Statement of:

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Testimony before the:

Committee on Financial Services
United States House of Representatives

Hearing on:

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

July 18, 2013

<u>Introduction & Summary of Testimony</u>

Chairman Hensarling, Ranking Member Waters and distinguished Members of the Committee, my name is Tom Deutsch and as the Executive Director of the American Securitization Forum (the "ASF")[1], I very much appreciate the opportunity to testify here regarding the proposed "Protecting American Taxpayers and Homeowners Act" ("PATH Act"), on behalf of the hundreds of ASF member institutions who originate, structure, trade, service, invest[2] and serve as trustee for residential mortgage-backed securities ("RMBS") and asset-backed securities ("ABS") created in the United States, including those backed entirely by private capital as well as those guaranteed or insured by public entities such as Fannie Mae and Freddie Mac (the "Government-Sponsored Enterprises" or "GSEs") or the Federal Housing Administration ("FHA").

ASF strongly supports the introduction of the PATH Act, as its proposal should continue to fuel what we hope to be a tangible, constructive dialogue to resolve the future of U.S housing finance reform. We strongly advocate that this dialogue culminate sooner rather than later in answering the core question of what the federal government will do with the GSEs. For the five years since the onset of the GSEs' conservatorship, the mortgage reform dialogue has been, in our opinion, far too theoretical. As ASF testified in 2010[3] and in 2011[4] regarding Congressman's Garrett's introduction of the Private Mortgage Market Investment Act, we have been strong supporters of turning this theoretical debate into tangible legislation. While ASF and others all along the political spectrum will likely propose changes to this discussion draft, we believe this bill, along with the recent introduction of GSE and FHA reform bills in the U.S. Senate, serve as concrete steps towards comprehensively restructuring the currently misguided U.S. housing finance system that relies on the U.S. government to backstop over 90% of residential mortgages made in this country. No other country in the world, small or large, has ever put their taxpayers in such an extreme backstop position. We believe Congress must take steps to substantially reduce the government's role in mortgage finance. This must be done responsibly so that greater dislocation does not occur within our nation's fragile housing market through materially reduced access to credit and/or impairment of value of agency and private-label RMBS. There are many aspects of the PATH Act that work toward this goal and that ASF strongly supports.

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[1] The American Securitization Forum is a broad-based professional forum through which participants in the U.S. structured finance market advocate their common interests on important legal, regulatory and market practice issues. ASF includes hundreds of member firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in structured finance transactions. ASF also provides information, education and training on a range of structured finance market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

[2] The preponderance of investors in the structured finance market are institutional investors, including mutual funds, money market funds, pension funds, banks, insurance companies, hedge funds and sovereign wealth funds. Although these direct market participants are institutions, many of them, such as pension funds and mutual funds, ultimately invest on behalf of individuals and their retirement savings. ASF investor member institutions have outstanding RMBS assets under management measured in the trillions of dollars.

[3] *See* http://www.americansecuritization.com/uploadedFiles/ASF_HFSC_Testimony_09.29.10.pdf.

[4] *See* http://www.americansecuritization.com/uploadedFiles/ASF_Private_Mortgage_Testimony_11_3_11.pdf.

In the testimony that follows, we make the following key statements:

I. **Short-Term Transition to More Private Capital**—ASF is strongly supportive in the near term of ratcheting down the federal government's involvement in the U.S. housing finance system through gradual reductions in loan limits, appropriate increases in guarantee fees and the GSEs' issuing material amounts of their securities that expose investors to credit risk of the underlying mortgages. In an April 2013 ASF White Paper,[5] we provide substantially more detail about appropriate bipartisan steps Congress, the Federal Housing Finance Agency ("FHFA") and other regulators should take to increase private capital in the mortgage market if the broader housing finance reform debate stalls passage of major reform.

II. **Long-Term Transition to More Private Capital**—As the credit risk investor base is rebuilt, heavier competition returns to the RMBS issuance market, and crisis-era regulations are finalized, Congress and FHFA should push additional volume of loans outside of the GSEs and FHA through its various levers in the form of either GSE risk-sharing deals or purely privately-issued transactions.

III. **Market Standards Utility**—ASF is supportive of the GSEs and/or a subsequent utility furthering market standards in the form of mortgage loan level data, representations and warranties, repurchase provisions, etc., though the extent of their usage by private market participants will be bounded by the benefits the Utility offers, as opposed to issuing private-label RMBS outside of the Utility without the associated Utility platform costs.

IV. **Covered Bonds**—ASF has and continues to be a strong supporter of instituting a legislative covered bond framework in the U.S. to provide additional outlets for capital markets sales of mortgages and other assets, which would also keep U.S. institutions on a level playing field with other countries around the world, such as Canada and Australia, who have most recently instituted similar legislated frameworks and whose banks sell billions of dollars to U.S. investors.

V. **Impediments to Mortgage Originations and Sales**—ASF is strongly supportive of targeted corrections to the Dodd-Frank Act, Basel III and other regulations to better facilitate the origination and capital markets sales of mortgages and securities backed by them.

