PENNSYLVANIA CREDIT UNION ASSOCIATION

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July 8, 2011

Jennifer J. Johnson, Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. 2011-1411

Dear Secretary Johnson:

The Pennsylvania Credit Union Association (PCUA) is a state-wide advocacy organization that represents a majority of the 538 credit unions located within the Commonwealth of Pennsylvania. PCUA appreciates this opportunity to submit comments in response to the Board of Governors of the Federal Reserve System (Board) proposed rule that addresses credit risk retention. We also appreciate the extension of the comment deadline which afforded PCUA and our member credit unions with additional time to respond.

To prepare this comment letter, PCUA consulted with its Regulatory Review Committee and State Credit Union Advisory Committee (the Committees). The Committees consist of CEOs and executive management staff from credit unions representing all asset-sized peer groups. The comments contained in this letter articulate the input of the Committees and PCUA staff.

As a general proposition, the Committees support securitized loan pools backed by safety and soundness standards. Such standards might include risk retention requirements and limitations on the attributes of loans that are permitted into securitizations. Pennsylvania's credit unions, predominantly, underwrite real estate loans and mortgages to the standards set by the Government Sponsored Enterprises (GSEs). However, a small portion of loans granted will be held in an individual credit union's portfolio. In addition, Pennsylvania's credit unions did on extend so-called "no documentation" or "low documentation" loans or engage in other predatory practices that crept into securitizations and polluted the secondary market. Though the Committees strongly desire a safer secondary market environment, we do not support the

proposed definition of Qualified Residential Mortgage (QRM). For the reasons articulated below, we contend that the definition unduly excludes loans that, in our experience, are safe and appropriate for securitization.

A second overriding concern expressed by the Committees relates to the availability of credit. Mortgage loans that fall outside the definition of QRM might not be available to consumers as a result of the risk retention regulation. Secondary market access is critical to credit unions. The risk retention rules and QRM, however, will limit the amount and types of loans that can be placed into securitizations. This will force credit unions to examine their array of mortgage offerings. If the balance-sheet management function of securitizations is rendered scarce, credit unions will likely cut back on the type of loan products offered. While it cannot be expressed in concrete terms, there is an outside limit on the extent to which it is prudent for individual credit unions to hold mortgages or portions thereof in their portfolios. Further, prudential regulators, such as the National Credit Union Administration (NCUA) will scrutinize those portfolios for interest rate risk. Consequently, in order to manage risk and the overall balance sheet, credit unions might not extend loans with terms that do not meet QRM criteria. Consumers, in turn, will experience diminished availability of credit.

Risk Retention Requirement

The Dodd-Frank Act mandates that a securitizer retain not less than five (5%) of the credit risk for any asset transferred into a securitization. The Committees understand that requiring an entity to hold a stake in the performance of the asset can mitigate risk in the pool of assets. We would like to point out some significant compliance consequences for credit unions that may result from the risk retention rule.

Credit unions must satisfy a net worth maintenance regime known as Prompt Corrective Action (PCA). 12 USCA § 1790d, 12 C.F.R. Part 702, 17 P.S. § 513. It is vital to point out that credit unions are non-profit, mutually owned financial cooperatives. Credit unions do not issue capital stock. Credit unions build net worth through set-asides of retained earnings. Pursuant to PCA, once a federally insured credit union's net worth ratio (a ratio of net worth to total assets) dips below 7%, it must respond to an increasingly strict scheme of supervisory enforcement actions aimed at restoring the net worth ratio. The risk retention requirement adds an additional layer of balance sheet management for non-QRM loans. It will force credit unions to select the credit terms they offer to members and abandon loans that do not meet the definition of QRM in order to satisfy or manage to PCA rules. As a result, consumers realize less access to credit.

