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13 UNITED STATES DISTRICT COURT
14 NORTHERN DISTRICT OF CALIFORNIA
15 SAN FRANCISCO DIVISION

16 WELLS FARGO NATIONAL ASSOCIATION,
17 as Trustee, *et al.*,
18 Plaintiffs
19 v.
20 CITY OF RICHMOND, CALIFORNIA, a
municipality, and MORTGAGE RESOLUTION
21 PARTNERS LLC,
22 Defendants

Case No. CV-13-3663-CRB

**MEMORANDUM OF STRUCTURED
FINANCE INDUSTRY GROUP, INC., AS
AMICUS CURIAE, IN SUPPORT OF
PLAINTIFFS' MOTION FOR A
PRELIMINARY INJUNCTION**

Date: September 13, 2013
Time: 10:00 a.m.
Judge: Hon. Charles R. Breyer

23
24
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26
27
28

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

TABLE OF CONTENTS I

TABLE OF AUTHORITIES II

INTEREST OF *AMICUS CURIAE* AND SUMMARY OF ARGUMENT IV

ARGUMENT — ABSENT A PRELIMINARY INJUNCTION, THE SEIZURE PROGRAM WILL CAUSE IRREPARABLE INJURY NOT ONLY TO PENSION FUNDS AND OTHER INVESTORS DIRECTLY AFFECTED, BUT TO THE ENTIRE HOME MORTGAGE SYSTEM, AND THUS TO PROSPECTIVE HOMEOWNERS ACROSS THE COUNTRY 1

I. PRIVATE LABEL SECURITIZATIONS PLAY A CRITICAL ROLE, AND WILL PLAY AN INCREASINGLY IMPORTANT ROLE, IN THE HOME MORTGAGE SYSTEM..... 2

II. THE SEIZURE PROGRAM WILL CAUSE IRREPARABLE INJURY TO PENSION FUNDS AND OTHER INVESTORS THAT HOLD INTERESTS IN THE PLS TRUSTS WITH SEIZED LOANS..... 4

 A. The Structural Predicate of the Seizure Program Conflicts with the Legal and Economic Reality of PLS Trusts. 4

 B. The Seizure Program Disregards—and Potentially Seriously Undermines—the Tax Structure of RMBS, Yielding Severe Adverse Tax Consequences to the Trusts and Their Investors 5

 C. It Is Highly Unlikely That a Post-Seizure Valuation Proceeding Could Provide Adequate Relief 7

 1. The Damage to the Home Mortgage Industry Would Be Incalculable and Uncompensable7

 2. The Damage To Individual PLS Trusts Which Have Loans Seized Would Exceed the Face Value of the Seized Loans8

 3. Even on an Individual Loan Basis, the Financial Predicate of the Seizure Program Is To Provide Less than Just Compensation9

 D. The Direct Damage Will Be Sustained By Pension Funds and Other Investors, and Impact Ordinary Americans Across the Country 11

III. THE PUBLIC INTEREST WARRANTS AN INJUNCTION BECAUSE THE SEIZURE PROGRAM WOULD CAUSE IRREPARABLE INJURY TO THE MORTGAGE SYSTEM AND PROSPECTIVE HOMEOWNERS ACROSS THE COUNTRY 11

IV. THERE ARE ALTERNATIVES AVAILABLE TO HELP BORROWERS IN NEED 12

CONCLUSION..... 15

APPENDIX A — CORPORATE MEMBERS OF SFIG A

TABLE OF AUTHORITIES

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

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**INTEREST OF *AMICUS CURIAE*
AND SUMMARY OF ARGUMENT**

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3 Structured Finance Industry Group, Inc. (“SFIG”), as *amicus curiae*, respectfully submits
4 this Memorandum of Law in support of Plaintiffs’ motion for a preliminary injunction.

5 SFIG is a member-based trade industry advocacy group, with over 150 corporate members
6 from all sectors of the structured finance and securitization market, including investors, issuers,
7 financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers,
8 and trustees. SFIG was established in March 2013. A list of SFIG’s corporate members appears as
9 Appendix A. SFIG’s purposes include: educating members, legislators, regulators, and others about
10 structured finance, securitization and related capital markets; building the broadest possible
11 consensus on policy, legal, regulatory and other matters affecting or potentially affecting these
12 markets; and advocating on behalf of the structured finance and securitization industry.

13 SFIG is sympathetic to the difficulties faced by municipalities and borrowers adversely
14 affected by the current condition of the housing market and the economy. However, the City of
15 Richmond’s proposed use of eminent domain to seize mortgage loans from private securitization
16 trusts—especially performing mortgage loans with borrowers able to continue to pay—will cause
17 substantial, irreparable harm not only to the Trusts which have loans targeted for seizure, but also to
18 the nation’s home mortgage system. This Court should grant a preliminary injunction so that it can
19 determine “the constitutionality of the disputed governmental action before potentially
20 uncompensable damages are sustained.” *Eastern Enterprises v. Apfel*, 524 U.S. 498, 521 (1998)
21 (granting injunctive relief to enjoin unconstitutional taking), quoting *Duke Power Co. v. Carolina*
22 *Environmental Study Group, Inc.*, 438 U.S. 59, 71, n. 15 (1978).

23 SFIG supports in full Plaintiffs’ position. We write as *amicus* from our unique position as
24 industry participants to highlight the serious conflict between the Seizure Program, on one hand, and
25 the very structure, nature, and reasonable investor expectations in Private Label Securitizations
26 (“PLS”), on the other hand. The consequences of this clash—and specifically, of yanking
27 performing mortgage loans out of PLS Trusts—are serious and, absent injunctive relief, will cause
28 irreparable injury not only to investors but to the entire mortgage system and thus to prospective

1 homeowners across the country.

