district court to consider all these issues, and never once said what their interest was and then they file this brief.

I am bothered by the fact that the United States Government is filing briefs supporting the Congo—the government of the Congo. And in support of Iran—against terrorism victims, despite congressional legislation giving them the right to sue the government of Iran. And then, repeatedly, on the side of Argentina. And as I said, the Argentine government says this validates our strategy against United States investors.

I kept asking, "Why is the United States Government constantly taking the side of tyrants against U.S. investors?" And someone said, "Ted, you don't understand; at the State Department, there is no American desk."

Mr. GRIMM. And on that, I yield back.

Chairman GARRETT. The gentleman yields back. Thank you.

Mr. Miller, you are recognized for 5 minutes.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman. This hearing is an interesting exercise. I think the Majority wants to ingratiate themselves to Wall Street, but Wall Street is actually not a monolith. There are diverse interests, and in fact, adverse interests. And this is an exercise in how to let mortgage investors say

how they have been done wrong, when in fact their interests are very adverse to those of the biggest banks, by saying the hearing is about how mortgage investors have been done wrong by the government.

Ms. Goodman, Mr. Fiorillo, do you agree with Mr. Levitin that the injustice in the mortgage servicing agreement—and I agree with you that there was an injustice in having investors pay for the sins of servicers and in having seconds treated the same, instead of behind firsts in line. But do you think that injustice was done to harm investors or was it done to advantage the servicers—the big banks—unjustly to your disadvantage? Do you really think the government wanted to hurt you?

Mr. FIORILLO. It is funny. The banks have really good attorneys. And by the way, I would like to thank you personally for your support of investors through a lot of this. You have been very supportive. But I think it is really important to understand that without investors at the table, there was no one to raise the issue.

Mr. MILLER OF NORTH CAROLINA. I did.

Mr. FIORILLO. Okay. So what I think we have to deal with is, yes, the banks have done it, and we need the government's backing to make sure that we get it right.

Mr. MILLER OF NORTH CAROLINA. Right. Ms. Goodman—

Ms. GOODMAN. Can I just say that there was a very simple way to structure the settlement, that was to require the banks to pay for it themselves. That is, no use of private investor money. It is your wrongdoing. You pay for it. And for that part, the government is responsible.

Mr. MILLER OF NORTH CAROLINA. Okay. Your criticism is good when it is not that principal was reduced. In fact, in your testimony, you said that you support principal reduction.

Ms. GOODMAN. I have been a huge supporter of principal reduction, even before it was cool to be that.

Mr. MILLER OF NORTH CAROLINA. And your objection is that the principal reduction should have come from the pockets of the servicers, not the investors. Is that correct?

Ms. GOODMAN. Even doing principal reduction on investor loans is fine because there are lots of instances where that is the highest net present value modification alternative. What I object to is the banks getting credit for their own wrongdoing for doing it because it encourages abuse.

Mr. MILLER OF NORTH CAROLINA. Ms. Goodman, both you and Mr. Fiorillo talked about the conflict for servicers servicing firsts that are owned by somebody else by investors while holding or being an affiliate holding seconds that they do actually own.

Ms. GOODMAN. Huge problem.

Mr. MILLER OF NORTH CAROLINA. I had introduced legislation, as has Mr. Garrett, to prohibit that conflict of interest.

Ms. GOODMAN. Thank you.

Mr. MILLER OF NORTH CAROLINA. Do you support that legislation?

Ms. GOODMAN. Absolutely.

Mr. MILLER OF NORTH CAROLINA. Okay. It seems if the servicer was truly acting without a conflict on behalf of the investors, they would have a great deal of bargaining power to go the holder of the

second and say, "The homeowner is a couple of months past due. He says he can pay a mortgage if it is reduced some. We can foreclose and you will lose everything. Or we can talk."

It seems like there is a lot of bargaining power there. Do you agree with that?

Mr. FIORILLO. Yes. I totally agree. I am sure Laurie agrees as well.

Mr. MILLER OF NORTH CAROLINA. Mr. Levitin, I think you have written on this topic. What bargaining power would a servicer hold if they were truly acting on behalf of the firsts and had no conflict?

Mr. LEVITIN. If a servicer is acting on behalf of the firsts and has no conflict, you should be seeing a lot more principal write-downs.

Mr. MILLER OF NORTH CAROLINA. On the first without—on the seconds without—

Mr. LEVITIN. I am sorry. I may be confused by the question. If the servicer is acting on behalf—is servicing the first known as the second or does not own the second?

Mr. MILLER OF NORTH CAROLINA. Would they be going to the seconds and saying, let us reduce in pari passu, or would they be saying, let us talk about knocking yours down 90 percent before we knock mine down at all?

Mr. LEVITIN. I think you would see them talking—looking to see reduction of the second before you would have a reduction of the first.

Mr. MILLER OF NORTH CAROLINA. Okay. Mr. Chairman, I will yield back.

Chairman GARRETT. The gentleman yields back. Now, the gentleman from Arizona is recognized for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

Let us see if I can sort of paint this picture from being—I look at the world more from the finance side. And I am also one of those great believers that one of the reasons certain countries are wealthy and some are poor is one of the key factors is the rule of law. That we see rule of law allows capital to be created and flow and investment to work.

Am I looking at maybe only the tip of the iceberg? But a series of things where the rule of law is being thrown aside for what is, at the moment, what appears to be the most convenient or the most politically charged, or even in some models, at that moment, it appears to be economically rational.

I am going to start with Professor Skeel and sort of work through the panel.

First, one of my fixations is outlier added risk premiums that will be added into the mortgage market. If we are ever able to start to rebuild a private MBS market again. We have already been doing a series of things that start to change pre-payment risk and how you would build a model. A number of the heart programs of those things, we have to deal with the reality we changed how you and I would build our statistics there. Have we just now started to add, with something such as the settlement, a whole new level of legal risks that actually now comes from government? And is there a way to calculate that type of risk premium or does it even exist?

Mr. SKEEL. I definitely agree—I believe—

Mr. SCHWEIKERT. I beg you to pull the microphone closer.

Mr. SKEEL. Sorry. People usually don't have any trouble hearing my voice, but I will use the microphone.

I absolutely believe that we now have a political risk factor in a variety of different markets. I think it is difficult to measure, but it is measurable. And people are trying to measure it.

For instance, there were a couple of studies after the Chrysler case trying to measure the effect on credit rates as a result of Chrysler. And what ends up happening is, it depends on who you are and what industry you are in.

I think it is true that these interventions affect people differently, and you can't always tell who the winner and who the loser is going to be. But even if there is not a systematic distortion, there is going to be a distortion, an uncertainty distortion, and I think it is in principle measurable.

Mr. SCHWEIKERT. Professor Levitin, convince me that I am off base that these types of interventions—and, Doctor, you are also welcome to comment on this, too—is that are we starting to create an environment where we are adding a risk premium to maybe all forms of credit markets. Because we are starting to head towards a world where—the agreement is the agreement up until someone wants to change their mind and has good friends in the government.

Mr. LEVITIN. I certainly hope not. My sense is that the market is going to look at the events of the last few years as being sui generis, that they were in response to a particular crisis and that going forward, they are not something that we should expect to be repeated.

That said, if we see a return to sort of a faux private mortgage securitization market, where we have an implicit guarantee, then we do have that risk. That is, but I think instead we are much more likely to see some kind of an explicit guarantee in the market and that will—that will take care of the political—

Mr. SCHWEIKERT. And obviously, my fixation on the mortgage market is very, very small degrees of risk when you start to analyze it and you model it—can sometimes make fairly substantial differences in your cost. And it is not only the mortgage market, but I worry about sort of the stigma through the Bankruptcy Code to even engaging in foreign investments, particularly if there have been waivers of immunity. Is this a pattern or are we just looking at a handful of outliers?

Mr. LEVITIN. In regard to the Bankruptcy Code in foreign immunity, I think there is a debate about how the law is supposed to be interpreted. And there is an easy solution to that. If you don't like the way that the law was interpreted, Congress can clarify that. Congress can clarify what—can add additional protections to Section 363 of the Bankruptcy Code. Yes.

Mr. SCHWEIKERT. With the concerns you have heard, particularly of the Chrysler servicers and some of the others that may have been better than other investors and holders, would you recommend that we go back and take a look at that section of the bankruptcy law?

Mr. LEVITIN. Yes. And similarly, the Foreign Sovereign Immunities Act. If the concern is that Argentina is able to sort of snake

out of its debts—that clarify the extent of sovereign immunity under the FSIA.

Mr. SCHWEIKERT. Dr. Lubben, I know we only have a couple of seconds, but did you also want to share on this?

Mr. LUBBEN. I think on this specific issue, to answer your question about is this an outlier, on the specific issue of the auto cases, I think it is an outlier. Specifically, I think the syndicated loan market would have been very shocked if the Indiana pension funds actually had won that, because the standard terms of the documents are majority rule.

Mr. SCHWEIKERT. All right. Thank you. And—

Chairman GARRETT. Yes?

Mr. SCHWEIKERT. Mr. Chairman, thank you.

Chairman GARRETT. Thank you. The gentlelady from New York is now recognized.

Mrs. MALONEY. Thank you very much. I will be brief. First of all, I want to direct my question to the Honorable Theodore Olson, and to thank you for your public service. I do want to mention that I worked with your wife on the Oversight and Government Reform Committee, and I would like to offer my condolences. All of us in New York are working every day responding to that tragedy.

I would like to address some questions on the Argentina debt issue. And both Treasury and State officials have responded in recent months saying, Argentina must honor their international obligations and the United States will take necessary steps to make sure that they do so and send a clear message that they should. I just want to commend that approach. They should honor the obligations to U.S. lenders.

What more should we be doing to ensure that Argentina is responsible and is true to its debt obligations to America?

Mr. OLSON. One of the things—there can be more pressure put upon Argentina. Argentina has resisted every effort by the United States to require Argentina to submit to judgments of United States courts. The interpretations that the United States Government have given to this Foreign Sovereign Immunities Act—we have talked a little bit today about whether the Foreign Sovereign Immunities Act ought to be amended. But the Foreign Sovereign Immunities Act does not provide protection for the things that Argentina is doing.

And I will recite from the bond agreement that the Argentine government offered when it enlisted American investors in this. It specifically agreed that it would irrevocably agree not to claim and has irrevocably waived such immunity to the fullest extent permitted by the laws of the State of New York.

So what the Argentine government is doing is defying those judgments. It is refusing to live up to its waiver of immunity, its consent to jurisdiction in New York. And the United States Government is repeatedly filing briefs, supporting Argentina's effort to do that. It filed a brief supporting Argentina's effort in connection with its shielding of its central bank. It is using its central bank as an alter ego to transfer money in and out of the central bank to use funds from the central bank for its own purposes. And then when a judge found after 2 years of looking at it that the central bank was indeed the same thing as the government of Argentina.

When that case goes to the Supreme Court, the Government of the United States takes the side of Argentina and says the Supreme Court shouldn't take the case—shouldn't even consider the case.

The same thing happened in connection with the other issues that we have been talking about today. It is incomprehensible to me. The government of Argentina has very, very fine lawyers and very sophisticated legal counsel with respect to this. When not even asked by the United States courts for the United States Government to come in and offer its legal assistance, and say that it is necessary to allow governments to work out their debt problems, when it has nothing to do in fact with the Greek obligations or other obligations, which have been solved by not including the clauses that we are talking about here today, and including collective action clauses in the indebtedness that those governments issue. It has nothing to do with the issue that the United States is raising.

So it seems to me that at a minimum, the United States ought to stay neutral. But if it is going to intervene in legal proceedings on behalf of tyrants who are not obeying the rule of law, or American investors who are depending upon the rule of law, the answer is that it should be supporting United States investors, not the government of Argentina.

Mrs. MALONEY. I couldn't agree more. And I believe Judge Griesa, the judge overseeing the court cases with Argentina and the U.S. creditors in New York has said, "What is going on between the Republic of Argentina and the Federal court system is an exercise of sheer willful defiance of the obligations of the Republic to honor the judgments of a Federal court."

Do you believe that that is a fair assessment?

Mr. OLSON. That is a fair assessment. Judge Griesa has handled scores of these cases against the government of Argentina. I have been in the court where the judge has looked at all of the evidence. He expressed his exasperation over and over again. He says, you do have the money. They have never denied that they have the money to pay these debts. These are judgments of the United States courts.

He has been extremely patient. He has been extremely careful. And he has said over and over again that Argentina has the money to pay this debt. It is willfully defying the orders of the court. It is doing everything possible to spit in the face of United States law and United States courts. He has been very patient, but he has made these conclusions after an abundance of evidence has been presented to him.

Mrs. MALONEY. So what do we do about it?

Mr. OLSON. I think that the expression here today of this committee or this subcommittee and our United States Government that it will not tolerate rules of law frustrating the laws of the United States, which include the Foreign Sovereign Immunities Act.

The other example I mentioned earlier in my testimony had to do with the government of Iran. Congress specifically authorized the victims of terrorism to sue state sponsors of terrorism and to get judgments against them.

The people that we represent are victims of terrorism. There is no doubt that Iran sponsors that terrorism. They are trying to find assets of Iran in the United States and the United States Government has taken the position that they can't have discovery to find out what those assets are in the United States. It has already been decided that Iran is not immune. It is subject to the jurisdiction of the courts with respect to these victims of terrorism.

And the history that you and Congress put in the bill that says that this law has nothing to do with discovery. The United States is taking the position that it indeed gives them immunity from discovery. I don't find that comprehensible.

Thank you.

Mrs. MALONEY. My time is up. Thank you.

Chairman GARRETT. The gentlelady's time has expired. The gentleman from Texas is recognized.

Mr. NEUGEBAUER. Thank you, Mr. Chairman. And by the way, thank you for having this hearing. I think this is an extremely important hearing.

When I think about the credit markets right now and globally, if there is ever a market that needs more certainty, it is the credit markets and certainly less uncertainty. I want to go back to some of the earlier comments. I think a number of us have been working to try to figure out how we get the private mortgage-backed securities market back operating again.

Right now, Freddie Mac, Fannie Mae, and FHA have over 90 percent of the market. And as I have sat down with a number of market participants and they are saying—what does it take to get people back into the mortgage-backed business. One of the things they keep telling me is that all of the uncertainty that surrounds mortgage origination now, whether it is servicing with the regulatory risk of CFPB and all of these new rules coming out.

And then, of course, obviously, one of the things that was brought up was the legislative risk. And now, I think there are these two new risk premiums that are creeping into the market. It is the legislative risk, but it is also the regulatory risk of all of these new regulations and whether these new products or are the existing products in compliance.

So I think the question I would have, Mr. Fiorillo, for you, is what does it take for us to—what kinds of things do we need to send from a signal standpoint to the marketplace to get the private market back operating again, because we can never get the—wing the marketplace from Freddie and Fannie as long as there is no private participation?

Mr. FIORILLO. Congressman, one of the things that frightens me after doing this for 35 years is that the head of a very large insurance company recently said she would never buy another non-agency mortgage-backed security ever again. Okay, that is a pool of a couple of hundred billion dollars in dollars that could go into this market.

You know the "KISS" symbol, the "Keep It Simple Stupid." We have to keep it simple. We can't have 400-page prospectuses. We have to have an investor who can trust the servicer to do what is necessary for the benefit of the security holder. We need a borrower who is going to put some equity into the game. That doesn't nec-

essarily exclude those folks who need extra help. We have FHA. We can use that vehicle to get there and to do that.

But for the basic $600,000 to $800,000 mortgage, that shouldn't be a government product. The U.S. taxpayer shouldn't be financing millionaire holders. Okay? We can do that. Investors know how to price risk. So if you allow us to tell you we need a minimum downpayment. We need to know the foreclosures are done properly. We need to know that the titles have transferred properly and there are ways to do that. And finally, we need to know that when someone says, I make "X" amount of dollars, I can trust that servicer and that originator actually checked that out. And more importantly, when that loan is made, that first lender should have something to say about someone adding a second lien. If you do all of those things—it is not hard—we can get back, I think.

Mr. NEUGEBAUER. Ms. Goodman.

Ms. GOODMAN. Yes, I think the first thing you need is regulatory certainty in terms of what the origination landscape looks like; that is, QM, QRM, HOEPA, disparate impact. You have a bunch of different sets of rules that have interactions that haven't been fully appreciated. They have to be made consistent. You need simple, clear rules.

Second, you have to address the second lien issue, as Vincent mentioned, which means you have to change that clause in Garn-St. Germain, which does not—which essentially prohibits a first from allowing the placing of a second.

And third, investors have to be assured that the conflicts of interest that are inherent in the securitization process. To the extent the rules are spelled out now, they are not going to be changed later.

Mr. NEUGEBAUER. So if I can clear up those and assure the investor that somebody can't come in there and just arbitrarily give them a 5, 10, 16 percent haircut because somebody didn't like the way the policy was implemented, or that is another part of that.

I think the important thing here—this is the last point I want to make, and I think one of you on the panel made this point—ultimately, who pays for these additional risks and uncertainty? Who is penalized for that?

Mr. FIORILLO. The borrower—the new borrower coming into the marketplace.

Ms. GOODMAN. Yes.

Mr. FIORILLO. The more constituents. So they are paying more for the consumer. They are getting more government, but they are getting higher interest rates.

Ms. GOODMAN. Absolutely.

Mr. FIORILLO. No doubt about it.

Chairman GARRETT. The gentleman's time has expired. Now, it is the gentleman from Connecticut.

Mr. HIMES. Thank you, Mr. Chairman.

Mr. Olson, thank you for appearing before us today. And though I don't always agree with the causes on which you advocate, I have a lot of respect for the way in which you do it. An exception to that is your work in California, which I thought was superb and courageous on your part.

I am not a lawyer, so I just want to clarify a few things here in your testimony. We heard you talk quite a bit about the Congo, about Iran, and about terrorism. I wonder with sovereign states, many of which you listed, is it your contention that just because a sovereign state may be a bad actor that they are not entitled to due process within a court of law?

Mr. OLSON. They are entitled to the protection of the Foreign Sovereign Immunities Act, which was enacted by Congress. With respect to terrorist states—

Mr. HIMES. Let us not address terrorist states. Sovereign states, regardless of how we feel about their activities or motivations, are entitled to protection under sovereign immunity and to due process.

Mr. OLSON. They are entitled to those things in different ways.

Mr. HIMES. So it would be—and just, again, principles of law. I might—we would all agree that, for example, a lawyer for one of those States wouldn't be held accountable or wouldn't somehow be regarded as bad for advocating on behalf of that State.

The question I am trying to get at is you don't want this committee to take away the impression that because the President and his Administration have filed amicus briefs on behalf of Argentina or anyone else that they somehow are fellow travelers with the Congo, or that they somehow validate or endorse the positions of those governments. That is not your intention. Am I correct in that?

Mr. OLSON. That is correct. And I might say this: I specifically said in my testimony that it is not specifically focused on this Administration. It has happened in other Administrations.

What I am concerned about is that the governmental entities are looking at this from the perspective or through the lens of the foreign sovereign, as opposed to seeing the perspective of the American investor trying to seek vindication of his or her rights in American courts. Those foreign sovereigns are getting due process in the rule of law and they are represented by very sophisticated, very successful lawyers.

Mr. HIMES. I understand. I just wanted to really clarify that you don't want this committee, out of your testimony, to draw the conclusion that somehow this Administration is—we heard the term "crony capitalism." You are not trying to leave the impression that somehow this Administration is cronies with Argentina, the Congo, or—

Mr. OLSON. No, I did not mean that at all.

Mr. HIMES. Okay. Thank you. Is the filing of an amicus brief, unrequested by a court, which you have highlighted a couple of times here today, very unusual? Do people file amicus briefs when they are not requested to do so by courts?

Mr. OLSON. Circumstances vary. And the United States Government from time to time does that without being invited to by the court. But I quoted, particularly, the United States Court of Appeals for the District of Columbia, which last year chastised the government for waiting until the appellate level, then coming in gratuitously and what the Judge—Judge Silberman—said for the court, in that case, was that this was unfair to the litigant, to come in at this late date and disrespectful of the district court.

Mr. HIMES. No, I understand and appreciate that. And frankly, I am sort of willing to stipulate that it was unfair and disrespectful, but I guess my final question is, would you contend that the Administration has, in any way, usurped or acted extra-legally in any of its actions with respect to these States?

Mr. OLSON. I am not saying they are violating the law. No.

Mr. HIMES. Okay. Thanks. So, sharp-elbowed, disrespectful, but there is no usurpation of the rule of law here by—

Mr. OLSON. Utilizing the power of the United States Government to come in on the side consistently of foreign tyrants, as opposed to United States citizens—I am disappointed that is happening. I think it is the wrong approach. I don't say it violates the law.

Mr. HIMES. You are much more familiar with this case than I am. Do you think that it is likely that the Administration has taken the position that it has because it is somehow a—and again, the Majority's word—"crony" of these countries? Or is it possible that the Administration has taken the position and filed the briefs that it has because it has competing interests of international diplomacy or strategy that might, in fact, be driving the Administration's position here?

