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Invested in America

May 14, 2012

The Honorable Noreen Evans
Co-Chair, Conference Committee on Assembly Bill 278 and Senate Bill 900
State Capitol, Room 4032
Sacramento, California 95814

The Honorable Mike Eng
Co-Chair, Conference Committee on Assembly Bill 278 and Senate Bill 900
State Capitol, Room 4016
Sacramento, California 95814

The Honorable Sam Blakeslee
Member, Conference Committee on Assembly Bill 278 and Senate Bill 900
State Capitol, Room 4066
Sacramento, California 95814

The Honorable Ron Calderon
Member, Conference Committee on Assembly Bill 278 and Senate Bill 900
State Capitol, Room 5066
Sacramento, California 95814

The Honorable Mike Feuer
Member, Conference Committee on Assembly Bill 278 and Senate Bill 900
State Capitol, Room 2013
Sacramento, California 95814

The Honorable Donald P. Wagner
Member, Conference Committee on Assembly Bill 278 and Senate Bill 900
State Capitol, Room 4153
Sacramento, California 95814

**RE: Conference Committee on Financial Services Legislation**

Dear Honorable Members of the Conference Committee:

The Securities Industry and Financial Markets Association[1] is sending you this letter to provide a focused discussion on how the mortgage servicing legislation the Committee is considering relates to the secondary mortgage markets that fund the vast majority of credit for California borrowers. We will do

[1] The Securities Industry and Financial Markets Association brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org

this through the lens of mortgage securitization, which is the largest and most important secondary market for mortgage lending. Securitization[2] is critical to the ability of California borrowers to obtain mortgage loans, and any actions taken must be considered in the light of their impact on the ability of securitization markets to fund mortgage credit creation. In addition, everyday Californians invest in mortgage securitization via their retirement and other investment funds. These interests must likewise be taken into account when legislation is considered.

***Overview***

SIFMA is deeply concerned that the proposed package of bills exceeds the bounds of the recently negotiated Attorneys General settlement ("Settlement") and calls into question the ultimate ability of a servicer or secondary market participant to access the collateral that backs a loan in the event that a foreclosure is unavoidable. The Settlement was an effort to balance the legitimate needs of mortgage borrowers in default with those of loan holders and servicers to enforce the terms of their security interests. This legislation upsets that balance.

In addition, to the extent that it becomes difficult or impossible to access the collateral that secures a mortgage loan, the impact will be borne by all mortgage borrowers, through increased cost and/or decreased availability of mortgage credit. This will happen for two reasons: banks that lend and retain loans in their portfolio will become more conservative as to avoid borrowers more likely to face payment challenges, and secondary markets will demand higher rates of return for their investments in all California mortgage loans, not just those most likely to default. The decline in value of mortgage investments will also negatively impact current investors in mortgage backed securities, including individual California citizens.

SIFMA is further concerned that the legislation is being rushed through the deliberative process, thereby avoiding much of the discussion, debate, and information gathering that typically is required for such significant proposals. We believe that it would be a grave error to not give full consideration to the balancing of all of the benefits and costs of legislation that would make fundamental changes to California's mortgage market.

***SIFMA's Concerns with the Legislation***

SIFMA is supportive of efforts to provide sensible loan modification and other foreclosure alternatives to troubled borrowers, but unfortunately loan modifications will not always succeed. When home retention efforts fail, foreclosure is an unfortunate but necessary process as set forth in the deed of trust that each borrower agreed to when they sought a mortgage from a lender. We agree that this process must be lawful, fair and respectful of the rights of borrowers, but at the same time, legal devices should not be used to unduly delay the inevitable when other options have been exhausted.

SIFMA's primary concern from the secondary market perspective is that these bills will make it exceedingly difficult for a servicer to foreclose on a defaulted borrower, even when it is clear that there is no alternative short of a foreclosure that will keep the borrower in the home. Contrary to the Settlement, for example, under the proposed legislation, borrowers would be required to be re-

[2] Please see the appendix for a detailed overview of the securitization process, and data and analysis showing its critical importance to California and the nation's economy. We hope this discussion is helpful in this legislative process, and stand ready to provide more discussion and information as needed.

evaluated for modifications even if they had already been evaluated pursuant to HAMP or another proprietary loan modification program. Borrowers that were either rejected or failed a loan modification trial under such a program are presumably unlikely to be approved or successful if re-evaluated. What is likely, however, is that the provision would significantly lengthen the time it takes to foreclose.

