AMI ASSOCIATION OF MORTGAGE INVESTORS

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

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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.
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> *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.
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> *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.