WRITTEN STATEMENT

ON BEHALF OF

THE ASSOCIATION OF MORTGAGE INVESTORS (AMI)

BEFORE THE

UNITED STATES SENATE
BANKING SUBCOMMITTEE ON
SECURITIES, INSURANCE, AND INVESTMENT

THE STATE OF SECURITIZATION MARKETS

MAY 18, 2011

by CHRIS J. KATOPIS, Executive Director

Introduction

Chairman Reed and Ranking Member Crapo, 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.

The Association of Mortgage Investors (AMI) commends you and your Senate 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. 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 a 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).[1] 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 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

[1] 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.

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.[2] 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.

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

[2] The exceptions are two recent securitizations by Redwood Trust.

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.[3]

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 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

[3] *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).

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;[4]

- **Originators and Issuers May not be Honoring their Contractual Representations** about what they sold into securitizations. Additionally, the documents are vague, with basic terminology 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 2nd lien (to allow for more effective workouts with the homeowner on the first lien).

[4] 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.

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.*[5]

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).

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[5] 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).

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 competiveness 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 view 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 at 202-327-8100 or by email at katopis@the-ami.org. We welcome any questions that you might have about securitization, representations and warranties, or other mortgage industry topics.

White Paper

Reforming the Asset-Backed Securities Market

Association of Mortgage Investors

March 2010

Introduction

In the two and a half years since the financial crisis began, it has become clear that the continued health of the securitization markets is crucial not just to U.S. economic recovery but to the financial system as a whole. There are three sources of residential and commercial mortgage capital in the United States – bank balance sheets, which are full and stressed; the securitization market, which is effectively shut down; and the government (Fannie Mae, Freddie Mac, FHA, etc.). For other types of debt capital, there are only two sources – banks and the securitization market – as the government does not directly provide capital the way it does for mortgages. Restoring the securitization market is necessary to get more private capital flowing to those who wish to use it, and accordingly to reduce the government's role of providing public capital to, and allocating that capital among, private borrowers.

The structures and mechanisms that have defined the securitization market to date have been constructed by issuers, underwriters, credit rating agencies and asset servicers with minimal disclosure-based, procedural or substantive regulation by Congress, financial regulators or the SEC. Investors provide the capital that make the securitization markets work yet have been ignored in market structure discussions. They have been told by other parties to securitization to "take it or leave it" on disclosures, definitions and structures, in other words - "just buy the securities we offer you". Now that poor credit underwriting, moral hazards, inadequate disclosures, asset servicer conflicts of interest, ratings agency failures, and logistical obstacles to working out bad collateral assets have scared investors away from the securitization markets, it is important for the government to consider the policy recommendations of investors, whose participation and capital are needed for there to be an asset-backed securities market at all. In fact, while issuers suggest otherwise and ideally it would be great if a consensus between issuers and investors could emerge, there need not be a consensus as investors ultimately provide the capital and have the responsibility to define the terms on which they will commit their capital.

We believe that the following recommendations support healthy and efficient 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 the spread between price and value and are entirely consistent with the government's traditional roles of standard-setting in emerging capital markets.

1. **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 a securitization.** Currently loan-level financial and related due diligence information is not required to be publicly disclosed. Issuers, underwriters and asset servicers already have this information and it costs little to make it publicly available on EDGAR or similar systems. Investors in asset-backed securities have both the interest and the ability to analyze such information to help them make better purchase and sale decisions relating to asset-backed securities.

Data should be provided on a daily, or at least monthly, basis in both the primary and secondary markets. To ensure adequate transparency, enhanced disclosure rules should be required both for deals with and without static pool data such as asset-backed commercial paper. Data on the specific underlying collateral in each pool should be made available for a reasonable period – not less than two weeks – before a deal is sold and brought to market. This should be

done to enhance investor due diligence, to foster the development of independent analytical data providers, and to reduce reliance on rating agencies. To ensure the accuracy of the information, loan-level data offered by issuers, underwriters or assets servicers for investors should be accompanied by an auditor attestation verifying that the data has been properly aggregated, calculated and published. The loan-level data should be available in an electronically manageable and industry standardized format. After the deal is sold, all data fields in the pre-issuance disclosures and material information about the loan-level collateral in the pool should be updated and be similarly disclosed on a daily, or at least monthly, basis. The data already exists and the creation of standard data fields and automation of this process would create little regulatory burden.

Capital markets would be less volatile if investors could fully model the expected performance of underlying loan-level collateral before a deal comes to market and, on a regular basis, assess the deviance from expectations. The provision of loan-level performance to investors on a regular basis would allow any degradation of performance to be observable and therefore priced in over incremental periods. By requiring that investors receive early and regular disclosures of all available information about collateral performance, the importance of NRSROs' ratings will be diminished to the level of equity analysts' research notes.

