



WRITTEN STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

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

THE STATE OF SECURITIZATION MARKETS

SEPTEMBER 6, 2011

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## **Introduction**

Chairman Garrett and Ranking Member Waters, and distinguished members of the Subcommittee, thank you for the opportunity for the Association of Mortgage Investors (AMI) to testify and comment on this critically important topic of “Facilitating Continued Investor Demand in the U.S. Mortgage Market Without a Government Guarantee.”

The Association of Mortgage Investors (AMI) commends you and your House colleagues for your leadership in pursuing responsible and effective oversight and vigilance to enhance the health and effectiveness of the U.S. financial markets, and in particular, the U.S. housing finance system.

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

- Market opacity, an asymmetry of information, and a thorough lack of transparency;
- Poor underwriting standards;
- A lack of standardization and uniformity concerning the transaction documents;
- Numerous conflicts-of-interest among servicers and their affiliates;
- Antiquated, defective, and improper mortgage servicing practices; and,
- Investors lack effective legal remedies for violations of RMBS contractual obligations and other rights arising under state and federal law.

## **I. Background**

The AMI was formed to become the primary trade association representing investors in mortgage-backed securities (MBS), along with life insurance companies, state pension and retirement systems, university endowments, and pension funds. It has developed a set of policy priorities that we believe can contribute to achieving this goal. We were founded to play a primary role in the analysis, development, and implementation of mortgage and housing policy that keep homeowners in their homes and provide a sound framework that promotes continued home purchasing. In practice, only three sources of residential mortgage capital exist in the United States: (1) the bank balance sheets- which are arguably full and stressed; (2) the government (Fannie Mae, Freddie Mac, FHA); and, finally, (3) securitization, which is effectively shutdown for the reasons described herein.

Today's U.S. mortgage market consists of approximately \$11 trillion in outstanding mortgages. Of that \$11 trillion, approximately one-half -- \$5.4 trillion -- are held on the books of the GSEs as agency mortgage-backed securities (issued by one of the agencies) or in whole loan form. Another \$4.0 trillion are on the bank balance sheets as whole loans or securities in their portfolios, of which \$1 trillion are second liens (*i.e.*, home equity loans/lines of credit or closed end second mortgages).<sup>1</sup> Of the \$1.1 trillion outstanding second mortgages, only 3.7% of the total (or \$41 billion) is held by private investors in securitized form. The remaining \$1.2 trillion in first lien mortgages reside in private label mortgage-backed securities (MBS). AMI's members hold a significant proportion of these investments; AMI members have approximately \$300 billion of assets under management.

The development of enhanced structures, standards, and safeguards will contribute to improving the functioning of capital markets for all investment asset classes, especially those pertaining to a necessity of

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

life, namely housing. Your work will contribute to helping to keep Americans in their homes, making credit available, and the development of effective tools against the foreclosure crisis.

Mortgage investors share your frustration with the slow restoration of the housing market, relief for homeowners, and finally offering the capital markets and homeowners that are truly in need meaningful and permanent relief. In fact, the markets for Residential Mortgage Backed Securities (RMBS) securitization have virtually ground to a halt since the financial crisis for reasons that we will enumerate.<sup>2</sup> We are hopeful that meaningful solutions can be implemented more quickly, and we believe that our interests are aligned with responsible homeowners. As difficult as it may be to believe, many of the most sophisticated investors were as victimized and abused by the servicers and their affiliates as were many consumers. Investors are essential in order to rebuild the private mortgage market. However, investors and their private capital will only return to a market which is transparent, has non-conflicted stakeholders, and the protection of contract law.

#### **a. The Role of Mortgage Investors in the Marketplace**

Mortgage investors, through securitization, have for decades contributed to the affordability of housing, making credit more inexpensive, and making other benefits available to consumers. Today, however, mortgage investors face enormous challenges in the capital markets due to opacity, an asymmetry of information, poor underwriting, conflicts-of-interests by key parties in the securitization process, as well as, the inability to enforce rights arising under contracts, securities and other laws. This list is by no means intended to be exhaustive. Accordingly, investors, average Americans, and the U.S. economy at-large are harmed.