Mr. OLSON. I am not saying—I didn't say and I didn't intend to imply, and at no point did I say that it was cronyism.

Mr. HIMES. I am just asking whether it is possible.

Mr. OLSON. What I said is they are looking at this from the perspective of the foreign government, as opposed to from the perspective of the citizens who need their help as much as the foreign governments do.

Mr. HIMES. Thank you.

Professor Skeel, a quick question for you. You raised the specter of a risk premium, if I may use my words, associated with the aggressive activities of the Obama Administration in these three cases. Mr. Olson said that this is not a purely Obama thing. And in fact, we have seen this over a substantial time.

So my question for you is, is there any academic proof of any kind that suggests that the kind of risks that might be—and by the way, I haven't opined on the merits of any of these cases. They are actually quite interesting and complicated. My question for you—is there any proof at all, any analytically supportable proof that in fact in the market today, investors are demanding a risk premium associated clearly with this activity, rather than the destruction of our financial markets or the housing markets, the economy? Is there any evidence out there that that may in fact be true?

Mr. SKEEL. We do have some early studies of the Chrysler case, in particular. And they can be interpreted in different ways. One of the studies finds that the cost of credit for heavily unionized industries went up significantly as a result of Chrysler. Another study finds that bond prices went up, bond costs went down, as a result of Chrysler in unionized industries, presumably because of the expectation of a bailout in those kinds of industries.

So what I would say is we are still at the early stages. It does look like there is an effect as a result of these cases, particularly in industries that look like them.

Mr. HIMES. Thank you, Mr. Chairman. Thank you.

Chairman GARRETT. The gentleman yields back. Mr. Stivers is recognized.

Mr. STIVERS. Thank you, Mr. Chairman.

My first question is for Mr. Olson. I want to kind of follow up on something the gentleman asked you a minute ago. It is my understanding that you testified that U.S. investors have won over 100 judgments against the government of Argentina, yet the government of Argentina is still not making any effort to satisfy those judgments. Can you help me understand, while it is not illegal, why the Administration would choose to interfere and file an amicus brief on behalf of the government of Argentina? And clearly, they have the right to file an amicus brief on anything they want, but what would be a motivation for that? And maybe you can't get into motivation, but I am just curious.

Mr. OLSON. I don't know the motivation, and I certainly do not want to suggest any improper or illegal motivations by the lawyers in our government. I think they are all honorable people. I am disappointed. And I think the American citizens would be disappointed that when there are these close interpretations, and we are talking about provisions of contracts that are very clear. The provision that we are talking about in the one case in the Second Circuit says that the payment obligations under these bonds shall be treated at least equally with other payment obligations. And what Argentina has done is refuse to do that.

The judge, after listening to all this, finds that it is clearly violating those provisions, and now the United States Government is coming in with an interpretation that is not consistent with any court decisions and not consistent with what the scholars have said. And it is unaccountable to me. I would think that as an American citizen, if I was a pension fund and so forth, I would ask, why isn't our government coming in on our side of the interpretation of that, rather than the foreign government, which is defying the rule of law?

Mr. STIVERS. Sure. And one follow up to that. Earlier this year, the U.S. Trade Representative announced that the decision to suspend the general system of preferences eligibility for Argentina because of their unwillingness to try to meet the court's decisions to repay the awards that were found by U.S. courts for these U.S. investors. Yet, then the Administration files this amicus brief that supports Argentina. Does that send mixed signals to the government of Argentina?

Mr. OLSON. It sends a signal to the—here is how the government of Argentina saw it. And I quoted this in my earlier statement—the government of Argentina, as soon as that brief was filed, says that vindicates our position. It vindicates our strategy against the American investors. Their strategy is defiance and they even passed a law prohibiting their payment of this indebtedness or responding to this judgment. That is their strategy. So they took the filing of that brief as support for their strategy against American investors.

Mr. STIVERS. And it is my understanding that Argentina has $45 billion in reserves. So it is not like they can't pay these judgments.

Mr. OLSON. The judge asked them—District Judge Griesa asked them over and over again, are you taking the position that you

can't pay? Is there any evidence that you cannot pay these judgments? Argentina never once took the position that it couldn't pay them. They have $45, $46, $47 billion in reserves in Switzerland. They can pay this indebtedness and, in fact, it will help them ultimately because they might restore some credibility in the financial markets. But they will not pay.

Mr. STIVERS. One last question for Mr. Olson, and then I want to get to Professor Skeel.

What impact will this have on investors' willingness to look at sovereign bonds if they think that an American Administration is going to back the foreign country over the American investor?

Mr. OLSON. It is very devastating for foreign governments who wish to issue bonds to U.S. investors. U.S. investors and any investor needs to know that it will be backed by the rule of law. That is why when Argentina issued these bonds, they said they would submit to the jurisdiction of New York courts under New York law. Because they knew that if they did that, investors would be secure in New York law and in American law. Now, when they don't pay any attention to it, that sends a signal to investors—stay away from this kind of indebtedness, which costs those foreign governments a lot of money.

Mr. STIVERS. Thank you. And to Professor Skeel, a similar question. What kind of impact do you think that the actions of the mortgage servicer settlement will have on investors' appetite for future private label mortgage-backed securities?

Mr. SKEEL. I think it is going to interfere with them detrimentally. I think you can't do something like this and pass on a cost without it having an effect on the market.

Mr. STIVERS. Thank you. My time has expired.

Chairman GARRETT. Thank you. The gentleman yields back.

Mr. Peters is recognized for 5 minutes.

Mr. PETERS. Thank you, Mr. Chairman. I want to move back to the auto side of the discussion here.

I think it is easy to pass judgment now that we are here in 2012 and make up some stories about hypothetical investors who were somehow harmed by the government's intervention in the auto industry, but I think the facts are fairly clear. The rescue of GM and Chrysler has been a huge success for investors. It has been a success for workers, as well as taxpayers.

The Center for Automotive Research has done extensive research on this topic. And in 2010, they issued a research paper entitled, "The Impact on the U.S Economy of the Successful Automotive Bankruptcies." And in this memorandum, they discuss how the orderly bankruptcy saved 1.14 million jobs and that this has had a substantial benefit on government receipts. Rescuing the auto industry avoided a much deeper and longer recession and saved the government tens of billions of dollars in lost revenue and increased unemployment payments.

Mr. Chairman, I would like to ask for unanimous consent that this report be made a part of the record.

Chairman GARRETT. Without objection, it is so ordered.

Mr. PETERS. Thank you, Mr. Chairman.

Professor Skeel, I listened to you with intent to your testimony in talking about other parties bidding in this process. Can you

identify, for the committee here, any other party that wanted to bid on the assets of General Motors or Chrysler?

Mr. SKEEL. In the actual transaction, as you know, the ultimate recipient of Chrysler was Fiat. I think if we had had an ordinary bankruptcy process where there was actual non-governmental money exchanging hands, I think it is quite likely that Fiat would have made a bid for at least some, maybe most, of Chrysler's assets. There may have been other bidders as well.

Mr. PETERS. But you don't know of any other bidders that had any interest in this at the time? At the time when we were in a financial crisis, these companies were in desperate shape. You have no other people who are out there. This is just hypothetical that there were people out there?

Mr. SKEEL. Chrysler certainly had been talking to Fiat for a good period of time.

Mr. PETERS. Other than Fiat.

Mr. SKEEL. Other than Fiat, there were rumors in the market of people who might be—

Mr. PETERS. But nothing substantial?

Mr. SKEEL. But I do not have a specific bidder that I am confident would have been.

Mr. PETERS. Right. Thank you.

Mr. Levitin, do you agree with Professor Skeel that there may have been other private interests out there interested in purchasing these companies that were somehow crowded out because the government was involved?

Mr. LEVITIN. We don't know of any.

Mr. PETERS. Right. So if there is no private financing available for bankruptcy, what is the alternative with restructuring? Is that liquidation?

Mr. LEVITIN. Liquidation was really Chrysler's only alternative to the sale. And that would have cost not just jobs at Chrysler, but it would have cost jobs at GM. It would have cost jobs at Nissan. It would have cost jobs at Ford. It would have cost jobs at all of their suppliers.

Mr. PETERS. But catastrophic, do you have any sense of what the cost—or I should say, what the value of those companies would have been in early 2009, during the height of this crisis?

Mr. LEVITIN. In liquidation?

Mr. PETERS. Yes.

Mr. LEVITIN. I have no sense, but I think it would be very low. I think the Chrysler secured lien holders would have been lucky if they had received anywhere close to 29 cents on the dollar.

Mr. PETERS. Anywhere close to 29 cents. That would have been a generous amount of money in liquidation.

Mr. LEVITIN. Yes.

Mr. PETERS. Mr. Lubben, investors were in fact buying and selling debt right up to the point of bankruptcy, weren't they?

Mr. LUBBEN. Yes, they were.

Mr. PETERS. And is it true that at the time that is where Chrysler was selling—was around 30 cents on the dollar?

Mr. LUBBEN. Around 30 cents and the pension funds had bought in a few months before, at a little higher than that.

Mr. PETERS. And that is basically what the investors ultimately received?

Mr. LUBBEN. That is what they ultimately received. They received 29 cents on the dollar.

Mr. PETERS. So they received what the value would have been. In fact, Mr. Levitin's testimony is that, likely, it was even lower when you are trying to sell off abandoned auto plants, there wasn't a real high value in the marketplace at that time. Nor were there many willing buyers to go in to do that.

Mr. LUBBEN. Yes, if the company had been liquidated, was no longer a going concern, the recovery would have been a lot less. And as it turned out, the recovery was very close to what the market estimated it would be.

Mr. PETERS. So Mr. Lubben, based on the value of those assets at the time, would you say that investors got a fair deal?

Mr. LUBBEN. I think they got a fair deal. I think they got exactly what the market expected they would get.

Mr. PETERS. Now, could you also talk a little bit about what the courts who have reviewed this matter—there has been—Mr. Skeel mentioned that there is some contention as to what the courts have said. I think that is different than your testimony. How have the courts viewed this bankruptcy? Was this an aberration or consistent with bankruptcy law?

Mr. LUBBEN. No, I just—I quote in my written testimony, Judge Gonzalez in the Chrysler opinion, who said that this case is just like any other 360 sale, except for the identity of the Debtor-in-Possession (DIP) lender, namely it is the U.S. Treasury, as opposed to Chase or Bank of America.

So two bankruptcy courts, two different bankruptcy judges approved those two cases. And so far, all the cases have been—when the courts have gotten to the merits, all the cases have been affirmed on appeal. Now, Professor Skeel did note that the Supreme Court vacated the Second Circuit's decision, but they vacated as moot, which basically means the case is over at that point. There wasn't any actual decision on the merits.

Mr. PETERS. Thank you. I believe my time is up. I yield back

Chairman GARRETT. The gentleman yields back. The gentleman from California has joined us. That is great. Mr. Ellison.

Mr. ELLISON. I yield 1 minute to Brad Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Ellison. My question is one in which Mr. Ellison has the same interest.

Ms. Goodman, you said in your testimony that principal modification was good for the investor and that the interest—the principal reduction was good for the investor and that homeowners and investors' interests were aligned on that point.

There has been a great deal of debate about whether the Federal Housing Finance Agency (FHFA) should allow principal reductions by Fannie and Freddie. FHFA says they are different. Their mortgages are better and they are worried that if they allow modifications, people who can pay will stop paying.

Have you done any analysis of whether principal modification makes sense for Fannie and Freddie's loans as well?

Ms. GOODMAN. There are clearly cases in which it does. The FHFA has done a couple of pieces of analysis where they have

shown that it hasn't. But in fact, what they haven't allowed for is using principal forgiveness on some loans and principal forbearance on others. And had they done the analysis properly, they would have found that principal reduction, under some circumstances, makes a lot of sense.

And as to their moral hazard criticism, it is important to realize that you can put gating around the situation to eliminate the moral hazard. You have to be delinquent before a certain date or you can't get the reduction.

Mr. MILLER OF NORTH CAROLINA. Right. Mr. Ellison?

Mr. ELLISON. Thank you. I just want to make a quick comment before I ask a question. I know we are running low on time. I think the framing of this hearing is really unfortunate. And the reason why is because if we were to take any one of these three issues that have been set forth today, I think we would be perfectly legitimate to question the settlement. Is that right or is it not right? Does it make sense—should it not make sense? This Argentine bond issue—clearly, I think it is fair to raise questions here. Different people can disagree.

But to frame the whole hearing as harm the government is doing to the people or to the investors—I guess, let me get the exact title of this hearing—"The Need to Protect Investors from the Government"—is just like flagrant political ideology and I just think it is a misuse of the gavel. And I am very disappointed.

I hope that when we get together back, we don't engage in this kind of just base ideological fighting. Because I think it just lowers the whole Congress when we do it that way. And again, this is without any disrespect to any of the testimony we have heard today. I thank the witnesses for coming in. I think it is important that we have this kind of testimony. I think it is unfortunate that the three issues are grouped this way, as just as sort of general framing of the government or the Obama Administration, quite specifically, as being out to hurt investors or Americans, generally. It is just not true and it is an abuse of this process.

Anyway, Professor Levitin, I just want to ask you a question. In your testimony, you said that investors are not likely to be harmed by this AG settlement if servicers are complying with the pulling servicer agreement. And you state that investors will only be harmed if modifications are being done that are not permitted to be performed by the contract. Can you expand on that?

Mr. LEVITIN. Some pulling and servicing agreements prohibit modifications of various sorts or place restrictions on loan modifications, including principal write-downs. There is variation among pulling and servicing agreements on what servicers may or may not do. In some cases, those servicers are actually instructed to take steps to manage the loans as if for their own account. And if a servicer were doing that, it would be trying to maximize the value of the loan. In some cases, that would mean doing a principal write-down, rather than having a foreclosure.

So following the pulling and servicing agreements in some cases would mean doing principal write-downs, and in other cases would mean not doing them. And it is not clear what is going to happen in terms of the settlement. Generally, if servicers are going to be complying with the pulling and servicing agreements, and there-

fore, simply and not doing modifications on them, or if they are going to violate them and do modifications when they aren't supposed to be doing them. Or if they are going to do modifications they are already obligated to do.

So basically, there are two possibilities: either servicers are going to be doing things they are already obligated to do, in which case, they shouldn't be getting any credit for it under the settlement—that is just a sham; or they are going to modify loans they shouldn't be modifying. And it is going to be done at the expense of investors. That is wrong, too. Either way, it doesn't come out well.

Chairman GARRETT. The gentleman yields back. And at this point, we look for the final word on the matter. The gentleman from California, and congratulations, also, on your recent win the other night as well. The gentleman is recognized for 5 minutes.

Mr. SHERMAN. Only in California does your congratulations on win need to be followed by a "good luck, we hope you defeat the same candidate in the second"—

Chairman GARRETT. It is temporary. Yes, I understand.

Mr. SHERMAN. We have a unique system in California. We are the only State with an exhibition season as part of our—

Chairman GARRETT. We will restart your clock at 5 minutes.

Mr. SHERMAN. That is okay. I won't be long. As to the GM settlement, it is pretty apparent that the Federal Government provided a subsidy for—or an investment for the auto companies as part of the overall deal. If the Federal Government had just stayed out, the companies would have gone bankrupt.

Ms. Goodman, is there any reason to think that if the Federal Government had done absolutely nothing, and the bond holders were picking through the carcasses of these two former auto companies, that the bond holders would be any better off?

Ms. GOODMAN. I am going to actually defer to someone else who has more expertise in that matter.

Mr. LUBBEN. I can give it a shot. So the question, as I understand it, was if the government—

Mr. SHERMAN. If they had gone into a freefall bankruptcy at the worst possible time for our economy, at least in my lifetime, with no Federal involvement whatsoever, why would the bond holders have been better off than they are today?

Mr. LUBBEN. They would have been, I think, far worse off. Because given that there was no liquidity, no financing available at that point in time, and financing—debtor in position financing is vital to continue operating during Chapter 11, because your creditors—your trade creditors, who previously would have extended you trade credit are not going to do that after you file Chapter 11. So it is vital to have that financing. No financing was available at the time. You file bankruptcy with no financing. You pretty much have to liquidate.

Mr. SHERMAN. But the bond holders would be the proud owners of vacant auto plants.

Mr. LUBBEN. Non-operating auto plants.

Mr. SHERMAN. Non-operating auto plants in the Midwest in the height of a financial crisis.

Mr. LUBBEN. Right.

Mr. SHERMAN. I am glad the Federal Government did protect the bond holders from that eventuality. But obviously what the Federal Government did was not focused on trying to help the bond holders, and if the subsidy had been equally proportioned among all the stakeholders, then the bond holders would have been better off.

Now, as to Argentine bonds, Mr. Olson, I have had an interest in these China bonds. I don't know if you have focused on that at all. Britain was able to force Beijing to provide some settlement to those who held the bonds and who are British Nationals. Has the U.S. Government helped or hurt Americans' efforts to collect on those bonds?

Mr. OLSON. I think—I am not aware of anything that the Federal Government has done to help.

Mr. SHERMAN. In contrast to how the British government helped its—

Mr. OLSON. I can't speak to that. I am not sufficiently versed in that, but what I have said is that the consistent taking of legal positions supporting the Argentine government has hurt. So when the United States says it is important to our foreign policy interests or that sort of thing, that a contract be interpreted in a certain way, that is inconsistent with the rule of law and not very helpful.

Mr. SHERMAN. I forget which British prime minister said this but he said, "The home interests have the home office and the foreign interests have the foreign office." Whether the State Department represents us to the world or represents the interests of the world or foreign governments here in the United States is perhaps a subject for another hearing. I yield back.

Chairman GARRETT. The gentleman yields back. And that bell means that votes are upon us at this time. Without objection, we will enter into the record a letter from the American Council of Life Insurers (ACLI).

Without objection, it is so ordered.

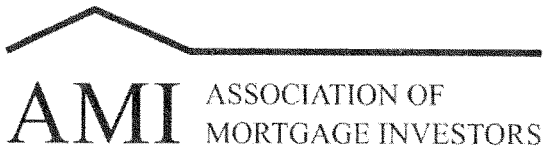
The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to these witnesses and to place their responses in the record.

And with that, this hearing is adjourned.

[Whereupon, at 4:36 p.m., the hearing was adjourned.]

A P P E N D I X

June 7, 2012



WRITTEN STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

HOUSE FINANCIAL SERVICES SUBCOMMITTEE ON CAPITAL MARKETS AND GOVERNMENT SPONSORED ENTERPRISES

INVESTOR PROTECTION: THE NEED TO PROTECT INVESTORS FROM THE GOVERNMENT

JUNE 7, 2012

by VINCENT A. FIORILLO, DOUBLELINE CAPITAL, LP

Introduction

Chairman Garrett, Ranking Member Waters, and other distinguished Subcommittee members, thank you for permitting the Association of Mortgage Investors (AMI) to testify before you on this important topic impacting the capital markets, as well as, America's savers, consumers, and borrowers.

The Association of Mortgage Investors (AMI) commends you and the other members of the full Committee for your leadership in pursuing responsible and effective oversight, your vigilance in helping to keep Americans in their homes, and your tenacity in the development of effective tools against the foreclosure crisis. Since the AMI's formation as the primary trade association representing investors in mortgage-backed securities (MBS), including university endowments and pension funds, AMI has been developing a set of policy priorities that we believe can contribute to achieving this goal. The AMI was founded to play a primary role in the analysis, development, and implementation of mortgage and housing policy to help keep homeowners in their homes and provide a sound framework that promotes continued home purchasing.

Mortgage investors share your frustration with the slow pace of efforts to provide homeowners and the entire housing market with meaningful and permanent relief. We are hopeful that substantial solutions can be implemented more quickly, and we believe that our interests are aligned with homeowners. The AMI supports initiatives designed to help homeowners get out of bad mortgages and into sound mortgages that will allow them to stay in their homes and build equity at the same time. AMI is first to say that investors ought to offer distressed borrowers "a helping hand." Likewise, we favor the "helping hand" of light-handed prudent government regulation. We share the concerns voiced by many from both sides of the spectrum that some recent government interventions into the mortgage market may have not achieved their well-intentioned goals. Even worse, these actions may have unintended consequences that are harmful for the mortgage investors and our partners, including everyday American savers and public institutions such as retirement funds and pension systems.

The Role of Mortgage Investors in the Housing Marketplace

It is important to note that mortgage finance 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, at the time 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 became national and 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 securities structuring techniques.

Mortgage investors are aligned with both homeowners and the government in our shared goals of keeping 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 industries such 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 borrowers.

The use of mortgage-backed securities equitably distributes risk in the mortgage finance industry, and prevents a build-up in a specific geographic region or a specific type of underlying asset. These features, and many others, are those of a market which makes access to capital cheaper and thus spurs more mortgage lending.

Today's single-family mortgage market consists of approximately $10.3 trillion in outstanding mortgages.[1] Of that $10.3 trillion, approximately $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 $3.6 trillion are on the bank balance sheets as whole loans or securities in their portfolios, of which $1.1 trillion are second liens (home equity loans/lines of credit or closed end second mortgages). 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 $1.5 trillion in first lien mortgages reside in private label mortgage-backed securities.