The fact that investors have to pay to subscribe to services such as Loan Performance to get data on collateral underlying asset-backed securities they are offered and may already hold is outrageous in light of the no-cost extensive public disclosure required for corporate securities. Arguments that the amount of loan-level information exceeds the capacity of investors to process and analyze – when issuers, underwriters and asset servicers have no problem processing and analyzing the very same data – are absurd on their face.

2. **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.** Currently investors in primary offerings of asset-backed securities are forced to make decisions as to whether or not they want to purchase immediately after deals come to market. As with existing SEC requirements relating to new issues of equity and debt securities, issuers should have to wait for a reasonable period of time before closing offerings of asset-backed securities. A two-week period would permit investors to properly analyze loan-level collateral and independently determine whether projected performance expectations are adequate.

3. **Make deal documents for all asset-backed securities and structured finance securities publicly available to market participants and regulators.** This will substantially increase market liquidity for such securities after they are sold. In the lead-up to the financial crisis, even primary financial regulators could not analyze or even have access to deal documents of asset-backed and structured finance securities (e.g. CDOs) that their regulated institutions held. The common practice of making fundamental asset-backed and structured finance deal documents proprietary and subject to confidentiality obligations is fundamentally inconsistent with properly functioning capital markets and prudential regulation of financial institutions.

4. **Develop, for each asset class, standard pooling and servicing agreements with model representations and warranties as a non-waivable industry minimum legal standard.** Right now every pooling and servicing agreement for a securitization is custom-written. Representations and warranties vary tremendously from deal to deal, even within the same fundamental asset class (mortgages, credit cards, etc.). This requires investors to spend tremendous amounts of time analyzing the differences between different transactions' legal terms and subjectively weighing the economic meaning of those terms before coming to investment decisions – or alternatively to ignore these differences of legal terms in the interest of time, to the peril of investors when problems develop in the market.

This lack of standardization and the length of the legal documentation effectively created opacity in the securitization market, which substantially contributed to the recent problems experienced by market participants. When collateral pool performance deteriorated, panic set in and investors began to question the value of their securities, they knew that they did not have the time to read all of the different several-hundred-page deal agreements to evaluate their holdings. This reinforced the rush to liquidate positions. What investor wants to be the last one holding a security the terms of which he doesn't fully understand? Potential buyers of these securities in turn would not step into the market without having read the documents themselves, causing the entire fixed-income market worldwide to freeze up.

Standardizing legal documentation gives investors a common framework with which to evaluate their potential and actual holdings of asset-backed and structured finance securities based largely if not solely on collateral pool performance. The asset-backed securities market as a whole would thereby become more homogenous and therefore more liquid. Investors should be able to rely on certain baseline assurances as to the nature of the collateral underlying their securities. Having a single standard set of representations and warranties that must be met or exceeded in every transaction gives investors comfort about the assets in which they have an interest, and reduces the overhead costs of investing in these securities. In addition, standardized representations and warranties would streamline resolution of disputes as to whether representations and warranties are met by individual assets within collateral pools.

Model agreements for the asset-backed securities market should be drafted with the best interests of the investing public, and with clarity of rights and responsibilities, at their cores.

5. **Develop clear standard definitions for securitization markets.** Without a common language and agreement on the meanings of fundamental concepts – such as "delinquency" and "default" – the value of data is diminished, the ability to compare securities across different pools is diminished, and the concepts of relative collateral pool performance and economic value become seriously muddied. There are no such standard definitions currently, and as a result servicers with very similar underlying collateral pools and servicing standards can produce radically different reports of collateral performance. For example, the term "delinquency" can be determined either on a contractual or recency-of-payment basis. Even among firms that would define delinquency on the same basis, each servicing agreement can have different interpretations on reporting of delinquencies – some may report advances that a servicer makes to a pool that could be applied to reduce stated delinquencies, but other servicing agreements may not. When no one agrees on what delinquencies are and how they must be reported, then how do we know what the term "default" means? How can anyone really understand what is happening if there is so much variability deal-to-deal and there are no industry-standard

practices? This is a huge problem that interferes with investors' ability to make investment decisions among various deals and issuers. The lack of clear standard definitions reinforces the complexity from the lack of standard contracts in securitization deals, and also makes it harder for capital markets to function.

Conversely, if everyone is using common language in loan origination and securitization then it becomes very hard to game the system as issuers and servicers have.

6. **Directly address conflicts of interest 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.** Servicers of mortgage or other financial asset pools often have economic interests that differ from those of investors. Simple contracts between servicers and securitization trustees, which themselves are subject to little or no accountability to investors, have not sufficiently aligned the interests of servicers to those of investors over time.