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<sup>2</sup> The exceptions are two recent securitizations by Redwood Trust.

## **b. The History and Rise of MBS Securitization**

It is important to note that securitization as a mortgage finance tool has been instrumental in reducing housing costs and helping citizens achieve the American dream of homeownership. In the 1970s, the mortgage finance industry was in its infancy. In fact, then the market consisted solely of two products – those backed by Ginnie Mae and Freddie Mac. The advent of the mortgage-backed securities market resulted in de-regionalizing or nationalizing real estate investment risk, increasing liquidity to mortgage originators, and lowering barriers to home ownership. Securitization was a key factor in improving regional real estate markets. New York State is a case in point. In the 1970s, most New York depositories were flush with cash but had a hard interest rate limit on mortgages. The result was a flow of California mortgages to New York and a flow of dollars to California. New York was an unattractive and non-competitive local market. With securitization, the New York market, as well as other markets became national markets; and hence, mortgage funds were more readily available. Since the 1970s, mortgage-backed securities have increased lending levels, with even state housing agencies benefiting from the mortgage-backed securities’ structuring techniques. The benefits of securitization are widely known.<sup>3</sup>

## **II. Mortgage Investors’ Interests Align with Responsible Borrowers**

Mortgage investors are aligned with both homeowners and the government in our shared goals of keeping responsible Americans in their homes and rebuilding and maintaining a vibrant real estate market. In fact, the maintenance of a healthy securitization market is a vital source of access to private capital for mortgages as well as autos and credit cards. Moreover, an efficient securitization market provides more and cheaper capital to originators, which allows them to issue more loans to additional qualified

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<sup>3</sup> See e.g., *Securitization and Federal Regulation of Mortgages for Safety and Soundness*, CRS REPORT FOR CONGRESS at 2 (RS-22722, Oct. 21, 2008). (“This securitization of mortgages increased the supply of funds available for mortgage lending”).

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

Mortgage investors seek effective, long-term sustainable solutions for responsible homeowners seeking to stay in their homes. We are pleased to report that mortgage investors, primarily the first lien holders, do not object to modifications as part of a solution. Unfortunately, mortgage investors are often powerless under the operative Pooling and Servicing Agreements (PSA) to offer such support. We strive for additional remedies to assist homeowners. Likewise, if a borrower speculating in the housing market, engaging in a strategic default or paying only their second lien mortgages, then they should not be eligible for receiving subsidized first lien interest rates. Potential structural changes that should be examined include: full recourse, blockage of interest payments on second lien debt if the first lien is in default, prohibitions on the second lien debt above a specified loan-to-value (LTV).

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

the same challenges. Unfortunately, this critical component of mortgage securities market has broken down, harming mortgage investors including state pension and retirement systems.

With a restored, vital and healthy securities market, we will be able to attract more private capital into mortgage investments and, in turn, provide more affordable mortgages for potential qualified home buyers.

**a. Problems Arising from Improper Servicing**

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

- **Many Servicers are Conflicted; They May not be Servicing Mortgages Properly.** Very often they are harming the interests' of both investors and homeowners' interests. This has a negative impact on private investor demand for mortgages and limits housing opportunities;<sup>4</sup>
- **Originators and Issuers May not be Honoring their Contractual Representations** about what they sold into securitizations. Additionally, the documents are vague, with basic terminology

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

having no definite meaning (*e.g.*, delinquency or default). The past is prologue and there are no assurances that they will not repeat these practices in the future; and,

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

### **III. Solutions offered by Mortgage Investors**

The current legal and regulatory landscape presents numerous obstacles for the MBS securitization, including a lack of the necessary transparency for the effective functioning of capital markets in connection with several fundamental aspects of the system. These problems are varied and numerous in the RMBS context. For example, investors were offered transactions with overly complex legal documentation, obscured salient facts about a deal, and take-it-or-leave-it time frames for acceptances of offers to purchase securities in underwritings. The lack of transparency in this context distorted markets and ultimately proved to impair the health and stability of our housing and mortgage markets. In essence, mortgage investors simply seek the salient facts underlying a transaction. In fact, last week, Mr. Edward DeMarco, Acting Director, Federal Housing Finance Administration (FHFA), testified before a House of Representatives Subcommittee and explained the following:

*FHFA views enhanced, loan-level disclosures as necessary for investors to analyze and assess the potential risks associated with the collateral of asset-backed securities, including mortgages.*<sup>5</sup>

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<sup>5</sup> Hearing on *Transparency as an Alternative to the Federal Government's Regulation of Risk Retention*, before the House Oversight and Government Reform Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs, May 11, 2011 (testimony of Acting Director Edward DeMarco).