Rule of Law: The Role of Contracts in the Mortgage Markets

Those "private label" (non-Federal agency) securities are put together by banking institutions that pool the mortgages into a trust. That trust is built around a document called a Pooling and Servicing Agreement (PSA). This 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 PSA agreement, there are numerous representations and warranties 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 has been attractive, in part, because they are governed by binding contracts that lend to the stability and predictability that investors desire. Like any purchaser, investors expected the sellers of mortgage securities (which were often large banks) to stand behind their promises. Unfortunately, this critical component of the mortgage securities market has broken down.

Government Interventions into the Markets May be Harmful to Multiple Constituencies

With a restored, vital and healthy securities market, the U.S. will be able to attract more private capital into mortgage investments and, in turn, provide more affordable mortgages for potential home buyers. Mortgage investors understand that many hard-working, middle class Americans were economically harmed by the financial crisis. Accordingly, we have strived to work with all parties on long-term, sustainable, effective solutions to the mortgage crisis. AMI is on record for supporting many kinds of relief for responsible borrowers and providing a "helping hand." This relief includes cash-for-keys, deeds-in-lieu and when appropriate principal reduction, provided it makes economic sense for all parties.

With the National Foreclosure Settlement, we recognize the goal of achieving a fair settlement that would have helped consumers while punishing responsible parties for servicing transgressions. We believe that all principals were well-intentioned in designing a plan for relief, but unfortunately, uninvolved pension plans, 401k funds, and mutual funds were made a party to the settlement and forced to shoulder some of the burden for the bad acts of others. AMI is on-the-record as supporting a settlement of claims against the mortgage servicers if it ensures that responsible borrowers are treated fairly throughout the foreclosure process; while at the same time providing clarity as to investor rights and servicer responsibilities. We cannot, however, support asking others to shoulder the financial burden of the settling parties. By way of background, the Subcommittee must remember that the investors have been as harmed, just as many consumers, due to the breakdown of the current servicing model. Yet, while the settlement was directed

[1] *See* http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm.

at servicer misconduct such as robosigning, savers like you and your constituents are the ones who really pay the price.

The settlement, unfortunately, has the potential to be a retirement tax— a "401K tax." It will place the costs of the settlement on our clients, the public, who were not involved in the alleged robosigning and anti-consumer activities. Further, we were not a participant in any of the negotiations. It is problematic that the mortgage servicers receive credit for modifying mortgages held by third parties, which are often pension plans, 401K plans, endowments and "Main Street" mutual funds. This is why many on the left and the right have called the settlement a bank bailout. As it stands, it will damage the RMBS markets further. By adding yet another risk premium due to governmental intervention, it will further restrict the ability of deserving Americans to obtain credit for homes for generations to come.

Please understand that we are not saying no to principal modifications. Servicers have the right and obligation to make modifications to mortgages they service. Further, the servicers should do so irrespective of the settlement. However, servicers certainly should not be able to reduce the cost of the settlement by modifying mortgages that they service, rather than the ones they own.

Our hope was that the final settlement would be appropriately designed to address such alleged wrongdoing while not settling with the money of innocent parties. The retirement security of these innocent parties will likely be impacted by this settlement as it is currently filed. The settlement was negotiated among the state Attorneys General, the federal government, and certain bank-owned mortgage servicers. On behalf of the public interest, AMI asks that the settlement be amended in the interest of those not a party to the settlement and not responsible for the claimed bad acts. We regret that the settlement was approved by the federal court without a public hearing to allow impacted parties to voice their concerns.

Necessary Amendments Sought to Protect Public Institutions and the Markets

The final settlement is now the responsibility of the Oversight Committee for the next three and one-half years. AMI asks that the following changes be made on behalf of all stakeholders, including retirees and the public at-large:

> *Transparency.* The NPV (net present value) model incorporated into the settlement must consider all of a borrower's debts, be national in scope, transparent, and publicly disclosed. The NPV model must be developed by an independent third-party. An incorrect NPV model will likely lead to further re-defaults and further harm distressed homeowners. Any debt analysis must consider the borrowers' total debt, including mortgage, credit card, and student loans. A borrower's back-end DTI (debt-to-income ratio) is a significant factor in any analysis.
>
> *Monetary Cap to Protect Public Institutions.* As intended, the settlement causes financial loss to the abusers (*e.g.,* the bank servicers and their affiliates). Unfortunately, the settlement is expected to also draw billions of dollars from those not a party to the settlement, including public institutions, unions, and individual investors. It places first and second lien priority in conflict with its original construct, thereby increasing future homeowner mortgage credit costs. It is unfair to settle claims against the robosigners with other people's funds. While we request that it not be done, then at a minimum we request that a meaningful cap be placed on the dollar amount of the settlement satisfied by innocent parties per bank-servicer. Again, any restitution should come from those who are settling these claims and lien priority must be respected.
>
> *Public Reporting.* We ask that the settlement Administrator be required to make reports public and available on a *monthly* basis, reporting progress on clearly defined benchmarks and detailing

on both a dollar and percentage basis whether the mortgages modified are owned by the mortgage servicers or the general public.

Investor Stakeholder Participation. Our clients and the general public are important stakeholders in this settlement. Yet we were excluded from the negotiations over its 15 month process. As long as we are affected, investors must be included in any further negotiations with additional servicers in the future.

The consequences and the mechanism underlying this settlement greatly concern investors, including:

- The establishment of a precedent that condones the bad debts of others are paid by innocent, responsible parties; and,
- The settlement will undo contractual obligations and have second liens treated in *pari passu* with other senior debt.

Garrett CJS Appropriation Amendment

Finally, we wish to thank Subcommittee Chairman Garrett and his U.S. House colleagues for his recent appropriations bill, H.R. 5326, floor amendment which has passed the full U.S. House of Representatives last month. The amendment stated:

> *None of the funds made available by this Act may be used by the Department of Justice to be a party where a single or multi-state court settlement where the funds are removed from any residential mortgage-backed securitization trust.*

While some may critique its language, we agree with its intent: namely, that the federal government should not jeopardize Americans' financial and retirement security with such actions. We are happy to work with you and your Congressional colleagues to perfect the language as the year goes on. We believe the dual goals of protecting seniors and savers across the country; and, providing relief to responsible distressed homeowners, are obtainable and bipartisan. These efforts on the federal level should be bipartisan as well.

Conclusion

Mortgage investors believe that there is a powerful case and history illustrating that well-functioning markets can help expand housing opportunities for responsible borrowers across the country and among all demographics. Government interventions into these markets, while well-intentioned, may have unintended consequences which harm the market and its participants, such as public entities and hard-working American savers. We urge policy-makers on the state and federal level to engage in a dialogue with us about developing long-term, effective solutions to the housing crisis. The system requires the rule of law, effective remedies, transparency, and certainty as to execution of legal promises. Furthermore, by not respecting the priority of liens, rebuilding the mortgage market in the future will only be more difficult.

Thank you again for the opportunity to share my views and those of the Association of Mortgage Investors with the Subcommittee. Please do not hesitate to use the AMI and its members as a resource in your continued oversight concerning the many issues under review. We welcome any questions that you might have.

Amherst® Securities Group LP

June 7, 2012

Laurie S. Goodman / lgoodman@amherst.com / 212.593.6026

6/7/2012 Testimony of Laurie S. Goodman, Amherst Securities Group

Before the

U.S. House of Representatives Committee on Financial Services

Subcommittee on Capital Markets and Government Sponsored Enterprises

TOPIC— Investor Protection: The Need to Protect Investors From the Government

Chairman Garrett, Ranking Member Waters, and Members of the Subcommittee, I thank you for your invitation to testify today. My name is Laurie Goodman, and I am a Senior Managing Director at Amherst Securities Group, L.P., which is a leading broker/dealer specializing in the trading of residential and commercial mortgage-backed securities. We are a market maker in these securities, dealing with an institutional account base; that includes financial institutions, money managers, insurance companies and hedge funds. I am in charge of our firm's Strategy function. Our group performs extensive, data-intensive studies to keep ourselves and our customers informed on critical trends in the mortgage-backed securities market.

I have been asked to testify today on behalf of the Association of Institutional INVESTORS, a very important subgroup of our customer base. The members of this Association are some of the oldest, largest and most trusted federally registered investment advisory firms in the U.S. Collectively, the members of the Association of Institutional INVESTORS manage ERISA pension, 401(k), mutual funds and personal investments on behalf of more than 100 million American workers and retirees. The asset managers that comprise the Association are long term investors whose holdings reflect the patient capital of their beneficiaries, and they have a fiduciary duty to the organizations and individuals whose money they manage. Thus, the concerns raised here today are not just the concerns of a group of institutional investors, but they reflect the concerns of and impact on the more than 100 million individuals they ultimately serve.

I will focus on the mortgage market, where institutional investors are a critical group of stake holders. As we try to bring private capital back into the mortgage market, this group will ultimately bear the risk. A disregard for the interests of these institutional investors will impact the cost and willingness of their participation in the mortgage market going forward. I discuss 3 specific topics where the government has taken actions *not* in the interests of investors, without even giving investors a seat at the table. The most recent is the State Attorneys' General Settlement with mortgage servicers, which I will dwell on at some length. In addition, I bring up 2 other topics where the government has wrongly harmed investors—the treatment of second liens in mortgage modifications (where lien priority is violated), and the unwillingness of the government to recognize that the costs of delays in the foreclosure process are borne by investors, not the banks/servicers that created them. I will take each of these points in turn.

I. The State Attorneys General Settlement

This settlement, between the State Attorneys General (AGs) and the 5 largest servicers (Bank of America Corporation, J.P. Morgan Chase & Co., Wells Fargo & Co., Citicorp, Inc., and Ally Financial, Inc.), with the heavy involvement of the Departments of Justice, Treasury, and Housing and Urban Development (HUD), was finalized in March 2012. This settlement was initiated in response to the use of "robo-signed" affidavits in foreclosure proceedings across the country.

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It resulted in approximately $25 billion in monetary sanctions and fines: $5 billion in cash to the general and state governments, with the remaining $20 billion to be used for relief to borrowers. Of that $20 billion, at least $10 billion must be dedicated to reducing principal for borrowers who owe more than their home was worth, and are either delinquent or at risk of default. At least $3 billion must be dedicated to a refinancing program for borrowers who are current on their mortgages, but owe more than their home is worth. The remaining amount, up to $7 billion, must be dedicated to other forms of relief, including forbearance of principal for unemployed borrowers, anti-blight programs, short sales and transitional assistance, benefits for members of the armed forces, and other programs.

Note that the largest chunk of the assistance, at least $10 billion, is dedicated to principal reductions. The relief is tallied using a series of credits. If the bank/servicer does a principal reduction on a first lien loan in its own portfolio, under the terms of the AG settlement, the servicer "earns" $1 credit toward the settlement for each $1 written down. For loans in private label securitizations, which the institutions/servicers do not own, the servicers earn a $0.45 credit for each $1 written down. The servicers are required to complete 75% of their customer relief obligations within 2 years, and 100% within 3 years. There are additional incentives to relief provided within the first 12 months, and additional cash payments required from any servicer failing to meet its obligations within 3 years. We expect the AG settlement will dramatically increase the use of principal reductions by the affected servicers.

And while the most immediate effect will be on portfolio loans owned by the banks, we also expect an impact on loans in private label securities, including those owned by members of the Association of Institutional INVESTORS. ***Yes . . . the settlement banks can use modifications on loans owned by others to pay for their wrongdoings.***

We believe principal reduction is the most effective form of modification, and we are thrilled to see greater use of this modification tool. However, the Association of Institutional INVESTORS is greatly concerned about the potential for abuse—if the affected servicers are unable to economically *modify* sufficient *portfolio* loans to meet their targets, they might choose to aggressively write down principal on *investors'* loans (e.g. do a larger modification when a smaller one would have been more economically reasonable). It has been argued that the so-called Net Present Value (NPV) test limits the potential for this abuse. Using the Treasury NPV test, as HUD has indicated will be the case, (rather than a less rigorous test designed by the servicers themselves), will certainly help, but does not eliminate the problem. The NPV test requires only that the Net Present Value on the modified loans be slightly better than the proceeds from liquidation; it does not require the servicer to pick the modification that produces the maximum NPV of each loan. It also does not require that the modification be superior to other pre-foreclosure workouts (e.g. temporary hardship payment plan, deed-for lease, FHA short refi, short sale). We would hope that the settlements are closely monitored so that servicers are unable to abuse investor funds to meet their target.

We recognize that the settlement is done; a *fait accompli*. At this point, speaking on behalf of the Association of Institutional INVESTORS, we have three pragmatic requests:

1) Since the settlement is being monitored by the very capable Joseph A. Smith, Jr., we hope he would persuade the banks to at least, provide investors with information on modification activity on private label securities undertaken under the settlement. More detailed loan-by-loan information is preferable, but we would, at the minimum, want to see aggregated information that allows us to look at, on a servicer by servicer basis by mortgage loan ownership (bank portfolio versus securitization) and lien type (first versus second):
    - number of loans modified
    - outstanding balance of loans modified
    - principal reduction percentage
    - percentage of investor loan modifications that followed HAMP standards
    - percentage of investor loans in which the bank owned the second lien
    - average principal reduction amount and percentage on such second liens

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The Association of Institutional INVESTORS has detailed these requests in a separate white paper attached as Appendix A. If banks truly intend to avoid using reductions on private investor loans to meet their required settlement credits, providing this information should not prove much of a burden. And it would provide an easily installed and important transparency for investors.

2) We request that, going forward, banks/servicers be unable to use investor money to settle charges of bank/servicer wrongdoings. We understand that there is discussion on other mortgage settlements, and want to ensure that the AG settlement, with banks/servicers permitted to pay with investor funds, does not become the blueprint for future settlements. We applaud Congressman Garrett's amendment to the Department of Justice (DOJ) Appropriations bill, which would ensure that any future agreement or future expansion of the National Mortgage Agreement protect the interests of investors, both by guaranteeing that investors participate and have a "seat at the table" in any future settlement negotiations, and by preventing servicers from receiving "credit" for their own wrongdoings via spending investor funds. We are very supportive of settlement agreements that treat borrowers fairly through the foreclosure process, and hold servicers accountable; but clearly, investors' contractual rights need to be respected.

3) Finally, for almost zero cost, this settlement could have provided some investor protection in the loan servicing process, via adequate disclosure on fees charged, but it did not. Our proposed protections would be easy to incorporate, even at this late time. The settlement documents require that the mortgage servicers implement new, borrower-friendly servicing standards. These new standards are designed to prevent mortgage servicers from engaging in robo-signing and other improper foreclosure practices; require banks to offer loss mitigation alternatives to borrowers before pursuing foreclosure; increase transparency of the loss mitigation process by providing borrowers more information regarding why they were turned down for modification or short sale; impose timelines to respond to borrowers; and restrict "dual tracking" (where a foreclosure is initiated despite the borrower's engagement in the loss mitigation process). It also provides more transparency on servicing fees and costs, including requiring that all default, foreclosure fees and bankruptcy-related services (including third-party fees) be *bona fide*, reasonable in amount, with detailed disclosure to the borrower. The problem is that nothing requires these fees be disclosed to the investor. This is a large issue for investors, who are effectively paying for these fees by allowing the servicer to net them for loan proceeds. And the potential for abuse is present, as some banks/servicers may own pieces of the foreclosure process. These services include force-placed insurance and property preservation (maintenance services, as well as property inspection services). Furthermore, even when a servicer is not affiliated with the company providing the property preservation activity, the servicer could mark up the fee considerably, and pass the cost along to the private label trust. Shouldn't investors, who ultimately pay these fees through a lower recovery on their loans, have the right to disclosure about these costs? A provision to provide investors the same disclosures as the borrower could have been established at a low marginal cost, and would have been if investors had a seat at the table. We hope that banks would voluntarily agree to this disclosure.

II. Second Liens, and Lien Priority

When investors initially purchased private label securitizations, they had assumed that lien priority would be respected. In the past, when loans defaulted, they were generally liquidated with the first lien holder receiving all the proceeds up to the limit of the original loan, as lien priority would dictate. While loan modifications on this scale were never contemplated, it was natural for investors to assume the second (subordinate) lien would be written off, or at the minimum, curtailed sharply, before the first lien suffered any diminution of cash flows.

Among non-performing borrowers whose loans are in private label securities, a sizeable 31% have second liens. Those second liens are often held in a bank portfolio, and most commonly, that same bank is also servicing the first lien. Of the $873 billion in home equity lines of credit and closed-end second liens, a whopping 92% is held by depository institutions. Of that, $656 billion (or 75%) is held on the balance sheets of commercial banks (including $370 billion on the balance sheets of the 4 largest banks, all party to the AG Settlement), while another $151 billion (17%) is held by non-bank depository institutions (credit unions and savings institutions).

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Owning the second lien while servicing both the first and second liens poses obvious conflicts of interest when the borrower runs into financial difficulty and the loans must be modified. Modifying the first lien increases the value of the second lien. Imagine the surprise to investors when the first version of HAMP was announced and the first lien was the only item modified. Once again, the original modification plan was designed by Treasury, with input from the largest servicers but no input from investors. That is despite the fact that investors in private label securities represent 12% of outstanding first lien loan balances but 38% of the 60+ delinquent loans.

In response to investor outrage, Treasury introduced the 2MP program, a second lien modification program. If a HAMP modification is done on the first lien, the second lien receives the same treatment. So if the interest rate is reduced on the first lien, the interest rate is also reduced on the second lien. If principal is forborne on the first lien, principal is also forborne to the same extent on the second lien. If principal is forgiven on the first lien, principal is forgiven to the same extent on the second. In other words, on a HAMP modification, the first and second liens are essentially treated *pari passu*. But since banks have a safe harbor for modifications done consistent with the HAMP framework, investors have no ability to appeal, and are thus totally at the mercy of the conflicted servicer who is making the decisions on investor-owned assets.

Note that in the AG settlement, the same *pari passu* treatment applies. If the first lien in a private label securitization is written down and credit is taken toward the settlement, the second lien must be written down proportionately. And investors were told they should be grateful for that treatment—in proprietary modifications, if the first was modified, it was unnecessary to impair the second at all.

Even the bank examiners condoned behavior in which banks/servicers modified the first mortgage and took no action on the second mortgage. It is only recently that banks have been required to take an impairment charge for performing second liens secured by the same property backing a non-performing or modified first lien.

Note that there was no attempt, at any point in the development of the modification process, to enforce the legal contract of lien priority.

III. Cost to Investors of Delays in Foreclosure Processes

Neither borrowers nor investors want to see foreclosures, it is the worst option for both—the borrower is removed from their home, and the investor receives a low recovery. Quick resolution is in everyone's interest. For example, modification success is an order of magnitude higher if modifications are done early in the delinquency process. There is no reason that over 40% of modifications occur on loans that are more than 12 months delinquent. However, some foreclosures are inevitable. There needs to be a recognition that the long delays in the foreclosure process, aggravated by government policies, are detrimental to both borrowers and investors.

The average loan in a private label security is 26 months delinquent at liquidation. On average, recently liquidated loan have spent 16 months in a delinquent state, then 7 months in foreclosure, and another 3 months in REO (the "real estate owned" asset category of banks). And these metrics just cover loans with completed liquidations. The delinquency timelines are apt to be longer for seriously delinquent loans that have not yet liquidated; this category disproportionately contains loans in judicial states, where liquidation takes longer. To put these numbers into context—3 years ago the average loan was 16 months delinquent at liquidation; today that number painfully draws out to 26 months. The entire difference is the time spent in delinquency (the period prior to foreclosure filing)—that ran 6 months in 2009, but has now stretched to 16 months. The time in foreclosure + REO has been constant at 10 months.

There is a real cost to these delays, and it is one that hits investors' pockets. If a borrower is not paying, the lender must continue to make the tax and insurance payments (and if force-placed insurance is used, the insurance payments can be quite large). Moreover there is an additional cost, one that we call "excess deprecation". Each day a home is either occupied by a non-paying borrower, or that home is not occupied, someone must pay to maintain it. If it is not being maintained, it will sell for less at liquidation. Based on a detailed loan level severity model, Amherst Securities estimates that these costs total approximately 0.5% of the value of the property per month (or 6% per year).

The foreclosure timeline has been extended in part because servicers have struggled with implementation of the HAMP modification programs (they could not efficiently gather and process the documentation needed for a modification). But

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when servicers finally instituted the systems to gather and process documentation, the robo-signing issue emerged. The remedial efforts further extended timelines and delayed foreclosures. Bank/servicers then had to go back and perfect the chain of title before they could foreclose on a property. We believe that the chain of title should be established prior to foreclosure. It is, and always has been, the responsibility of the servicers to make that happen. But the costs of these delays have been at investors' expense; they should accurately have been charged to the account of the banks/servicers who had the original and ongoing responsibility.