2 (I) PLS Trusts—that is, Residential Mortgage Backed Securities (“RMBS”) issued by
3 private mortgage securitization trusts rather than by the United States Government or a Government-
4 Sponsored Enterprise (“GSE”)—play a critical role in the nation’s home mortgage system. PLS
5 Trusts will play an increasingly important role as the roles played by GSEs, such as Fannie Mae and
6 Freddie Mac, are reduced. Fannie Mae and Freddie Mac, under agreements with the U.S. Treasury,
7 have already begun to reduce their mortgage holdings, and there are bills pending in Congress—
8 with White House support—to wind down Fannie Mae and Freddie Mac. PLS Trusts are fixed pools
9 of geographically diverse mortgage loans. By design, the loans in the pools are not actively traded,
10 so that performing loans remain in the Trust until paid in accordance with their terms (except if
11 modified based on financial hardship of the specific borrower). The structure of PLS Trusts, and the
12 market for the trading of securities issued by such Trusts, has never had any reason to factor in, and
13 has not factored in, the possibility that performing loans with creditworthy borrowers would be
14 seized in eminent domain for less than their face amount. Permitting such loans to be seized before a
15 determination of the constitutionality of the Seizure Program would introduce uncertainty into the
16 entire valuation system and market for securities issued by PLS Trusts.

17 (II) The irreparable injury caused by the Seizure Program would likely be aggravated
18 because the Seizure Program, by disregarding the structure and economics of PLS Trusts, directly
19 clashes with provisions of the Internal Revenue Code and Treasury Regulations. There is a grave
20 risk that the Seizure Program would cause the imposition of punitive taxes on investors. It is highly
21 unlikely that the a post-seizure compensation proceeding could provide adequate relief at any of the
22 three levels at which damage would be sustained: The nation’s home mortgage industry, the PLS
23 Trusts which suffer seizure, or even at the individual mortgage loan level. This damage would be
24 sustained by pension funds and other investors, and would impact ordinary Americans who have
25 what they have reasonably believed to be conservative investments.

26 (III) The public interest warrants injunctive relief, because the housing market will not
27 recover absent a steady and reliable source of private capital for mortgage loans—which will be
28 jeopardized if the Seizure Program proceeds without a determination of its constitutionality.

1 (IV) There are alternatives available that have been helping, and will continue to help,
2 borrowers in need. Financial institutions and servicers, including many of SFIG’s members,
3 participate in and support these programs, including the Home Affordable Modification Program
4 (HAMP)—part of the “Making Home Affordable Program,” a joint program of the U.S.
5 Departments of the Treasury (“Treasury”) and Housing and Urban Development (“HUD”). Two
6 attributes are central to HAMP and other loan modification programs. First, to assess whether
7 default is imminent, HAMP and other programs use a detailed analysis of the borrower’s financial
8 condition and ability to pay—both to ensure that the program’s benefits go to borrowers under real
9 financial hardship, and to provide realistic loan modifications which will enable borrowers to make
10 their payments. Second, HAMP and other industry loan modification programs generally require
11 that modifications be Net Present Value (“NPV”) positive—that is, that the NPV of the modified
12 loan be greater than what would be recovered if a loan went into foreclosure. The Seizure Program
13 has neither of these characteristics; it proposes to seize performing loans at a target price based
14 solely on the market value of the underlying homes, and then give the borrowers new, more
15 favorable loans—even if the borrowers have been able to continue to make their mortgage payments
16 on the seized loans. And by proposing to seize performing loans for less than their face value, the
17 Seizure Program would impose a loss of NPV on the persons who hold interests in PLS Trusts.

18 To avoid irreparable injury to the investors which hold securities backed by targeted loans, to
19 avoid irreparable injury to the nation’s home mortgage industry, to encourage the return of private
20 capital to the mortgage market, and to further the public interest, SFIG respectfully joins in
21 Plaintiffs’ motion for a preliminary injunction.

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ARGUMENT

**ABSENT A PRELIMINARY INJUNCTION, THE SEIZURE PROGRAM WILL CAUSE
IRREPARABLE INJURY NOT ONLY TO PENSION FUNDS AND OTHER INVESTORS
DIRECTLY AFFECTED, BUT TO THE ENTIRE HOME MORTGAGE SYSTEM, AND THUS
TO PROSPECTIVE HOMEOWNERS ACROSS THE COUNTRY**

The proposed seizure by Richmond and Mortgage Resolution Partners LLC (“MRP”) of mostly performing mortgage loans, held in PLS Trusts, would up-end the nation’s home mortgage system. Were the Seizure Program to go forward before the serious constitutional questions presented are addressed by this Court, it would cause real and irreparable injury at three levels:

- The entire home mortgage industry will be up-ended. The market for securities issued by PLS Trusts will be fundamentally shaken if the structure can be pulled apart by municipalities seizing loans, especially by cherry-picking individual performing loans.
- Each PLS Trust which holds to-be-seized loans will be damaged by an amount that exceeds the face value of the loan, because the structure, as a fixed, geographically diverse pool, will be undermined. The market value of the interests in the PLS Trust will likely decline by an amount which far exceeds the face amount of the loans seized. This injury may well be uncompensable through post-seizure compensation proceedings.
- Each PLS Trust which holds to-be-seized loans will, at a minimum, lose the value of those loans—which the Seizure Program, by its nature and structure, seriously undervalues as part of its very premise. The consequences will fall upon public and private pension plans, retirement accounts, college savings accounts, hospital and university endowments, and other funds, and ultimately will damage the ordinary Americans who are the beneficiaries of such accounts.

The irreparable damage would thus reach far beyond the particular investors with interests in the seized loans; the Seizure Program would also irreparably harm prospective homeowners across the country by imposing new, unanticipated and unquantifiable risks upon investors in mortgages, depressing the value of mortgage-based investments, and impeding the return of private capital to the residential mortgage market. The Seizure Program is likely to have a particularly adverse impact in Richmond and in other localities, if any, which seek to use eminent domain in this manner.

1 Given that there is no adequate way, after-the-fact, to undo the severe damage that will be
2 done to the particular investors with interests in the seized loans, or to the home mortgage industry,
3 the Seizure Program should not go forward until its constitutionality is fully addressed by this Court.
4 *Eastern Enterprises v. Apfel*, 524 U.S. 498, 521 (1998) (granting injunctive relief to enjoin
5 unconstitutional taking), quoting *Duke Power Co. v. Carolina Environmental Study Group, Inc.*, 438
6 U.S. 59, 71, n. 15 (1978) (Declaratory Judgment Act “allows individuals threatened with a taking to
7 seek a declaration of the constitutionality of the disputed governmental action before potentially
8 uncompensable damages are sustained.”).

