



GAVIN NEWSOM
LIEUTENANT GOVERNOR

Attorney General Eric Holder
U.S. Department of Justice
950 Pennsylvania Avenue, NW
Washington, DC 20530-0001

Joseph Wayland
Acting Assistant Attorney General
Antitrust Division
950 Pennsylvania Avenue, NW
Washington, DC 20530

September 10, 2012

Dear Mr. Attorney General and Acting Assistant Attorney General:

It has come to my attention that investors in private label securitization (PLS) trusts may be colluding to restrain trade and to redline communities in California since they became broadly aware of the proposal to use eminent domain to purchase loans from PLS trusts. While I am aware that this issue may be affecting other areas of the country, I am most concerned with my communities in San Bernardino County, California, where more than half of the homes have underwater mortgages or are in process of foreclosure.

I am most disturbed by the threats leveled by the mortgage industry and some in the federal government who have coercively urged local governments to reject consideration of any proposal that would exercise the powers constitutionally granted local governments to use eminent domain to help stem the intractable mortgage crisis in America.

As you may be aware, the Homeownership Protection Program Joint Powers Authority (JPA) formed in San Bernardino County, California, is set to call for proposals later this year for programs to help local governments deal with this mortgage crisis. Among those solutions is likely to be a proposal for the JPA to implement a program whereby homeowners who are underwater or in process of foreclosure can opt into a program that would use eminent domain to reset the principal balance of those homes to fair market value, refinance the debt and remove the yoke of unbearable debt from the homeowner.

It has been six long years since the housing bubble burst. In the most distressed areas of the country – those most seriously considering taking action – housing prices have fallen by more than 50% from their highs. Across the country, more than 12 million homes (nearly a quarter of homes with mortgages) are underwater. The housing crash has caused years of economic crisis and stagnation, has made it impossible for any housing market recovery to restore solvency to most of those 12 million homeowners, and has left everyone with the wreckage of trillions of dollars of household debt that cannot be repaid.

Despite this, most holders of the nation's \$10.5 trillion of residential mortgage debt have been unwilling or unable to grant meaningful principal relief even when doing so would ultimately recover more for lenders than would the lengthy and costly process of foreclosure and liquidation. This is especially the case with mortgages held in private securitization trusts that do not benefit from any form of government or agency insurance, whose trust agreements make it extremely difficult to meaningfully reduce loan principal absent (and often even after) a default.

I recognize and appreciate the actions of this Congress, the Administration, and government agencies to attempt to remedy the mortgage crisis. But the fact remains that, especially in the more severely affected areas and for the most severely underwater homeowners, the federal government is unable to be of much help in keeping homeowners out of default and in reversing the decline of their communities. The recent spate of expected municipal bankruptcies in California provides a vivid example of this.

In the absence of mortgage industry action and federally or state mandated and funded solutions to restructure the principal of underwater mortgages, distressed local governments – acting in the best interests of their citizens – are left with no choice but to seek local solutions. This includes using their powers under state court supervision to purchase and fix local mortgage loans while their borrowers are still qualified and creditworthy, rather than wait until they are eventually forced to default, suffer the loss of their homes, and cause continuing harm to their communities because of the intolerable weight of a loan that for the foreseeable future will always remain higher than the value of their home.

The proposals are clearly a matter of local law, governed by the constitutions of the several states, all of which provide due process, require a demonstrable public purpose, and require payment of fair value. It is equally clear that under our federal system, the federal government respects the authority of each state within its jurisdiction, including the authority to use eminent domain to acquire private property for the public good.

Laurie Goodman, an analyst for Amherst Securities, wrote a private sales and trading report on June 28, 2012, detailing collusion among PLS investors to stop municipalities from using eminent domain to acquire mortgage loans. She notes widespread investor concerns “that the price paid under [eminent domain] will be low (although we don't know the price), and [that PLS] investors have little real protection.”¹ Under the headline “What Actions Can be Taken at this Point?” she reports that PLS investors have discussed ways to try, “through non-legal channels, to stop municipalities from using eminent domain in this context.” On information and belief, representatives of Fannie Mae and Freddie Mac participated in these discussions and in collusive actions that followed, as did other major PLS investors including members of SIFMA and the ASF. Goodman lists specific actions that PLS investors discussed. Following are items from that list, and actions that PLS investors have taken in furtherance of their collusion.

“Investors can seek to apply business pressure to stop the [eminent domain] program—they will not work with any of the servicers, originators, investment banks involved in the program.”

¹ “Creative Uses of Eminent Domain – Implications for PLS Trusts,” Amherst Securities Group LP (June 28, 2012). Excerpts from page 13 quoted below.