Conclusion

These 3 instances of government intervention harming investors stemmed from well intentioned actions to keep borrowers in their homes through foreclosure prevention. However, foreclosure prevention should be done by banks/servicers as a matter of course, to maximize the net present value of the loans. In fact, the interests of borrowers and investors are totally aligned—the net present value of a loan is maximized when the borrower is successfully modified (as the costs of foreclosure are huge; so avoiding that helps everyone).

In the AG settlement, the government is allowing banks to use investor funds to pay for their own wrongdoings. In the case of second liens, the government has ignored the lien priority issue, as well as the inherent conflicts of interest between the first lien holder and the bank/servicer who is also the second lien holder. In the third instance, the government has required banks to perform their contractual duty, which is to maximize the net present value of the loans. However, the banks/servicers are ill-equipped to take these actions, and the costs of the delays are being borne not by the offending institutions, but by investors.

Members of the Association of Institutional INVESTORS have a fiduciary duty to the organizations and individuals whose money they manage to ensure that the risks of investments are understood and priced accordingly. Governmental realignment of the risks of investment will force institutional asset managers to either: 1) demand higher returns for those risks in future investments, which will ultimately result in higher mortgage rates for loans where private capital is taking the credit risk, or 2) redirect investable funds away from those assets, which also has consequences. It is therefore important that the government address these concerns and explicitly acknowledge the role of investors as a very important group of stakeholders in the mortgage market.

I appreciate the opportunity to share the Association of Institutional INVESTORS' views on this critical issue and would be happy to answer any questions the Subcommittee may have.

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Appendix A: Association of Institutional INVESTORS White Paper

Discussion Paper:

Recommendations of Reporting Metrics
To Be Required By Settlement Participants
To Assist the Independent Settlement Monitor
In Successfully Overseeing the AG Settlement's Implementation

Submitted by the:

Association of Institutional INVESTORS

May 3, 2012

OVERVIEW

The Association of Institutional INVESTORS[1] believes it is important for taxpayers, homeowners, and financial market participants to have the ability to see exactly how the five large servicers are meeting their obligations under the agreement. Accountability and transparency are particularly important because each bank faces a clear conflict of interest in how it directs principal reduction modifications – writing down principal on loans owned by the bank is likely less economically attractive than writing down loans owned by other investors. Additionally, banks often hold second lien mortgages in situations where other investors hold the first lien, but the banks service the loan. In such cases, writing down the first lien owned by other investors but keeping their own second lien in place further benefits the bank at the expense of other investors..

KEEPING THE BANKS ACCOUNTABLE

Given these concerns, The Association of Institutional INVESTORS suggests that the Independent AG Settlement Monitor requests a complete report from the five large servicers that focuses on the following principles:

- **Provision of Specific Information Provided by Each Bank Seperately On Steps Taken to Meet Obligations:** The independent monitor, and ultimately financial market participants, should be able to see how each institution is meeting its obligations under the agreement
- **Require Reports on a Monthly Cycle:** Given that the banks only have 12 months to complete the modification process, quarterly reporting would be insufficient. Under a quarterly reporting system, it would take two reports simply to confirm whether the banks are following the agreement. At that time, there would be less than six months would be left to make any changes
- **Disclosure of the Opportunity Set of Loans Considered for Modification:** Banks should disclose both the entire opportunity set of loans that could be reviewed and the opportunity set of loans that were considered each month before the bank decided which loans to modify. This information would ensure that banks are not simply focusing on potential loan modifications for loans in non-agency MBS transactions, but rather are also considering loans in the bank's owned portfolio as well.
- **Require a Break Down of the Modifications by Loan Owner and Lien Position:** It is imperative that the monitor require the banks to break down which loans are receiving a

[1] The Association of Institutional INVESTORS is an association of some of the oldest, largest, and most trusted investment advisers in the United States. Our clients are primarily institutional investment entities that serve the interests of individual investors through public and private pension plans, foundations, and registered investment companies. Collectively, our member firms manage ERISA pension, 401(k), mutual fund, and personal investments on behalf of more than 100 million American workers and retirees. Our clients rely on us to prudently manage participants' retirements, savings, and investments. This reliance is built, in part, upon the fiduciary duty owed to these organizations and individuals. We recognize the significance of this role, and our comments are intended to reflect not just the concerns of the Association, but also the concerns of the companies, labor unions, municipalities, families, and individuals we ultimately serve.

modification. Metrics should include whether the loan is bank-owned first lien, bank-owned second lien, investor owned first lien without a bank-owned second lien, or investor-owned first lien with a bank-owned second lien

- **Track What Percent of Modifications are Following Government-Prescribed HAMP Guidelines:** Based on our conversations with HUD, it is our understanding that 100% of investor loans modified are supposed to follow HAMP guidelines, but banks may have a strong incentive to use less rigorous modification methods for investor loans to reduce the need to modify bank-owned loans.

DATA REQUIREMENTS

Data can be provided in one of two forms: loan-level (each loan laid out separately) or as a comprehensive summary. The Association of Institutional INVESTORS' believes that loan-level data will allow the independent monitor to more effectively monitor the banks to ensure that the banks are following the settlement agreement. This requirement would be similar to the loan-level data that HUD and the Treasury Department receive for all HAMP modifications to ensure that the banks are compliant with the HAMP program. The Association of Institutional INVESTORS' members would appreciate the opportunity to see the loan-level data. Should it be determined that some of this information should remain confidential, summary tables on the data would still provide some useful information to investors to assist market participants in understanding whether banks are acting properly.

Additionally, we also believe it is important that the independent monitor have access to the bank's methods and formulas for loan modifications. These formulas will be invaluable in ensuring that each bank operates clearly within the confines of the language and spirit of the AG Settlement and will address conflict of interest inherent in how the bank directs the principal reduction modifications.

Loan-Level Information that Banks Should be Required to Report Monthly Should Include the Following Information:

- Number of Loans Modified
- Outstanding Balance of Loans Modified
- Principal Reduction Percentage
- Percentage of Investor Modifications that Followed HAMP Standards
- Percentage of Investor Loans in which the Bank Owned the Second Lien and Average Principal Reduction on such Second Liens
- Unpaid Principal Balance of the Loan (UPB)
- Delinquency Status Before the Modification (*i.e.* Current, 30-day delinquent, etc)
- Borrower State
- Origination Date
- Borrower Interest Rate Before the Modification

- Borrower Payment Before the Modification
- Borrower Rate After the Modification
- Borrower Payment After the Modification
- Borrower Principal Reduction as a Result of the Modification
- Home Appraisal Value
- Borrower Loan-to-Value Before the Modification (for 1st Lien Only)
- Borrower Loan-to-Value After the Modification (for 1st Lien Only)
- Borrower Combined Loan-to-Value Before the Modification (All Liens)
- Borrower Combined Loan-to-Value After the Modification (All Liens)
- Gross Principal Forgiven (Forgiven Late Fees, Penalties, Capitalized Interest, and Change in UPB)
- Owner of Mortgage (Bank vs. Investor)
- Total Debt-to-Income Ratio, Including All Consumer Debts (Pre/Post Origination of Subject Mortgage) and All Subordinate Mortgage Liens (at Time of Origination of Subject Mortgage and Subsequent to its Origination)
- Whether the Bank has an Economic Interest in the Second Lien on the Loan
- The Borrower's Residual Income (Pre/Post Modification) (*i.e.* How much does the borrower pay on cell phone coverage? Cable? Restaurants? Entertainment?)
- Time to Complete Modification (from First Solicitation through First Modified Payment)

Banks Should Also Be Required to Report to the Independent Monitor:

- Their Method for Establishing Current Marked-to-Market Loan-to-Value Ratio
    - Broker's Price Option (As is or Quick Sale/With or Without Marketing Time)
    - Automated Valuation Model
    - Appraisal
    - Whose Cost?
- The Net Present Value Test Formula and Inputs
    - Re-Default Rate – Timeframe (e.g. 1 year, 2 years, 5 years, or other)
    - Discount Rate
    - Forward House-Price Index
- Re-Defaults Rates on Principal Modifications Made Under the Settlement and the Total Severity of the Re-Defaulted Modification versus Forgone Recovery if Liquidated at Time of the Modification

At a Minimum, We Request that there be Public Disclosure of Summary Information in the Following Categories, Broken Down by Loan Owner and Lien:

- Number of Loans Modified
- Outstanding Balance of Loans Modified
- Principal Reduction Percentage
- Percentage of Investor Modifications that Followed HAMP Standards
- Percentage of Investor Loans in which the Bank Owned the Second Lien and Average Principal Reduction on such Second Liens

Sample Reports

Bank Level

Bank	Portfolio Loans (2nd Liens)			Portfolio Loans (1st Liens)			Investor Loans			% of Investor Modifications that followed HAMP Standards	% of Investor Loans where Bank Owns 2nd Liens	Average Principal Reduction on Bank-Owned 2nd Liens Where the Investor Owns the 1st Lien
	# of Mod. Loans	Bal. before Mod.	Principal Reduction %	# of Mod. Loans	Bal. before Mod.	Principal Reduction %	# of Mod. Loans	Bal. before Mod.	Principal Reduction %			
Bank 1	15.00	2,670,000	15%	70.00	124,600,000	15%	40.0	12,800,000	25%	95.0%	10.0%	30%
Bank 2												
Bank 3												
Bank 4												
Bank 5												

Loan Level

Loan	Bank/ Servicer	Month Modified	Lien (1st or 2nd?)	DQ Status Before Mod.	Loan Bal. Before Mod.	Loan Bal. After Mod.	Rate Before Mod.	Payment Before Mod.	Payment After Mod.
Loan #1									
Loan #2									
Loan #3									
Loan #4									
Loan #5									

Principal Reduction Amount	Owner of Mortgage (Bank v. Investor)	Total Debt-to-Income Ratio	Trust Name if owned by Investors	Does 2nd Lien Exist?	Does the Servicer own 2nd lien?	Borrower State	Residual Income	Time to Complete Modification	Origination Date

Home Appraisal Value	Borrower LTV Before the Mod (1st Lien Only)	Borrower LTV After the Mod (1st Lien Only)	Borrower Combined LTV Before the Mod (All Liens)	Borrower Combined LTV Before the Mod (All Liens)					

GEORGETOWN UNIVERSITY LAW CENTER

Adam J. Levitin
Professor of Law

Written Testimony of

Adam J. Levitin
Professor of Law
Georgetown University Law Center

Before the
House Financial Services Committee
Subcommittee on Capital Markets and Government Sponsored Enterprises

"Investor Protection: The Need to Protect Investors from the Government"

June 7, 2012
2:00 pm
2128 Rayburn House Office Building

Witness Background Statement

Adam J. Levitin is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in financial regulation. Professor Levitin has previously served as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP) and as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College, all with honors.

Professor Levitin has not received any Federal grants nor has he received any compensation in connection with his testimony, and he is not testifying on behalf of any organization.

Mr. Chairman Garrett, Ranking Member Waters, Members of the Subcommittee:

The topic of this afternoon's hearing is "the need to protect investors from the government." Specifically, today's hearing references three episodes in which it is alleged that the Obama Administration has treated investors unfairly: the treatment of secured bondholders in the Chrysler bankruptcy; the Argentine debt litigation; and the federal-state mortgage servicing settlement.

The three episodes on which this hearing is to focus must each be judged by their own merits, and I address each episode in turn, below. It is risible, however, to contend based on these three entirely unconnected and ultimately *sui generis* episodes that investors need "protection" from the government. To the contrary, recent events have shown that if anything investors have greater need of government protection. While some investors may be unhappy with the outcomes of each of these episodes, they can reasonably complain of unfair treatment only in regard to the federal-state mortgage servicing settlement, and even then it is not clear what the extent of the harms are. There are serious flaws with the mortgage-servicing settlement, but treatment of investors is far from foremost among them.

As an initial matter, however, it is important to clarify what is at issue here. The implication from this hearing is that the Obama Administration is somehow "anti-investor." Each of the three episodes cited as evidence for this proposition involves Administration actions that are unfavorable to particular groups of well-connected investors with the ability to successfully lobby for Congressional action. Yet that hardly makes the actions "anti-investor." Indeed, actions that are unfavorable to one set of investors are frequently favorable to another set, and in at least two of the episodes involved, the Administration's actions were favorable to many more investors than they were unfavorable. In short, these episodes could just as easily be spun as examples of the Obama Administration's solicitous concern for investors.

For example, senior lienholders in the Chrysler bankruptcy had a limited recovery, yet the success of the bankruptcy benefitted investors in other auto manufacturers by preventing a domino chain of failures throughout the auto industry. A court ruling adverse to the handful of holdout investors in the Argentine debt litigation would help the 92% of Argentine bondholders who accepted Argentina's exchange offer by ensuring that the majority of Argentine bondholders get paid according to the terms of their settlement. Actions that transfer liability from banks to mortgage investors harm mortgage investors, but help bank investors.

The problem, then, is not a bias against investors as a group, but rather a picking and choosing among investors. Of course, this sort of picking and choosing is what Congress and the Administration effectively do all the time when either passing laws, making regulations, or deciding how and when to enforce them. While one can debate whether the picking and choose has been done correctly, it is not a matter of disfavoring investors as a class.

THE CHRYSLER BANKRUPTCY

Chrysler filed for bankruptcy on April 30, 2009, after lengthy attempts to restructure its debt to avoid bankruptcy. Immediately after filing for bankruptcy, Chrysler received debtor in possession (DIP) financing from the United States and Canadian governments, which enabled it to continue operations while in bankruptcy. The bankrupt companies ("Old Chrysler")

subsequently sold its "good" assets pursuant to section 363 of the Bankruptcy Code[1] to a newly formed company ("New Chrysler").

As part of the sale, New Chrysler paid Old Chrysler $2 billion and also assumed certain liabilities of Old GM and Old Chrysler, including the firms' collective bargaining agreements with the United Auto Workers (UAW) and Canadian Auto Workers (CAW) and liability for certain health care and retiree benefits. New Chrysler directly assumed liability for non-unionized employees' health care and retirement benefits. Chrysler's approximately $10.6 billion in liability for unionized employee healthcare and retiree benefits was assumed by a newly created Voluntary Employee Benefit Association (VEBA) in exchange for New Chrysler providing the funding for the VEBA. Thus, going forward, the healthcare liabilities of unionized Chrysler employees—a major liability that hindered the company's competitiveness before bankruptcy—are the responsibility of the VEBA, not New Chrysler.

The New Chrysler VEBA was funded with a $4.6 billion 14-year New Chrysler note and 55% of the equity in New Chrysler. A consortium of the Italian auto manufacturer Fiat, the United States and Canadian governments, owned the remaining 45% of New Chrysler's equity.

The proceeds of the sale of the "good" assets of Old Chrysler were dispersed according to the requirements of the Bankruptcy Code under a plan of liquidation along with the proceeds from the liquidation of the "bad" assets to the creditors of Old Chrysler. The first lien secured claims on Old Chrysler received a distribution of approximately 29%. The Old Chrysler plan of liquidation was approved by 96% of secured claims (76 of 79 claims) representing over 99% of the dollar amount of secured claims.[2] In both cases, the sale proceeds only managed to cover part of all secured lenders' claims (first and junior liens) against Old Chrysler; the sales were insufficient to generate returns for general unsecured creditors' claims.

The Chrysler bankruptcy was basically a textbook affair;[3] indeed, Chrysler is such a good illustration of the normal operation of a bankruptcy that it is the first case I present to students in my business bankruptcy course. The major anomaly in these cases is the involvement of the United States government as DIP financier.

While there are questions of whether the government's provision of DIP financing was in fact authorized under the Emergency Economic Stabilization Act (namely, whether Chrysler was a "financial company"),[4] it is clear that absent the government's provision of DIP financing, Chrysler would have had to shut down operations and liquidate. Chrysler's unsecured creditors, such as bondholders, would have had zero recovery in a liquidation, and its $7 billion in secured debt would have been able to realize only the liquidation value of their collateral, likely less than a $2 billion recovery.

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[1] 11 U.S.C. § 363.

[2] *In re* Old Carco LLC (f/k/a Chrysler LLC) *et al*, 09-50002 (AJG) (Bankr. S.D.N.Y. Mar. 9, 2010), Docket No. 6577, at 3 (Declaration of Jeffrey B. Ellman Certifying the Tabulation of Votes on, and the Results of Voting with Respect to, Second Amended Joint Plan of Liquidation of Debtors and Debtors in Possession).

[3] *See* Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 101 (2009).

[4] *See* Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC), 576 F.3d 108, 121-123 (2d Cir. 2009) (finding the plaintiffs lacked standing to challenge the use of the TARP funds in the Chrysler bankruptcy because they lacked an injury in fact).

Liquidation would have brought no benefit to any investors on account of their Chrysler debt or stock. Moreover, assuming that the investors were diversified in their investments and generally long on the economy, it would likely have brought them significant losses in their other holdings. The failure of Chrysler would have triggered the failure of General Motors (and vice-versa) because of reliance on common suppliers, which would have also failed absent steady orders from both manufacturers. Moreover, the failure of either Chrysler or GM would have resulted in the failure of other auto manufacturers, domestic and foreign, again because of shared suppliers. For example, it is quite likely that a failure of Chrysler would have brought down Nissan. These failures would have cascaded up and down the American industrial base, affecting first, second, and third-tier suppliers (suppliers to suppliers to suppliers). The economic and social dislocation would have been widespread and almost unimaginable in extent. It goes without saying that the collapse of the United States industrial sector would have greatly harmed many investors.

As it stands, Chrysler and GM have emerged from bankruptcy as success stories. This is not to say that all jobs were saved—Chrysler and GM laid off thousands of employees before they filed for bankruptcy and shut down numerous dealerships, again affecting thousands of jobs. Nonetheless, Chrysler and GM have exited bankruptcy and are again operating profitably, for the first time in years.

So what, if anything, occurred in the Chrysler bankruptcy that might be anti-investor? The major argument is that the sale price for the "good" assets of Old Chrysler was too low, which had the effect of siphoning off value from the creditors of Old Chrysler (including the UAW and CAW) to the owners of New Chrysler (including the UAW and CAW VEBA). Because of the Bankruptcy Code's priority scheme, the effect, it is alleged, was to enable a greater recovery for the UAW and CAW than would have occurred had the assets been sold at their real value, and that this harmed investors in Old Chrysler.

This argument depends entirely on the assumption that the sale price was too low. There is no evidence to support that assumption, and was rejected by the Second Circuit Court of Appeals.[5] The Bankruptcy Court in both cases approved an arms-length transaction; other parties were welcome to bid, but none did.[6] Simply put, in 2009, with credit markets frozen, there was no other market demand for the good assets of the auto companies of this scale as going concerns. Chrysler had nearly $7 billion in secured debt, meaning that a bidder would have to pay over $7 billion to purchase the Chrysler assets free and clear of the liens other than under a 363 sale.

There is simply no evidence that there were *any* other parties prepared to bid on the Chrysler assets, much less bidders who would have bid over the $2 billion paid by the New Chrysler consortium. To believe that there were such bidders abounding, only to be frustrated by the bidding procedures requirement of assuming the collective bargaining agreements, is to defy credulity, not least because case law makes abundantly clear that Bankruptcy Courts must entertain the highest bid presented, regardless of whether it conforms to bidding procedures.[7] As

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[5] *See* Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC), 576 F.3d 108 (2d Cir. 2009).

[6] Bids were required to be "qualified bids," but despite criticism of the "qualified bid" definition from some commentators, *see e.g.*, David Skeel, *The Real Cost of the Auto Bailouts*, WALL ST. J., June 6, 2011, creditors did not appeal the sale procedures regarding what was a "qualified bid."

[7] *See, e.g.*, Corp. Assets, Inc. v. Paloian, 368 F.3d 761 (7th Cir. 2004); In re Wintex, 158 B.R. 540 (D. Mass. 1992); In re Financial News Network, Inc., 126 B.R. 152 (S.D.N.Y. 1991); In re Edwards, 228 B.R. 552 (Bankr. E.D.

New Chrysler was the only bidder, it was the market. Thus, the sale price was the market price and therefore fair. None of this is in any way controversial as a matter of bankruptcy law.[8] While one can reasonably argue that the section 363 sale process needs clearer statutory protections, the sale of assets from Old Chrysler to New Chrysler was par for the course in 363 sales as they are currently conducted.

At the end of the day, there is no question that the UAW fared better than many other unsecured creditors and even than first lien secured creditors. That better treatment, however, was provided by the United States government, not by the bankruptcy estate. But for the favorable treatment of the UAW, the United States government would not have served as purchaser for the Chrysler assets, which would have meant a liquidation of Chrysler and a recovery for secured creditors of likely less than the 29 cents on the dollar generated by the $2 billion going-concern purchase price. The United States arguably paid an inflated price for the Chrysler assets in order to fund the UAW VEBA, and doing so not only saved Chrysler, but also GM and a slew of other American industrial firms, thereby protecting *those firms*' investors. Given the social and economic consequences of the failure of either Chrysler or GM, the government would have been playing a grossly irresponsible, high-stakes game of "chicken" had it not assisted the firms.

