PIMCO

Via Electronic Submission

April 14, 2017

The Honorable Mike Crapo
Chairman, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20515

The Honorable Sherrod Brown
Ranking Member, Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20515

Dear Chairman Crapo and Ranking Member Brown,

We welcome the opportunity to provide a response to your call for legislative proposals that could help "consumers, market participants and financial companies to better participate in the economy." Below we focus our comments on specific legislative solutions that we believe could help to bring back private capital to the moribund non-Agency mortgage market.

As background, PIMCO is one of the world's leading active fixed income asset managers that manages approximately $1.5 trillion of assets on behalf of millions of individuals and thousands of institutions globally, including pension plans, foundation and endowments, sovereign wealth funds, and state retirement plans that represent teachers, firefighters and other government employees. As a fiduciary to clients that are often saving for retirement, PIMCO's principal goal is to make sound, long-term investments that meet our clients' objectives. Additionally, as a large, active market participant, we have a strong interest in transacting in a stable, resilient and deep financial market system. It is with these goals in mind that we make our comments below.

Background:

As one of the largest investors in Agency (Fannie Mae, Freddie Mac and Ginnie Mae) mortgage-backed securities (MBS) and non-Agency residential mortgage-backed securities (RMBS), PIMCO is committed to a well-functioning, liquid and robust housing finance market.

Although the Agency MBS market is healthy, the non-Agency RMBS market (also known as the private-label securitization or "PLS" market) remains nearly dormant with significantly smaller issuance and volumes relative to pre-2008 levels. (See appendix.) This is in part due to the legal uncertainty and higher costs associated with the regulatory regime imposed on the non-Agency market after the financial crisis. The higher costs have led originators and securitizers to effectively exit the non-Agency market, while the increased legal and other associated risks have caused private investors, who are oftentimes fiduciaries such as PIMCO, to withdraw from this market in favor of the Agency market, which has fewer unknowns and more investor protections. Practically, this means that 1) residential mortgage originations are dominated by the Agencies, thereby putting more pressure on the government's balance sheet, and 2) many borrowers who want to get a mortgage loan simply cannot.

As fiduciaries and large market participants, we have no interest in returning to the pre-crisis years of lax underwriting and poor-performing loans. However, we believe that in some narrow respects, the pendulum has swung too far and that minor regulatory and legislative changes could help return private capital to the mortgage market in a responsible manner, which would importantly facilitate increased access to mortgage credit for those borrowers who want it at the same time.

Additionally, as policymakers think about GSE reform, we would assert that reviving the private mortgage market is an integral and necessary first step before comprehensive GSE reform is truly viable. After all, without a functioning private mortgage market, it is practically difficult for the GSEs to successfully shrink their footprint without significant disruption to the mortgage finance and housing market.

Policy Recommendations to Revive the Non-Agency Market:

With the above as background, we would encourage policymakers to consider two modifications that we believe would help to bring back private capital to the non-Agency mortgage market and expand credit access for millions of credible borrowers:

I. **Eliminate assignee liability under the Truth in Lending Act for purchasers of loans in the secondary market;** and

II. **Eliminate risk-retention requirements for RMBS**

We expand on these recommendations below.

I. Eliminate Assignee Liability under the Truth in Lending Act (TILA) for Secondary Market Participants

Description:

As you may know, TILA and the CFPB's subsequent regulations create a path for a defaulting borrower to take legal action against the lender for irresponsible lending. Under the CFPB's Ability-to-Repay (ATR) rule, if a bank makes a loan that is not considered a qualified mortgage (QM), a defaulting borrower has the ability to sue the lender. We support this as it holds the originator accountable for potentially predatory lending activities, and it is a component of sound underwriting. However, under the ATR rule, purchasers in the secondary mortgage market, such as PIMCO, are subject to the *same* liability and damages as originators in the event that loan originators violate the rule, even though these purchasers do not participate in origination and do not have discretion or oversight over the origination process. Additionally, potential damages associated with assignee liability litigation can expand beyond the loan amount, meaning that the potential losses related to assignee liability can be material.