Moreover, certain provisions of the bills are unclear. For example, an agent of the holder of beneficial interest in a mortgage loan may not file a notice of default without specific direction from the holder. Among other things, it is not clear what "specific direction" means. Does it mean a loan-by-loan approval? Can these directions be given contractually, for example through language in securitization transaction documents which outline the duties and obligations of securitization transaction parties?

We are also concerned with other issues that on the surface would appear to primarily affect originators and servicers but also have an impact on secondary markets. We are troubled that the legislation would create private rights of action on servicers, without a corresponding right to cure violations. This would be in addition to the significant penalties for noncompliance which are included in the Settlement, and would allow for repeated and spurious requests to enjoin trustee sales. The legislation would also create numerous technical and documentation requirements. A minor failure on a non-material provision could subject the servicer to litigation and significant cost, and mere suspicions of failure are grounds for delays in the process.

In sum, various provisions of the bills will cause significant delays of questionable value, create confusion as to how to comply, and create significant liability risk for mortgage servicers. These provisions will call in to question the ability of a servicer or holder to access the collateral that secures a mortgage loan. This will have a negative impact on California borrowers and savers, as lenders will become more conservative and secondary markets will demand compensation for the increased risk they face, and existing mortgage investments will decline in value.

***Impact on California Borrowers and Investors***

SIFMA understands the desire to provide assistance to troubled mortgage borrowers and believes it should be targeted towards those borrowers most in need who have a realistic opportunity to be helped. This legislation, however, is not targeted in such a manner and is likely to impose costs on all California borrowers, especially those most likely to default at some point in the future. It will also impose costs on California investors, be they retirees, workers, or other individual investors.

The piling on of risk and cost burdens on to originators, servicers, and secondary markets will likely cause lending decisions to be made in a very conservative manner and make loans more expensive for all borrowers, but especially for those marginal borrowers who have less stellar credit profiles. The borrowers who would appear to be more at risk of default, and therefore more at risk of becoming subject to these provisions and risks, will likely pay more for their loans, and in the worst case, may be avoided all together. The worst impact will not be felt by well off, middle age borrowers. Rather, the worst impact will be borne by those borrowers closer to the margins, such as first-time homebuyers and others that we need to encourage back into the market.

At its core, mortgage lending is premised on the security provided by the claim to the collateral. In situations where home retention efforts have failed and foreclosure is unavoidable, holders of the mortgage must be able to claim the collateral that secures the loan without undue delay or obstruction. To the extent that the legislation significantly extends foreclosure timelines and makes collateral far more difficult to access, the effect will be to change the nature of the loan closer to the unsecured end of the spectrum, making lending (or funding a loan though secondary markets) a much riskier proposition. As the foreclosure process lengthens, the value of the collateral to the investor drops. This may be for a variety of reasons; property may be damaged, taxes and other bills may accrue, servicers will recoup principal and interest advances and other property preservation expenses from the ultimate foreclosure sale proceeds, and so on. Loans will be less attractive to secondary markets, and their value will decrease. When the value of a loan in the secondary market drops, the price to a prospective borrower in the primary market must necessarily increase.

It is important to repeat that all California borrowers will likely bear some of this added cost. There is an appropriate balance between protections and the cost thereof, and we believe the bills stretch too far in this regard. We question whether the cost to all borrowers will justify the purported benefits to a much, much smaller subset of delinquent borrowers.

In addition to decreasing the value and increasing the cost of new originations, the legislation would decrease the value of existing loans and investments in those loans which are held by ordinary California citizens. As we describe in more detail in the Appendix, pension funds, retirement plans, 401k plans, insurance companies and REITs are all significant investors in mortgage backed securities. These institutional investors hold the life, retirement, and other savings and investments of everyday workers and citizens. It is critically important that in seeking to protect a small group of individuals, the legislation does not actually harm a much larger group of people.

We hope this submission has been helpful to the Committee. We remain concerned that several of the provisions in this legislation will serve to significantly and unnecessarily extend the time it takes to foreclose and make the ultimate recovery of collateral less certain, which will harm prospective mortgage borrowers and California investors. We agree that avoidable foreclosures should be avoided, but we feel strongly that those which are unavoidable must be allowed to proceed in an expeditious manner.

We stand ready to provide additional data or analysis, as needed. Please do not hesitate to contact Kim Chamberlain at 212-313-1311 or kchamberlain@sifma.org with any questions or for more information.