Whether the United States government should have assisted the UAW is a question about which there is a separate debate, but it does not implicate the issue of whether the government treated investors fairly. Investors did not pay for the treatment of the UAW in the Chrysler bankruptcy, so to cast the episode as somehow anti-investor is unfair to the Obama Administration, which managed to make the best of a bad situation in the midst of a financial crisis created under the watch of the Bush Administration.[9]

THE ARGENTINE DEBT LITIGATION

A second example of the Obama Administration's abuse of investors cited in the notice of this hearing was the filing of an *amicus curiae* brief by the Treasury Department in litigation regarding Argentine sovereign debt. In December 2001, Argentina suspended payments on its approximately $80 billion of public foreign debt, the largest sovereign debt default in history. Argentina managed to restructure 92% of this debt through exchange offers in 2005 and 2010 in which creditors were offered new debt with more generous terms ("exchange bonds") in exchange for their old debt. After reopening the exchange offer in 2010, Argentina passed a law that prohibits payment to non-exchanging bondholders on terms better than those under the exchange bonds.[10]

The old Argentine debt documentation contained "*pari passu*" (hand-in-hand) clauses. Historically, these clauses have always been interpreted to mean that the debt cannot be legally

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Pa. 1998).

[8] BFP v. Resolution Trust Corp., 511 U.S. 531 (1994).

[9] Indeed, a subsequent study has found that the Chrysler bankruptcy engendered a *positive* response from bondholders in unionized firms, who subsequently demanded a smaller premium for the bonds of unionized firms. *See* Deniz Anginer & A. Joseph Wharburton, *The Chrysler Effect: The Impact of the Chrysler Bailout on Borrowing Costs*, Jan. 2011, *at* http://www.clevelandfed.org/research/conferences/2011/4-14-2011/Anginer_Warburton.pdf.

[10] Republic of Argentina, Law 26,547 (Dec. 9, 2009).

subordinated to other, subsequent debt;[11] it is a promise of legal priority, which functions much like a negative pledge clause that prohibits the granting of security to other creditors.[12] Accordingly, as traditionally understood, *pari passu* does not prohibit states from creating *de facto* priority by paying some creditors first; indeed, this is what has been done from time immemorial, as states do not pay all of their creditors simultaneously.[13]

In the current litigation, however, some holdout Argentine creditors have advanced a relatively novel argument that the *pari passu* clause requires that if Argentina makes *any payment* on its unsecured unsubordinated foreign debt, then it must pay all foreign creditors with a *pari passu* clause ratably.[14] To illustrate, under the holdout creditors' interpretation, if Argentina paid on one bond series, it would have to pay simultaneously on *all* bond series with *pari passu* clauses.

In the instant litigation, the United States District Court for the Southern District of New York ruled in favor of the holdout creditors and issued injunctions against Argentina paying the exchange bonds without paying the holdout creditors in full and against third parties from assisting Argentina in making payments on the exchange bonds without ensuring that full payment to the holdout creditors was also made.[15] The case has been appealed to the United States Court of Appeals for the Second Circuit, and the United States submitted an *amicus curiae* brief urging reversal of the District Court's *pari passu* holding.[16] The United States as *amicus curiae* argues that the District Court misinterpreted the *pari passu* clause, that even if the holdout creditors' interpretation is correct it does not give rise to an injunctive remedy, and that injunctive remedies of the type issued by the District Court are inappropriate under the Foreign Sovereign Immunities Act (FSIA).

The United States' actions in the Argentine debt litigation are neither unusual nor unwarranted nor anti-investor. The United States has filed *amicus curiae* briefs in sovereign debt litigation in the past, including a brief filed on this very issue in 2004 by the Bush Administration.[17] Moreover, the Obama Administration has taken significant action against Argentina related to its default; the Obama Administration imposed trade sanctions on Argentina

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[11] *See, e.g.*, Lee C. Buchheit & Jeremiah S. Pam, *The Pari Passu Clause in Sovereign Debt Instruments*, 53 EMORY L.J. 869, 870 (2004).

[12] One might reasonably ask why there would be *pari passu* clauses at all, if they have little effect. For a review of the complicated history of these clauses, *see* Mark C. Weidemaier, Robert E. Scott & Mitu G. Gulati, *Origin Myths, Contracts, and the Hunt for Pari Passu*, UNC Legal Studies Research Paper No. 1633439 (Mar. 25, 2011), *at* http://ssrn.com/abstract=1633439.

[13] *See, e.g.*, Lee C. Bucheit & Ralph Reisner, *The Effect of the Sovereign Debt Restructuring Process on Inter-Creditor Relationships*, 1988 U. ILL. L. REV. 493, 497 (1988).

[14] The creditors proceed on the basis of a single favorable decision from a Belgian court. *See* Elliot Assocs., L.P. v. Banco de la Nacion, General Docket No. 2000/QR/92 at 3 (Court of Appeals of Brussels, 8th Chamber, Sept. 26, 2000) (holding without citation to authority "the various creditors benefit from a *pari passu* clause that in effect provides that the debt be repaid pro rata among all creditors."). The decision was functionally overruled by a subsequent Belgian statute that precludes creditors from obtaining orders blocking payments through bank settlement systems. See Belgium Law 4765 [C-2004/03482].

[15] Order, NML Capital, Ltd. v. Republic of Argentina, 08-cv-06978 (TPG) (S.D.N.Y. Dec. 7, 2011); Order, NML Capital, Ltd. v. Republic of Argentina, 08-cv-06978 (TPG) (S.D.N.Y. Feb. 23, 2012).

[16] Brief for the United States of America as *Amicus Curiae* in Support of Reversal, NML Capital, Ltd. et al. v. Republic of Argentina, 12-105-cv(L) (2d Cir. April 4, 2012).

[17] Statement of Interest of the United States, Macrotechnic Int'l Corp. v. Republic of Argentina, 02-CV5932 (TPG); EM Ltd. v. Republic of Argentina, 03-CV-2507 (TPG), (S.D.N.Y. Jan. 12, 2004).

following Argentina's refusal to pay an International Centre for the Settlement of Investment Dispute (ICSID) award.[18] There is simply no basis for interpreting the Obama Administration's actions in regard to Argentine debt as "anti-investor."

In the current *amicus curiae* brief, as in the Bush Administration's *amicus curiae* 2004 brief, the United States makes clear its interest in this issue: preserving global financial market stability and protecting the foreign relations interests of the United States. The United States is not looking to further the interests of any particular party in the litigation; rather it is concerned that a ruling that disturbs settled expectations about sovereign debt would roil global financial markets with widespread domestic effects, that a ruling in favor of the plaintiff investors in this litigation would make it impossible to restructure sovereign debt, and that the granting of injunctive relief endangers the foreign relations of the United States and exposes the United States and its property to foreign judgments.

The United States has a great interest in global financial market stability; global financial markets are interconnected, and financial events abroad reverberate at home. Sovereign debt is an important category of financial instruments; many sovereigns, including the United States, borrow to fund government operations.

Sometimes sovereigns find themselves overleveraged and need to restructure their debts. We have all seen the on-going global economic turmoil stemming from Greece's inability to do so. As things currently stand, the only way to restructure sovereign debt is through consensual negotiations; there is no sovereign bankruptcy. In sovereign debt restructurings, like Argentina's old debt is typically exchanged for new debt with some combination of lower interest rates, longer maturities, reduced principal, or with payment obligations tied to the debtor's economic growth (capitalization bonds).

A major problem with such exchanges is the existence of holdout creditors who refuse the exchange offer of new debt for old debt. These creditors are still looking to recovery 100 cents on the dollar on the old debt (even if they bought it at a steep discount in the secondary market). If holdouts are able to successfully realize 100 cents on the dollar, there is a strong disincentive for any creditor to accept the exchange offer. If not enough creditors take exchange offers, then sovereign debt restructuring attempts fail. It bears strong emphasis that failure of a sovereign debt restructuring does *not* mean that creditors receive 100 cents on the dollar per their original contract. Instead, it typically means more negotiations, further delay in any payment, and more domestic and international financial turmoil.

Interpreting *pari passu* clauses as the holdout creditors do would make it impossible to restructure sovereign debt. Under the holdout creditors' interpretation, if sovereigns paid any of the exchange bonds, then it would trigger an obligation to repay the holdouts as well. In such a world, there is no incentive to tender the old debt in an exchange offer. Everyone will be a holdout and economic crisis will metastasize. The holdout creditors' interpretation would require governments to completely suspend *all* payments in order to restructure their debts, which is something that no bankrupt company does and no country can. It is not only reasonable, but also appropriate in a globally interconnected financial world for the United States to urge a court to uphold the traditional understanding of a sovereign debt contract clause when the alternative is an interpretation that would make it impossible for sovereigns to restructure their

[18] Doug Palmer, *Obama Says to Suspend Trade Benefits for Argentina*, REUTERS (MAR. 26, 2012).

debts and would exacerbate global economic crises.[19]

The other main concern of the United States in this case is stems from the issuance of injunctive relief, which the United States argues goes beyond the scope of the court's jurisdiction and which complicates the United States foreign relations. As a general matter, foreign governments are immune from suit in the United States and their property immune from attachment, arrest, or execution under the Foreign Sovereign Immunities Act of 1976 (FSIA).[20] There is an exception, however, for when foreign government engage in commercial activity.[21] An earlier case involving a prior Argentine debt default held that Argentina was subject to suit in the United States because it fell within the commercial activity exception because payment on the bonds was to be made in New York.[22] Subsequently issued Argentine debt, such as the bonds at issue here, has a different payment arrangement, with payments made outside of the United States. Accordingly, the holdout creditors in this case have sought an injunction, rather than a money judgment because a money judgment would be unenforceable under FSIA because the funds in question are located outside of the United States.[23]

The injunction the holdout creditors obtained is against a foreign state prohibiting any payment on its unsecured, unsubordinated external debt without payment in full to the holdout creditors. Thus, a payment by Argentina to a Swiss creditor made through a Thai bank in Bhatt without payment to the holdouts would violate the injunction. Such a broad injunction would allow the holdout creditors to restrain Argentina from using funds that the holdout creditors cannot attach directly. The United States is reasonably concerned that an expansive reading of the commercial activity exception to the FSIA would have adverse consequences for the United States, as enforcement of the injunction would effectively be dictating domestic policy to foreign states and taken as an affront. Moreover, some states own sovereign immunity law is based on reciprocity. Accordingly, the injunction against Argentina could encourage foreign courts to issue similar injunctions against the United States and its property abroad in the future.

The United States *amicus curiae* brief in no wise condones Argentina's default or seeks to prevent investors from collecting on their debts as a general matter.[24] Instead, it is concerned about larger issues than those of a particular investment fund that purchased distressed debt with full knowledge of the risks it was running and discounted its purchase price accordingly. The United States filed its *amicus curiae* brief because it was appropriately looking out for the larger

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[19] Critically, this is not a sanctity of contract issue. Contracts are written against a backdrop of enforceability. In the United States, this means they are written against a backdrop of bankruptcy law. In the sovereign context, this means they are written against a backdrop of functional and legal sovereign immunity—the sovereign only pays when it wishes to. This makes sovereign debt fundamentally different from other debt, and presumably it is priced to reflect this risk.

[20] 28 U.S.C. §§ 1604, 1609.

[21] 28 U.S.C. § 1605(a)(2).

[22] Republic of Argentina v. Weltover, 504 U.S. 607 (1992).

[23] It is not clear that a violation of a *pari passu* covenant triggers injunctive relief, at least in this case. The Argentine debt documentation provides that if covenants are not upheld, then the bondholders can accelerate the debt and demand payment for the entire bond principal. If that payment demand is not met, then there is a default. In this case, the holdout creditors have not accelerated the debt and declared a default because they do not want a money judgment on the debt, as they would then be subject to the application of the merger doctrine, meaning that their rights under the debt contract would be replaced by their rights under the judgment, and those rights would not include *pari passu*.

[24] Again, though, as with Chrysler and GM, the United States' position is adverse to that of some investors, but supportive of that of other investors, namely the vast majority who accepted the exchange bonds.

interests of society, including global economic stability and maintaining the foreign relations of the United States.

MORTGAGE SERVICING SETTLEMENT

On February 9, 2012, the federal government, 49 state attorneys' general,[25] and five major mortgage servicers agreed to enter into a settlement (the "federal-state settlement") over various frauds alleged to have been committed by the servicers.[26] This followed on the heels of the April 11, 2011 consent orders entered into by the Office of Comptroller of the Currency and the Federal Reserve Board with sixteen servicers and holding companies.[27]

There are numerous substantive problems with the mortgage servicing settlement. The settlement provides too little relief for too few homeowners. It will not clear housing markets. It will not deter future consumer fraud by too-big-to-fail banks, and does not even force the banks to disgorge the wrongful profits from their misbehavior. Despite the settlement's unprecedented size, it is a slap on the wrist for one of the most pervasive violations of procedural rights in history.[28]

That said, the settlement is still not a completely free pass; it has a $25 billion price tag, a record for any consumer fraud settlement.[29] The catch, however, is that most of that price tag will not be paid by the defendants. The defendant banks only have to pay $5 billion in hard cash under the settlement.[30] Another $10 billion is to come in the form of principal reductions on mortgages, a further $3 billion from refinancing underwater mortgages, and another $7 billion in other forms of relief such as short sales and forbearance.[31] The settlement does not specify which mortgages must be restructured or refinanced other than in terms of broad category requirements.

Critically for the purposes of this hearing, the settlement permits the banks to receive credit under the settlement by reducing principal or refinancing on mortgages that they service, but do not own.[32] The Obama Administration does not dispute this, but instead contends that "this settlement will not force investors to incur losses. That's because any loan modification tied to this settlement will result in more of a financial return for an investor than a foreclosure

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[25] I have served as a consultant for the New York Attorney General in regard to mortgage servicing issues and as a Volunteer Deputy Attorney General for the State of Delaware in regard to another related mortgage servicing litigation. The views I express here are my own, and not necessarily those of the New York Attorney General or Delaware Attorney General.

[26] Press Release, U.S. Dept. of Justice, *Federal Government and State Attorneys General Reach $25 Billion Agreement with Five Largest Mortgage Servicers to Address Mortgage Loan Servicing and Foreclosure Abuses*, Feb. 9, 2012, *at* http://www.justice.gov/opa/pr/2012/February/12-ag-186.html.

[27] *See, e.g.*, http://www.occ.gov/news-issuances/news-releases/2011/nr-occ-2011-47.html.

[28] *See, e.g.*, Adam Levitin, *The Servicing Settlement: Banks 1, Public 0*, CREDITSLIPS.ORG, Fed. 9, 2012, *at* http://www.creditslips.org/creditslips/2012/02/the-servicing-settlement-banks-1-public-0.html.

[29] Dept. of Housing and Urban Development, *Fact Sheet: Mortgage Servicing Settlement*, *at* http://portal.hud.gov/hudportal/HUD?src=/mortgageservicingsettlement/fact-sheet.

[30] *Id.*

[31] *Id.*

[32] Dept. of Housing and Urban Development, *Myth vs. Fact: Setting the Record Straight about Historic Mortgage Servicing Settlement*, Mar. 12, 2012, *at* http://blog.hud.gov/index.php/2012/03/12/myth-vs-fact-setting-the-record-straight-about-historic-mortgage-servicing-settlement/ ("The settlement could affect some investor-owned loans, depending on existing agreements servicers have with those investors.").

would."[33] The Obama Administration claims to anticipate that servicers will first modify loans they hold on balance sheet and only then look to modify securitized loans.[34]

Unfortunately, some of the Obama Administration's predictions about the impact of the settlement belie the contention that it will not affect mortgage investors. HUD Secretary Shaun Donovan has stated that the non-cash portion of the settlement might result in as much as $32 billion in relief for homeowners, rather than $20 billion.[35] How does $20 billion become $32 billion?

The settlement credits servicers with $1 of settlement credit for every $1 of principal they write down on loans owned by servicers. The settlement gives 45 cents of credit, however, for every dollar in principal reduction on loans owned by investors.[36] Thus, for the servicers to get $10 billion in principal reduction credit under the settlement, they would have to write down principal on $22 billion in investor-owned loans. The Obama Administration's prediction of $32 billion in relief assumes that servicers will engage in principal write-downs *solely* of investor-owned loans. This is entirely inconsistent with the Administration's claim that servicers will modify the loans on their balance sheets first.

It is hard to know if the Administration's $32 billion claim is merely wildly optimistic spin of a grossly inadequate settlement or evidence of connivance with the too-big-to-fail banks to pass the costs of the settlement on to investors. We know, however, that servicers have strong incentives not to engage in principal write-downs on loans they own, lest they be forced to recognize losses and raise capital. Indeed, were it otherwise, the servicers would have written down loans they own already. Instead, it appears likely that most of the principal reductions will come from investor-owned mortgages. Procedurally, this raises serious concerns, as investors were not at the table during the settlement discussions nor are they party to the settlement, and the Obama Administration is clearly cognizant that some investor-owned loans might be modified under the settlement.

It is not clear, however, whether investors will suffer any harm from the settlement. The Obama Administration insists (rightly) that defendant banks are still obligated to comply with the terms of their servicing contracts, known as pooling and servicing agreements or PSAs.[37] PSAs typically restrict the ability of servicers to modify loan terms unless the loan is in default or default is imminent or reasonably foreseeable.[38] PSAs will often impose further restrictions

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[33] *Id.*

[34] *Id.*

[35] Ben Hallman, *Shaun Donovan, HUD Chief, Hopes Fannie Mae and Freddie Mac Will Write Down Mortgages*, Feb. 16, 2012, *at* http://www.huffingtonpost.com/2012/02/16/shaun-donovan-fannie-mae-freddie-mac-mortgage-write-down_n_1283020.html.

[36] *See e.g.*, Consent Judgment, United States v. Bank of America Corp., et al., 12-cv-00361 (D.D.C. filed Apr. 4, 2012), Exhibit D-1, *at* https://d9klfgibkcquc.cloudfront.net/Consent_Judgment_BoA-4-11-12.pdf.

[37] Dept. of Housing and Urban Development, *Myth vs. Fact: Setting the Record Straight about Historic Mortgage Servicing Settlement*, Mar. 12, 2012, *at* http://blog.hud.gov/index.php/2012/03/12/myth-vs-fact-setting-the-record-straight-about-historic-mortgage-servicing-settlement/ ("First and foremost, the settlement in no way overrides any existing contractual agreements or requirements between the servicer and the investors. If investors do not allow for principal reduction in a specific securitization, then the servicers will not be able to utilize on loans underlying the securities.").

[38] Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 32-33 (2011).

on loan modification.[39] If servicers violate these provisions, they should be sued for breach of contract; nothing in the federal-state settlement prevents this.[40] PSAs also often require servicers to maximize the net present value (NPV) of loans.[41]

Taken all together, this suggests that *if servicers are complying with PSAs*, then there are no additional principal modifications that they should undertake *because* of the settlement. In other words, if servicers are complying with PSAs, then servicers will get credit under the settlement for loan modifications that they would have done anyhow. If so, then the price tag of the settlement isn't being borne by investors. Instead, it is just a sham settlement in which the banks settle by agreeing to do what they were already required to do.

On the other hand, *if servicers have not been complying with PSAs*, but not start performing loan modifications because of the settlement, investors may be harmed by the settlement. If the servicers are not performing the loan modifications they were supposed to perform, there is no investor harm. Yet if the servicers are performing loan modifications under the settlement that they are not permitted to perform by contract, then there is likely investor harm, and investors should sue servicers over this.

Herein lies the problem: we do not know if the servicing settlement is a sham settlement in terms of only obligating servicers to do what they were already obligated to do, whether it will bring servicers into compliance with their PSAs or induce them to breach their PSAs. (The settlement, like the OCC and Fed consent orders is undoubtedly inadequate in terms of providing proper sanction for the largest consumer fraud in history.) Depending on the answer, the servicing settlement may or may not harm investors. My own intuition is that the settlement is a combination thereof. Some of the loan modifications for which servicers will receive credit will be loan modifications they were already obligated to do either under PSAs or under HAMP. In other words, the $20 billion or $32 billion price tag is at least partially a sham. At the same time, I would expect servicers to perform some modifications that violate PSAs in order to get additional settlement credit. If I am correct, then the settlement is the worst of both worlds—in part a sham and in part its costs are pushed onto mortgage investors.

Irrespective of the substantive harm involved the settlement, the settlement procedure was problematic. Regardless of how one believes that the cost of principal reduction—and thus ultimately responsibility for the housing bubble—should be allocated, if at all, the *process* of allocating the costs must be done fairly. That means it must be done either through a political process, through consensual negotiations with all parties, or a judicial proceeding in which *all* parties are represented. It is, however, manifestly unfair to have that principal reduction be paid by MBS investors when they were not even at the table.

While this settlement appears to be a one-off, unique event,[42] one can envisage similar

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[39] Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075, 1089-91 (2009).

[40] Other issues, such as the disinterest in RMBS trustees in enforcing investor rights exist without the federal-state settlement. *See* Levitin & Twomey, *supra* note 38, at 58-63.

[41] *Id.* at 30.