This is a boycott, and it is a per se violation of the Sherman, Clayton, and Robinson-Patman Antitrust Acts.² Consistent with Goodman's report of collusion, PLS investors have in fact threatened companies that are involved in the program. Fannie Mae threatened a backlash against one participant that is heavily dependent upon PLS investors for its business. A major New York based hedge fund threatened another participant, stating in an email that "this move to pick the pockets of investors in the mortgage market will have far reaching implications on your business. I am sure others feel the same way." The hedge fund copied 21 other investment firms on the email.

The Securities Industry and Financial Markets Association (SIFMA) and its members are fully aware that antitrust violations are illegal. SIFMA's own policy on the antitrust laws states:

This compliance booklet focuses on ensuring that, especially in the context of SIFMA activities, nothing occurs that might lead to the perception that any SIFMA members or their employees have violated the antitrust laws.

Such communications could arise in many contexts – from a formal discussion at an SIFMA committee meeting to a casual conversation in a taxi or over lunch . . . Why is antitrust compliance important? The penalties for violating the antitrust laws can be severe. As the statement of policy adopted by the SIFMA Board of Directors indicates, compliance with the antitrust laws is essential to preserving the vigorous competition that exists in the securities industry today. Competitive markets enhance public trust and confidence in the securities industry and help to ensure that the U.S. securities market is the most liquid and efficient in the world.

Violating the antitrust laws can be a felony offense. Individuals involved in some antitrust violations can, and do, go to jail. In addition to imprisonment, criminal prosecutions for antitrust violations can result in severe financial penalties for companies and individuals. In addition, the costs and burdens involved in defending a government antitrust investigation can be exorbitant, as can the costs of defending a private antitrust class action, where plaintiffs can seek to recover triple their actual damages as well as their attorneys' fees.

SIFMA and its members are also fully aware that boycotts are per se illegal and must not be discussed. SIFMA's policy states:

A group boycott exists when a group of competitors agrees to take some form of joint action to exclude someone from the market, such as by agreeing to refuse to deal with another competitor, or with a supplier or customer. Group boycotts are per se illegal, and no discussion about forming a boycott should take place.

Thus the participants in the collusive discussions have violated SIFMA's own policies in knowingly violating the antitrust laws.

² See, e.g. *United States v. Association of Retail Travel Agents (ARTA)*, <http://www.justice.gov/atr/cases/f209100/209152.htm>.

“Investors and dealers, through SIFMA (Securities Industry and Financial Markets Association, the trade organizations for the securities industry), can conceivably . . . make FHA short refi-loans ineligible for GNMA TBA delivery.”

Goodman states that the purpose of this collusion is to raise the price of credit in participating communities to “thwart” the eminent domain program. This collusion would target borrowers who seek to refinance loans that a city acquires by eminent domain. The goal is to increase the refinancing cost to the borrower by excluding his new FHA guaranteed loan from the normal process of pooling federally guaranteed loans for sale through the to be announced (TBA) market. There is no legitimate reason for this exclusion, meaning that its sole purpose is that of coercion – a clear-cut abuse of market power. Condemning private loans from PLS trusts has no effect on federally guaranteed loans. There might have been a legitimate reason for exclusion if a city had condemned federally guaranteed loans, but no city has ever proposed to do so – and the collusive proposal would apply to cities that condemn only private loans. The only purpose, as Goodman explains, is to raise the price of credit in order to put pressure on local governments to stop them from using eminent domain to purchase private loans.

On July 16, 2012, Timothy Ryan, the CEO of SIFMA, disclosed that SIFMA was in fact considering following through on this collusive and coercive plan. He described the market power that SIFMA has over this market and raised the possibility of exclusion: “We run the TBA market. SIFMA does. We make a decision who is in the TBA market and who is not. The industry does. And I can tell you, this is a serious question whether these re-securitized loans would be TBA eligible.”³

Standard setting is subject to the antitrust laws and redlining laws like other behavior.⁴ SIFMA’s own policy states:

Product standards development refers to the process of identifying and agreeing upon a specific set of criteria to which a particular type of product should conform . . . Standards development may create antitrust problems where, for example, they preclude certain entities from competing in the sale of that product, or features are added to a product for no reason other than to increase the price of the product. Care must be taken to ensure that any such standards can be supported by legitimate business justifications.

The proposal lacks any legitimate business justification. PLS investors discussed it solely to exclude municipalities from participating in the market for purchasing mortgage loans. It would apply solely to raise prices for the illicit purpose of preventing municipal use of their constitutional authority to purchase private property.

Notwithstanding these illicit motives, Goodman noted that merely excluding the refinanced loans “cannot change the economics enough to thwart the program.” In other words, fully realizing the aim of coercing municipalities out of exercising their constitutional authority would require yet more extreme abuses of market power. Therefore, the participants discussed a broader plan to exclude from normal TBA trading all federal agency-guaranteed loans originated in a jurisdiction that uses eminent domain to purchase private loans.