Sincerely,

Kenneth E. Bentsen, Jr.
EVP, Public Policy and Advocacy
Securities Industry and Financial Markets Association
1101 New York Ave., N.W. 8th Floor
Washington, D.C. 20005

## Appendix -- What is Mortgage Securitization and Why is it Important to California?

### What is Mortgage Securitization?

Securitization is the process through which mortgage loans are bundled and sold into a trust, which then issues certificates or notes (we will refer to each as "bonds" for the sake of simplicity) which depend upon the performance of the underlying mortgage loans for their payments of principal and interest to bondholders. A securitization trust may issue a single bond which passes through all principal and interest as it is received, except for servicing fees and other administrative fees (often called a "passthough" security), or the cash flows from the mortgage loans may be structured into various tranches of debt, each with specific repayment expectations and levels of risk.

Fannie Mae, Freddie Mac, and Ginnie Mae are government-sponsored issuers and/or guarantors of MBS. Their MBS is often called "agency MBS", and carries an implicit or explicit government guarantee depending on who issues it. Other MBS is issued in non-government markets, by banks and finance companies, and is often referred to as "private label MBS".

Over the last 40 years, securitization has become very important to financing the needs of Californian and, more generally, American mortgage borrowers. Securitization provides a range of important benefits, including:

- Securitization provides an essential source of funding for home mortgages in excess of that which is available directly from the balance sheets of banks and other mortgage lenders.
- Securitization attracts tremendous amounts of private investment capital from investors around the world to the U.S. mortgage market.
- Securitization promotes efficiencies throughout the lending system because it transforms illiquid mortgage loans into highly liquid securities.
- Securitization allows banks to manage risk and funding needs by enabling them to obtain long term funding for their long term assets (i.e., 30 year funding to match the terms of the loans, as opposed to deposits).

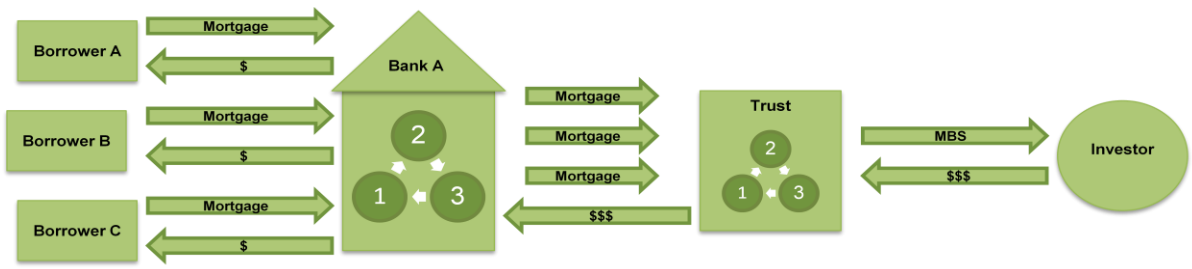
The bottom line is that securitization increases the supply of credit, because loans do not sit on balance sheets until they are repaid. In other words, lending capital is recycled more quickly. Bank balance sheets alone cannot supply the level of credit demanded by consumers. This is critical, as housing-related activities, on average, have represented almost 15% of U.S. GDP.

### How is a Loan Securitized?

The securitization process can be roughly described as follows. There are, of course, variations on this model.

1. A lender makes loans to borrowers.
2. The lender pools groups of loans with similar characteristics to collateralize securities, or sells the loans to another institution, such as a bank or one of the GSEs.
3. The loans are sold to a trust, which will be the issuer of the MBS.
4. Once securitized, the MBS can be sold to investors, or retained as investments.