9
10 **I. PRIVATE LABEL SECURITIZATIONS PLAY A CRITICAL ROLE, AND WILL PLAY
AN INCREASINGLY IMPORTANT ROLE, IN THE HOME MORTGAGE SYSTEM**

11 PLS Trusts play a critical role in our nation’s home mortgage system, and are expected to
12 play an increasingly important role as steps are taken to reduce or eliminate the role played by
13 GSEs, such as Fannie Mae and Freddie Mac.

14 The aggregate United States home mortgage debt of \$8.6 trillion includes three components:
15 85% is securitized debt issued by or guaranteed by the U.S. Government or a GSE, 5% is not
16 securitized; and 10%, or \$864 billion, is securitized through PLS Trusts. Burnaman Decl. ¶ 17 (Dkt.
17 11). But since 2008, Fannie Mae and Freddie Mac have been under Government conservatorship. As
18 a condition for the Government’s investment, Fannie Mae and Freddie Mac each agreed to reduce
19 the aggregate amount of mortgage assets it holds by at least 10% each year from 2008 to 2012, and
20 thereafter by at least 15% each year.¹ Fannie Mae and Freddie Mac’s role in the future of the home
21 mortgage industry will likely be further reduced. Both a bi-partisan bill in the Senate, the Housing
22 Finance Reform and Taxpayer Protection Act of 2013 (S.1217) (the “Corker-Warner Bill”) and a
23 Republican sponsored bill in the House, the Protecting American Taxpayers and Homeowners Act
24 of 2013 (H.R. 2767) (the “PATH Bill”), would wind down Fannie Mae and Freddie Mac. The

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26 ¹ Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of Sept. 26, 2008, as
27 further amended, between United States Department of the Treasury and Federal National Mortgage
28 Association, ¶ 5.7; Amended and Restated Senior Preferred Stock Purchase Agreement, dated as of
Sept. 26, 2008, as further amended, between United States Department of the Treasury and Federal
Home Loan Mortgage Corporation, ¶ 5.7, available at <http://www.fhfa.gov/Default.aspx?Page=364>
(cont’d)

1 Obama Administration has also endorsed winding down Fannie Mae and Freddie Mac.² As the role
2 of Fannie Mae and Freddie Mac is diminished, it will be increasingly important that capital be
3 available through PLS Trusts.

4 Foremost among the sources of capital for PLS Trusts are pension funds (for public and
5 private employees), retirement accounts, college savings plans, insurance companies, and university
6 and hospital endowments. Certain characteristics of PLS Trusts heighten investor interest:

- 7 • **Geographic Diversity**. Mortgage loans assembled into an individual PLS Trust are
8 selected from a diverse geographic area across the nation, to mitigate any potential
9 adverse impact from adverse economic conditions in a specific region or locality.
- 10 • **Fixed Asset Pool**. Once mortgage loans are assembled into a PLS Trust, and the interests
11 in that Trust are sold, the assets are fixed. By design, the Trust is not actively managed.
12 Neither the trustee nor the servicer is permitted to sell or modify the terms of any
13 performing mortgage loan, except to the extent permitted by the Trust documents.
14 HAMP and other loan modification programs, described below, recognize these
15 limitations and require, among other things, an assessment of whether the borrower has
16 the wherewithal to continue making payments under the existing loan, without hardship.
17 Performing loans that do not qualify for modification remain in the Trust, unmodified,
18 until the mortgage is paid in accordance with its terms (which may be a prepayment,
19 such as upon a sale, or a payment upon completion of the mortgage term). Typically,
20 cash flows on the performing loans are used in part to cover losses incurred on defaulted
21 loans; maintaining performing loans in the Trust is therefore essential to the structure's
22 integrity.

23 This structure produces a security that does not depend on the acumen of an active manager, and
24 avoids risks that are unanticipated and cannot be quantified, recognizing that such risks drive away

25 _____
(visited Aug. 29, 2013).

26 ² “End Fannie Mae and Freddie Mac’s failed business model so taxpayers are never again on the
27 hook for bad loans and bailouts.” The White House, “Fact Sheet: A Better Bargain for the Middle
28 Class: Housing, <http://www.whitehouse.gov/the-press-office/2013/08/05/fact-sheet-better-bargain-middle-class-housing> (Aug. 5, 2013) (visited Aug. 29, 2013).

1 fiduciaries and other conservative investors which are the source of private capital for PLS Trusts.

2 Securities issued by these PLS Trusts are sold at initial issuance, and trade in the secondary
3 market, on the basis of computer models that take into account the loan and pool characteristics, and
4 the cash flow structure (or “waterfall”) for the transaction. These models incorporate the ability to
5 specify assumptions about factors such as prepayment speed, prevailing market rates, home price
6 appreciation/depreciation rates, default frequency and loss severity. Investors who buy and sell
7 RMBS rely on these models to provide an indication of fair value of these securities. These models
8 do not contemplate or factor in the possibility of performing loans with creditworthy borrowers
9 being taken from the issuing trusts for less than their principal amount. If as a result of the Seizure
10 Program a new paradigm is created under which performing loans with borrowers not under
11 financial hardship can be taken from pools at a loss, then the entire valuation system for all
12 outstanding RMBS will be undermined. Given an inability to model this possibility with any degree
13 of sound analysis, it can be anticipated that markets will overreact for this uncertainty. This could
14 lead quickly to a sharp devaluation of outstanding RMBS generally, and forced sales due to margin
15 calls on RMBS that are held on a leveraged basis (often the case).

