Colorado Mortgage Lenders Association

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August 1, 2011

Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
Docket Number OCC-2010-0002

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1411

Robert E. Feldman
Executive Secretary
Attention: Comments, Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
File Number S7-14-11

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, DC 20552

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, SW
Room 10276
Washington, DC 20410-0500

Re: Credit Risk Retention Proposed Rule; IV. Qualified Residential Mortgages

Dear Sirs:

This comment letter replaces our previous comment letter regarding the referenced topic submitted on June 10, 2011. Please disregard our previous comment letter. Further review of our previous comment letter revealed a misinterpretation of the data referred to in the first paragraph on page three of our letter. We have therefore made the appropriate corrections in this, our final comment letter in the matter.

The Colorado Mortgage Lenders Association is a 56 year old organization made up of over 140 companies employing in excess of 3000 individuals involved in the Mortgage Lending Industry in Colorado. Our membership is made up of Mortgage Bankers, Mortgage Brokers, Banks and Credit Unions located throughout the State. Our members originate the majority of residential real estate loans made in the State of Colorado.

We appreciate the opportunity to comment on the Credit Risk Retention Proposed Rule ("Proposed Rule") issued jointly by your agency and the other federal banking, housing and securities regulatory agencies. Our comments focus specifically on Section IV of the Proposed Rule concerning Qualified Residential Mortgages.

Housing is a critical component of our nation's economy, and home ownership is an important part of the American Dream. The definition of a Qualified Residential Mortgage (QRM) in the Proposed Rule could have a dramatic negative impact on homeownership because the QRM definition determines which mortgages will be exempt from risk retention requirements.

Much of the current debate surrounding the QRM definition deals with the appropriate level of down payment. We would therefore like to share with you a recent analysis of data from CoreLogic Inc. conducted by Vertical Capital Solutions.[1] When an observation is repeated

[1] Vertical Capital Solutions, an independent valuation and advisory firm in New York, utilized loan performance data maintained by First American CoreLogic, Inc. to conduct the analysis covering loans originated from 2002 to 2008 and using sample QRM criteria that reflect sound underwriting. Analysis is referenced in detail in "White Paper" titled "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery", dated August 1, 2011 by The Coalition for Sensible Housing Policy.

over and over again, many will start to believe that it is true, even when the facts lead to a different conclusion. An example of this is the common belief that a higher mortgage down payment will significantly reduce the likelihood of default. However, years of data show that the principal determinant in the rate of default is the quality of underwriting standards, not the down payment level. The historical data also shows the danger of arbitrarily raising the down payment requirement for a QRM loan. As outlined in the Vertical Capital Solutions analysis, an increase in the minimum down payment from 5% to 10% would likely have only a negligible impact on default rates (reducing them by less than 1 percent), but would significantly reduce the number of eligible borrowers (anywhere from a 4% to 7% reduction), and increasing the minimum down payment to 20% would reduce eligible borrowers by 15% to 20%, again with a negligible reduction in default rates.

Creating an arbitrary down payment requirement in regulation will in fact exclude many creditworthy borrowers from home ownership. Underwriting a residential mortgage is a process requiring solid data analysis, accurate and true verification of the borrower's financial situation, coupled with good objective underwriting judgment. Part of sound underwriting judgment is the ability to analyze many compensating factors that determine the borrower's ability to pay. There are many factors in the loan process that need to be weighed and evaluated, down payment is only one consideration when underwriting a loan and it is important not to overemphasize its contribution to the final likelihood of loan performance. More compelling factors for successful home ownership and avoidance of default are the demonstrated ability to meet financial obligations, stable employment and a commitment to home ownership. According to the *FHA Handbook section 1633 (3)* "the quality of the real estate security, or a low ratio of loan-to-value cannot compensate for an unacceptable mortgagor."

A case in point is the home loan guaranty program of the Veterans Administration. These loans require no down payment and a small investment in closing costs by the veteran borrower. Analysis shows that over time VA guaranteed loans perform as well or better than FHA or other low down payment programs. While it's important to note that the VA loan has a very select demographic, in this case it is clear that solid, well thought out underwriting compensates for the lack of down payment.

It is worth noting in the broadest sense, that global and national economic forces along with personal and family issues are governing factors in loan performance. In the 1980's the mortgage insurance companies deleted the section of their claim forms dealing with the reasons for default; recognizing the fact that unforeseen events such as loss of job, death, divorce and health reasons are factors that cannot be foreseen in the underwriting process. It is also worth noting that with the emergence of strategic defaults in many areas plagued by collapsing real estate values, the amount of down payment has not stopped some homeowners from defaulting when the value of their home has fallen below the amount owed on their mortgage. Many of these borrowers have the income and assets to continue to meet their mortgage obligations, yet nevertheless, elect to default.