VI. **Use of Eminent Domain**—ASF is extremely supportive of the PATH Act's prohibition of the GSEs and FHA from guaranteeing or insuring mortgages

[5] ASF's April 23, 2013 White Paper constitutes a concise summary of key policy proposals that can be implemented in the short-term to expedite the process of bringing private capital back to the mortgage market by incrementally reducing the government-guaranteed market well below the current 90+%. These tangible proposals are proposed to be addressed in a comprehensive manner to promote a robust private-label RMBS market. *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=9337.

originated in a county that has exercised eminent domain to seize mortgage loans in the past 10 years. The basic premise is simple—governments should not change the rules of the game after a mortgage is originated. Investors buy mortgages and RMBS at prices they believe are appropriate. There is no role for the government to come along later and seize those mortgages for another private firm's gain and then pay the original investors what the government thinks is appropriate, particularly when the exercise of eminent domain does not yield an appropriate public purpose such as building a road or laying water lines. Many would also argue the history of the use of eminent domain has often yielded too low of a price to the owner of a seized asset.

VII. **Suggested Additions to the PATH Act**—Upon initial review, ASF offers additions to the PATH Act to evolve and clarify governance of FHFA and the Utility over time. In addition, we propose to eliminate many of the counterproductive applications of the derivatives section ("Title VII") of the Dodd-Frank Act to RMBS and ABS transactions. In particular, application of swap and margin requirements to securitization transactions could have extremely damaging impacts to the return of RMBS by forcing issuers to effectively strand valuable capital in transactions for long periods of time.

I. Short-Term Transition to More Private Capital

Because broad legislative reform of U.S. housing finance could unfold and eventually pass over the course of several years, the ASF urges Congress and U.S. regulators to continue to move forward with other incremental steps to increase private capital, while the broader reform debate unfurls. Earlier this spring, ASF released a detailed set of policy proposals to increase private capital in the U.S. mortgage finance system, including:

- Increase GSE Guarantee Fees/FHA Premiums
- Reduce GSE and FHA Conforming Loan Limits
- GSE Risk Sharing Transactions
- Align QM, QRM and Basel III Risk Weighting Definitions
- Eliminate QM and Risk Retention Provisions that Favor GSE Execution
- Eliminate Basel III LCR Recourse Requirements
- Establish U.S. Covered Bond Market.

We strongly support the inclusion of many of these proposals in the discussion draft of the PATH Act and would urge Congress to pass them as part of the Act. But many of these proposals, such as the Basel III liquidity coverage ratio ("LCR") requirements, will be implemented by regulators under their own authority or can and should be legislated as stand-alone legislation.

II. Long-Term Transition to More Private Capital

Reducing dependence on public guarantees for new mortgage origination necessarily implies that private capital investment in mortgage originations will have to be reinvigorated. Securitization is the essential funding mechanism for this to occur to move loans in bulk from originators balance sheets to investors who have long-term capital to put to work. This is also evidenced by observing the significant proportion of consumer credit RMBS financed in the U.S. in the last few decades and the growing regulatory emphasis on banks shedding credit risk. Securitization generally refers to the process by which consumer and business assets are pooled into securities that are issued and sold into the capital markets. The payments on those securities depend primarily on the performance of the underlying assets. Over the past 25 years, securitization has grown from a relatively small and unknown segment of the financial markets to a mainstream source of credit and financing for individuals and businesses, representing a vital sector of the financial markets.[6] It is estimated that securitization has funded between 30% and 75% of lending in various markets, including an estimated 59% of outstanding home mortgages.[7]

Since the rapid deflation of the housing bubble beginning in 2007, the question most trade groups are ultimately asked is whether market participants would ultimately support eliminating the government guarantee over an extended period of time, and ultimately what the mortgage market would look like without a guarantee. This is an extremely difficult, if not impossible, question to answer without some initial evolution in the mortgage finance system. Because the U.S. mortgage market has grown up for nearly a century around the presence of a government guarantee, breaking down institutional buildup of demand for government wrapped securities and rebuilding demand for deep and liquid markets for credit risk RMBS products will take time.

There is approximately $10 trillion in mortgage debt outstanding in the US, of which approximately $5.5 trillion has been funded through securitizations guaranteed by the GSEs (with an implicit/explicit government guarantee) or Ginnie Mae (with an explicit government guarantee). Many of those investors who have provided that $5.5 trillion do invest in these mortgage-backed securities in a meaningful way precisely because of the government wrap—banks, sovereign wealth funds, the Federal Reserve, insurance companies, just to name some of the larger holders.

Securitization also helps foster origination of the popular 30-year fixed rate mortgage. We don't believe the question is whether the 30-year fixed rate mortgage will continue to exist without any government guarantee, because it will. Long-term investors have and will continue to invest in RMBS backed by 30-year fixed rate collateral. In fact, a number of the private-label transactions sold in 2013 were entirely backed by the 30-year fixed rate collateral.

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[6] For more information on the role and importance of securitization to the financial system and US economy, see ASF's August 2010 Reg AB II Comment Letter, Attachment II, pg. 143-147, at http://www.americansecuritization.com/uploadedFiles/ASFRegABIICommentLetter8.2.10.pdf.