16 **II. THE SEIZURE PROGRAM WILL CAUSE IRREPARABLE INJURY TO PENSION**
17 **FUNDS AND OTHER INVESTORS THAT HOLD INTERESTS IN THE PLS**
18 **TRUSTS WITH SEIZED LOANS**

19 **A. The Structural Predicate of the Seizure Program Conflicts with the**
20 **Legal and Economic Reality of PLS Trusts.**

21 In PLS Trusts, no mortgage loan is a stand-alone asset. Each loan is part of a geographically-
22 diverse pool, assembled and intended to be maintained as a static pool. PLS Trusts do not include
23 the concept of salability of individual mortgages, nor is their value measured by reference to the
24 “market value” at which individual mortgages or groups of mortgages from within a PLS Trust
25 might sell on the open market, since PLS Trusts do not sell performing mortgages and there is no
26 open market. Instead, investors measure the value of the securities issued by PLS Trusts based on
27 the unpaid principal balance of the loans and the cash flow which those loans produce. Burnaman
28 Decl. ¶37 (Dkt. 11). When each PLS Trust was assembled, its assets were fixed, and certificates
were sold, no investor had any reason whatsoever to consider the risk that a municipality would pick

1 and choose among loans in a Trust, and seize some of them—and thus that a program of eminent
2 domain would undermine both the geographical diversity and the fixed nature of the PLS Trust. The
3 entire proposition of RMBS, through which mortgage loans are assembled, and certificates in the
4 resulting security are valued, rated and sold, is undermined if the mortgage loans in the Trust are
5 subject to selective removal. And, although this would be equally true whatever criteria were used
6 for selective removal, the Seizure Program doubles down on the damage by specifically cherry-
7 picking performing mortgage loans for removal, plucking out high performing assets and throwing
8 the structure in jeopardy.

9 **B. The Seizure Program Disregards—and Potentially Seriously**
10 **Undermines—the Tax Structure of RMBS, Yielding Severe Adverse**
11 **Tax Consequences to the Trusts and Their Investors**

12 The Seizure Program, in its utter disregard for the structure and economics of PLS Trusts,
13 directly clashes with the provisions of the Internal Revenue Code and Treasury Regulations
14 applicable to PLS Trusts which are structured as Real Estate Mortgage Investment Conduits
15 (“REMICs”). The possibility that a performing mortgage loan inside a REMIC might be seized
16 through eminent domain was not contemplated in the Code and Regulations.

17 The provisions of the Code applicable to PLS Trusts structured as REMICs both reflect and
18 require that each REMIC be a fixed pool of assets, not actively traded. The sale of a mortgage out of
19 a REMIC is a “prohibited transaction,” subject to narrow exceptions.

20 (2) **Prohibited transaction.**—For purposes of this part, the term “prohibited transaction”
21 means—

22 (A) **Disposition of qualified mortgage.**—The disposition of any qualified
23 mortgage transferred to the REMIC other than a disposition pursuant to—

- 24 (i) the substitution of a qualified replacement mortgage for a qualified
25 mortgage (or the repurchase in lieu of substitution of a defective obligation),
26 (ii) a disposition incident to the foreclosure, default, or imminent default of
27 the mortgage,
28 (iii) the bankruptcy or insolvency of the REMIC, or
(iv) a qualified liquidation.

26 U.S.C. § 860F. None of the exceptions apply to the Seizure Program.³ The Code provides two

³ The taking of a performing loan is not a substitution of a qualified replacement mortgage or a
disposition incident to “foreclosure, default, or imminent default”; the Seizure Program does not
involve either the bankruptcy or insolvency of the REMIC; and the Seizure Program does not

(cont'd)

1 strict penalties when there is a prohibited transaction in a REMIC. First, there is a 100 percent tax on
2 net income from prohibited transactions:

3 **(a) 100 percent tax on prohibited transactions.—**

4 **(1) Tax imposed.**—There is hereby imposed for each taxable year of a REMIC
a tax equal to 100 percent of the net income derived from prohibited transactions.

5 26 U.S.C. § 860F(a)(1). Second, the income or loss from prohibited transactions is not taken into
6 account in computing taxable income:

7 **(1) Taxable income.**—The taxable income of a REMIC shall be determined
8 under an accrual method of accounting and, except as provided in regulations, in the
same manner as in the case of an individual, except that— * * *

9 (C) there shall not be taken into account any item of income, gain, loss, or
deduction allocable to a prohibited transaction, * * * .”

10 26 U.S.C. § 860C(b)(1). Taken together, this means: Net income from the seizure of a loan is
11 subject to 100% tax. A loss from loan seizure is not taken into account in computing the overall
12 income of the Trust, or the income passed through to the holders of REMIC residual interests.⁴

13 If the Seizure Program were to work as MRP intends, a loss on a seized loan would be far
14 more likely than a gain, because the Program contemplates that “just compensation” will be below
15 the face amount due on the loan. Thus, if there were a \$393,000 performing mortgage held with a
16 tax basis at par and if, based, on MRP’s calculations, the compensation was \$248,000, there would
17 be a loss of \$145,000.⁵ Absent the Code’s prohibited transaction provision, that loss would be
18 available to offset income. But because of Section 860C, that loss would be disregarded, resulting in
19 a higher effective tax on the balance of the loans in the Trust. There is thus not only a loss of
20 principal, but a special tax because this type of transaction is not supposed to take place.

21 Conversely, if the compensation was more than the tax basis on the seized loans, the
22 resulting gain would be subject to 100% tax. This special provision of the Code could alone inhibit
23 California courts from awarding just compensation. Either way, adverse tax consequences would

24
25 involve a qualified liquidation, defined in the Code as a complete liquidation of the REMIC subject
to additional requirements, 26 U.S.C. § 860F(a)(4).

26 ⁴ The provision in 26 U.S.C. § 860C that the gain is not taken into account in computing income is
simply to avoid double taxation; the gain has already been subject to a 100% tax.

27 ⁵ These numbers reflect the average balance of targeted loans, the average market value of the
28 homes, and proposed compensation at 80% of market value. Burnaman Decl. ¶¶ 41-42. (Dkt. 11).

1 aggravate the damages.

2 There is also risk that the PLS Trusts affected by the Seizure Program would lose their
3 qualifications as REMICs. A “regular interest” in a REMIC must have an unconditional entitlement
4 to the receipt of principal. While Treasury Regulations § 1.860G-1(b)(3)(ii) specifically provides
5 that certain credit losses do not cause a failure to qualify as a REMIC, the Regulations do not
6 contain any such provision with respect to losses due to seizure of performing loans. The IRS has
7 not taken a position on this issue. If a PLS Trust lost REMIC status as a result of the Seizure
8 Program, the PLS Trust would likely be taxed as a corporation. If, as a result of the Seizure
9 Program, REMIC regular interests lost their characterization as debt instruments, then two resulting
10 adverse consequences are that (a) this may create tax withholding that did not otherwise exist for
11 non-U.S. investors, and (b) payments denominated as interest to holders of REMIC regular interest,
12 not characterized as debt would not be deductible by the PLS Trust, further increasing the amount of
13 taxes owed by the PLS Trust and thus reducing the amount available to pay investors.⁶

14 **C. It Is Highly Unlikely That a Post-Seizure Valuation Proceeding Could**
15 **Provide Adequate Relief**

16 If the Seizure Program proceeds before determination of its constitutionality, given the
17 nature and breadth of damages that go far beyond assessing the value of a single mortgage, it is
18 highly unlikely that any post-seizure valuation proceeding would provide an adequate remedy.