Where servicers are charged with enforcing representation and warranty claims on specific collateral pool assets so they are put back to originator affiliates of the servicers at par, the servicers have a conflict of interest and appear to have been delaying in carrying out such put-backs so as to avoid losses to their affiliates. Where servicers have affiliates that hold second lien or mortgage pool residual interests, they appear to have been carrying out their loss mitigation duties in ways that delay resolution and thereby maximize the option value of such second lien or residual interests, often at the direct expense of the senior tranche holders. Investors in asset-backed securities need to know that servicing is being performed in a way that maximizes the present value of the entire collateral pool without regard to such conflicts, and this can only be done if fiduciary duties flow directly from servicers that are sufficiently kept away from such competing economic interests.

Servicers, securities administrators and trustees must also establish and enforce uniform accounting policies and procedures for loan restructurings. Since the existing securitization contracts did not contemplate the scope and economic impact of the modifications being implemented under today's environment, it is imperative that securitization accounting in the future reflects the actual economic impact of the modified cash flows associated with the restructuring. Where loan modifications involve principal forbearance, there must be recognition of economic losses that affect how cash flows are allocated within securitizations.

7. **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**. Right now, trustees of collateral pools play a largely passive role and bear little if any accountability to the holders of securities which they have agreed – and are being compensated – to serve. In practice they do not supervise the servicers of collateral pools, who are often affiliated with the loan originators and therefore have strong incentives not to enforce representation and warranty claims on behalf of investors. Trustees have no practical means of monitoring or reacting to servicer performance, and no incentive to do so.

If one considers that the trustee of a securitization is like the board of directors of a company and the servicer of a collateral pool is functionally like the management, then it must be stated that holders of asset-backed securities are not given the protective rights, relative to those expected to serve them, that shareholders are provided. Securitization legal structures may utilize trustees and holders of asset-backed securities may have their rights shaped by contracts, but these holders are collectively the equity of the trust and they are owed fiduciary duties which must be respected. At least shareholders have the right to find out who their fellow security holders are, the right to an annual meeting, and the right to remove and elect new directors. Holders of asset-backed securities have none of these rights.

Given servicer incentives and conflicts of interest, the only effective way to effectively enforce deal representations and warranties back to the originator or sponsor is to give investors the ability to re-underwrite the loans as per initial collateral guidelines. Current private-market ABS legal structures seriously limit investors' access to data and ability to require put-backs of bad collateral by onerous minimum ownership hurdles and legal procedures. Legal rights to the integrity of pool collateral without a practical means of enforcement are meaningless in practice, both as a deterrent to originators' knowingly dumping bad assets into ABS pools and as a remedy to investors harmed by such practices.

8. **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.** Just as these legal provisions extend to equity and debt securities and help to support investor confidence that they are being treated fairly by issuers, they should similarly extend to asset-backed securities.

9. **Certain asset-backed securities could 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.** This could result in better price discovery, additional market transparency, additional liquidity and reduced bid/ask spreads. In the interim, investors should be strongly encouraged to buy only those financial instruments which they have an understanding of and are able to analyze completely, including the instruments' current market value. All dealers should be required to disclose historical trade prices on these simplified and standardized asset-backed and structured finance securities daily.

10. **Ratings agencies need to use loan-level data in their initial ratings and to update their assumptions and ratings as market conditions evolve and collateral performance is reported.** The poor record of recently issued asset-backed securities, in light of high initial ratings which were infrequently if at all updated as collateral performance came in, shows that we need fundamental change in the ratings process.

Rating agencies should have to base initial ratings on loan-level data with publicly disclosed economic and collateral performance assumptions including a life-loss curve. As time goes on, they should be required to update their models periodically with updated economic assumptions and new monthly remittance data from servicers. There should be regular secondary market re-ratings, frequent and timely enough to be of real use to investors. Each

NRSRO should have an independent office of a chief statistician that would archive and update ratings models firm-wide, and should be paid based on the accuracy of their ratings as collateral performance is reported. Rating agencies should have their liability exemptions carved back, should have minimum industry standards for analyst professional training in structured finance, and should prohibit revolving-door employee moves to issuers and underwriters. (Of course analysts should be able to join investor firms after leaving the rating agencies as there is not the same conflict of interest as with issuers and underwriters.)

We should create financial and reputation-based incentives for rating agencies to utilize a regular loan-level and cash flow approach to re-rating securities on a regular and frequent basis and their income should be specifically tied to the performance of the rated securities over the life of the issue.

Conclusion

Securitization has shifted significant funding for many asset classes away from bank balance sheets and into the hands of capital markets participants. With appropriate standards and rights for the holders of asset-backed securities, securitization would more efficiently fund markets, result in less volatility, and produce a better convergence between the pricing and value of assets in support of economic activity. This is the reason that we must now restart the securitization markets. If these markets are not functioning as an alternative to portfolio lending where economically less expensive, then there is no way to finance an economy that has previously been funded by global capital flows.

Given the problems in the securitization market that have been exposed by the financial crisis, if the fundamental market restructuring steps taken above are not taken then it will be difficult if not impossible for capital market investors to return to funding economic activity to the degree that they did previously.