[7] Citigroup, "Does the World Need Securitization?" pg. 10-11 (Dec. 2008), available at http://www.americansecuritization.com/uploadedFiles/Citi121208_restart_securitization.pdf.

III. Market Standards Utility

A key goal of the PATH Act appears to be to increase standardization and uniformity within the secondary mortgage market by directing FHFA to establish a National Mortgage Market Utility ("Utility") to develop an open-access common securitization platform and a set of standards relating to servicing, pooling, and securitizing residential mortgage loans. FHFA has previously contemplated the need to establish a single platform for the future issuance of all RMBS that are guaranteed by the GSEs, both during the remainder of the conservatorship period and thereafter, including a standardized form of pooling and servicing agreement ("PSA").[8] ASF supports this initiative, as we have worked with a wide range of industry participants to develop standards and practices that improve overall market functions and thus benefit all participants in the securitization market. Please see ASF's December 3, 2012 comment letter responding to the proposals set forth in FHFA's White Paper for a more detailed explanation of the arguments set forth below concerning the development of a common securitization platform and market standards for private-label securities.[9]

In the context of fully guaranteed Enterprise securitizations, the standardization of loan delivery interfaces and data validation will create efficiencies for lenders. The standardization of disclosure and reporting, in particular if it were based on current market and regulatory efforts, would create efficiencies across the market and ensure that each Enterprise was distributing robust data to investors. ASF also supports the development of a model PSA, which will standardize contractual and governance provisions between the Enterprises. We believe the standardization afforded by a single securitization platform and model PSA could, if effectively implemented over time, ultimately result in substantial efficiencies and reduced costs, and in connection with other efforts by FHFA to further standardize and align business practices of the Enterprises, potentially offer comparable security performance. However, if the guarantee is eliminated and credit risk is sold in a risk sharing securitization, the incentives among lenders and investors will be altered, and individual determinations of contractual and securities law liability may lessen the Enterprises' ability to impose standard terms and documentation.

The proposed standards for qualified securities under the Utility would attempt to replicate much of the liquidity function of the so-called "To-Be-Announced" ("TBA") market, through the establishment of standards for debt-to-income ratio, loan-to-value ratio, credit history, loan documentation, occupancy, credit enhancement, and loan payment term. A TBA is a contract for the purchase or sale of GSE MBS to be delivered at a future, specified date, sometimes

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[8] *See* FHFA's October 4, 2012 White Paper, "Building a New Infrastructure for the Secondary Mortgage Market," at http://www.fhfa.gov/webfiles/24572/FHFASecuritizationWhitePaper100412FINAL.pdf.

[9] ASF's December 3, 2012 comment letter submitted to FHFA in response to their October 4, 2012 White Paper, "Building a New Infrastructure for the Secondary Mortgage Market," details our general support for the development of a single securitization platform with a model PSA for fully guaranteed securitizations issued by the GSEs, as well as our support for the use of the single securitization platform for GSE risk sharing transactions, using either a senior/sub or a synthetic structure. In addition, our letter provides an overview of current factors inhibiting a robust private-label securities ("PLS") market, industry efforts to restart the PLS market through ASF Project RESTART, and a detailed description of how PLS securitization differs from GSE securitization.
Also *see* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6608 for ASF's July 2, 2012 White Paper, "Discussion of a Proposed Single Agency Security," for additional discussion regarding a new infrastructure for the GSEs, including a single securitization platform and the development of a single agency security.

substantially (up to 90 days) in advance of the settlement date. The TBA market makes it possible for borrowers to have the peace of mind of locking in favorable mortgage rates and originators' immediate and liquid sale in the capital markets. The TBA model is valuable and informative because it allows for mortgages to be priced based on general characteristics without loan-level data, which keeps prices down as a standardized product.

However, as the GSEs are gradually phased out in favor of a risk sharing model, TBA eligibility becomes a concern. If a senior/sub structure is implemented in which non-guaranteed subordinate first loss classes evidencing a direct interest in the mortgage pool are issued to investors, the non-guaranteed subordinate classes would not meet TBA guidelines. In addition, prospective investors in these securities may insist on receiving detailed loan-level data prior to purchase, or at a minimum would require robust disclosure of pool characteristics including stratifications, which in either case would not be consistent with how the TBA market currently operates. In a synthetic risk sharing structure,[10] on the other hand, the fully guaranteed RMBS would be very similar to those currently issued by the Enterprises because the structure does not impact the guaranteed securities in any way, and should therefore continue to be TBA eligible. It is also important to consider how these two possible structures for a common securitization platform after the wind-down of Fannie and Freddie relate to ongoing regulatory initiatives, including risk retention, Reg AB II, Basel III, and commodity pool regulations. Any reform of the GSEs which does not accommodate, or suitably replace, the existing GSE MBS TBA market will undoubtedly impact mortgage originators and borrowers both severely and negatively. At the same time, while ASF fully supports the shift towards such a common platform as envisioned by the PATH Act as a mechanism to gradually introduce more private capital into the market, we also urge caution and a recognition that the private and agency markets are inherently different, meaning that if the guarantee is eliminated and credit risk is sold, the incentives among transaction parties will shift, and individual determinations of contractual and securities law liability as well as the simple process of negotiation will result in non-standard transactions that have differences in structure, governance and disclosure.