19 **1. The Damage to the Home Mortgage Industry Would Be**
20 **Incalculable and Uncompensable**

21 Eminent domain proceedings, by their nature, are not equipped to and cannot measure
22 damage which goes beyond the individual entities whose property is taken. The only parties to
23 eminent domain proceedings brought as part of the Seizure Program would be the City of
24 Richmond, as plaintiff, and “those persons who appear of record or are known by the plaintiff to
25 have or claim an interest in the property described in the complaint.” Cal. Code Civ. Proc. §§

26 _____
27 ⁶ In response to concerns that modifications of performing loans under HAMP were prohibited
28 transactions and jeopardized REMIC qualification, the IRS issued Revenue Procedure 2009-23,
2009-17 IRB 884 (04/10/2009), stating that such modifications did not have that effect. However,
(cont'd)

1 1250.210,1250.220. Although the damage to the home mortgage industry caused by the Seizure
2 Program would be incalculable, none of the affected participants (other than those PLS Trusts with
3 seized loans) would be parties to state court proceedings, and none would receive compensation.

4
5 **2. The Damage To Individual PLS Trusts Which Have Loans Seized
Would Exceed the Face Value of the Seized Loans**

6 Any eminent domain proceeding in the Seizure Program would likely begin with a basic
7 dispute as to what property was being taken; the uncertainties presented by that dispute present an
8 additional reason why the constitutionality of the Program should be determined before it proceeds.

9 Is each individual mortgage loan targeted for seizure a separate item of property, which
10 should be valued as a stand-alone loan? That is the apparent position taken by the City of Richmond,
11 which, having made separate settlement offers on a loan-by-loan basis apparently intends to proceed
12 with condemnation on a loan-by-loan basis.

13 Or will the eminent domain proceeding reflect the way the industry and market views PLS
14 Trusts? What the City of Richmond and MRP propose to seize is a part of each affected PLS Trust,
15 so that compensation must include the damage to the remainder of the PLS Trust (valued by taking
16 into account, among other things, diminution in the value of the securities issued by the Trust) under
17 basic principles of eminent domain law that when part of property is taken, proper measure of
18 damages includes the “difference in the fair market value of his property in its ‘before’ condition
19 and the fair market value of the remaining portion thereof after.” *Los Angeles County Metropolitan*
20 *Transportation Authority v. Continental Development*, 16 Cal. 4th 694, 712, 941 P.2d 809, 820
21 (1997); Cal. Code Civ. Proc. §§ 1263.410 et seq. (“Where the property acquired is part of a larger
22 parcel, in addition to the compensation ... for the part taken, compensation shall be awarded for the
23 injury, if any, to the remainder.”). If the condemnation proceeds, the Trustees may seek
24 compensation measured in this manner. If that view prevailed, just compensation from seizing that
25 \$393,000 performing loan would far exceed \$393,000, and it is highly likely that Richmond will not
26 have the financial wherewithal to pay. There is risk, as noted above, that if each PLS Trust were
27
28 this Revenue Procedure did not address loans seized by eminent domain.

1 entitled to compensation that fully took into account the damage to the Trust, as a whole, that gain
2 from the additional compensation would be subject to the 100% tax on a prohibited transaction—
3 making it impossible to award just compensation.

4
5 **3. Even on an Individual Loan Basis, the Financial Predicate of the
Seizure Program Is To Provide Less than Just Compensation**

6 Richmond appears to contend that only the value of any individual loan seized is worthy of
7 compensation. Worse yet, Richmond contends that the only compensation paid on a \$393,000
8 performing loan, secured by a house with depressed market value of \$310,000 would be \$248,000.
9 But even if loans were valued on an individual basis, the value of any individual performing loan,
10 with a creditworthy borrower, cannot be computed merely as a percentage of home value.

11 To illustrate: On a \$393,000 loan on a house with a depressed market value of \$310,000,
12 Richmond proposes to provide compensation of \$248,000 (80% of the depressed market value), and
13 to finance the condemnation by “flipping” the loan—investing no money to improve the underlying
14 real property and doing nothing else that would enhance the loan value—for \$294,500 (95% of the
15 appraised value), using the \$46,500 spread to pay the expenses and make a profit. Burnaman Decl.
16 ¶43 (Dkt. 11). But there would be no projected profit on the “flip” if Richmond intended to pay just
17 compensation. This is nothing like a traditional eminent domain proceeding where government
18 action may both serve a public purpose and help create value—for example, taking blighted real
19 property, so that new funds can be invested in redevelopment. It is untenable to contend that a
20 \$393,000 performing mortgage on a home with a market value of \$310,000 is worth \$248,000, when
21 a new \$294,500 mortgage secured by that same home will be worth \$294,500 or more.

22 These numbers also help to illustrate why the overwhelming majority of homeowners do not
23 default on their mortgage loans even when the value of the homes decline below the outstanding
24 balances. If a homeowner has the financial wherewithal to continue to make mortgage payments on
25 a \$393,000 mortgage when the market value of the home has declined to \$310,000, should the
26 homeowner default, and subject himself or herself to possible foreclosure? The obvious answer—
27 given by homeowners through their rational conduct across the country—is that it is in the
28 homeowner’s interest not to default. The overwhelming majority of homeowners who are able to

1 pay their home mortgages do not want to suffer the personal and financial consequences of default
2 and possible foreclosure—uprooting a family, incurring the substantial costs of moving, giving up
3 the “sweat equity” in the home, sustaining damage to a credit rating, perhaps (depending upon loan
4 terms and applicable State law) remaining liable for the underlying debt, trying to buy a new home
5 without having received any equity from the home that could be applied to a down payment (thus
6 making a comparable home, with a similarly depressed market value, less affordable than a current
7 home), and giving up the possibility that the homeowner will once again have equity in the home
8 after the housing market rebounds. It is not as though the homeowner will make an \$83,000 profit
9 by defaulting on his or her \$393,000 mortgage loan; to the contrary, the homeowner who defaults
10 and suffers foreclosure on a mortgage suffers tangible personal and financial consequences.