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

We believe that the recommendations below, which are detailed in depth in the attached white paper, support healthy and efficient securitization and mortgage finance markets, with more information made more widely available to participants, regulators, and observers; incentivize positive economic behavior among market participants; reduce information asymmetries that distort markets and are entirely consistent with the government's traditional roles of standard-setting in capital markets. In sum, the AMI offers the following recommendations to enhance transparency and best securitization practices within capital markets:

- *Provide loan-level information that investors, ratings agencies and regulators can use to evaluate collateral and its expected economic performance, both at pool underwriting and continuously over the life of the securitization.*
- *Require a "cooling off period" when asset-backed securities are offered so that investors have sufficient time to review and analyze loan-level information before making investment decisions.*
- *Make deal documents for all asset-backed securities and structured finance securities publicly available to market participants and regulators sufficiently in advance of investor decisions whether to purchase securities offered.*
- *Develop, for each asset class, standard pooling and servicing agreements with model representations and warranties as a non-waivable industry minimum standard.*

- *Develop clear standard definitions for securitization markets.*
- *Directly address conflicts of interests of servicers that have economic interests adverse to those of investors, by imposing direct fiduciary duties to investors and/or mandatory separation of those economic interests, and standardize servicer accounting and reporting for restructuring, modification or work-out of collateral assets.*
- *Just as the Trust Indenture Act of 1939 requires the appointment of a suitably independent and qualified trustee to act for the benefit of holders of corporate debt securities, model securitization agreements must contain substantive provisions to protect asset-backed security holders.*
- *Asset-backed securities should be explicitly made subject to private right of action provisions of anti-fraud statutes in securities law and to appropriate Sarbanes-Oxley disclosures and controls.*
- *Certain asset-backed securities can be simplified and standardized so as to encourage increased trading in the secondary market on venues, such as exchanges, where trading prices are more visible to investors and regulators.*
- *Ratings agencies need to use loan-level data on their initial ratings and to update their assumptions and ratings as market conditions evolve and collateral performance is reported.*

#### **IV. Conclusion**

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

more expensive credit, and fewer housing options and less opportunity for working class Americans.

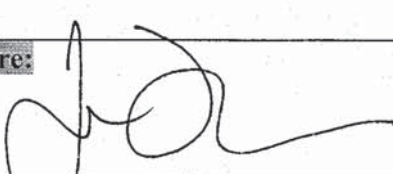
These are the reasons that we need solutions providing for more transparent systems and restarting our capital markets.

Thank you for the opportunity to share the views of the Association of Mortgage Investors with the Subcommittee. Please do not hesitate to use the AMI as a resource in your continued oversight concerning the many issues under review. We may be reached through AMI's Executive Director, Chris Katopis, at 202-327-8100 or by email at [katopis@the-ami.org](mailto:katopis@the-ami.org). We welcome any questions that you might have about securitization, representations and warranties, or other mortgage industry topics.

United States House of Representatives  
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

<b>1. Name:</b>	<b>2. Organization or organizations you are representing:</b>
Jonathan A. Lieberman	Association of Mortgage Investors
<b>3. Business Address and telephone number:</b>	
<div style="background-color: black; width: 100%; height: 100%;"></div>	
<b>4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>	<b>5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>
<div style="display: flex; justify-content: space-between;"><span><input type="checkbox"/> Yes</span><span><input checked="" type="checkbox"/> No</span></div>	<div style="display: flex; justify-content: space-between;"><span><input type="checkbox"/> Yes</span><span><input checked="" type="checkbox"/> No</span></div>
<b>6. If you answered yes to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.</b>	
<b>7. Signature:</b>	
	

*Please attach a copy of this form to your written testimony.*