As indicated above, a shift to a common platform through the National Mortgage Market Utility and the introduction of market standards are worthy goals that will be helpful to the private-label market, but it is also important to understand that such goals will inherently have limits. Private-label market participants have endeavored to create standardization and best practices through ASF's Project on Residential Securitization Transparency and Reporting ("ASF Project RESTART"),[11] which began in late 2007 as an industry-developed initiative to help rebuild investor confidence in RMBS. As part of this effort, ASF developed and finalized loan-level disclosure and reporting packages (the "ASF RMBS Disclosure and Reporting Packages")[12] that have since been largely incorporated by the SEC through proposed Regulation AB II, as well as a set of model representations and warranties (the "ASF RMBS Model Reps")[13]

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[10] In a synthetic structure, credit linked notes issued by a special purpose entity are sold to investors, the proceeds of which are held in pledged accounts, and the entity issues a credit default swap to the Enterprise, whereby if losses are incurred on the reference pool of mortgage loans up to certain limits, funds in the pledged account are paid to the Enterprise.

[11] For more information on ASF Project RESTART, s*ee* http://www.americansecuritization.com/restart.

[12] *See* www.americansecuritization.com/uploadedFiles/ASF_Project_RESTART_Final_Release_7_15_09.pdf.

[13] *See* www.americansecuritization.com/uploadedFiles/ASF_Project_RESTART_Reps_and_Warranties_121509.pdf.

aimed at infusing transparency and comparability across securitization transactions. Our work to date on ASF Project RESTART, with a wide variety of stakeholders in the PLS markets including issuers, investors, financial intermediaries, trustees, servicers, rating agencies, professional firms and service providers, none of whom have the power to unilaterally set standards and practices, has made it clear to us that these markets are very dynamic. Consensus is only achieved over time through an iterative process, and its implementation in new transactions evolves over time. We look forward to working with the regulatory agencies on improving these standards and practices with the help of private and public partnership, as well as continued input and feedback from the buy and sell sides. We are committed to creating liquidity in the market, and believe that increased standardization will help boost liquidity generally, as well as during times of stress, and assist replacing the government guarantee market with private capital. We also propose further governance considerations in Section VII of this testimony.

As stated previously, the PATH Act contemplates the Utility to establish uniform underwriting standards. A clear advantage to having the Utility, or any other government agency, set these standards is that bright-line underwriting guidelines will bring additional clarity and certainty with respect to the underwriting of mortgage loans. However, we have concerns with government involvement in setting underwriting criteria as they could, over time, become susceptible to political interference, such as pressure to achieve increased homeownership in particular segments of the country or access to credit for certain borrowers. If the goal of the legislation is to promote robust private capital without government involvement, then it may be advisable to move some of the standard-setting process to private market participants or leave it to evolving market practice. This could be accomplished in a variety of different ways, including a "standards board" comprised of issuers and investors.

IV. Covered Bonds

ASF has long supported the creation of a legislative framework for covered bonds in the United States. Covered bonds and securitization can and do co-exist in a complementary fashion with one another, as they have for some time in Europe. The PATH Act has the power to create a new channel of efficient credit flow through our financial system while facilitating an accelerated and more orderly exit of U.S. government financial support for the private sector. The economic benefits of a country's covered bond program can be significant. Market research shows that banks issuing covered bonds can save between 20 and 60 basis points per year on interest rates when compared to the rates paid on their senior unsecured issues of comparable maturity.[14] Such savings can be transmitted through society in the form of lower rates on the consumer and commercial credit that finances our economy, stimulates growth, and creates jobs. The ability to issue relatively lower-cost financing, which becomes increasingly relative lower-cost financing during periods of worsening economic and financial stress, is a distinguishing benefit of covered bonds.

The proposed legislation would create a new and disciplined market structure around which free market forces can organize to better balance the flow of money, capital, and credit in our

[14] *Natixis Credit Research*, Cristina Costa and Jennifer Levy, March 2011.

highly sophisticated financial system. The concentrated U.S. banking system market structure invites the creation of new financing channels, so we can better democratize the flow of credit to Main Street in an effort to improve its post-crisis affordability and accessibility to American consumers and businesses. In addition, covered bonds would help extend the balance sheets of banks to fund additional mortgages because they remain on the balance sheet of the corporate issuer. Please click here for ASF's March 14, 2012 joint letter to the Senate, supporting S. 1835, the "United States Covered Bond Act," and here for ASF's March 11, 2011 testimony before the HFSC Subcommittee on Capital Markets and Government Sponsored Enterprises regarding covered bonds legislation.[15]

V. Impediments to Mortgage Originations and Sales

As ASF believes that housing finance reform is critical to the long-term efficiency and sustainability of the housing market, we are strongly supportive of many of the provisions in Title IV of the PATH Act, intended to reduce unnecessarily burdensome regulatory requirements that impede the return of private capital to the mortgage market. In our May 2011 U.S Senate and November 2011 HFSC testimonies,[16] we articulated many of the most pressing regulatory issues currently confronting the securitization industry, and just this past month circulated a list of key proposed statutory changes that, if implemented, would eliminate important impediments to securitization that exist in Dodd-Frank, Basel III and Reg AB II rulemakings.[17] We believe that many of the key policy proposals ASF has articulated over the past several years and that are substantially included in this bill can be implemented as part of the broader PATH Act or, as an alternative, in the more immediate near-term by separate legislative or FHFA action, to expedite the process of bringing private capital back to the mortgage market by incrementally reducing the government-guaranteed market well below the current 90-95%.