11 And because, as their rational behavior demonstrates, homeowners will continue to make
12 payments on their home mortgages even when the market values decline below the face amount of
13 the mortgages, the value of those mortgages is properly based on the creditworthiness of the
14 borrowers, the face amount of the mortgages, and on the continuing, projected income stream which
15 is being received. Public statements by the City of Richmond and MRP make clear that they have
16 ignored these factors. As reported in *San Francisco Chronicle*’s SFGate, the City of Richmond
17 acknowledged that the loans had been “selected by MRP,” and Steven Gluckstern, chairman of
18 MRP, had this to say about how MRP targeted the loans:

19 We don’t discriminate against anyone in this program. We don’t pick and choose who’s
20 entitled to their property and who isn’t. The criteria for which loans were chosen is how
21 much underwater they are and the propensity to default.^[7]

22 It would, of course, be reprehensible if the Seizure Program selected mortgage loans for seizure as a
23 political or personal favor to the individual homeowner. But one cannot assess the “propensity to
24 default” of any mortgage loan—especially a performing loan—without assessing the
25 creditworthiness of the homeowner. MRP’s statement is thus an acknowledgement that it has not
26 fairly valued the mortgage loans chosen for seizure.

27 ⁷ “Pricey homes in Richmond’s eminent domain plan,” SFGate, Aug. 20, 2013, available at
28 <http://www.sfgate.com/business/article/Pricey-homes-in-Richmond-s-eminant-domain-plan-4745146.php> (visited Aug. 29, 2013).

1
2 **D. The Direct Damage Will Be Sustained By Pension Funds and Other**
3 **Investors, and Impact Ordinary Americans Across the Country**

4 The Seizure Program also appears to be predicated upon the relative anonymity of the
5 persons who will sustain injury if the program goes forward—the mortgage loans are held in PLS
6 Trusts, for the benefit of unidentified investors. But the fact is that the victims of the Seizure
7 Program will be millions of ordinary Americans, who are the beneficiaries of public and private
8 employee pension plans which have funds invested in PLS Trusts, or who have interests in PLS
9 Trusts through 401(k) plans, mutual funds, or other investment tools.

10 In considering whether the balance of equities favors granting injunctive relief, this Court
11 should consider: Even if it could be considered a “public purpose” to seize a \$393,000 performing
12 loan, with the intent of reducing the face amount due by \$100,000 for the direct benefit of MRP and
13 the individual homeowner who has demonstrated his or her capability to pay the full loan on a
14 current basis: Does any conceivable damage caused by delaying the seizure until after a full hearing
15 on the constitutionality of the Seizure Program outweigh the risk that an unconstitutional Seizure
16 Program will cause a public or private employee to lose funds in his or her retirement account?

17 **III. THE PUBLIC INTEREST WARRANTS AN INJUNCTION BECAUSE THE SEIZURE**
18 **PROGRAM WOULD CAUSE IRREPARABLE INJURY TO THE MORTGAGE SYSTEM**
19 **AND PROSPECTIVE HOMEOWNERS ACROSS THE COUNTRY**

20 The public interest weighs heavily in favor of preliminary injunctive relief. The housing
21 market will not recover unless there is a steady and reliable source of private capital for mortgage
22 loans. As efforts are underway in Congress to reduce the role of Fannie Mae and Freddie Mac in the
23 home mortgage market, it is critical that private capital be encouraged to support home mortgages. If
24 the Seizure Program is allowed to proceed—and especially if it proceeds before a determination of
25 its constitutionality—it will introduce a new substantial risk for investors that is not only not
26 anticipated, but also not capable of quantification. That will drive private capital away from the
27 home mortgage market—making mortgages less available and less affordable. If investors cannot be
28 found for PLS Trusts, then the Trusts will not be formed. If Trusts are not available to purchase
mortgage loans, less mortgage money will be available to prospective homeowners. If investors will
only invest in PLS Trusts if they will receive higher rates of return to compensate for the additional

1 risk of seizure of loans by eminent domain, then mortgage rates will increase.

2 This is likely to have a particularly adverse impact in Richmond and other localities that use
3 eminent domain to seize mortgage loans. Companies that assemble PLS Trusts will be reticent to
4 purchase loans secured by homes in municipalities that have seized loans through eminent domain
5 or have stated their intent to do so. If the secondary market for such mortgage loans therefore dries
6 up, it will be difficult for lenders to extend loans to prospective homeowners in municipalities that
7 seize loans through eminent domain. If such prospective homeowners are able to obtain mortgage
8 loans, they will, at a minimum, face a higher cost of mortgage credit due to a lender's increased risk
9 of loss, a lack of legal certainty, and reduced liquidity for local mortgage loans. The Seizure
10 Program undermines—it does not help—the prospect of affordable home ownership.

11 **IV. THERE ARE ALTERNATIVES AVAILABLE TO HELP BORROWERS IN NEED**

12 The issues which the Seizure Program pretends to but does not address—providing relief to
13 homeowners who cannot afford their mortgages and avoiding the detrimental impact of foreclosure
14 on communities—are being addressed effectively both by the federal government and the industry.

15 The City of Richmond would have the Court believe that write downs of undercollateralized
16 but performing mortgage loans is a standard lending practice, and that the fact that this cannot be
17 done with loans in PLS Trusts is due to a flaw in structuring, for which the drastic remedy of seizure
18 by eminent domain is the only solution. This conclusion is wrong because the premise is wrong. In
19 reality, the relief available to struggling homeowners whose loans are held in PLS Trusts is very
20 similar to that for those whose loans are owned or guaranteed by the GSEs. The notion advanced by
21 Prof. Hockett that lenders who hold mortgage loans in portfolio would write off principal on
22 performing loans merely because the property value has declined, as a standard or typical practice,
23 has no basis in reality. Hockett Decl. ¶¶ 11,14 (Dkt. 35).