The litigation risk – and potential large losses associated with assignee liability – has been a key impediment to private capital returning to the non-Agency mortgage market over the past several years. Investors, such as PIMCO, have no incentive to take on unknowable risk when they could invest elsewhere (such as the Agency market) where there is much less uncertainty and the risks are quantifiable. We assert that if assignee liability is not eliminated for secondary market participants, the non-Agency mortgage market will continue to be moribund.

<u>Specific Recommendations:</u>

We are supportive of all efforts to reduce the risk of assignee liability for secondary market participants, but believe the simplest way of addressing this issue is to preserve assignee liability exclusively for originators and eliminate for other participants.

The legislative language proposed below seeks to carve out a specific exemption under TILA for asset managers who purchase loans from third parties or the related securities. It also strikes assignee liability in several key areas of the TILA to ensure a fully functioning secondary market. Lastly, it directs conforming rulemaking to take place within 6 months of enactment.

<u>Proposed Legislative Text:</u>

SEC. XXX. AMENDMENTS TO THE TRUTH IN LENDING ACT

> (a) DEFENSE TO FORECLOSURE.—Sections 130(k) of the Truth in Lending Act (15 U.S.C. 1640) is amended by inserting after subsection (2) the following new subsection:
>
> > "(3) Limitation on Liability for Assignees.—Notwithstanding paragraph (1), consumers may only seek such recoupment or set-off under paragraph (2) against the creditor that allegedly violated paragraph (1) or (2) of section 129B(c) or of section 129C(a).
>
> (b) PRESUMPTION OF ABILITY TO REPAY.— Section 129C(b)(1) of the Truth in Lending Act is amended.—By striking ", and any assignee of such loan subject to liability under this title,".
>
> (c) ARBITRATION.— Section 129C(e)(2) of the Truth in Lending Act is amended.—By striking "or any assignee";

(d) EXEMPTION FROM LIABILITY AND RESCISSION IN CASE OF BORROWER FRAUD OR DECEPTION.— Section 130(1) of the Truth in Lending Act is amended.—By striking "or assignee";

(e) PERIODIC STATEMENTS FOR RESIDENTIAL MORTGAGE LOANS.— Section 128(f)(1) of the Truth in Lending Act is amended.—By striking ", assignee".

(f) EXEMPTIVE RELIEF FOR CERTAIN TYPES OF ASSIGNEES. — Section 130(l) and Section 131(g) of the Truth in Lending Act is amended by inserting at the end the following:

> "(_) TREATMENT OF CERTAIN TYPES OF ASSIGNEES.
>
> (1) IN GENERAL. — Any secondary market purchaser of a mortgage loan or any consumer credit transaction that is a secured by the principal dwelling of a consumer shall not be treated as an assignee of such an obligation for purposes of this Act.
>
> (2) DEFINITION. — For purposes of this subsection, the term "secondary market purchaser" means any asset manager that purchases or receives from a third party, residential real estate loans, mortgage-backed securities or mortgage-related securities. It excludes mortgage originators as defined in section 103(cc)(2) (15 U.S.C. 1602(cc)(2)).
>
> (3) APPLICABILITY. — This subsection shall apply to all consumer credit transactions in existence or consummated on or after the date of the enactment of the [insert name of legislation] of 2017."

(g) AMENDMENT OF CFPB REGULATIONS.

> (1) IN GENERAL. —Not later than the end of the 6-month period beginning on the date of the enactment of this Act, the Consumer Financial Protection Bureau shall amend Regulation Z and the Truth in Lending Act and Real Estate Settlement Procedures Act Integrated Disclosure requirements to implement the amendments made by this Act.
>
> (2) ADDITIONAL CLARIFICATIONS.—In addition to the required rulemaking referenced in subparagraph (1), the Consumer Financial Protection Bureau shall proceed with notice and comment rulemaking within a 6-month period beginning on the date of the enactment of this Act to accomplish the following:
>
> > (A) Providing a means to cure numeric clerical errors on the Projected Payments table.

(B) Clarifying which of the individual components of the Projected Payments table give rise to statutory damages.

(C) Clarifying that when a lender cures an error on the Projected Payments table post-consummation, the material disclosures are deemed to have been delivered prior to consummation—so that the rescission period is not reopened even notwithstanding the cure.

(D) Identifying which components of the Projected Payments table are material disclosures, as it may not be necessary for all components of the table to give rise to rescission rights.