[42] It bears noting, however, that an earlier settlement between the California and Illinois Attorneys General and Countrywide/Bank of America involved promises by Countrywide/Bank of America to modify loans that it serviced, but did not own as compensation for mortgage origination fraud. *See* Order, Greenwich Fin. Serv. Distressed Mortgage Fund 3, LLC v. Countrywide Fin., No 650474/2008 (N.Y. Sup. Ct. Oct. 7, 2010) (dismissing

conflicts arising in the future. In the servicing settlement, the Obama Administration found itself forced to do something about robosigning—the evidence of widespread fraud was too great to ignore—but the administration also decided it was far better to have the costs diffused among investors—such as pension plans and mutual funds—rather than be concentrated on a handful of too-big-to-fail banks. Rather than being somehow "anti-investor" the Obama Administration was held hostage because it tolerated the continued existence of too-big-to-fail banks, and as a result, its scope for policy action through the settlement was limited.

CONCLUSION

There is no dispute that American investors need better protections, but it is not from the government, but rather from financial institutions that have become too-big-to-fail. Serious steps toward investor protection would be to increase the SEC and CFTC budgets and to facilitate securities fraud litigation. I recognize that those are steps unlikely to be even contemplated by the current Congress, but that is what real investor protection would entail and doing so would strengthen investor confidence in US capital markets.

As far as the specific cases examined by this hearing, the Chrysler bankruptcy and the Argentine debt amicus brief are in no way evidence of anti-investor bias from the Obama Administration, but rather examples of responsible stewardship of state. The mortgage servicing settlement, on the other hand, was deeply flawed in many ways, including its unfair treatment of mortgage investors who may have to shoulder most of the cost of the settlement without having engaged in any wrongdoing themselves and without having had a seat at the negotiating table. That said, it is not an example of anti-investor bias, but rather the inevitable result of the existence of too-big-to-fail banks. The Obama Administration's hands were tied because of its toleration of the too-big-to-fail banks; there was little it could do but allow a settlement that enables the banks to put the costs of the servicing fraud settlement on investors.

We should recognize the deep costs the continued existence of too-big-to-fail will have in a range of policy contexts. As long as too-big-to-fail banks continue to exist, they will continue to externalize the costs of their behavior on other parties. In 2008 the costs were externalized to taxpayers. In 2012, they were externalized to investors. Taking investor—and taxpayer—protection seriously means eliminating too-big-to-fail. Otherwise, when push comes to shove, costs of bank misbehavior will again be shunted onto investors and taxpayers.

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investor suit over Countrywide's actions on the basis of plaintiffs not having achieved the PSA's collective action threshold for suit). In other words, investors paid for Countrywide's fraud.

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Testimony of Professor Lubben before U.S. House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises regarding Argentinean Debt Default and the Automotive Bankruptcy Cases

Washington, D.C. -- June 7, 2012

Chair Garrett and Distinguished Members of this Subcommittee:

I hold the Harvey Washington Wiley Chair in Corporate Governance & Business Ethics at Seton Hall University School of Law in Newark, N.J. I have been at Seton Hall since entering academia in 2002, and I teach Bankruptcy, Corporate Finance, and Financial Institutions at the Law School. I also write the *In Debt* column for the New York Times' *DealBook*, and write about corporate bankruptcy for *Credit Slips*.

Before entering academia, I was an associate for several years with the law firm of Skadden, Arps, Slate, Meagher & Flom in New York and Los Angeles, where I specialized in corporate reorganization and debt restructuring. But my comments today of course only reflect my own opinions on these matters.

I was asked by minority staff to address two of the issues covered in today's hearing: the role of the United States government in both the 2001 Argentinean debt default, especially as that issue is currently being litigated, and the bankruptcy cases of GM and Chrysler in 2009.

The topic of this afternoon's hearing is "the need to protect investors from the government." As I argue below, neither topic really implicates this issue. And I have some real concerns that investors may be using the Argentinean situation to make bad law.

The Argentine Debt Litigation

At heart, Argentina's bond debt and the interpretation thereof is a matter of New York State contract law. And as a matter of New York State law, it is pretty clear that Argentina has breached the contract.

But sovereign debt implicates other considerations, as the holdout bondholders undoubtedly knew when they bought this debt.[1] Most importantly, foreign nations have sovereign immunity. Sovereign immunity is a long recognized concept – indeed, the individual states in this nation have a form of sovereign immunity recognized by the 11th Amendment to the Constitution, which was ratified in 1795.

Knowing this, the holdout bondholders nonetheless decided to decline Argentina's proffered debt restructuring and take their chances on outside litigation. In essence the holdout bondholders opted for the option bondholders always have outside of bankruptcy: liquidation instead of reorganization.

That is an acknowledged strategy, carries obvious risks and rewards. Most notably, "liquidating" a sovereign is limited to collecting a small subset of the country's property, namely that which is not protected by sovereign immunity.

But in the process of implementing this strategy, the holdout bondholders have advanced an interpretation of the *pari passu* clause– a clause that appears in all types of bond indentures, sovereign and corporate – and a notion of sovereign immunity that is tension with existing law.

A *pari passu* clause reaffirms that debt issued under a particular indenture is not subordinated, and ranks equally with all other unsecured debt of a particular issuer. In the corporate context, this distinguishes the debt from subordinated debt, which ranks lower in payment. In the corporate setting it is quite clear that such a clause does not protect the bondholders against preferential payment of other unsecured creditors.

Indeed, the general rule is that under state law there is no prohibition against preferential payments. Protection against paying one unsecured creditor ahead of another is only granted in a federal bankruptcy proceeding.[2]

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[1] *See* Stephen J. Lubben, *Out of the Past: Railroads & Sovereign Debt Restructuring*, 35 GEO. J. INT'L L. 845 (2004).
[2] 11 U.S.C. § 547.

Obviously there is no applicable federal bankruptcy proceeding with regard to sovereign debt. The holdout bondholders nonetheless have attempted to transform the *pari passu* clause from a rule of rank into a rule against preferential payments.

This is inconsistent with the settled understanding under New York law in both the corporate and sovereign debt markets, and it seems entirely appropriate for the U.S. government to bring that to the Second Circuit's attention. If the holdout creditor's position were to be sustained on appeal, not only would it have serious consequences for the sovereign debt market, but it might have unforeseen effects on the ability of corporate debtors to engage in out of court workouts and exchange offers.

Similarly, the injunction issued by the District Court at the holdout bondholders' request seems to be in direct conflict with the notion that the Foreign Sovereign Immunities Act of 1976 largely displaced courts' equitable or common law powers in this area. Given Argentina's intransigence in this matter, the District Court's frustration is understandable. But it is not in comport with the law that Congress has enacted, and the Justice Department properly advised the Second Circuit of this fact.

Indeed, I would note that the Justice Department's current actions seem in keeping with those of prior Administrations, from both parties. If Congress disagrees with the status quo in either respect, it could enact legislative changes.

That said, it should be noted that changes on either front could seriously impede this country's position with regard to the sovereign debt markets, and have serious consequences for New York's role as one of the two leading jurisdictions for sovereign debt issuance. Moreover, attempts to impose a new reading of *pari passu* clause at the federal level would intrude on what has traditionally been a state concern, namely the common law of contract.

GM & Chrysler Bankruptcies

The GM chapter 11 case, and the Chrysler case before it, involved the quick sale of the debtor's assets under section 363 of the Bankruptcy Code.[3] The terms of that sale, and the speed of the sale, were largely dictated by the post-bankruptcy (or DIP) lender. In these cases, that was the U.S. Treasury.

Before 1995 the structure of these cases might have been a novelty, but for about fifteen years quick asset sales done at the direction of a controlling lender have become rather routine.[4]

As Judge Gonzalez noted in Chrysler, "[t]he sale transaction...is similar to that presented in other cases in which exigent circumstances warrant an expeditious sale of assets prior to confirmation of a plan. The fact that the U.S. government is the primary source of funding does not alter the analysis under bankruptcy law."[5]

Nonetheless, several commentators have continued to argue that Chrysler in particular was defective because senior creditors received partial payment, while certain employees and former employees received higher recoveries as the result of payments made after the sale. Notably, Fiat and the government agreed to provide ownership stakes to certain union retirement plans after the sale.

Note that these payments to current and former employees were paid outside the bankruptcy process. There is no real connection between creditor recoveries in the bankruptcy cases, and union recoveries outside the bankruptcy case.

We can debate whether it is wise for the government to bail out the UAW, but it does not implicate the bankruptcy process *unless* this bail out is being funded by value that should have gone into the debtors' estates. And it is not even clear that it was a

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[3] Stephanie Ben-Ishai & Stephen J. Lubben, *Sales or Plans: A Comparative Account of the "New" Corporate Reorganization*, 56 McGill L.J. 591 (2011).
[4] Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 Am. Bankr. L. J. 531 (2009).
[5] *In re Chrysler LLC*, 405 B.R. 84, 87 (Bankr. S.D.N.Y. 2009), *aff'd*, 576 F.3d 108 (2nd Cir. 2009). The Second Circuit's judgment affirming, but not the bankruptcy court ruling approving the sale, was subsequently vacated as moot by Indiana State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015, 175 L. Ed. 2d 614 (2009).

bail out: the government-backed buyer may have simply wanted to make the UAW happy, so that it did not destroy the value of the automakers post-bankruptcy.[6]

In short, Fiat and the U.S. and Canadian governments needed the UAW in a way that they did not need the former lenders. Anybody who has every negotiated a restructuring understands that power comes in many forms.[7]

In the absence of any other bidder interested in buying either of the automotive companies, the argument that the funds going to the unions should have instead gone into the estates amounts to little more than a claim that government should have overpaid for the debtors' assets. Or, alternatively, that the creditors should have received a bailout too – a policy question, and not one that demonstrates a violation of the Bankruptcy Code or the "rule of law."

Indeed, if the creditors had been bailed out we can be sure that would have been the subject of much criticism too. The U.S. and Canadian governments negotiated hard, just a private DIP lender would. I think we should expect nothing less.[8]

We should also note that 90% of the Chrysler creditors agreed to take the sale proceeds offered to them. At heart, chapter 11 is always a process where a majority can bind a holdout minority to a deal.

A few holders of a minority stake in Chrysler's syndicated loan did object to the sale process – most notably the Indiana pension funds. But the terms of every syndicated loan agreement I've ever seen provides the lead banks with the power to settle a default, often subject to approval by a majority of the debt holders.

Chrysler's loan was no different: the vast majority of the holders approved the settlement that involved them receiving all of the sale proceeds. That's precisely what they were entitled to.[9]

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[6] Douglas Baird makes this point well here: http://jla.oxfordjournals.org/content/early/2012/02/28/jla.las001.full#xref-fn-36-1

[7] http://epicureandealmaker.blogspot.com/2009/05/more-of-kickin-sitcheyation.html

[8] http://epicureandealmaker.blogspot.com/2009/05/you-realithe-of-courth-thith-meanth-war.html

[9] As Baird, *supra*, neatly summarizes:

And I'm quite sure that any distressed debt investor – like the Indian pension funds, who bought the Chrysler debt at pennies on the dollar – would understand that this is how floating rate debt works. The dissenting creditors were outvoted. They agreed to majority rule in their contract, and there does not seem to be any reason why they should not be bound by their contract.

Finally, it is often argued that the bidding procedures used in these cases somehow "stacked the deck" in favor of government as buyer of the automotive companies. Some have argued that the bidding procedures may have deterred an unknown bidder, thus undermining the process.

This again shows a lack of understanding of modern chapter 11 practice and presumes that the procedures have more "stickiness" than they actually do. The caselaw is abundant and clear that bankruptcy courts have an obligation to consider the highest bid presented, even if it does not conform with previously approved bidding procedures. Any investor who contemplates buying a multi-billion dollar distressed corporation will know this – the contrary presumption is just not credible. If there was another bidder out there, it would have shown up with its bid and asked the court to consider it.

The reality is that both automakers failed at a point where the government was the only possible source of financing. Lehman had failed just months before – there was no possible way these companies could have received private DIP financing, especially GM, which required a DIP loan several times larger than any other. The government stepped in to provide the needed financing. As a result, it was in a position to negotiate the best possible deal it could – just as any other lender would have done.

In an idea world the automotive companies would have gotten their houses in order before the financial crisis struck. But they didn't, and the government had to act as DIP lender or face the chaos of these companies liquidating at a time of economic stress. That would have imposed severe costs on U.S. taxpayers as a result of management's failures. Hopefully the U.S. government will never have to do that

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Chrysler, the debtor that filed the bankruptcy petition, gave everything it had to its secured creditors. It did not pay its general creditors anything. It sold its assets to New CarCo for $2 billion in cash. The absolute priority rule required that all of this cash go to the secured creditors and it did.

again, but again there is little to the notion that the government perverted the Code or otherwise overplayed its hand.

I appreciate the opportunity to appear before the Committee today to share my views and look forward to any questions.

Written Testimony of

THEODORE B. OLSON
GIBSON, DUNN & CRUTCHER LLP

Before the
House Financial Services Committee
Subcommittee on Capital Markets and Government Sponsored Enterprises

"Investor Protection: The Need to Protect Investors from the Government"

June 7, 2012
2:00 p.m.

2128 Rayburn House Office Building

Thank you, Chairman Garrett, Representative Waters, for holding this hearing on an issue of great importance to American investors. My name is Theodore B. Olson, and I am a partner with the law firm of Gibson, Dunn & Crutcher in Washington, D.C. My firm and I represent NML Capital Ltd., which is one of many investors that has won substantial judgments from U.S. courts against the Republic of Argentina. NML is part of a family of funds that manages capital for dozens of U.S.-based organizations, including colleges, universities, hospitals, and pension funds. My firm and I have also recently represented victims of Hamas-orchestrated and Iranian-supported terror against the government of Iran.

In these representations, I have been troubled by our government's eagerness to side with lawless nations against the interests of Americans. For example, just last month, our government filed a brief in the United States Supreme Court supporting the position of the government of Iran that it can refuse to disclose to American victims of Iranian-sponsored terror the location of Iranian assets needed to satisfy the victims' judgments.[1]

I have been particularly troubled by positions our government has taken against investors in U.S. markets. For example, the government recently intervened in an appeal in favor of Argentina, in a case where the trial court had

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[1] Br. for the United States as *Amicus Curiae*, *Rubin v. Islamic Republic of Iran*, No. 11-431 (U.S. May 25, 2012).

ruled that Argentina must abide by a contractual obligation to treat one set of bondholders no less favorably than others.[2]

Although courts often request the government's views regarding federal law, that was not the case here. The government intervened without any invitation from the court, and the issues primarily concerned the enforceability of a contractual provision in the bonds under New York law. Not only did the government gratuitously intervene, but it also did so after showing no interest for a year-and-a-half as the trial court considered the investors' claims. Instead of advising the trial court of its views, the government suddenly emerged for the first time before the court of appeals. There, it largely repeated Argentina's arguments, adding only unsubstantiated and vague assertions that the trial court's order would hurt U.S. foreign policy interests.[3] The brief was signed by the U.S. Attorney for the Southern District of New York, an Acting Assistant Attorney General, the General Counsel for the Treasury Department, and the Legal Adviser to the State Department. Just one year ago, the United States Court of Appeals for the District of Columbia Circuit admonished the government that the gratuitous, last minute

[2] Br. for the United States of America as *Amicus Curiae* in Support of Reversal, *NML Capital Ltd. v. Republic of Argentina*, No. 12-105 (2d Cir. Apr. 4, 2012).
[3] *See id.* at 28-30.

filing of such a brief in an appellate court was "patently unfair" to the litigants and "disrespectful to the district judge."[4]

The broader context of the Argentina case raises grave questions about why our government would choose to side with Argentina against investors who put their faith and capital in U.S. securities markets and in the U.S. courts. The case arises from Argentina's worldwide default on more than $80 billion of its debt in 2001. That was the largest sovereign default in history.[5] It led to a series of lawsuits and billions of dollars of judgments in favor of investors against Argentina.

Argentina unquestionably has the ability to pay the investors it is betraying: It currently sits on $47 billion in foreign currency reserves in a Swiss bank account.[6] Yet it refuses to pay and has used every means imaginable to avoid its responsibilities. Indeed, Argentina has spirited its assets out of the United States[7]

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[4] *FG Hemispheres Assoc., LLC v. Democratic Republic of Congo*, 637 F.3d 373, 379 (D.C. Cir. 2011).

[5] For a brief overview of Argentina's history of defaulting on its sovereign obligations, see *EM Ltd. v. Republic of Argentina*, 473 F.3d 463, 466 n.2 (2d Cir. 2007).

[6] Argentina's Central Bank has, as of May 24, 2012, $47.154 billion in foreign currency reserves. Banco Central de la Republica Argentina, Main Variables, http://www.bcra.gov.ar/index_i.htm (last accessed June 5, 2012). The Argentine government recently amended the Central Bank's charter to permit the government greater access to the Bank's reserves to service Argentine debt. "Piggy Bank: Rootling Around For Cash," *The Economist* (Mar. 31, 2012).

[7] "The Government Is Protecting Itself From Attachment," *La Nación* (Feb. 5, 2004).

and has now filed more than thirty appeals from rulings in favor of investors.[8] Argentina has declared that it would never pay a penny on these debts or in response to these judgments. Indeed, it took the unprecedented step of enacting a law that makes it unlawful to pay these obligations.[9] According to the federal judge who has overseen most of this litigation: "What is going on between the Republic of Argentina and the federal court system is an exercise of sheer ***willful defiance*** . . . of the Republic to honor the judgments of a federal court."[10] Our government's decision to invest taxpayer resources in supporting such defiance—when the courts have not asked for its views—is disappointing to say the least.

It is all the more appalling in light of Argentina's recent actions. Just since the start of 2011, Argentina nationalized an oil company owned by the Spanish firm Repsol,[11] defied international arbitral awards of the World Trade

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[8] *See, e.g.*, *NML Capital Ltd. v. Republic of Argentina*, No. 12-105 (2d Cir.) (oral argument pending); *NML Capital Ltd. v. Republic of Argentina*, No. 11-4065 (2d Cir.) (decision pending); *NML Capital Ltd. v. Republic of Argentina*, ___ F.3d ____, 2012 WL 1059073 (2d Cir. Mar. 30, 2012); *NML Capital Ltd. v. Banco Central de la Republica Argentina*, 652 F.3d 172 (2d Cir. 2011); *NML Capital Ltd. v. Republic of Argentina*, 621 F.3d 230 (2d Cir. 2010); *EM Ltd. v. Republic of Argentina*, 389 F. App'x 38 (2d Cir. 2010); *Aurelius Capital Partners, LP v. Republic of Argentina*, 379 F. App'x 74 (2d Cir. 2010); *Seijas v. Republic of Argentina*, 606 F.3d 53 (2d Cir. 2010); *Seijas v. Republic of Argentina*, 352 F. App'x 519 (2d. Cir. 2009); *Aurelius Capital Partners, LP v. Republic of Argentina*, 584 F.3d 120 (2d Cir. 2009); *Fontana v. Republic of Argentina*, 415 F.3d 238 (2d Cir. 2005); *EM Ltd. v. Republic of Argentina*, 382 F.3d 291 (2d Cir. 2004).

[9] *See* Republic of Argentina, Prospectus Supplement, at S-53 (Apr. 28, 2010) (describing the Lock Law, which prohibits Argentina from paying "any claims or judgments based on" securities that were not exchanged in 2005 debt restructurings).

[10] *EM Ltd. v. Republic of Argentina*, 720 F. Supp. 2d. 273, 304 (S.D.N.Y. 2010) (emphasis added).

[11] Editorial, "The Argentine Model," *The Wall Street Journal* (Apr. 17, 2012).

Organization,[12] incited tensions with Britain over the sovereignty of the Falklands,[13] and confiscated cargo from a U.S. Air Force transport plane that was sent to Argentina to train local police to rescue hostages.[14] These actions have drawn the rightful condemnation of the international community, leading to trade sanctions,[15] suits in the WTO,[16] and repeated public denouncements from high-level governmental officials throughout the world.[17]

But our government's legal action in support of Argentina sent the exact opposite signal to Argentine Finance Secretary Adrian Cosentino. He celebrated the filing of our government's brief, declaring that it "validat[es] the arguments used and the general strategy of the Argentine government against" American

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[12] *See* Proclamation 8788 of March 26, 2012, 77 Fed. Reg. 18,889 (Mar. 28, 2012).

[13] Eliana Raszewski, "Argentina To Raise U.K. 'Militarization' Of Falklands At UN," Bloomberg (Feb. 8, 2012).

[14] CNN Wire Staff, "Cargo Sparks Dispute Between Argentina, U.S.," CNN (Feb. 16, 2011).

[15] Proclamation 8788, *supra* note 12 (removing Argentina from the Generalized System of Preferences).

[16] Sebastian Moffett & Tom Miles, "EU Files WTO Suit Over Argentina's Export Restrictions," Reuters (May 25, 2012).