24 At the outset of the credit crisis, there was an industry wide effort to systematically modify
25 defaulted mortgage loans that would otherwise go into foreclosure. This occurred principally
26 through HAMP, under which a homeowner can seek to have a loan modified, and monthly payments
27 reduced, if he or she has a financial hardship and is (or is in danger of becoming) delinquent,
28

1 provided that the homeowner has sufficient income to support a modified payment.⁸

2 Lenders and servicers have since adopted HAMP-style policies and procedures for
3 systematic modification of defaulted mortgage loans generally (including loans not eligible for
4 HAMP). These programs are designed to maximize payment relief to borrowers with financial
5 hardships, while at the same time preserving the rights of investors (and in the case of the GSEs,
6 minimizing loss to taxpayers). These programs now reflect prevailing industry standards as well as
7 public policy at the federal level. Financial institutions and servicers, including many of SFIG's
8 members, participate in and support these programs, and engage in extensive outreach to
9 homeowners, through their websites and otherwise.⁹ In addition to HAMP, these programs include:

- 10 • Treasury/HUD's Principal Reduction Alternative (PRA) Program helps homeowners
11 where the amount owed is more than the home is worth, the mortgage payment is more
12 than 31% of the homeowner's gross (pre-tax) monthly income, the homeowner has
13 financial hardship and is either delinquent or in danger of becoming delinquent, and the
14 homeowner has sufficient, documented income to support the modified payment.
- 15 • Under Treasury/HUD's Second Lien Modification Program (2MP), homeowners whose
16 first mortgage was permanently modified under HAMP may seek modification or
17 principal reduction on a second mortgage to increase long-term sustainability.
- 18 • Special federal programs are available for homeowners whose mortgage loans are
19 guaranteed by the Federal Housing Administration, the United States Department of
20 Agriculture, and the United States Department of Veterans Affairs.
- 21 • For mortgages owned or guaranteed by Fannie Mae and Freddie Mac, homeowners who

22 _____
23 ⁸ Detailed information, including additional requirements, about the HAMP program and other
24 Treasury/HUD programs is available at www.makinghomeaffordable.gov (visited Aug. 29, 2013).

25 ⁹ See, e.g.,

26 **Bank of America**, "The Federal Government's Making Home Affordable Programs,"
27 http://homeloanhelp.bankofamerica.com/en/mha-programs.html?cm_mmc=CRE-Mortgage--vanity--MO01VN0026_mha--Online

28 **Chase**, "Chase Homeownership Center, How to Keep My Home,"
https://www.chase.com/chf/mortgage/hrm_options

CitiMortgage, "Trouble Making Payments,"
<https://www.citimortgage.com/Mortgage/displayHomeOwnerAssistance.do?page=troublepayment>

Wells Fargo, "Help for Homeowners," <https://www.wellsfargo.com/homeassist/>

1 have not been able to obtain traditional refinancing because the loan-to-value ratio on
2 their home was greater than 80% may be able to refinance, provided that they are current
3 on the mortgage and have a good payment history.

4 There are two key hallmarks of HAMP and other industry standard loan modification programs.
5 First, the loan must be in default or in imminent default. For loans not in default, a modification may
6 only made if the servicer makes a determination that the borrower is at risk of imminent default.
7 This determination is made based on the borrower's financial condition and ability to pay.
8 According to the Handbook for Non-GSE Mortgages for the Making Home Affordable Program:

9
10 When making an imminent default determination [under HAMP], the servicer must
11 evaluate the borrower's hardship as well as the condition of and circumstances affecting
12 the property securing the mortgage loan. The servicer must consider the borrower's
13 financial condition, liquid assets, liabilities, combined monthly income from wages and
14 all other identified sources of income, monthly obligations (including personal debts,
15 revolving accounts, and installment loans), and a reasonable allowance for living
16 expenses such as food, utilities, etc. The hardship and financial condition of the borrower
17 must be verified through documentation.^[10]

18 The "default or imminent default" standard employed here is consistent with standards under which
19 mortgage loans in PLS Trusts that are REMICs may be modified without adverse tax consequences
20 to investors. Second, the modification must be net present value (NPV) positive.¹¹ That is, the NPV
21 of the payments under the mortgage loan as modified must be greater than the NPV of the net
22 proceeds that would ultimately result if the loan went through foreclosure. (If the modification is
23 NPV negative, the modification may be made but only with investor consent.)

24 Prof. Hockett is incorrect to suggest that PLS Trusts are typically restricted from permitting
25 loan modifications. Hockett Decl. ¶ 13 (Dkt.35). The governing documents for PLS Trusts generally
26 permit modifications of defaulted loans, and the vast majority permit modifications for loans if
27 default is imminent or reasonably foreseeable. A small minority of PLS Trusts restrict the number of
28 loans that may be modified. Generally, there is a requirement that a modification must maximize

¹⁰ Making Home Affordable Program, Handbook for Non-GSE Mortgages, Chapter II: HAMP, p. 93
(Version 4.2, as of May 1, 2013) (available at
https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_42.pdf (visited
Aug. 29, 2013).

¹¹ *Id.*, p. 113.

1 recoveries or be in the best interests of investors.

2 The truth is that borrowers whose loans are held in PLS Trusts have the same access to
3 industry standard modifications for defaulted loans (or loans in imminent default) as do other
4 borrowers. The most recently published HAMP statistics indicate that of 954,443 active HAMP
5 modifications: 451,475 are GSE; 336,407 are in PLS Trusts; and 166,561 are in portfolio.¹²

6 The Seizure Program deviates in key respects from HAMP and similar programs. First, at the
7 expense of ordinary Americans with funds in pension plans and other investors, the Seizure Program
8 offers relief to borrowers with no demonstrated financial hardship. Second, for loans that are
9 performing with no pending foreclosure, and therefore for which the NPV of the existing loan is
10 based on the payment stream, the Seizure Program is clearly NPV negative. The Seizure Program is
11 directly counter to prevailing industry standards as currently applied to GSE, PLS Trust, and
12 portfolio loans alike, and is directly contrary to federal public policy for how borrowers with
13 hardships should be benefitted, as reflected in the HAMP program.