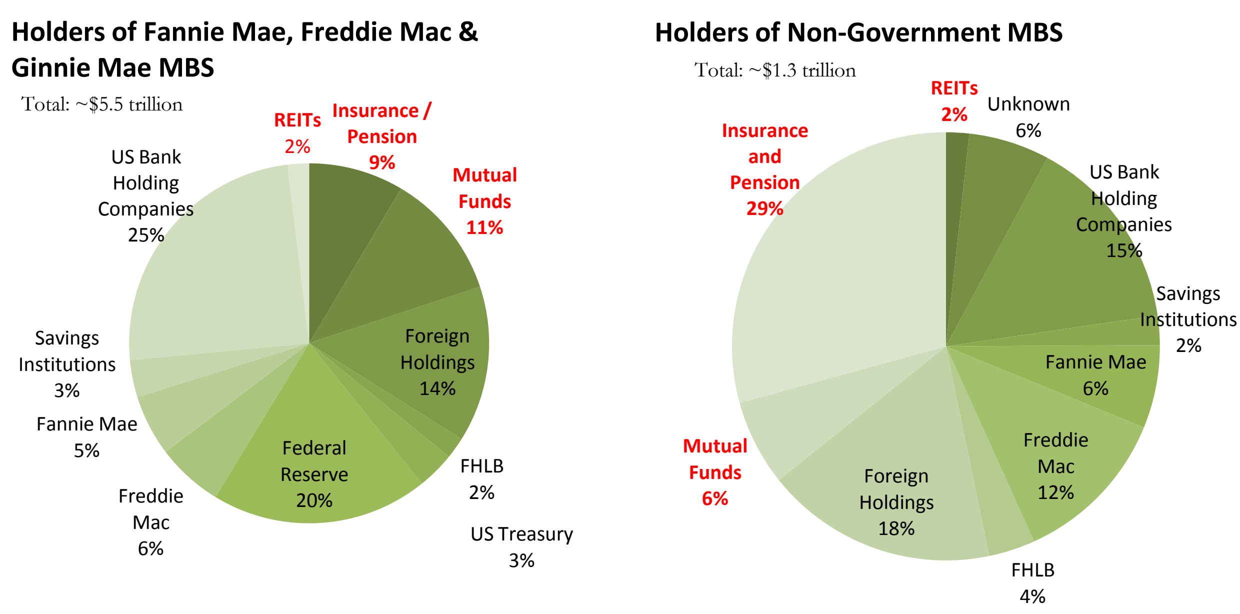
*Figure: The Securitization Process*




**Who are the Investors in Mortgage Securitizations?**

We have shown that secondary markets for mortgage loans are huge, and critically important on a local and a national level. The next question that follows is who are the secondary markets? Who buys the loans and the mortgage-backed securities? The answer is, quite often, the very borrowers who obtain mortgage loans. Everyday Americans are significant investors in mortgage securitization through their retirement, pension, or other investment funds. The figures below outline our estimates of major classes of investors in securitized mortgages. Pension funds, mutual funds, REITs and insurance companies hold well over $1 trillion of mortgage backed securities.

*Figure 4: Holders of Mortgage-Backed Securities*



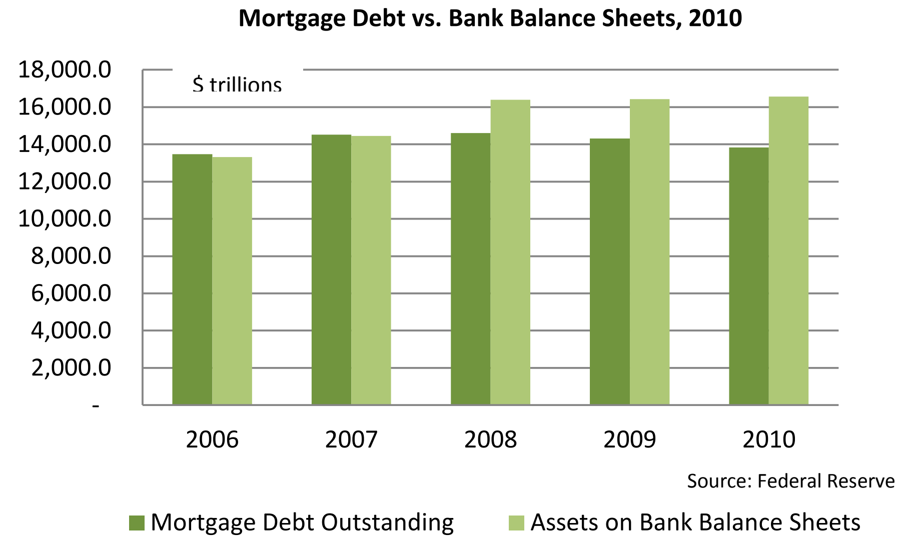

Source: SIFMA Analysis

The critical point is that when mortgage securitizations lose value, it is these end investors – pension funds, mutual funds, 401k plans, individual investors in REITs -- who ultimately take the loss. These are workers and retirees – everyday people -- they are not faceless financial institutions.