The risk retention requirements pose interest rate risk consequences as well. The portion of the asset held in the portfolio becomes a component of the credit union's asset-liability management (ALM) program. The credit union must account for interest rate fluctuations to manage in a prudent manner. Interest rate risk is a compliance priority evidenced by the NCUA's pending proposal. *Interest Rate Risk, 76 Federal Register 16570-16579.* Efforts to meet the risk retention mandates and manage to sound ALM and interest rate risk criteria could likewise retard the availability of credit.

With those concerns in mind, we urge the Board to delay a final rule. We maintain that the best interests of consumers and financial institutions would be better served by more study and public hearings related to the compliance and balance-sheet management consequences of the proposed rule.

Definition of QRM

After a careful review, the Committees concluded that the proposed definition is overly restrictive, excluding mortgages from securitizations that do not represent undue risk.

Loan-to-Value (LTV)/Down Payment: Credit unions encourage borrowers to have an equity stake in their home; however the 80% LTV may be an antiquated standard. In the experience of the Committees, loans with a 90% LTV or slightly higher accompanied with private mortgage insurance (PMI) have been quality performing assets. Depending on the performance of a given real estate market, a loan with an 80% LTV can be "under water" as evidenced by the recent experience in California or Nevada. As noted above, credit union underwriting adheres to GSE standards. Underwriting conducted by mortgage insurers is more exacting. Therefore, a mortgage with a greater loan to value ratio with PMI is an appropriate asset for securitization.

Points and Fees: The Committees suggest a more precise definition of the term, "points and fees." For example, does the definition include pass-through fees or discounts? Further elaboration would assist with compliance efforts.

Subordinate Liens: In the credit union experience, well-qualified borrowers may have junior liens attached to the property. We maintain that the presence of a junior lien, in and of itself, does not add significant repayment risk. Accordingly, the presence of a junior lien should not disqualify an asset from QRM.

Credit History: The proposal, as drafted, would limit a QRM to only the best qualified applicants and exclude consumers who may otherwise deserve an opportunity to obtain credit on reasonable terms. We urge the Board to redraft the credit history provision in such a way that a borrower who has a modest late payment history to be included in QRM. The borrower could be subject to an additional risk premium via the interest rate based on the borrower's credit score. Such loans could be identified in the securitization pools.

Source of Down Payment: The rules for the source of the borrower's down payment and the amount of the down payment should be read together. We view these rules as harmful, particularly toward first-time home buyers. We do not view borrowed funds as problematic.

Further, the proposed rule requires a creditor to verify that the borrower satisfies the criteria for the source of down payment. Lenders can conduct credit checks and compel a borrower to represent and warrant that the down payment satisfies the regulation. However, a lender should not be held responsible if the borrower falsified information. In addition, the verification provision raises a public policy quandary. Many local jurisdictions have imposed foreclosure

moratoriums. Various agencies of the Federal government are encouraging mortgage modifications. As such, the public policy question is whether a breach of a representation and warranty regarding the source of a down payment is material enough to accelerate a mortgage and possibly lead to foreclosure.

Deferred Interest and Balloon Payments: The Committees maintain that deferred interest terms or balloon payments should not disqualify a mortgage from QRM. In the credit union space, these options are appropriate credit facilities. The Board should consider whether deferred interest or balloons should qualify but be identified within the securitization pool. The application of an interest rate premium may be appropriate.

Conclusions

Credit unions are supportive of reforming securitization pools with the aim of preventing assets that carry undue risk from corrupting the secondary markets. A risk retention requirement is an appropriate means to such an end. We urge further study of the risk retention requirements juxtaposed with the corresponding compliance endeavors and ALM to determine whether the five percent established in the Dodd-Frank Act and the proposed rule is an appropriate criterion. We urge the Board to expand the definition of QRM to permit the inclusion of certain loan attributes consistent with our comments outlined above.

Sincerely,

James J. McCormack
President/CEO

JJM:RTW:llb

cc: PCUA Board
Regulatory Review Committee
State Credit Union Advisory Committee
M. Dunn, CUNA