Given the success of recent private-label issuers in the market, the time to implement these reforms is now. In 2012, there were approximately $3.5 billion of new-issue RMBS backed by newly-originated mortgage loans. So far in 2013, RMBS issuers have surpassed last year's total, and industry researchers estimate that the total volume for 2013 could be $15-$25 billion. Despite the market's recent success, however, these issuance levels are mere specks when compared to pre-crisis levels, which peaked at approximately $700 billion in 2006, or the approximately $1.7 trillion of mortgages originated in the U.S. in 2012. In order to promote a

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[15] Both ASF's March 14, 2012 letter and March 11, 2011 testimony indicate ASF's strong support for new legislation aimed at establishing a vigorous covered bond market in the United States, which would have the potential to create new credit for American businesses and consumers.
See http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=231757 for more information on the HFSC hearing

[16] *See* testimonies of ASF Executive Director Tom Deutsch delivered to the Senate Committee on Banking, Housing, and Urban Affairs ("SBC") Subcommittee on Securities, Insurance, and Investment ("Securities Subcommittee") on May 18, 2011, available at:
http://www.americansecuritization.com/uploadedFiles/ASF_Senate_Banking_Securitization_Testimony_5-18-11.pdf, and to the HFSC Subcommittee on Capital Markets and Government Sponsored Enterprises on November 3, 2011, available at:
http://www.americansecuritization.com/uploadedFiles/ASF_Private_Mortgage_Testimony_11_3_11.pdf.

[17] *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=9550 for ASF's July 8, 2013 list of proposed legislative fixes.

more meaningful private-label market, policymakers must begin pulling levers to eliminate impediments to private capital that currently exist, and we strongly believe many of the provisions set forth in Title IV of the PATH Act go a long way toward realizing this goal. In the discussion below, we focus on a number of the PATH Act proposals that specifically relate to the PATH Act.

i. *Basel III*

Sections 401 and 402 of the bill delay the implementation of Basel III in the U.S. to allow for further study of its impact and prohibit the imposition of a liquidity coverage ratio ("LCR") that would exclude non-recourse loans from eligibility as high quality liquid assets ("HQLA"). Given the complexity of the Basel III rules recently released by the Board of Governors of the Federal Reserve System ("FRB"), Federal Deposit Insurance Corporation ("FDIC"), and Office of the Comptroller of the Currency ("OCC"),[18] and their potential impact on securitization, ASF advocates a cautious approach to their implementation. For example, residential mortgage loans that are classified as qualified mortgages ("QMs") currently may or may not be considered Category 1 loans under the Basel III capital rules, creating disparate treatment between and among QMs. ASF believes that all QMs should ultimately be required to receive this more favorable capital treatment. In addition, under the current Basel III LCR proposal, higher quality private-label RMBS will only be eligible as HQLAs under the proposed Basel III LCR if all the underlying loans have full recourse back to the borrower's other assets. However, twelve U.S. states, including California and Texas, have non-recourse statutes. If the LCR proposal were to be implemented in the U.S. as proposed by the Basel Committee, no U.S. private-label RMBS (or GSE credit risk RMBS deal) would qualify as a HQLA. Therefore, eliminating the mortgage recourse requirement in the LCR for U.S. private-label RMBS, as the PATH Act does, would greatly improve liquidity and execution for high quality private-label RMBS and level the playing field between U.S. and non-U.S. RMBS. For more information on ASF's positions regarding potential concerns with the Basel III rules, please see page 9 of our July 8, 2013 Proposed Legislative Changes circulated to Members and staff of this Committee and the securitization related sections of ASF's October 22, 2012 joint comment letter to the FRB, FDIC, and OCC regarding the Basel III proposed rules.[19,20]

[18] *See* http://www.federalreserve.gov/aboutthefed/boardmeetings/20130702__Basel_III_Final_Rule.pdf.

[19] On July 8, 2013, ASF submitted a list of key proposed statutory changes that, if implemented, would eliminate important impediments to securitization that exist in Dodd-Frank, Basel III and Reg AB II rulemakings. We also propose federal government involvement to prevent the misguided use of eminent domain to seize residential mortgage loans out of securitization trusts. ASF members have reviewed and commented extensively on these proposals in an effort to hone these proposals into ones that work for all corners and constituencies in the market. These fixes are intended to apply to all securitization markets, including MBS and consumer ABS, where applicable, but the most likely vehicle in this Congress or the next for any of these changes to move is as part of broader housing finance reform discussions.