14 CONCLUSION

15 SFIG respectfully joins in Plaintiffs' motion for a preliminary injunction.

16 Dated: August 29, 2013

DENTONS US LLP

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27 ¹² Making Home Affordable, Program Performance Report Through June 2013, p. 12 (Aug. 9, 2013)
28 (available at <http://www.treasury.gov/initiatives/financial-stability/reports/Documents/June%20%202013%20MHA%20Report%20final.pdf> (visited Aug. 29, 2013)).

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APPENDIX A

CORPORATE MEMBERS OF SFIG

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|---------------------------------------|--|
| 1st Financial Bank USA* | Ford Motor Credit Company* |
| 20 Gates Management | Freddie Mac |
| ADS Alliance Data Systems, Inc. | General Electric Capital Corporation* |
| Allen & Overy LLP* | Global Securitization Services, LLC |
| Ally Financial, Inc.* | GM Financial Company, Inc. * |
| Ally Investment Management, LLC | GMO |
| Alston & Bird LLP* | Goldman, Sachs & Co.* |
| American Credit Acceptance, LLC | Goodwin Procter LLP |
| Amherst Securities Group, LP* | Harley-Davidson Financial Services, Inc.* |
| Andrew Davidson & Co., Inc.* | Hildene Capital Management* |
| Andrews Kurth LLP* | Hogan Lovells US LLP* |
| Ashurst LLP* | HSBC Securities (USA) Inc.* |
| Assured Guaranty Corp | Hunton & Williams LLP* |
| Babson Capital Management LLC* | Hyundai Capital America |
| Baker & McKenzie* | Impac Mortgage Holdings, Inc. |
| Bank of America* | Intex Solutions, Inc.* |
| Barclays* | J.P. Morgan Chase Bank |
| BB&T Capital Markets* | J.P. Morgan Investment Management Inc. |
| Bingham McCutchen LLP* | J.P. Morgan Securities LLC |
| Blake, Cassels & Graydon LLP* | John Deere* |
| Blank Rome LLP | Jones Day* |
| Bloomberg LP | JPMorgan Chase & Co.* |
| BlueMountain Capital Management* | K&L Gates LLP* |
| BMO Capital Markets CORP.* | Kanerai* |
| BNP Paribas* | Katten Muchin Rosenman LLP* |
| BNY Mellon* | Kaye Scholer LLP* |
| Cadwalader, Wickersham & Taft LLP* | Kirkland & Ellis LLP* |
| Cassels Brock & Blackwell LLP* | KPMG LLP* |
| Chapman and Cutler LLP* | Kramer Levin Naftalis & Frankel LLP* |
| Chase Bank USA, N.A. | Kroll Bond Rating Agency, Inc.* |
| Citi* | Latham & Watkins LLP* |
| Clayton Holdings LLC* | Lender Processing Services* |
| Cleary Gottlieb Steen & Hamilton LLP* | Lewtan* |
| Clifford Chance* | Locke Lord LLP* |
| CNH Capital* | Lord Capital LLC* |
| CoreLogic | LordSPV, a TMF Group Company |
| Credit Agricole* | Lowenstein Sandler LLP* |
| Credit Suisse* | Maples and Calder* |
| CREMAC | Mayer Brown LLP* |
| CrossCheck Compliance LLC* | MBSData, LLC |
| DBRS* | McCarthy Tetrault LLP* |
| Dechert LLP* | McDermott Will & Emery* |
| Deloitte & Touche LLP* | Mercedes-Benz Financial Services USA
LLC* |
| Dentons US LLP* | Mitchell Silberberg & Knupp LLP* |
| Deutsche Asset Management | Mitsubishi Motors Credit of America, Inc.* |
| Deutsche Bank* | Mitsubishi UFJ Securities (USA)* |
| Discover Financial Services* | Moody's Analytics |
| Emmet, Marvin & Martin, LLP* | Moody's Investors Service* |
| Ernst & Young* | Morgan Stanley* |
| Exeter Finance Corp.* | Morningstar Credit Ratings, LLC* |
| Fitch Ratings* | |

- 1 Morrison & Foerster LLP*
- 2 Nationstar Mortgage LLC
- 3 Natixis*
- 4 Nelnet, Inc.*
- 5 NORD/LB*
- 6 Ocwen Financial Corporation*
- 7 Opus Capital Markets Consultants, LLC*
- 8 Orrick, Herrington & Sutcliffe LLP*
- 9 Osler, Hoskin & Harcourt LLP*
- 10 Pillsbury Winthrop Shaw Pittman LLP*
- 11 PNC Capital Markets LLC*
- 12 PNC real Estate/Midland Loan Services
- 13 PricewaterhouseCoopers*
- 14 Prudential Fixed Income*
- 15 R&R Consulting*
- 16 Rabobank International*
- 17 RBC Capital Markets
- 18 RBS Securities Inc.*
- 19 Redwood Trust*
- 20 Richards, Layton & Finger*
- 21 Risk Management Group LLC
- 22 RiskSpan, Inc.*
- 23 Sallie Mae*
- 24 Santander Consumer USA*
- 25 Schulte Roth & Zabel LLP*
- 26 Seward & Kissel LLP*
- 27 Shearman & Sterling LLP*
- 28 Shellpoint Partners LLC*
- 29 Sidley Austin LLP*
- 30 Skadden, Arps, Slate, Meagher & Flom LLP*
- 31 Societe Generale*
- 32 South Street Securities, LLC*
- 33 Standard & Poor's*
- 34 Standard & Poor's Financial Services, LLC
- 35 Stikeman Elliott LLP*
- 36 Stonegate Mortgage Corporation
- 37 Stroock & Stroock & Lavan LLP*
- 38 Structured Asset Services
- 39 Sullivan & Worcester LLP
- 40 Synterra Capital Management LLC
- 41 TD Bank Group (TD)*
- 42 The Midway Group*
- 43 Two Harbors Investment Corp.*
- 44 U.S. Bank National Association*
- 45 Vanguard Group
- 46 VantageScore Solutions LLC*
- 47 Volvo Financial Services*
- 48 VW Credit, Inc.*
- 49 Wells Fargo*
- 50 Willkie Farr & Gallagher LLP
- 51 Wilmington Trust *
- 52 Winston & Strawn LLP*

27
28 * *Founding Member.*