A recent study from Moody's Analytics prepared by Mark Zandi and Cristian deRitis, shows that foreclosure rates through the recent recession have remained relatively low on mortgages that were underwritten well. In particular, the authors reference a study of foreclosure rates on loans that had mortgage insurance provided through MGIC and were originated in 2006 and 2007. The loans had strong underwriting criteria, in particular credit scores above 660 FICO. The study tracked the foreclosure rates on these loans through 2010. While the foreclosure rate was lower for higher down payment loans, the foreclosure rate did not significantly increase even with low down payments. For example, loans with a 10 percent down payment had a foreclosure rate of 3.3 percent, while those with a 5 percent down payment had a foreclosure rate of 4 percent. While the foreclosure rate for loans with a 20 percent down payment did drop to 1.3 percent, this must be weighed against the significant impact on borrower eligibility from a high down payment.[2]

There are additional likely consequences from a high down payment requirement in the QRM definition. It would increase mortgage costs, and further delay the housing recovery. This is due to the fact that risk retention is not cost free, and would result in higher interest rates on non-QRM mortgages. The effect of the high down payment requirements combined with the strict 28/36 debt to income standards also set forth in the proposed rules will effectively force many more borrowers into non QRM loans where higher rates (perhaps as much as 300 basis points higher based on a JP Morgan study of December 1, 2009[3]) would similarly limit their ability to qualify for a mortgage. In addition, a high down payment QRM would lead to further consolidation in the mortgage market since large banks will be the only lenders with sufficient capital to comply with the risk retention requirements that sponsors of securities transactions may pass on to originators of non-QRM mortgages. A further potential consequence is that more borrowers would be driven to FHA, VA, USDA and while under conservatorship, Fannie Mae and Freddie Mac, government programs that are exempt from the risk retention requirements. This would occur at the very time that many national policymakers are recommending a reduction in the federal government's role in the housing market.

A narrowly constructed QRM will have very serious negative consequences for borrowers seeking to own a home, and adversely impact an already weak housing market. The data shows that the best approach to reduce mortgage defaults is to focus on quality underwriting standards.

We recognize the concern that generated the risk retention requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Congress clearly

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[2] Mark Zandi & Christian deRitis, "Special Report: The Skinny on Skin in the Game," *Moody's Analytics* (March 8, 2011).

[3] J.P. Morgan Securities Inc. "Securitization Outlook" (December 11, 2009)

wanted to address weaknesses in the mortgage securitization process. However, Congress also wanted to ensure that borrowers would not be punished by changes that could increase the cost of traditional mortgages. Congress therefore specifically provided for an exemption from the credit risk retention requirements through the QRM. Unfortunately, the QRM definition in the Proposed Rule differs significantly from the Dodd-Frank QRM established by Congress.

Dodd-Frank requires the QRM definition to be based on "underwriting and product features that historical loan performance data indicate result in lower risk of default". It is clear that the Act requires that the financial resources relied upon to qualify for the mortgage must be documented and verified. Further, the Act specifies that the agencies are to promulgate rules that establish standards to set forth the following:

- "The residual income of the mortgagor after all monthly obligations"
- "The ratio of the housing payments of the mortgagor to the monthly income of the mortgagor"
- "The ratio of total monthly installment payments of the mortgagor to the income of the mortgagor"
- "Mitigating the potential for payment shock on adjustable rate mortgages through product features and underwriting standards"
- "Mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default"
- "Prohibiting or restricting the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default."

As you can see, Congress was quite specific in the definition of a QRM, and that definition does not include either a maximum loan to value ratio or a minimum down payment. Congress debated and rejected including a down payment requirement as one of the enumerated requirements of the statute. In fact, the three United States Senators who were instrumental in the creation of the QRM exemption have recently stated their intention. Senators Mary Landrieu (D-LA), Johnny Isakson (R-GA) and Kay Hagen (D-NC) recently wrote to regulators and stated: "We are concerned that efforts to impose a high down payment requirement for any mortgage to meet the QRM exemption standard would be inconsistent with our legislative intent. As the authors of the QRM provision, we can assure you that, although there was discussion about whether the QRM should have a minimum down payment, in negotiations during the drafting of our provisions we intentionally omitted such a requirement."[4]

CMLA believes that it is inappropriate for regulators to expand beyond what is clearly the congressional intent in drafting Dodd Frank, especially considering that little if any consideration

[4] Letter from Senators Mary Landrieu, Kay Hagen, Johnny Isakson to the QRM Regulators (February 16, 2011).

seems to be given to the economic impact of such onerous down payment requirements as set forth in the proposed rule.

Further, in addition to disregarding Congressional intent regarding the down payment requirements, the regulators have apparently concluded that private mortgage insurance does not reduce the risk of default. We at CMLA would dispute that conclusion. The use of private mortgage insurance provides a second set of eyes in reviewing a borrower's credit worthiness. By pooling the risk on high ratio loans across a large population of borrowers and a wide geographic area with an appropriate premium, a mortgage insurance policy provides a safe and prudent substitute for a 20% down payment. The mortgage insurance industry has provided a first line of private capital to absorb the losses of the current foreclosure crisis. Notwithstanding the troubled state of the capital markets several of the firms have been able to raise additional capital, a new firm has been founded, and a second new one is currently in the process of being formed. The private mortgage insurance industry provides competition and choice for both mortgage lenders and borrowers as well as the GSE's. The role of the private mortgage insurance industry in the QRM market segment provides a meaningful alternative to FHA at a time when the government is attempting to reduce its role in the housing market. It's important to note that a competitive mortgage insurance industry would not cause the FHA to be adversely selected.

A number of studies have shown that properly underwritten, documented and verified loans have historically performed well. The Colorado Mortgage Lenders Association encourages the regulators to pay heed to those studies and remove the minimum down payment requirement as a condition of a loan qualifying for the QRM safe harbor and instead focus on rule making in the areas set forth in the statute. Those standards, properly implemented, will result in loans where "underwriting and product features based on historical loan performance data will result in lower risk of default" as intended by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Sincerely,

Colorado Mortgage Lenders Association (CMLA)

By: T. K. Jones, Chairman
Legislative and Regulatory Affairs Committee
Colorado Mortgage Lenders Association