[17] *See, e.g.*, Testimony of Marisa Lago, Assistant Treasury Secretary, International Markets and Development before the House Financial Services Subcommittee on International Monetary Policy and Trade Holds (Sept. 21, 2011) ("[W]e also share concerns about [Argentina's] unwillingness to engage with its creditors, its unwillingness to engage with international institutions. We find Argentina's approach particularly troubling because if you look at Argentina's per capita income, it falls squarely within the ranks of middle income countries."); Jennifer M. Freedman & Jonathan Stearns, "EU Planning WTO Complaint Against Argentine Import Curbs," Bloomberg (Apr. 23, 2012) (statement by European Union Trade Commissioner Karel De Gucht: "I wish to express the EU's serious concerns about the overall business and investment climate in Argentina and, in particular, certain recent decisions by the Argentine government. . . . The situation is now at a point where it risks jeopardizing our overall trade and investment relations.").

investors.[18] The last thing American investors needed was their own government to encourage Argentina's lawless intransience.

This incident is not the only time that our government has sided recently with corrupt nations against investors. The government also backed the Democratic Republic of Congo against U.S. investors in 2010, arguing that a court could not hold a foreign government in contempt for disregarding its orders for two years.[19] And recently, it supported another Argentine scheme to evade its responsibilities, this time by arguing that investors cannot recover money Argentina owes them from Argentina's central bank[20]—even though the Argentine government itself draws from that bank at will to pay its other debts when it wants to,[21] and even though a federal trial court has ruled that Argentina and its bank have no separate identities in the eyes of the law.[22]

The time has come for our government to concern itself with the rights of American investors, the rule of law, thoughtfully drawn Congressional limits on sovereign immunity, the enforceability of contracts under U.S. laws voluntarily entered into by foreign sovereigns to induce our citizens to invest in their

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[18] "U.S. Treasury, In Favor Of Argentina," *Ambito Financiero* (Apr. 9, 2012).

[19] Br. of the United States as *Amicus Curiae* in Support of Appellant at 6, *FG Hemispheres Assoc., LLC v. Democratic Republic of Congo*, 637 F.3d 373 (D.C. Cir. Oct. 7, 2010) (No. 10-7046).

[20] Br. for the United States as *Amicus Curiae* at 8, *EM Ltd. v. Republic of Argentina*, No. 11-604 (U.S. May 25, 2012).

[21] Camila Russo, "Argentina Issued Note Of Up To $5.7 Billion To Central Bank," Bloomberg (Apr. 26, 2012).

[22] *EM Ltd. v. Republic of Argentina*, 720 F. Supp. 2d. 273, 301-02 (S.D.N.Y. 2010).

indebtedness, and the judgments of U.S. courts. These considerations should not be overridden by vague, inarticulate, and expedient concepts of foreign policy and the interests of foreign tyrants, lawless governments and terrorists. The lawful contractual and statutory rights of our citizens should be paramount over the unlawful defiance of our laws by governments that have no respect for the rule of law or the laws of nations.

That concludes my prepared remarks and I welcome your questions.

Written Testimony of David A. Skeel, Jr.

Before the Subcommittee on Capital Markets and GSEs
Committee on Financial Services
United States House of Representatives
June 7, 2012

Thank you for the opportunity to testify about "Investor Protection: How to Protect Investors from the Government." My name is David Skeel, and I am the S. Samuel Arsht Professor of Corporate Law at the University of Pennsylvania Law School. It is a great honor to appear before you today.

Introduction

The past few years have been extraordinary time, and government has taken a variety of extraordinary actions. Like many Americans. I believe that some of these actions have been essential, while others have been deeply mistaken. Although I would be happy to share my views on these issues, in the remarks that follow I will not focus primarily on the correctness or incorrectness of particular decisions; I will focus instead on what I believe is a very dangerous pattern that has emerged during the crisis: the undermining of basic rule of law principles in ways that have injected enormous uncertainty into the markets.

This pattern did not begin with the current administration. When Bush administration officials and the Federal Reserve bailed out the investment bank Bear Stearns in early 2008 by midwifing its sale to JPMorgan Chase, they "locked up" the transaction with provisions that were clearly illegal under Delaware corporate law, which was the law that governed the transaction. The bailout of AIG later that year also included provisions that violated ordinary corporate law.

In the past several years, the assumption that ordinary legal requirements—and more generally, the rule of law principle that we are governed by laws, not the whims of our leaders--

can simply be ignored increasingly has become the norm. This ends-justifies-the-means mentality sometimes seems to produce desirable results in the short-run. But even the short-run benefits are often illusory. And in the longer run, ignoring the rule of law has devastating consequences for investors, the markets, and the economy as a whole.

I believe that the enormous uncertainty in the markets is one of the major reasons the economy is still struggling so mightily. Repeated departures from the rule of law are not the only reason for the uncertainty, but they are an important contributing factor, especially in industries that are likely to be subject to governmental intervention.

In the remarks that follow, I would like to comment in some detail on two of the most troubling examples of this pattern: the carmaker bailouts, and the recent nationwide mortgage settlement.

The Chrysler and General Motors Bailouts

As everyone here will remember, Chrysler and General Motors were put through so-called "quick rinse" bankruptcies in the spring of 2009. In late 2008, the U.S. government loaned more than $4 billion to Chrysler and more than $19 billion to General Motors. As a condition of additional loans, President Obama required, at the recommendation of the Auto Task Force the administration set up in early 2009, both carmakers to restructure under the U.S. bankruptcy laws.

Although the carmaker bankruptcies made use of Chapter 11, the laws governing corporate reorganization, the two cases were highly irregular.[1] In effect, the administration commandeered the bankruptcy process for the purposes bailing out the carmakers. Rather than using the ordinary Chapter 11 process, which gives creditors a variety of protections, including the right to vote on the terms of a proposed reorganization, the administration circumvented

[1] Mark Roe and I discuss the irregularities of the Chrysler transaction in detail in Mark J. Roe & David A. Skeel, Jr., *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727 (2010). The discussion below draws on this analysis.

these provisions by structuring both bankruptcies as sales. Chrysler ostensibly sold all of its assets to a newly created shell corporation on June 10, 2009, and General Motors sold its assets to a new shell corporation on July 10, 2009.

The sales were not real sales at all, and they appear to have punished investors while rewarding favored constituencies. In the Chrysler bankruptcy, Chrysler sold its assets to the shell corporation (often referred to as New Chrysler) in return for $2 billion. Old Chrysler paid the $2 billion to Chrysler's senior lenders, which amounted to only 29% of the $6.9 billion that the senior investors were owed. Yet the administration arranged for New Chrysler to make enormous payments to two groups of lower priority creditors, United Auto Worker retirees and Chrysler's trade creditors. The UAW retirees received $1.5 billion in cash, a $4.6 billion promissory note, and 55% percent of New Chrysler's stock; $5.3 billion of Chrysler's trade creditors were paid in full.

If Chrysler's assets had truly been sold to the highest bidder, and the proceeds distributed in accordance with bankruptcy's ordinary priority rules, the case would have been unusual but arguably legitimate, even if the buyer decided to take on some of the old creditors. But this is not what happened at all. First, Chrysler signed an agreement of sale with New Chrysler that required New Chrysler to take care of the UAW retirees and the trade creditors as a condition of the transaction. Chrysler and the government were the ones who decided who would get paid, not the supposed "buyer," New Chrysler. Second, the supposed auction was not a real auction at all. If an outside bidder had wished to submit a bid for Chrysler, the bid would not have been recognized as a "qualified bid" unless the bidder agreed to pay off the UAW retirees and Chrysler's trade creditors, just as the government planned to do. In reality, the Chrysler reorganization was a restructuring in which the government decided which creditors would get paid and which would not.

In the General Motors bankruptcy, the government did not even pretend to conduct a real sale. Although they called the transfer of GM's assets to the shell corporation (generally referred to as New GM) a sale, no money changed hands. In GM, the senior creditors were paid in full.

The government once again arranged for UAW retirees to receive a large portion of what they were owed.[2]

Defenders of the carmaker bailouts have pointed to the car industry's recent resurgence as evidence that the bailouts were a shining example of successful government action.[3] Two assumptions underlying these claims are that Chrysler and General Motors would have been swept into the dustbin of history if the government hadn't commandeered the bankruptcy process, and that the costs of running roughshod over the rule of law are not great. Neither assumption is true.

Let me start with the likely outcome if the government had not commandeered the bankruptcy process. Chrysler and General Motors could, and surely would, have been restructured without violating basis bankruptcy law principles. It was common knowledge both that General Motors needed to file for bankruptcy and that it was precisely the kind of company for which Chapter 11 is well designed—a company with a viable business but excessive costs. Many of the terms of the restructuring could have been negotiated prior to the bankruptcy filing, and it could have been quickly reorganized in Chapter 11. Chrysler would have been either restructured or many of its assets sold to a buyer such as Fiat. This is essentially what actually happened, except that the government altered the treatment of Chrysler's creditors and it rather than Fiat footed the bill for the transfer of control to Fiat.

The principal obstacle would have been financing the bankruptcy process. Both companies were low on cash and needed to borrow funds for the restructuring process, at a time when the credit markets were very weak. General Motors might well have been able to arrange funding from private banks. Moreover, even if this proved impossible, the government could

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[2] After the bankruptcy, the administration further aided General Motors by giving it a special exemption from the rules on net operating losses. See J. Mark Ramseyer & Eric Bennett Rasmussen, *Can the Treasury Exempt its Own Companies from Tax? The $45 Billion GM NOL Carryforward*, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1873429.

[3] Some also point to the fact that bankruptcy judges (and with Chrysler, an appellate court) approved the government's transactions. But the Supreme Court seems to have been sufficiently worried about the Chrysler transaction that it voided the decision approving the transaction. Ind. State Police Pension Trust v. Chrysler LLC, 130 S. Ct. 1015 (2009).

have facilitated borrowing by offering to guarantee the financing,[4] or by lending the money itself. If the government decided to step in, it could easily have provided guaranties or lent the money without insisting that its preferred terms be locked up, and without dictating that some creditors got paid and others did not.

The government's manipulation of the process already has had adverse repercussions. After the Chrysler "sale" was announced, Warren Buffett speculated that it will "disrupt lending markets in the future" and warned, "We don't want to say to somebody who lends and gets a secured position that that secured position doesn't mean anything."[5] A recent study suggests that his fears may be well-founded. Studying investment in other politically sensitive industries, three finance scholars found that companies in these industries faced a steep increase in their cost of credit as a result of the Chrysler transaction.[6] Ironically, the violation of rule of law principles in the carmaker bailouts may put more pressure on the government to bail out companies in politically sensitive companies in the future, since these companies could find it difficult to raise money when they are in financial trouble.

The National Mortgage Settlement

Let me turn now to my second illustration, the recent National Mortgage Settlement. Here the administration has added in support of, and in concert with, litigation by state attorneys general.

The litigation that led to the settlement alleged that five of the nation's largest banks, each of which was a major mortgage lender and servicer during the real estate bubble, use "robsigners"—law firms that filed large numbers of foreclosure documents without bothering to check the details—and added unnecessary fees such as overpriced insurance. The practices in

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[4] The FDIC used a somewhat similar strategy with banks during the crisis.

[5] Lou Whitman, *Buffett warns of Chrysler cramdown ramifications*, TheDeal.com, May 5, 2009.

[6] Bradley Blaylock, Alexander Edwards & Jared Stanfield, *The Market-Wide Consequences of Governmental Intervention*, available at www.ssrn.com/papers=1685618. Another study finds that the cost of issuing bonds in favored industries went down, due to the prospect that these firms may benefit from a bailout. Deniz Anginer & A. Joseph Warburton, *The Chrysler Effect: The Impact of the Chrysler Bailout on Borrowing Costs*, available at www.ssrn.com/paper=1833731.

question are disturbing and, to the extent the allegations are true, deserve to be punished. But the litigation focused only incidentally on the actual misbehavior. It appears to have been designed to take money from the largest banks to use for other purposes.

Under the settlement, the banks agreed to provide for $20 billion in loan modifications and loan relief, together with $5 million in cash to the state and federal governments. Almost none of this money is linked to the abuses that gave rise to the litigation. Nearly all of the homeowners whose foreclosure documents were robo-signed appear to have been in default, and do not appear to have been capable of repaying their obligations. They are not the principal beneficiaries of the $25 billion. While a small amount of the settlement funds may go to preventing robo-signing and related practices in the future, the vast majority will go to mortgage relief for homeowners who were not affected by these practices, or to give budget relief for states.

The states' actions since the settlement was formally approved in April have dramatically underscored the disconnect between the ostensible basis for the litigation and the actual use of its proceeds. According to recent reports, the states have allocated nearly $1 billion of their settlement funds to general budgets and non-housing programs. To give three examples, Georgia intends to use its funds "to attract new businesses to the state in order to create more jobs," Missouri is using its funds for higher education, and Virginia "funneled almost all of its payout to the state's general fund."[7]

It is perhaps worth noting that I am no fan of the big banks or of the foreclosure practices that ostensibly gave rise to the litigation. I believe that the dominance of a small handful of giant banks is a major problem in our financial services industry.[8]

But the litigation that led to the mortgage settlement had almost nothing in common with genuine litigation. "In a real lawsuit," as I put it elsewhere, "lawyers investigate the grievance in

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[7] Meg Handley, *Should States be Chided for How They Use Their Mortgage Settlement Money?*, U.S. NEWS & WORLD REP., May 24, 2012, available at www.usnews.com/news/blogs/home-front/2012/05/24/ (relying on data from ProPublica).

[8] I discuss these concerns in great detail in DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2011).

question, and if they persuade the court that their client has been harmed, the court or jury awards relief that is designed to remedy the harm, and perhaps to deter violations in the future. The chief objectives of the judicial process are fact finding and redress."[9] The mortgage settlement doesn't have any of these qualities. The attorneys general who pursued the litigation do not seem to have done any meaningful investigation at all. Rather than interviewing witnesses, reviewing the relevant documents, and seeking redress based related to their findings, they and the administration seem to have viewed the litigation as a way to provide additional legislative stimulus without actually going to Congress. This is a dangerous misuse of the judicial process.

Conclusion

The examples I have focused on in these remarks unfortunately are not the only illustrations of eroding respect for the rule of law. This pattern is becoming the norm. To mention just one more major illustration, the recently enacted Dodd-Frank Act explicitly requires that bank regulators liquidate any large financial institution that that they take over under the new Title II resolution rules. Almost no one thinks a giant financial institution would actually be liquidated if it fell into financial distress, however, and regulators already are signaling that they would use the resolution rules to preserve, not to liquidate, a troubled financial institution.

In the past, terms like "political risk" and "moral hazard plays" were most often used in connection with investment in the volatile markets of the developing world. Since the onset of the economic crises, the repeated circumvention of basic rule of law principles has made these concerns increasingly relevant to U.S. markets. Investors' inability to assume that their legal priorities will be honored, that laws will be applied as written, and that litigation will not be used to extract money for unrelated purposes has injected enormous uncertainty into the markets. I believe that recommitting to honor rule of law principles would make an important contribution to economic recovery, and to ensuring that our markets once again live up to their reputation as the fairest and most robust in the world.

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[9] David Skeel, *Mortgage Settlement or Mortgage Shakedown?*, WALL ST. J., Feb. 21, 2012, at A19.

American Council of Life Insurers (ACLI) Statement for the Record
House Financial Services Committee
Subcommittee on Capital Markets and Government Sponsored Enterprises
"Investor Protection: The Need to Protect Investors from the Government"

June 7, 2012

Thank you Chairman Garrett and Ranking Member Waters for convening today's hearing on the impact of certain government actions on the public and the investor community. The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the concerns of the life insurance industry about recent mortgage settlements negotiated between banks, mortgage servicers, and state and federal authorities.

The ACLI is a national trade association with over 300 member companies representing more than 90 percent of the assets and premiums of the life insurance and annuity industry in the U.S. ACLI member companies provide the products that protect against life's uncertainties, helping individuals and families manage the financial risks of premature death, disability, long-term care, and retirement. More than 75 million American families, nearly 70% of households, rely on life insurers' products for their financial and retirement security. In 2010 alone, American families received $58 billion in life insurance death benefits, $70 billion in annuity payments, $16 billion in disability income insurance benefits, and $7 billion in long-term care insurance benefits.

Life insurance companies hold more than $5.3 trillion in assets, which support the life insurance, annuity, disability, and other financial commitments made to customers and policyholders. Life companies must invest these assets conservatively because, unlike nearly all other financial institutions, they are predominantly focused on the long term. Life insurers must manage the policy premiums and investments entrusted to them by their customers to meet obligations to those customers over multiple decades. The fundamental business model of a life insurance company does not involve high risk or short term profit seeking.

Insurance company investment activities are subject to rigorous oversight and examination by state insurance regulators. State regulators have comprehensive regulatory and reporting regimes for examining an insurer's investment activities and guarding against excessive risk in their investment portfolios. The majority of assets invested by life companies are invested in safe government and corporate bonds. Life insurers are the single largest source of bond financing for American business, holding 17% of all U.S. corporate bonds. Life insurers also have smaller but significant investments in residential mortgage-backed securities (RMBS) and as such play a meaningful role in America's home finance system.

The life insurance industry supports efforts to rehabilitate the nation's housing market and is not opposed to mortgage settlements that may help struggling families stay in their homes. Loan modifications in many cases make sense for both the homeowner and the lender and are consistent with efforts to heal the real estate market. However, any mortgage settlements negotiated by state and federal authorities should be fair, transparent, and should not undermine investor faith in mortgage markets.

Safeguarding the rights of investors as part of this mortgage settlement is essential for the future of mortgage markets and the recovery of the securitization process. The non-agency securitization market is more or less non-existent today and private mortgage funding is accessible only to those borrowers with a near perfect credit profile. As long as government policy undermines the rights of investors, such as recent actions that have upended lienholder positions, a return to healthy mortgage markets and full borrower access to affordable mortgages will be exceedingly difficult. If the authors of the mortgage settlement ultimately wish to achieve an affordable, sustainable, privately-financed mortgage system that is accessible to the average borrower, then they must act now to protect the rights of investors.

Conflicts of Interest May be Harming Investors

The most recent mortgage settlement allows banks to make principal reductions for mortgage loans in their portfolio and/or mortgage loans contained in RMBS trusts, which they service on behalf of investors. Most contracts governing RMBS trusts allow servicers to make loan modifications only if the servicer determines that the modification is in the best interests of investors. Banks and mortgage servicers could be incentivized to write down principal on trust owned loans in order to receive credit against the penalty stipulated in the settlement and to increase the value of any related second lien they may hold on their books. In short, servicers would be able to use investor money, instead of their own, to satisfy a commitment or penalty required by the settlement. In such a circumstance, investors would be paying fines for the questionable practices of servicers responsible for degrading the value of their mortgage loans. This conflict of interest is untenable and is likely to result in harm to investors. Bank-owned holdings are more than sufficient to support principal reductions covering the entire cost of this portion of the settlement and should be utilized.

Lienholder priority should be maintained

For principal reductions that are made as part of the mortgage settlement, lienholder priority should be maintained. Holders of first mortgages should not be required to accept principal reductions before holders of subordinate liens, particularly when the subordinated lienholder is making the decision on the principal reduction. In the event of a foreclosure, which the settlement is designed to prevent, holders of subordinate mortgages would come behind holders of first mortgages as a matter of definition. Holders of subordinate mortgages compensate for the higher credit risk by charging a higher interest rate. It would be conspicuously unfair and unusual for holders of subordinate mortgages to both charge higher interest rates to borrowers and receive preferential lienholder treatment as part of the mortgage settlement. Holders of subordinate mortgages clearly understood their lienholder position at the onset of the mortgage transaction and should not be allowed to game the system now.

Under the existing settlement, servicers are incentivized to make principal reductions on trust held mortgages as a way of shoring up subordinate liens in which they have an interest. Again, this conflict of interest is untenable and is likely to result in harm to investors. Clearly, subordinate mortgages should be considered for principal reduction before first mortgages.

Appropriate Standards for Transparency and Monitoring Should be Put in Place

As the settlement is implemented, it is essential that certain common sense standards of transparency and accountability be put in place to ensure fair treatment for investors.

1. The Net Present Value (NPV) formulas and calculations that banks use to assess a loan for possible modification should be the same for portfolio loans as they are for trust owned loans.
2. Banks should follow best practices with respect to appraisals, including a requirement for an independent, third-party broker price opinion which excludes distressed sales.
3. Banks should provide monthly reports, rather than quarterly, on the details of how they are meeting their requirements. This reporting should include disclosure of the set of loans considered for principal reduction, both trust and bank owned. It should include information on modifications by loan owner and lien position. It should include detailed information about the assumptions and the data that support their NPV calculations. In addition, an independent third-party credit monitor should be tasked to sample RMBS principal reductions and report its findings.

Thank you for convening this important hearing and highlighting the impacts of recent mortgage settlements on insurance companies and our customers. We appreciate your consideration of the views of ACLI and its member companies.