³ See <http://video.cnn.com/gallery/?video=3000103238> (July 16, 2012).

⁴ See, e.g., *National Society of Professional Engineers v. United States*, 435 U.S. 679 (1978). *United States v. Association of Retail Travel Agents (ARTA)*, <http://www.justice.gov/atr/cases/f209100/209152.htm>

“Investors and dealers, through SIFMA (Securities Industry and Financial Markets Association, the trade organizations for the securities industry), can conceivably determine that loans from affected areas would not be good delivery for TBA agency pools going forward. This would require Fannie and Freddie to build screens in their systems to filter out certain zip codes. The loss of TBA eligibility would raise the cost of all future borrowings from affected areas.”

The reference to “filter[ing] out certain zip codes” is particularly chilling. Such “filtering” is nothing less than redlining. Again, there is no legitimate reason for excluding a borrower’s federally guaranteed loan from trading the normal way just because a local government acquired another borrower’s private loan through eminent domain. Goodman implies as much by stating that investors and dealers “could conceivably” exclude the loans – it is barely conceivable that any self-regulation would exclude these loans, because there is no legitimate reason for doing so. Goodman makes the purpose of this collusive plan clear – to raise the cost of all borrowings throughout the community in order to intimidate municipalities out of employing eminent domain. This violates the antitrust rules as described above for the narrower proposal to exclude refinanced loans.

Consistent with Goodman’s report of planned collusion, investors working through SIFMA did in fact implement a rule to boycott jurisdictions that use eminent domain to acquire private loans by excluding all of their residents’ federally guaranteed loans from normal trading (those in Fannie Mae, Freddie Mac and Ginnie Mae pools).⁵ This violates the antitrust laws. To the extent Fannie Mae and Freddie Mac implement the screens described, they too will be responsible for collusion in violation of the antitrust and antidiscrimination laws.

In addition to being a restraint of trade, this action is geographic redlining, which violates consumer protection laws. San Bernardino County, which is furthest along in considering the use of eminent domain, has a predominately minority population that suffered a disproportionate amount of subprime loan origination during the bubble – an illicit practice known as “reverse redlining.” Redlining the county by limiting credit there because the local government acts to acquire and refinance these homeowners’ loans is geographic redlining.

“The final possibility is that the GSEs step in on the side of PLS investors . . . If FHFA and the GSEs announced that the GSEs will be unwilling to insure loans in municipalities which are using eminent domain in this manner, it would stop the program immediately.”

Again, there is no legitimate reason to redline a community and boycott all of its borrowers by denying Fannie Mae and Freddie Mac guarantees on their loans just because the local government uses eminent domain to purchase private loans. Condemning private loans has no impact on federally guaranteed loans. The purpose of any GSE action is, as Goodman reveals, simply to stop eminent domain programs immediately. Consistent with Goodman’s report of collusion, the FHFA as conservator for the GSEs recently announced that it is considering action to stop the eminent domain proposals.⁶ In its notice of rulemaking, the FHFA specifically takes the side of PLS investors, stating its concerns about “the effects on holders of existing securities . . . and, in particular, critical issues surrounding . . . valuation by local governments.” This is a direct result of the collusive discussions that Goodman reports – PLS investors discussed the possibility “that the GSEs step in on the side of PLS investors” in order to “stop the

⁵ See <http://www.sifma.org/news/news.aspx?id=8589939537> (July 19, 2012).

⁶ See FHFA notice No. 2012-N-11 (August 9, 2012): http://www.fhfa.gov/webfiles/24147/77_FR_47652_8-9-12.pdf.

program immediately” because they are worried that the price PLS trusts will receive in an eminent domain action will be “low.”

It is important to note that Amherst Securities agrees with the fundamental justification of using eminent domain to acquire and refinance loans held in private label securitizations:

We are sympathetic to the basic premise that it is very difficult to get loans out of the private label trusts to allow them to be restructured and more actively managed. In particular, there is no mechanism for restructuring a performing loan within a PLS trust, and we have no doubt that many performing underwater loans will eventually proceed through foreclosure without some form of restructuring. Based on a very careful analysis of the total credit profile of the borrowers, it can be determined which of these loans are most likely to default, and taking select loans out of a trust could conceivably result in a higher realized value for PLS investors.⁷

Notwithstanding the above, PLS investors seek to use “non-legal” (in fact illegal) means to stop governments from using their constitutional powers to acquire private property simply because they do not trust state courts, the securitization trustees, and servicers.