[20] For more information concerning ASF's advocacy efforts specifically regarding the development of the LCR, *see* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=8739 for the working draft of ASF's LCR study, http://asf.informz.net/ASF/data/images/asf_proposed_revisions_paragraphs_95-97_11.20.12.pdf for ASF's November 20, 2012 proposed revision to Paragraph 97, http://www.americansecuritization.com/uploadedFiles/ASF_Optimizing_LCR_4_22_12.pdf for an ASF presentation on the LCR delivered to American and European regulators on April 23, 2012, http://www.americansecuritization.com/uploadedFiles/ASF_Optimizing_LCR_Spring_2012.pdf for an ASF presentation on the LCR delivered to European regulators in June 2012,

ii. *Dodd-Frank Rulemakings*

a. Volcker Rule

In addition, ASF has long been concerned that many securitizations[21] will inadvertently be brought within the scope of the proposed Volcker Rule[22] simply because they share the same exemptions from the Investment Company Act as traditional hedge and private equity funds, and we strongly support the exclusion of ABS from covered funds under the rule, as proposed in Section 404 of the PATH Act. There is ample evidence that the Volcker Rule is intended to address concerns that have nothing to do with the securitization markets, including the securitization exemption language in Dodd-Frank that explicitly states, "[n]othing in [the Volcker Rule] shall be construed to limit or restrict the ability of a banking entity…to sell or securitize loans in a manner otherwise prohibited by law," which is also included in Section 13 of the Bank Holding Company Act. For this reason, industry participants believe that Congress intended the Volcker Rule to fully exempt securitizations from the regulation, and would advocate making this intention explicitly clear in subsequent legislation.

If a broad exclusion such as that included in Section 404 is not granted for securitization, other provisions of the proposed Volcker Rule, such as the so-called "Super 23A" provisions, which prohibit banking entities from engaging in certain "covered transactions" with securitization entities that are covered funds, may preclude banking entities from engaging in transactions that are integral to various types of securitizations, likely resulting in a substantial decrease in available liquidity in these markets and an increase in transaction costs and market volatility, leading to higher borrowing costs for consumers and corporations. Further, in light of changes to the Commodity Exchange Act ("CEA") and the CFTC's related regulations (notably, the inclusion of "swaps" in the definition of "commodity interests"), we are similarly concerned that without an explicit exemption, many securitizations may be classified as "commodity pools" under the CEA and, therefore, may be brought within the scope of the Volcker Rule simply because they make limited use of swaps for hedging or risk management purposes.[23,24] For a

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http://www.americansecuritization.com/uploadedFiles/Optimizing_LCR_Summary.pdf for two summary slides, and http://www.americansecuritization.com/uploadedFiles/ASF-Optimizing_the_Liquidity_Coverage_Ratio_Europe_Presentation.pdf for a presentation on the LCR delivered to European regulators in February 2012.

[21] Including asset-backed commercial paper ("ABCP") conduits, tender option bonds ("TOBs"), automobile and equipment lease securitizations in which significant residual value of the collateral is financed, corporate debt repackagings, and collateralized loan obligations ("CLOs").

[22] *See* http://www.gpo.gov/fdsys/pkg/FR-2011-11-07/pdf/2011-27184.pdf.

[23] The CEA and the CFTC's rules thereunder define a commodity pool as an "investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests" and the definition of "commodity interests" will include swaps after the effective date of new CFTC regulations. In its release relating to the elimination or modifications of certain exemptions from commodity pool operator registration, the CFTC indicated that it considers a vehicle with a single swap to be a commodity pool. 77 Fed. Reg. 11252, 11258 (Feb. 24, 2012). In light of the CFTC's historically broad interpretation of its authority with respect to vehicles that own commodity interests, we fear that securitization vehicles that are counterparties to swaps may be swept into the CFTC's interpretation of "commodity pool."

[24] We note that the CFTC has stated that "it is the position of the [CFTC] that a fund investing in an unaffiliated commodity pool is itself a commodity pool." 77 Fed. Reg. 11252, 11268 (Feb. 24, 2012). We also note that the CFTC has taken the position, in connection with controlled foreign corporations wholly owned by registered investment companies, that wholly owned subsidiaries – which by definition have a single equity investor, and thus

more detailed and expansive explanation of why securitizations should not be considered covered funds, please see ASF's February 13, 2012 broad comment letter regarding the Volcker Rule and our August 23, 2012 comment letter specifically regarding the Volcker implications of securitizations being classified as commodity pools.[25]

b. Risk Retention

Furthermore, while there are many investors who generally support the premise of risk retention requirements, and therefore would not endorse the full repeal included in Section 407 of the PATH Act, most industry participants agree that there are certain extremely problematic elements to the proposed risk retention rules that should not be included in the final rule, and ASF supports legislative action to repeal these components. We broadly believe that risk retention can aid in efforts to align the incentives of issuers and originators with investors, and believe these incentives should encourage the application of sound underwriting standards by both the originator and securitizer, so long as the requirements ultimately prescribed are appropriately tailored to each class of securitized assets where misalignment of incentives have been demonstrated to have caused substantial losses. We are concerned, however, that the rules put the private markets at an enormous disadvantage vis-à-vis the government-backed market, which will ultimately keep the private markets on the sidelines.