**Why is Securitization Important? The Mortgage Markets are Too Large for Banks to Fund without Securitization**

To put the size of the mortgage lending markets in perspective, below is a chart showing that the U.S. mortgage market, in and of itself, is nearly as large as all bank balance sheets combined (keep in mind that banks do other things than originate commercial and residential mortgages).

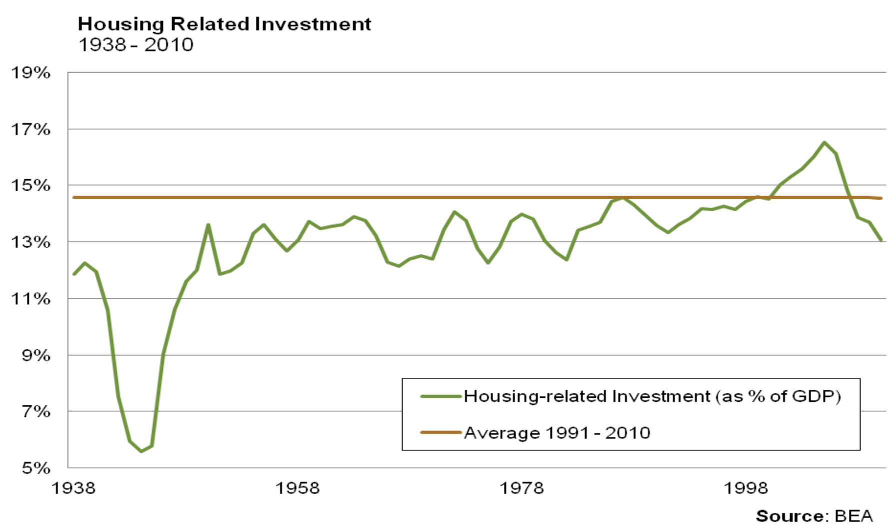
*Figure: Size of Mortgage Markets vs. Size of Bank Balance Sheets*




**Why Is Securitization Important? Housing-Related Activity is One-Seventh of U.S. GDP**

Housing related activities represent approximately 15% of US GDP, on average.

*Figure: Housing Related Investment - Share of GDP*

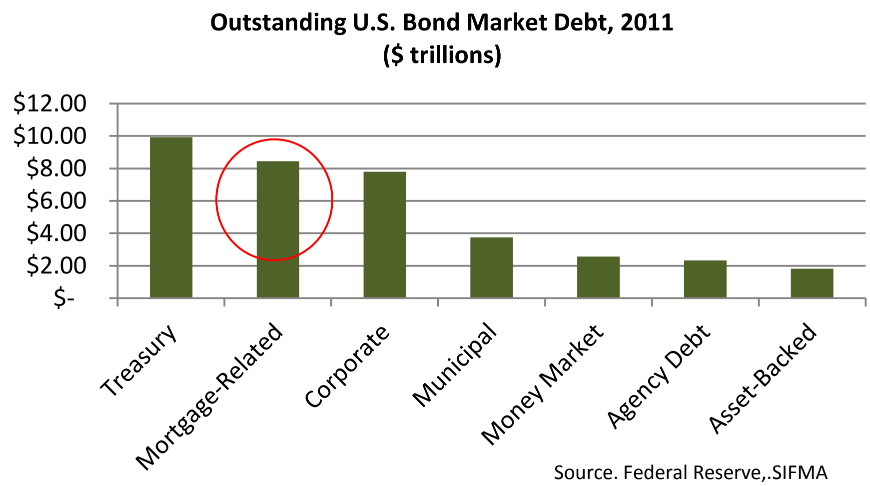


Securitization, being critically related to the level of housing activity, is tremendously important to our economy.

**Why Is Securitization Important? The Secondary Mortgage Market is one of the Largest Financial Markets, and Funds More than Half of All Outstanding Mortgage Loans**