CAR Research Memorandum

The Impact on the U.S. Economy of the Successful Automaker Bankruptcies

November 17, 2010

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Introduction

In late 2008 and throughout much of 2009, the global economy was in recession and the world's automotive industry was in crisis. In the United States, automotive sales plummeted to historically low levels, both automotive commercial and consumer credit availability contracted sharply, and critically, two major automotive manufacturers—General Motors and Chrysler—were on the brink of collapse. Across the globe, federal, state and provincial governments stepped in to provide aid to the Detroit-based automakers with operations in their countries. These loans and other financial assistance provided to General Motors and Chrysler by the U.S. and foreign governments averted certain economic catastrophe had the companies been allowed to fail. Now that sufficient time has passed since the U.S. policy intervention, it is possible to evaluate the magnitude of the economic disaster averted, and weigh the public and private benefits against the public cost of aid to General Motors and Chrysler.

The View from 2008 and 2009

Throughout the debate on whether the U.S. government should intervene to save the U.S. automotive industry, there was general agreement that the failure of General Motors and Chrysler would cause harm to the U.S. economy. The magnitude of the potential employment and economic impacts, the size of the government response, and the precedent that would be set by government action were the focus of intense debate.

On November 4, 2008, CAR produced the first rigorous estimate of job loss and economic impact related to the 2008 automotive crisis in a research memorandum entitled, "The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers."[1] As the decision on whether to proceed with structured bankruptcies of General Motors and Chrysler was being debated in the Spring of 2009, CAR produced a second research memorandum entitled, "The Impact on the U.S. Economy of Successful versus Unsuccessful Automaker Bankruptcies."[2] Several other industry analysts, economists, policy organizations, and government offices—including the White House—also weighed in on the issue of how big the economic impact would be if one or more of the Detroit Three automakers were to fail.[3]

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[1] McAlinden, Sean P., Kristin Dziczek and Debra Maranger Menk, **CAR Research Memorandum: The Impact on the U.S. Economy of a Major Contraction of the Detroit Three Automakers**, Center for Automotive Research, November 4, 2008. http://www.cargroup.org/documents/Detroit_Three_Contraction_Impact.pdf

[2] McAlinden, Sean P., Debra Maranger Menk, Adam Cooper, **CAR Research Memorandum: The Impact on the U.S. Economy of Successful versus Unsuccessful Automaker Bankruptcies**, Center for Automotive Research, May 26, 2009. http://www.cargroup.org/pdfs/impact.pdf

[3] A sampling of reports forecasting the economic impacts if one or more U.S. automakers were to fail includes:
"The Economic Impact of the Detroit Three Automakers in Canada," The Centre for Spatial Economics, December 2008.
Scott, Robert, "When Giants Fall: Shutdown of one or more U.S. automakers could eliminate up to 3.3 million U.S. Jobs," Economic Policy Institute, December 3, 2008.
"Automaker Bankruptcy Would cost Taxpayers Four Times More Than Amount of Federal Bridge Loans," Anderson Economic Group/BBK, December 8, 2008.
Wial, Howard, "How a Metro Nation Would Feel the Loss of the Detroit Three Automakers," The Brookings Institution, Metropolitan Policy Program, December 12, 2008.
Werling, Jeffrey, "Potential Job Losses from Restructuring the U.S. Auto Industry," University of Maryland, Inforum Economic Summary, December 16, 2008.
"Fact Sheet: Financing Assistance to Facilitate the Restructuring of Auto Manufacturers to Attain Financial Viability," White House, Office of the Press Secretary, December 19, 2008.
"U.S. Motor Vehicle Industry: Federal Financial Assistance and Restructuring," Congressional Research Service, 7-5700, January 30, 2009.
"Bankruptcy or Bailout—Which Would Best Help the American Auto Industry?" IHS Global Insight, February 9, 2009.

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In CAR's November 4, 2008 memorandum, economic impacts were estimated for two scenarios involving a short-term, severe (50- to 100-percent) contraction of Detroit Three capacity in the United States. The job loss estimates ranged from 2.5-3 million jobs in the first year, and 1.5-2.5 million in the second year, the estimates of personal income loss ranged from $125.1-150.7 billion in the first year, and $86.4-138.2 billion in the second year, and the estimates of net impact to government, in terms of increased transfer payments, reduced social security receipts and reduced personal income taxes paid, ranged from $49.9-60.1 billion in the first year, and $33.7-54.3 billion in the second year.[4]

CAR's May 26, 2009 memorandum produced estimates for two scenarios, as well: a quick, orderly Section 363 bankruptcy (which is what happened), and a drawn-out, disorderly bankruptcy proceeding leading to liquidation of the automakers. A summary of the 2009 and 2010 employment and economic impacts is presented in Table 1.

Table 1: May 2009 Forecast of Economic Impact of Government Aid to U.S. Automotive Industry

	Best Case Estimates		Worst Case Estimates	
	2009	2010	2009	2010
Total Employment	-63,200	-179,400	-1,344,000	-446,700
Personal Income (Lost)	-$3.4	-$9.9	-$68.7	-$26.4
Increase in Transfer Payments	$0.3	$0.9	$6.6	$2.3
Decline in Social Security Receipts	-$0.5	-$1.3	-$9.5	-$3.5
Decline in Personal Income Taxes	-$0.5	-$1.6	-$11.0	-$4.2
Net Impact to Government of Avoiding the Worst Case	$25.8 billion in 2009 $6.5 billion in 2010			

Note: All dollar amounts are in billions of current dollars

The difference between the two scenarios presented in CAR's May 2009 memo represented the anticipated private and public benefits of avoiding the scenario of a bankruptcy liquidation of both General Motors and Chrysler. The "good bankruptcy" outcome was projected to have avoided a loss of 1.28 million jobs in 2009, and 267,300 in 2010. Personal income losses were expected to be $65.3 billion less in 2009, and $16.5 billion less in 2010. It was estimated that avoiding the worst case scenario provided a net government impact—in terms of changes in transfer payments, social security receipts and personal income tax receipts—of $25.8 billion in 2009 and $6.5 billion in 2010, a total of $32.3 billion.

The View from 2010

Earlier this year, The White House produced a document entitled, "A Look Back at GM, Chrysler and the American Auto Industry,"[5] which assessed that automotive employment, production and sales had begun to stabilize. Now that data are available on more than a year of General Motors and Chrysler operating results, the forecasted economic impact of the government's intervention in the auto industry can be compared against actual economic events. In so doing, a retrospective measurement of the value of the government's actions in support of the U.S. automotive industry can be constructed.

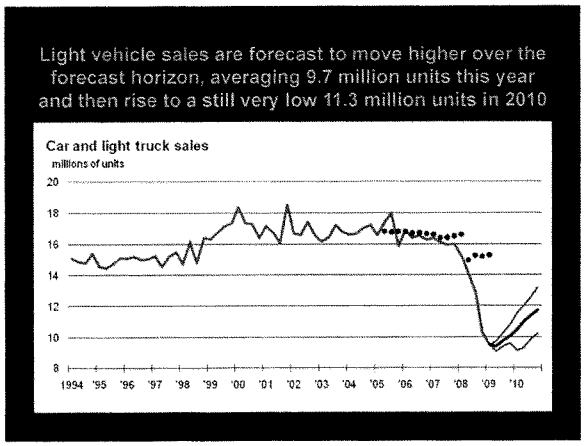
The forecast model used to produce CAR's 2008 and 2009 economic impact studies contained an underlying model of the U.S. economy. Specifically, the model used to produce the May 2009 estimates of the economic impact of "good" versus "bad" bankruptcies assumed that Gross Domestic Product

[4] McAlinden, Dziczek, Menk, op.cit., pages 4-6.
[5] "A Look Back at GM, Chrysler and the American Auto Industry," Executive Office of the President of the United States, April 21, 2010.

(GDP) would fall 3 percent in 2009, and grow at a rate of only 1 percent in 2010. In fact, the economic activity was higher in the period, with actual GDP falling 2.6 percent in 2009 and gaining at a rate of 2.5 percent in the first nine months of 2010.

Although motor vehicle sales were weak in the second half of 2009 and throughout 2010, market performance was still better than what was anticipated[6]. The weak sales were mainly attributed to the unexpectedly high levels of unemployment, and sluggish consumer confidence. If the government had not invested in the automotive industry, up to 80,000[7] automotive jobs would have been lost, and General Motors alone would have lost one million units of sales in 2009.

Chart 1: Light Vehicle Sales Forecast

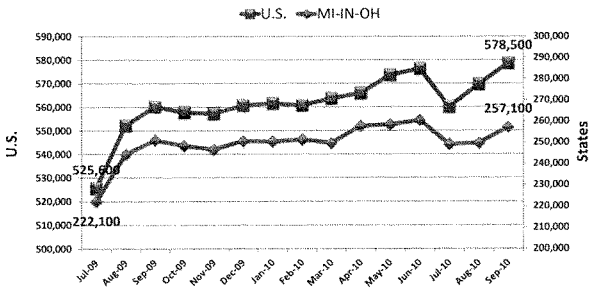


Source: Federal Reserve Bank of Chicago, June 5, 2009

Once Chrysler and GM emerged from their "orderly" bankruptcies, the growth of automotive sector employment has been strong, with 52,900 workers added since July 2009. Had GM and Chrysler not successfully emerged, those jobs would have been permanently lost.

[6] "Consensus Forecast 2009 and 2010", Federal Reserve Bank of Chicago, June 5, 2009.
[7] In 2009, "New GM" sold roughly 1.0 million vehicles between 7/10/09 and 12/31/09. Assuming the U.S. automotive labor productivity is 12.5 units per worker, it is equivalent of 80,000 automotive jobs.

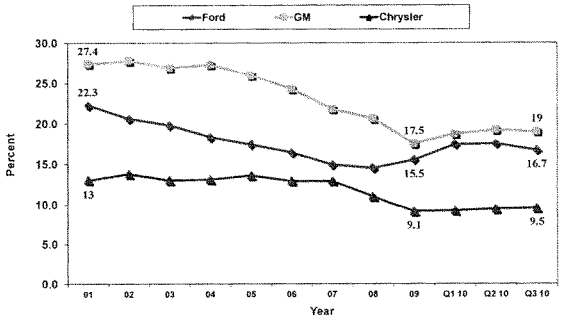
Chart 2: Motor Vehicle and Parts Manufacturing Employment, July 2009-September 2010



Source: BLS, U.S. DOL

In terms of market share, the Detroit Three automakers' shares had stopped plummeting by the end of 2009, albeit in a smaller market. In the first three quarters of 2010, market shares were gradually restored. Although the domestic automakers' market shares are less likely to climb back to where they were in the beginning of the past decade, they are expected to hold up and even improve slightly in the years to come. If the U.S. government had let GM and Chrysler go bankrupt, the U.S. motor vehicle market would be dominated by foreign companies.

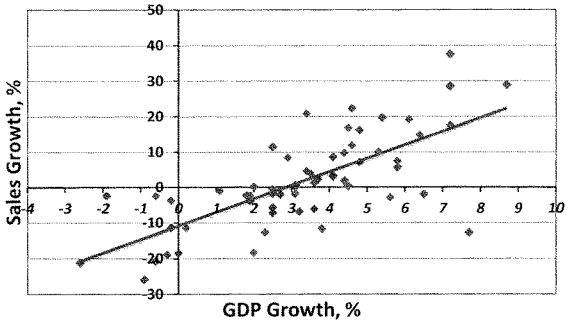
Chart 3: Detroit Three U.S. Market Share, 2001-2010 Q3, Sales of Detroit Three North American Owned Production



Source: CAR Research

Finally, while the U.S. economy has officially been in recovery since Q2 2009, according to the National Bureau of Economic Research, growth has been sluggish. Except for the first quarter, this year's GDP growth was lower than 2 percent SASAR. Historically speaking, vehicle sales do not increase if the GDP annual growth rate is less than 3 percent. So far this year, GDP has only grown 2.5 percent. If the sluggish economic growth continues throughout this year and into next year, overall sales will likely remain at current levels. On the other hand, if the GDP growth rate were 1 percent, as was expected had the government not intervened, auto sales would have dropped another 8 percent this year, according to historical trends (Chart 4).

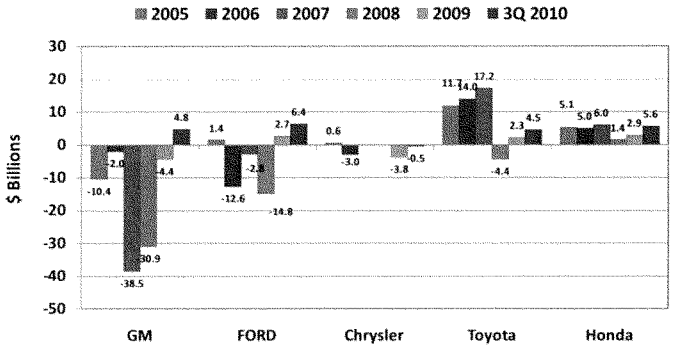
Chart 4: Need 3% GDP Growth to Have Positive Automotive Sales Growth, GDP Growth Rate and Automotive Sales Growth Rate, 1950-2009



Source: CAR Research

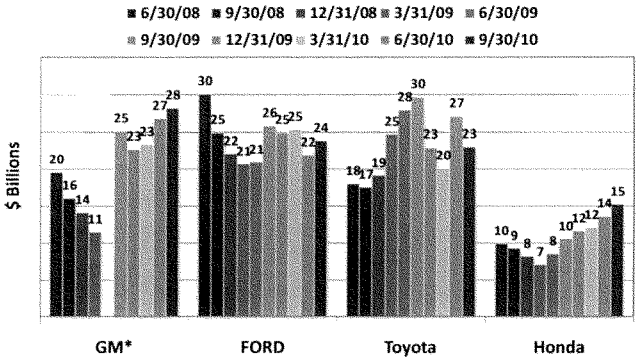
Against the backdrop of lackluster overall economic recovery, and the mixed bag of automotive-specific results from 2008-2010, the Detroit Three automakers have proven that they can make money at far lower volumes than was true prior to the crisis. The break-even point has been lowered for all three companies, and profits and cash flow have been positively impacted.

Chart 5: Earnings Are Positive: Corporate Net Income (Loss), 2005-2010 Q3



**GM represents both General Motors Corp. and General Motors Co.*
***Chrysler represents Chrysler Group of DaimlerChrysler AG, Chrysler LLC, and Chrysler Group LLC.*
****Toyota/Honda data reflect corresponding fiscal year financial results.*
Source: Companies' financial reports

Chart 6: Cash and Cash Equivalent – Quarterly, 2008 Q2-2010 Q3



**The numbers reflect both old GM and new company after the bankruptcy. Second quarter of 2009 data was not available due to the bankruptcy process.*
Source: Companies' quarterly reports.
Source: Companies' quarterly reports.

Scenario and Methodology

For purposes of this study, CAR researchers replicated the exact scenarios produced for the May 26, 2009 memorandum on the difference between the economic impacts of "good" and "bad" bankruptcies—using a model loaded with actual economic performance data for the period 2009-2010. As in the previous economic impact studies, CAR employed the Regional Economics Models, Inc. (REMI) forecasting model.

The REMI model uses annualized data. At the REMI website, www.remi.com, the resources tab provides model documentation detailing every dataset, as well as data scrubbing procedures. The REMI model provides for central bank monetary responses and federal fiscal policy responses to movements in the economy. There are three options that may be chosen for simulation purposes. Each of these options provides varying levels of federal involvement and different rates of policy response. We use the Keynesian closure option. This option has the lowest level of federal response to economic upheavals, with no fiscal intervention to economic shocks in any sector of the economy. This option provides the clearest picture of the true role that any one industrial sector has within the national and regional economies. The purpose of the study was not to forecast Fed response to the automotive industry contraction, but to show the extent to which the auto industry is a large component of the U.S. economy.

Within the REMI model, important algorithms affecting the rate of economic growth or contraction are the migration equations (the movement of population from one area or state to another). Migration occurs due to economic pulls or pushes; the migration equations used in REMI reflect the mobility of the population as experienced in the U.S. economy over the past 30 years. Therefore, the ability of a labor force to recover from this type of industrial shock is reflected in model results.

Trade with other nations, via imports and exports, is part of the model and is affected by economic changes. Exchange rates are not a focus of the model, and are incorporated into the trade effects based on historical data.

Generating meaningful results from an economic model requires:

- having an understanding of the algorithms, datasets and formulae of the model being used,
- having familiarity with how changes in various data inputs will impact results, and
- calibrating the model to historical, known outcomes.

In addition, economic simulations are most useful when combined with a theory of how model results can be used against the backdrop of current economic conditions. Every situation has aspects that are not going to be captured in a model in such a way as to produce consistently accurate forecasts. The current economy in the U.S. is extremely volatile. The employment impact results found in this study–in either of the scenarios–are quite low, because many of the employment losses due to GM's and Chrysler's downsizing have already occurred and are part of the model's baseline. For all industries, capital funds are not as readily available as they were even a year ago. Therefore, investment spending (which is needed for economic and employment recovery) is presently not occurring at the healthier levels, seen as recently as 2007. This would indicate that the recovery predictors of the model (based on 15-year historical averages) are optimistic for current economic conditions.

Results

Table 2: November 2010 Backcast of Economic Impact of Government Aid to U.S. Automotive Industry

	Best Case Estimates		Worst Case Estimates	
	2009	2010	2009	2010
Total Employment	-193,078	-171,219	-1,329,406	-485,641
Personal Income (Lost)	-$12.61	-$12.32	-$84.47	-$36.95
Increase in Transfer Payments	$0.94	$0.88	$6.51	$2.49
Decline in Social Security Receipts	-$1.45	-$1.41	-$9.61	-$4.12
Decline in Personal Income Taxes	-$1.36	-$1.33	-$9.20	-$3.99
Net Impact to Government of Avoiding the Worst Case	$21.6 billion in 2009 $7.0 billion in 2010			

Note: All dollar amounts are in billions of current dollars

Jobs

The May results estimated that the outcomes of the orderly bankruptcy proceedings would save 1.28 million jobs in 2009, while the current review estimates slightly lower job savings of 1.14 million jobs. For 2010, original estimates (of orderly bankruptcies vs. unsuccessful proceedings) were that 267,300 jobs would be saved, while the current review estimates that 314,400 jobs were preserved.

Personal Income

From the May forecast, personal income losses were expected to be $65.3 billion less in 2009, and $16.5 billion less in 2010, with the review estimates higher at $71.9 billion for 2009 and $24.6 billion for 2010.

Net Impact to Government

The contrast between the two studies for the net impact to government budget—lower transfer payments, higher social security receipts and higher personal income taxes paid—amounted to original estimates for a public benefit of $25.8 billion in 2009, and $6.5 billion in 2010 compared to new estimates of $21.6 billion in 2009, and $7.0 billion in 2010, for a two-year total of $28.6 billion.

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Conclusion

In May, 2009, CAR estimated that if GM and Chrysler were able to enter into bankruptcy proceedings and exit within 90 days with operating cash, the effect on the economy would be an initial loss of 9,700 jobs (total for both companies) in 2009, and a cumulative total loss of 29,000 jobs by the end of 2010. Using historical employment and economic data, CAR now estimates that 23,900 jobs were lost at these companies by the end of 2009, and a net of 21,900 jobs will have been shed at these companies by the end of 2010. The cumulative losses to the economy as of the end of 2010 are less than originally forecasted. The original forecast predicted that nearly 180,000 jobs would be lost in the U.S., while in actuality, a total of slightly more than 171,000 total jobs will have been taken out of the economy.

The forecast and the review differ most significantly for the year 2009. For this year, the original forecast estimated that job losses would be minimal for the first 6 months following the bankruptcies, and that job losses would continue throughout 2010. In actuality, the companies moved quickly to optimize production capacities and rationalize operations. While this meant that most jobs were eliminated almost immediately, the companies were able to improve their operations with surprising speed. Although the loss of jobs has been a severe blow to the economy, these companies are now poised to operate profitably and at lower levels of production and sales.

Net Public Benefit of Government Intervention

Providing government assistance to General Motors and Chrysler through quick and structured bankruptcy proceedings avoided the worst case scenario. In reviewing the economic impacts using actual economic performance for 2009 and much of 2010, the net public benefit—the difference between what CAR estimated did happen and what CAR predicted might have happened to government transfer payments, social security receipts and personal income taxes paid—was just $4.2 billion in 2009 and $0.5 billion in 2010.

The U.S. government provided $80 billion in total assistance to General Motors, GMAC, Chrysler and Chrysler Financial[8], and stands to recover a substantial amount of this financial assistance through upcoming sales of stock in the Initial Public Offerings (IPOs) at General Motors and Chrysler. To date, $13.4 billion in principal has already been repaid, which brings the total remaining outstanding government investment to $66.6 billion. The updated analysis contained in this memo demonstrates that even if the net return to the U.S. Treasury is $28.6 billion (the amount of the net public benefit of the government intervention) lower than the outstanding public investment in these two companies, or $38 billion, the public will have at least met a two-year break-even. This means that if the Treasury recovers $0.57 on the dollar or more in upcoming equity sales, the public will have been made fully whole. Additionally, the government's actions avoided personal income losses totaling over $96 billion, 1.1 million net job losses in 2009, and another 314,400 in 2010.

[8] www.financialstability.gov, amount of assistance and repayments made confirmed in November 16, 2010 conversation with U.S. Treasury automotive staff.

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