For instance, the premium capture cash reserve account ("PCCRA") requirements of the proposed risk retention rules will eliminate the incentive of securitizers to issue ABS, and we propose prohibiting such requirements. In addition, in order to streamline compliance and ensure that lending standards are not overly restrictive, therefore constraining the availability of credit to borrowers, we believe the QM and "qualified residential mortgage" ("QRM") definitions should be substantially aligned, although many of our members, particularly institutional investors, believe that the QRM definition should also have a down payment requirement. We also propose to allow commingling of QRMs and non-QRMs in the same RMBS pool so that the QRM market does not suffer from unforeseen liquidity issues. Finally, certain aspects of ASF's Project RESTART serve to better align incentives within the industry, and depending on their specific language, representations and warranties and repurchase principles can function as an effective form of risk retention.[26] Please see both ASF's July 8,

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are not collective investment vehicles – can nonetheless be commodity pools. *Id.* at 11260. We believe that these two positions, when combined with a broad interpretation of the effect of hedging swaps on commodity pool status, may lead to illogical results—for instance that a wholly owned subsidiary of a bank could own a mortgage-backed security issued by a trust that included an interest rate swap and thus be treated as both a commodity pool and a "covered fund."

[25] For additional ASF commentary regarding the Volcker Rule, please *see* http://www.americansecuritization.com/uploadedFiles/ASF_CFTC_Volcker_Letter_4-13-12.pdf for ASF's April 13, 2012 comment letter specifically in response to the CFTC's proposal, http://www.americansecuritization.com/uploadedFiles/ASF_Volcker_Supplemental_Depositor_7_27_12.pdf for ASF's July 27, 2012 supplemental comment letter regarding intermediate entities, and http://www.americansecuritization.com/uploadedFiles/ASF_Volcker_Effective_Date_Correction_Request_3_21_12.pdf for ASF's March 21, 2012 letter requesting a correction to the Volcker Rule's statutory implementation date.

[26] *See* http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6705 for ASF's RMBS Model Representations and Warranties and http://www.americansecuritization.com/WorkArea/DownloadAsset.aspx?id=6545 for ASF's Model RMBS Repurchase Principles.

2013 Proposed Legislative Changes and ASF's April 23, 2013 White Paper, "ASF Policy Proposals to Increase Private Capital in the U.S. Housing Finance System," for more detail on risk retention issues.

iii. *Regulation AB II*

In a similar vein, ASF is generally supportive of the Securities and Exchange Commission's ("SEC") efforts through the registration, disclosure, and reporting requirements laid out in the Regulation AB II proposals and re-proposals to improve investor protection and promote more efficient asset-backed markets in the wake of the financial crisis. However, since the proposed rule's initial introduction in 2010, ASF has expressed a number of concerns and suggested changes to the proposals in order to ensure an effective balance between the aims of the regulation and the needs of the market. For example, among many other issues, the Reg AB II proposals would require issuers of structured finance products to provide public style disclosures for private transactions offered to highly sophisticated institutional investors. Such a requirement would likely be impossible for many types of structured finance products, including esoteric asset classes such as whole business, timeshares and rental cars, and we would suggest revising these provisions. Many aspects of Reg AB II are, we believe, essential to safeguard the securitization market going forward and have already begun to be incorporated by the industry, therefore making a full-scale suspension of the rulemaking such as prescribed in Section 405 of the PATH Act unnecessary. However, ASF is fully supportive of ongoing legislative oversight to ensure that certain problematic aspects of the proposed rules are fully addressed before they inflict substantial harm on the marketplace. Please see ASF's broad Reg AB II comment letter submitted on August 2, 2010 and ASF's October 4, 2011 comment letter in response to the SEC's Reg AB II re-proposal for significant additional detail on issues concerning Reg AB II.[27]

VI. Use of Eminent Domain

Lastly, I'd like to focus on the prohibition relating to eminent domain to seize mortgages contained under Section 107 of the bill. ASF is strongly opposed to the use of eminent domain to acquire mortgage loans, and we applaud the PATH Act's proscription. While we recognize and appreciate the serious challenges associated with the current housing market, poor policy solutions such as the proposal to seize mortgage loans through eminent domain are not productive, legal, or constitutional answers. Moreover, home prices throughout the country have been steadily increasing, returning many underwater borrowers to positive equity through natural market conditions and mitigating the incentives for undertaking such drastic and ill-conceived measures. Given sustained home price increases throughout the country, borrowers are