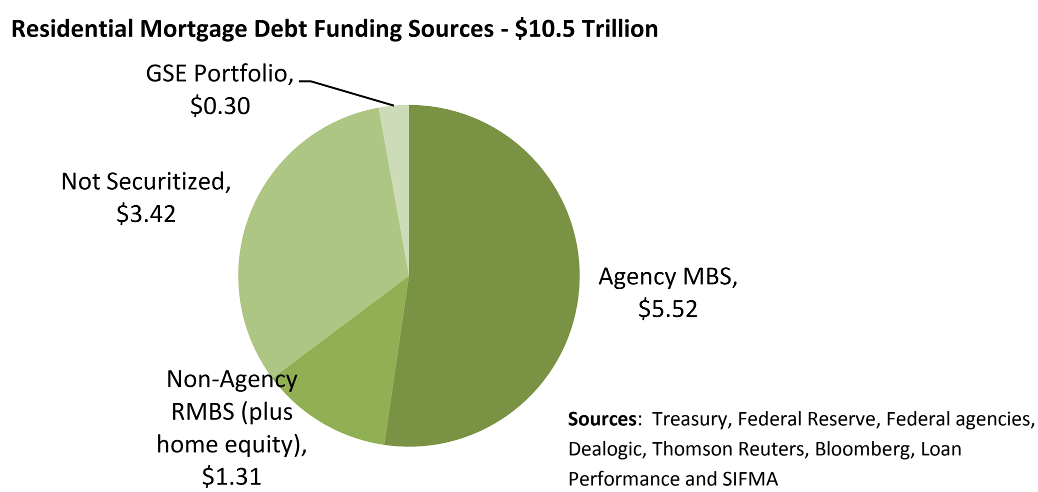
To put the size of the mortgage securitization markets in a broader perspective, the chart below places them in the context of the other fixed-income markets such as US Treasury and Corporate debt. The securitized mortgage market is larger than all other markets but for Treasuries.

*Figure: Outstanding US Bond Market Debt*




Below is a chart that shows how mortgages are funded in the United States. 67%, or $7.1 trillion, of home mortgages are held in a GSE portfolio or securitized (agency and non-agency). Secondary markets, therefore, are responsible for funding two thirds of residential mortgage lending.

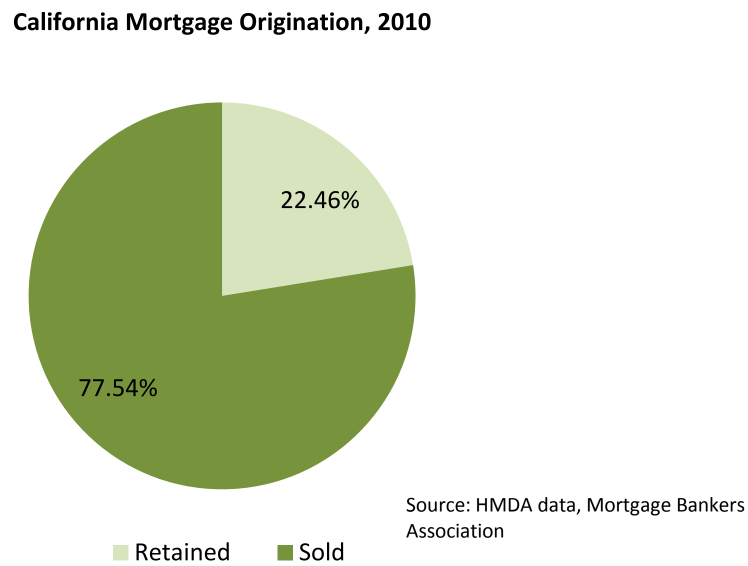
*Figure: Residential Mortgage Debt Funding Sources*



**Why Is Securitization Important to California? Secondary Markets Play a Key Role in California Lending**

The vast majority of loans to borrowers in California in 2010 were sold into the secondary market. According to HMDA data, more than ¾ of loans originated in 2010 were sold into secondary markets in 2010. It is clear that secondary markets are absolutely vital to California, and the impact of changes to mortgage lending and servicing law must be considered in the context of their impact on mortgage borrowers.[3]

*Figure: California Originations in 2010, Retained in Portfolio vs. Sold to Secondary Markets*




[3] We use this rate of sale into secondary markets as a proxy for the securitization rate of California loans. Nationally, the securitization rate has recently exceeded 90%; the proxy we use on this chart is somewhat lower for two reasons. First, the data shows the status of loans originated in 2010 at year end 2010. In other words, a loan could have been originated in 2010 but not sold or securitized in 2011, and that would not be reflected in this chart. The second reason is that California has a higher than average share of loans which exceed Fannie Mae, Freddie Mac, and FHA conforming loan limits. Given that the non-agency securitization markets remain dormant these loans tend to be retained in portfolio. However, we believe that if one were to review the secondary market share for individual institutions, instead of in the aggregate as below, it would be clear that many lenders rely on secondary markets for over 90% of their origination.