TESTIMONY OF

MANAGED FUNDS ASSOCIATION

UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES

HEARING ON

"PRIVATE SECTOR COOPERATION WITH MORTGAGE MODIFICATIONS – ENSURING THAT INVESTORS, SERVICERS AND LENDERS PROVIDE REAL HELP FOR TROUBLED HOMEOWNERS"

NOVEMBER 12, 2008

Chairman Frank, Ranking Member Bachus, members of the Committee, my name is Benjamin Allensworth and I am Senior Legal Counsel for Managed Funds Association ("MFA"). MFA represents the majority of the world's largest hedge funds and is the primary advocate for sound business practices and industry growth for professionals in hedge funds, funds of funds and managed futures, as well as industry service providers. MFA's members manage a substantial portion of the approximately $2 trillion invested in absolute return strategies around the world.

MFA appreciates the opportunity to testify today about efforts by private sector participants to work with federal, state and local officials in seeking to mitigate the current wave of foreclosures and defaults that are turning the dream of homeownership into a nightmare for millions of American families. Our fundamental belief is that effective mortgage modifications are preferable to foreclosure whenever possible. As we have learned over the past 12-18 months, our nation's housing market is critical to the social and financial well-being of families and communities throughout our country, and central to the health and vitality of our capital markets and our economy.

The wave of foreclosures has placed downward pressure on home prices, which in turn has eroded home equity and consumer confidence in the mortgage market. This diminished confidence has in turn led to a freezing-up of the mortgage backed securities ("MBS") market, which has been a major source of liquidity and credit to our capital markets. A final cascading effect has been the tightening of the broader credit markets as financial institutions and market participants have been forced to satisfy redemption requests of investors and to hold more capital due to write-downs.

To stem the effects of this crisis and revitalize our nation's mortgage and credit markets, bold, proactive steps need to be taken. MFA and it members are committed to working with Congress and other relevant stakeholders on both short-and long-term efforts to address these serious economic challenges.

Congress has recently enacted several measures in response to the mortgage and credit crisis, specifically the Emergency Economic Stabilization Act ("EESA") and the Housing and Economic Recovery Act ("HERA"). The central element of HERA is Hope for Homeowners ("H4H"), a program that seeks to help those at risk of default and foreclosure refinance into more affordable and sustainable loans insured by the Federal Housing Administration ("FHA"). With additional time and continued collaboration between the public and private sectors, we believe that H4H can serve as a valuable tool to mitigate foreclosures and help inject much-needed liquidity back into the mortgage and credit markets.

MFA and its members recognize the important social and economic value of effective loan modifications as a critical tool to help prevent foreclosures, to keep families in their homes, and to stabilize our markets. The success of such efforts will in large part be correlated to stakeholder collaboration on this common objective. Foreclosure mitigation is a challenge affecting all MBS market participants including banks, insurers, investment advisers, MBS pool trustees, mortgage servicers, mutual funds, pension plans, securities firms and other institutional investors. Hedge funds that invest in MBS are also part of this group, although a relatively small part as compared to other investors, with investments making up an estimated 5-20% of the MBS market.

MFA does not have a formal association policy regarding the terms and conditions for modifying MBS contracts. We and our members support effective mortgage modifications over foreclosure whenever permissible.

There are a number of legal, fiduciary and practical issues that the aforementioned market participants take into account when considering mortgage modifications. Mortgage servicers report to trustees, which have fiduciary duties to the investors in MBS pools. Similarly, institutional investors holding MBS also have fiduciary obligations to their clients. As market participants consider these fiduciary obligations, one of the primary determinations, consistent with the intent of H4H, are whether the net present value ("NPV") of a modified loan is greater than the NPV of a foreclosure. Fiduciaries must weigh the effects of loan modification on earnings of institutional investors, such as pension funds and retail mutual funds, among others. A variety of factors, including the likelihood of a subsequent default on a modified mortgage, is considered when making these important determinations. That said, for most investors these considerations occur against the backdrop that effective mortgage modifications are more preferable to foreclosures.

In seeking the views of our members and other stakeholders in preparation for this hearing, we became aware of several impediments that can hinder the ability of a mortgage servicer to modify a loan.

Accuracy of NPV for Aggregate Loan Modifications: Some have suggested calculating NPV and doing loan modifications on groups of mortgages with similar characteristics rather than on a case by case basis. While this may be a more efficient and effective process, there are questions as to whether or not servicers can meet the obligation to maximize NPV for each specific mortgage when making collective determinations. Questions have also been raised regarding the reliability of automated valuation models and other desktop valuations, which have also been suggested as a more efficient system for determining NPV on an aggregate basis.

Higher Default Rates/Lower NPV for non-HERA Loan Modifications: The potential of a subsequent default on a modified loan is a factor for servicers not only in determining the NPV calculation, but also for determining which loans should be modified, consistent with the objective of ensuring that a distressed homeowner can afford a modified loan. HERA acknowledges this particular problem and provides government protection, through FHA insurance, against future defaults for mortgages modified through the program. However despite this backing, most modifications made to date have been done through interest rate reductions, extensions of terms and back-loading principal payments, i.e., not through the HERA program.

Because most modifications fall outside of HERA there is no government guarantee against subsequent defaults. The likelihood of a higher default on non-HERA modified loan modifications negatively affects the NPV calculation factored into the determination of whether to modify a mortgage or foreclose.

Resource/Capacity Issues: Consistent with H4H, the starting point for servicers seeking to make a determination as to whether or not to modify a loan is the obligation to first determine, but also maximize, the NPV of each mortgage in the pool. As defaults and foreclosures have risen sharply, some servicers may be overwhelmed by the process of having to make NPV determinations on a case-by-case basis for so many troubled mortgages.

Operational Constraints: We have also heard that, in some instances, servicers may be unable to do loan modifications under HERA because they lack the operational capacity to originate FHA mortgages.

While each of these challenges have the potential to undermine foreclosure prevention efforts, in our view none are so daunting that they should deter us from our shared interest in keeping more American families in their homes and restoring stability and confidence to our mortgage and credit markets.

In this regard, we believe that there are a number of measures that can be considered to increase the number of loan modifications. One measure would be to develop a set of standardized protocols that servicers could use to calculate NPV. Such standardization would be particularly beneficial to the extent that those calculations are done on a mortgage by mortgage basis. Yesterday's announcement by the Administration that it, as part of the HOPE Now initiative, is implementing protocols to streamline the loan modification process is a hopeful sign.

The modification of loans owned by IndyMac Federal, and other banks who service their wholly-owned loans through an affiliate, suggests that consideration be given to a "single-owner/servicer" approach to loan modifications. A framework in which MBS are purchased, held and administered by a single entity, rather than a variety of investors with competing interests, may similarly allow more efficient loan modifications to occur.

Finally, we recognize that policy makers are likely to address the issue of the high subsequent default rates for non-HERA modified loans. We believe that it is important to develop a solution that reduces the risk of subsequent defaults on mortgage modifications of all types.

As we stated at the outset, MFA and its members appreciate the importance of preventing foreclosures and we encourage our members and all stakeholders to support loan modifications efforts, to the fullest extent they are able to. MFA remains committed to working with its members, policy makers and other market participants on these important issues and playing a constructive role in helping advance more robust loan modification efforts.

Thank you for this opportunity to testify before the Committee. I would be happy to answer any questions that you may have.