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Banking Committee Focuses on Private-Label Mortgage-Backed Securities Market

Yesterday, the U.S. Senate Committee on Banking, Housing and Urban Affairs continued its examination of housing finance reform with a hearing entitled “*Fundamentals of a Functioning Private Label Mortgage Backed Securities Market.*” The purpose of the hearing was to examine why private capital remains on the sidelines of the housing finance market and how to balance both the private and government sectors’ roles in housing finance reform. The hearing featured testimony from three experts: Martin S. Hughes, CEO and Director of Redwood Trust; John Gidman, President of the Association of Institutional Investors; and Professor Adam J. Levitin of Georgetown University Law Center.

In his opening statement, Chairman Tim Johnson (D-SD) noted that private capital currently represents only five percent of the housing finance market and remarked that the Committee must be certain that “any new system we design will actually attract private capital.” Ranking Member Mike Crapo (R-ID) agreed that a “vibrant, well-functioning” private mortgage-backed securities (MBS) market was critically important.

The witnesses discussed a variety of measures Congress could enact to revitalize the private-label MBS market, including increasing government loan limits and guarantee fees, standardizing securitization agreements, improving transparency, and enhancing the duties of trustees (including imposing fiduciary duties). All witnesses agreed that a “three-market” housing finance system of government, private-government hybrid, and private-label products would be an effective structure.

Several members (Ranking Member Crapo, Senators Corker (R-TN), Toomey (R-PA), and Hagan (D-NC)) raised the issue of the potential use of eminent domain by local governments to seize mortgages held in securitization trusts. Mr. Gidman expressed concern that use of eminent domain “would have an immediate and chilling effect on the entire asset class.”

Senator Elizabeth Warren (D-MA) observed that regulators would likely need the ability to exert counter-cyclical pressure on the house market, including increasing government guarantee fees during boom times and reducing them during downturns. However, she expressed concern that if regulators did not have authority to regulate the private-label market, counter-cyclical policies would merely drive market participants out of government-backed MBS and into private-label MBS. All witnesses agreed that the government should be able to exert some counter-cyclical pressure over the private-label market.

Other questions centered on whether to impose fiduciary duties on trustees, the importance of preserving the 30-year fixed-rate mortgage, the impact of assignee liability on the market, and the capacity of the private market to bear credit risk.

Committee members and witnesses repeatedly expressed the urgency of creating legislation in the near term. Ranking Member Crapo reiterated that the Committee’s hearings were intended to produce a bipartisan agreement by the end of the year, while Senator Mark Warner (D-VA) warned that time was not on the side of Government-Sponsored Enterprise (GSE) reform.

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