[W]e suspect this program is being done without a careful analysis of which borrowers need the write down, and we also suspect that the parties are incented to purchase the loans below fair market price. Moreover, [there is a] lack of a “protector” for the PLS loans, potentially allowing for a purchase at less than fair value . . .⁸

It is outrageous that PLS investors – including Fannie Mae and Freddie Mac, aided by the FHFA – are violating the antitrust laws and anti-redlining laws by conspiring against local governments, their citizens, and their service providers. PLS investors bought securities in trusts knowing the roles and responsibilities of trustees and servicers, and knowing that trust assets generally are subject to eminent domain. All property holders are subject to the sovereign power of eminent domain, and none is above the law. None can violate the law because they do not trust the managers they hired or because they think that they know more about the value of property than state courts and state juries.

I urge you and your respective divisions to join with me in recognizing the importance of local action, consistent with state law, to resolve difficult local economic problems without undue direct or indirect federal interference. Furthermore, I urge you to reject attempts by private financial interests to seek the assertion of federal control over these matters to the detriment of the authority and interests of local and state governments.

Central to the claims of industry interest groups is the argument that private lenders will eschew lending in communities that seek to solve their mortgage crisis locally. The farcical notion that there is, at this time, any real private mortgage lending going on in these communities is, on its face, expedient and the argument is likely meant to be coercive.

Private mortgage lenders are currently irrelevant in the hardest hit communities and unwilling to make loans because of the lingering uncertainty that the underwater mortgage crisis presents to the market.

⁷ Amherst report p. 2.

⁸ Amherst report p. 2.

The proposals being considered in places like San Bernardino County, California would bring stability back to the private lending market by clearing the specter of underwater mortgages and stabilizing housing prices, making these communities more attractive to lenders – not less.

The global lending market is not monolithic. It is deep, broad and competitive when home prices are stable. When we eliminate the shadow inventory of underwater mortgages, housing prices will stabilize and private lending will return. Using eminent domain in this crisis will not affect lending in a normal market, in which there will be no public purpose for acquiring mortgage loans.

Additionally, I note again the declarations and intentions of several influential private financial services groups to collude and retaliate against communities considering the use of eminent domain. I find those actions morally reprehensible and legally questionable. I ask the Department of Justice, and its Antitrust Division, to consider whether such actions constitute illegal acts including, but not limited to, redlining, restraint of trade, and deprivation of the right of due process enjoyed as much by municipalities as by the holders of private property.

To the extent these acts remotely suggest illegality, I hope that the Department of Justice will both condemn them and take enforcement action to prevent such reprehensible activity.

Finally, let me state unequivocally that this letter in no way constitutes an endorsement of any proposal currently being developed. I simply want communities in my state to have the ability to explore every option as they seek to address the lingering mortgage crisis without fear of illegal reprisal by the mortgage industry or federal government agencies.

Sincerely,



Lieutenant Governor Gavin Newsom

CC

Director Gene B. Sperling, National Economic Council
The Honorable Timothy F. Geithner, Secretary of the Treasury
Chairman Ben S. Bernanke, Federal Reserve
The Honorable Shaun Donovan, Secretary of Housing and Urban Development
Acting Director Edward DeMarco, Federal Housing Finance Agency
Chairman Martin J. Gruenberg, Federal Deposit Insurance Corporation

Full text of relevant section of Goodman report (footnote omitted):⁹

What Actions Can be Taken at this Point?

There has been widespread market concern that the price paid under the HPP will be low (although we don't know the price), and investors have little real protection. Thus, there has been a good deal of discussion among investors as to what actions can be taken. Much of the discussion has centered on trying, through non-legal channels, to stop municipalities from using eminent domain in this context. Let's enumerate the specific actions that investors have contemplated, with our spin on the implementation difficulty and likely success of each:

- Investors can bring a lawsuit questioning the legality of this use of eminent domain, but several large market participants would end up funding the lawsuit, as there is no mechanism for cost sharing.
- Investors can seek to apply business pressure to stop the HPP program—they will not work with any of the servicers, originators, investment banks involved in the program. If this were followed up on, it would be successful in many cases; however, some of these entities are not reliant on business from PLS investors.
- Investors and dealers, through SIFMA (Securities Industry and Financial Markets Association, the trade organizations for the securities industry), can conceivably determine that loans from affected areas would not be good delivery for TBA agency pools going forward. This would require Fannie and Freddie to build screens in their systems to filter out certain zip codes. The loss of TBA eligibility would raise the cost of all future borrowings from affected areas. A less effective possibility would be to make FHA short refi-loans ineligible for GNMA TBA delivery. However, this possibility cannot change the economics enough to thwart the program.
- The final possibility is that the GSEs step in on the side of PLS investors. It is important to realize that Fannie and Freddie together hold \$112.9 billion of PLS, more than 10% of all PLS outstanding, and these portfolio holdings are clearly affected. If FHFA and the GSEs announced that the GSEs will be unwilling to insure loans in municipalities which are using eminent domain in this manner, it would stop the program immediately.

⁹ Amherst report p. 13.