II. <u>Elimination of risk retention for non-QRM RMBS</u>

<u>Description:</u>

Under current law, non-qualified residential mortgage (QRM) securitizations are subject to risk retention requirements under Dodd-Frank. While this requirement may sound appealing in theory, it has made securitizations for both originators and securitizers uneconomical in practice, and therefore has had a significant chilling effect on the creation of non-Agency securitizations comprised of non-QM loans. This has manifested in yet another headwind for many credit-worthy borrowers who fall outside of the QM/QRM framework either in the form of higher mortgage rates, or more frequently, in the form of no access to mortgage borrowing at all.

We believe that risk retention should be eliminated outright for RMBS; indeed, we do not believe risk retention is necessary given that investors are sufficiently protected under Dodd-Frank's Ability-to-Repay requirement. If wholesale elimination of risk retention for RMBS is not feasible, we would advocate for a calibrated risk retention threshold commensurate to the risk of the underlying loans versus the blunt, non-risk-based threshold under current law.

<u>Specific Recommendations:</u>

A repeal of risk retention for non-QRM RMBS.

<u>Proposed Legislative Text:</u>

SEC. XX. EXEMPTION FROM RISK RETENTION REQUIREMENTS FOR NON-QUALIFIED RESIDENTIAL MORTGAGE

(a) IN GENERAL.—Section 15G of the Securities Exchange Act of 1934 (15 U.S.C. 78o–11) is amended—

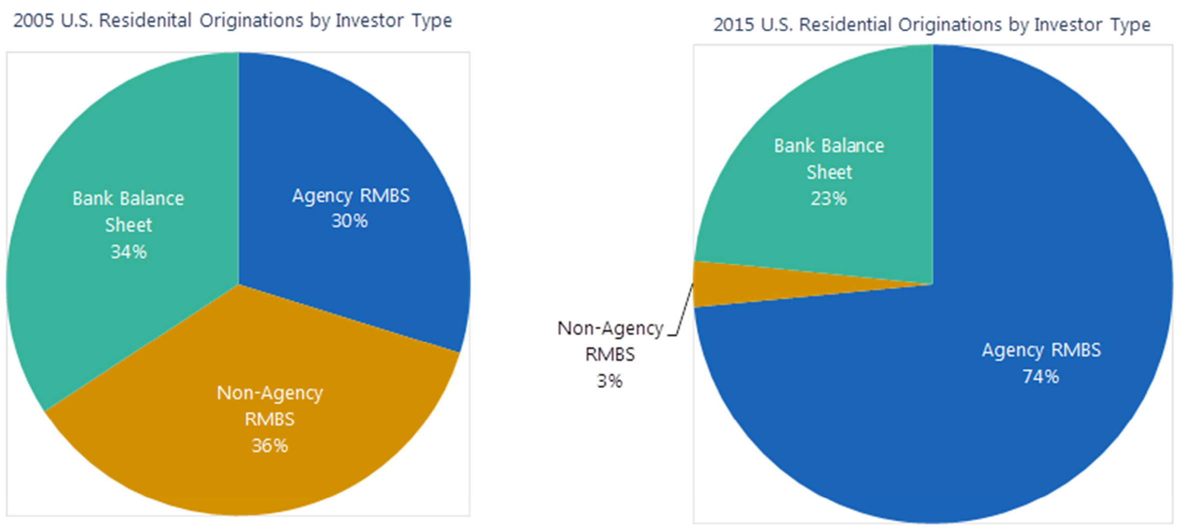
(1) in subsection (c)— by striking subsection (1)(B) and 1(C)(iii).

(2) in subsection (e) — by striking subsection (5).

(b) RULE OF CONSTRUCTION.—Nothing in the amendment made by this Act may be construed as establishing a risk retention requirement for non-qualified residential mortgages.

Appendix

i. Non-Agency RMBS comprised 3% of the market in 2015, down from 36% in 2005, the practical effect of which has been less access to mortgage credit broadly and a greater reliance on the GSEs



SOURCE: Freddie Mac, Inside Mortgage Finance (latest data as of 3Q '16), PIMCO

ii. Due to the lack of a functioning private mortgage market, the Federal Housing Authority has stepped in to fill the gap, putting more pressure on the government's balance sheet