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[27] In addition, *see* http://www.americansecuritization.com/uploadedFiles/ASFRegABIIABCPCommentLetter8.2.10.pdf for ASF's August 2, 2010 Reg AB II ABCP comment letter, http://www.americansecuritization.com/uploadedfiles/asf_reg_ab_ii_auto_abs_comment_letter_8.31.10.pdf for ASF's August 31, 2010 Reg AB II Auto Disclosure comment letter, http://www.americansecuritization.com/uploadedFiles/ASF_Reg_AB_II_Waterfall_Comment_Letter_8.31.10.pdf for ASF's August 31, 2010 Reg AB II Waterfall comment letter, and http://www.americansecuritization.com/uploadedFiles/ASF_Equipment_ABS_Letter_(11-2-11).pdf for ASF's November 2, 2011 Reg AB II Re-Proposal Equipment ABS comment letter.

considerably less likely to walk away from their homes and mortgages. The national delinquency rate has fallen to 6.08%, a drop of over 15% since December 2012, which is the largest year-to-date drop since 2002.[28] While many borrowers still remain underwater, the landscape is shifting markedly, and many of these borrowers may reasonably expect to return to positive equity in the coming months and years. In fact, approximately 850,000 properties returned to positive equity during the first quarter of 2013, and 1.7 million homes have emerged from being underwater over the past year, lowering national negative equity rates to below 15%, a decrease of 47% since 2012.[29] According to recent data from the S&P/Case-Shiller Home Price Indices, the 10-city, 20-city, and national composites each increased by over 1 percent since the previous quarter, and over 10 percent over the past year.[30]

Notably, such proposals are ***not*** set up to help borrowers who are having difficulties making their monthly mortgage payments, and do not take into account these recent market trends. As such, not only would such proposals fail to help those most at risk, they would undermine the national market as a whole, making credit less accessible for homeowners and devaluing the investments of pension funds, mutual funds and other entities that hold mortgage-backed securities. Because these programs would alter the value of Fannie Mae's, Freddie Mac's and the Federal Home Loan Banks' securities holdings, it is imperative that the GSEs be prohibited from purchasing or guaranteeing mortgages in these districts, as the PATH Act does, since such programs would negatively affect both investors and the extension of credit to borrowers. Please see ASF's most recent letter submitted to the North Las Vegas City Council on July 10, 2013 for our full legal and policy argument against the use of eminent domain.[31]

VII. Suggested Additions to the PATH Act

While ASF supports many aspects of the PATH Act, we propose below three additional features that we believe should be included in any final legislation.

i. Dodd-Frank Derivatives Title

First, while we very much support and appreciate most of the regulatory changes already included in the bill, ASF has developed a few other measures that we believe would materially contribute to increasing return of private capital to the mortgage market. Please see ASF's April 23, 2013 White Paper, as well as our July 8, 2013 Proposed Legislative Changes for more detail.

In particular, we consider it essential that certain ABS issuers are explicitly excluded from the swap clearing and margin requirements of the Commodity Exchange Act. The current

[28] *See* http://www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/MortgageMonitor/201305MortgageMonitor/MortgageMonitorMay2013.pdf.

[29] *See* http://www.corelogic.com/about-us/researchtrends/equity-report.aspx#.Ubinh4XbKwA and http://www.lpsvcs.com/LPSCorporateInformation/CommunicationCenter/DataReports/MortgageMonitor/201305MortgageMonitor/MortgageMonitorMay2013.pdf.

[30] *See* http://www.housingviews.com/wp-content/uploads/2013/05/CSHomePrice_Release_March-Qtr1-Results.pdf.

[31] Over the past year, ASF has submitted numerous letters to municipalities around the country urging them to oppose implementing eminent domain programs. *See* http://www.americansecuritization.com/Issues.aspx?taxid=6587 for a complete index of ASF's advocacy efforts concerning this issue.

proposed margin rules may inadvertently require RMBS and ABS to post margin into their securitization transactions, despite the fact that counterparties to a swap entered into by a securitization vehicle typically hold a senior priority position in the asset pool backing the RMBS or ABS. If securitization swaps were forced to be cleared and/or to post margin, many structures would become less efficient and potentially even uneconomical. Essentially, for similar reasons that the mechanics of the risk retention PCCRA provisions of the proposed risk retention rules are so problematic, requiring issuers to put up cash at the outset of the securitization can eliminate the economic incentive to issue ABS.

ii. *FHFA Board of Directors*

Given the significant amount of authority retained by the sole director of FHFA, ASF proposes that legislators consider shifting control of the conservator to a board structure, similar to those at the SEC and FDIC, where no more than three of the five Board members may be of the sitting President's party. A Director would continue to directly control and oversee the staff of the agency, but would have additional Board members of opposing parties to balance the considerations and actions of FHFA.

iii. *Self-Regulatory Authority for National Mortgage Market Utility*

We would also suggest that the National Mortgage Market Utility created by the PATH Act function ultimately as a self-regulatory organization ("SRO"), similar, for example, to the Municipal Securities Rulemaking Board ("MSRB") or to the Financial Industry Regulatory Authority ("FINRA"). Such a structure would guarantee the Utility appropriate autonomy, but, depending on how an agency oversight structure is developed, would still allow the federal government to retain appropriate broad oversight.

Conclusion

ASF greatly appreciates the invitation to appear before this Committee to share our views related to these significant policy issues. I look forward to answering any questions the Committee may have.

Thank you.