Community Mortgage Banking Project

July 11, 2011

Honorable Ben S. Bernanke
Chairman
Board of Governors of the
Federal Reserve System
Washington, DC 20551

Honorable Martin J. Gruenberg
Acting Chairman
Federal Deposit Insurance Corporation
Washington, DC 20429

Mr. Edward J. DeMarco
Acting Director
Federal Housing Finance Agency
Washington, DC 20552

Honorable Mary L. Shapiro
Chairman
Securities and Exchange Commission
Washington, DC 20549

Honorable Shaun Donovan
Secretary
Department of Housing & Urban Development
Washington, DC 20410

Mr. John G. Walsh
Acting Comptroller
Office of the Comptroller of the Currency
Washington, DC 20219

Re: Interagency Proposed Rule on Credit Risk Retention

- OCC: Docket No. OCC-2011-0002 regs.comments@occ.treas.gov
- Federal Reserve: Docket No. R-1411 regs.comments@federalreserve.gov
- FDIC: RIN 3064-AD74 comments@FDIC.gov
- SEC: File Number S7-14-11 Rule-comments@sec.gov
- FHFA: RIN 2590-AA43 RegComments@FHFA.gov
- HUD: RIN 2501-AD53 via www.regulations.gov

Ladies and Gentlemen:

This comment letter is being submitted on behalf of the 45 independent mortgage banking company members of the Community Mortgage Banking Project.[1] We appreciate the opportunity to comment on the proposed risk retention regulations and in particular on the standards for a Qualified Residential Mortgage (QRM). Our comments will be focused exclusively on those provisions in the proposed regulations that affect the single-family mortgage market, with a significant portion of our comments devoted to the QRM exemption.

I. Overview

We think it is important to begin our comments with a summation of the scope, purpose and Congressional intent behind the risk retention provisions and the QRM exemption, based on a review of the legislative record. Congress' intent in fashioning the risk retention provisions was to address

[1] The Community Mortgage Banking Project is a public policy organization that represents the views of independent, non-bank residential mortgage lenders.

what was believed to be a causative factor in the mortgage market meltdown of 2007-09. Congress took specific action to address the following identified flaw in the mortgage market: large numbers of poorly underwritten loan products that contained risk laden features were being placed into securitizations and were then sold to investors by issuers who had no long term stake in the success of the securitized loans that were being sold. This practice and the specific loan products being offered with poor underwriting standards made continued homeownership for consumers unsustainable. Risk retention was intended by Congress to address this issue, by requiring securities issuers to retain an interest in the securities that would be at risk to the performance

The CMBP and other organizations pointed out the flaw in this reasoning when Congress was considering the Dodd Frank Act (DFA). The financing of residential mortgages, through the issuance of securities backed by those mortgages, has benefited consumers immensely by opening access to investment sources that previously had not been available for residential lending. These are investment sources that seek longer-duration financial assets and uniform securities instruments that can be readily traded in the capital markets. Consumers enjoy the benefits of the ample liquidity and lower funding costs afforded by securitization.

Risk retention, CMBP and others pointed out to the Congress, would create an additional and significant cost of issuance to residential mortgages financed through securitization. If all mortgages were subject to risk retention, then the costs of risk retention would penalize creditworthy borrowers who were obtaining mortgages with consumer-friendly features, designed for sustainable and successful home ownership. With an across-the-board risk retention requirement every consumer would bear the cost of risk retention -- factors such as how well a consumer had managed his/her credit, how stable a mortgage the consumer obtained and how well the lender underwrote the mortgage, would not matter. In short, even lower risk responsible homeowners would pay more.

Congress extensively debated whether well underwritten mortgages, with consumer-friendly features should be exempted from risk retention requirements. Such an exemption would have two benefits: creditworthy consumers would continue to have access to affordable mortgage credit with loans that had features that would sustain, rather than curtail, home ownership; lenders and securitizers would have a positive incentive, i.e. an exemption from risk retention requirements, to offer consumers well-underwritten mortgages with consumer-friendly features throughout all phases of the credit cycle.

Ultimately, the QRM exemption was embodied in an amendment offered during Senate consideration of the DFA. The amendment was adopted by unanimous consent and ultimately, with some modifications, accepted by the Conference Committee and incorporated in the DFA. It is important to note at this point, that the House Conferees receded to the Senate on the question of incorporating the QRM exemption in the final legislation. Thus, the intent as expressed by the Senate sponsors of the QRM exemption – Senators Landrieu, Hagan and Isakson – is critical in determining Congressional intent behind the QRM exemption. And the intent expressed by the Senate sponsors is clear—risk retention was be targeted at risky loans, and the QRM was designed to encompass as much of the mortgage market as possible, consistent with prudent underwriting and product standards.

There is nothing in the legislative history to suggest that the QRM was designed or meant to be a "narrow" or "small" slice of the market. Such an assertion is unsupported by the facts. In fact, the only boundary established for the QRM is that it should be *no broader than* the Qualified Mortgage (QM)

safe harbor under the Title XIV of the DFA. Some of the regulators have argued this must mean the QRM should be "much narrower than" the QM, effectively turning the plain language of the statute on its head. If Congress had intended the QRM to be "much narrower than" the QM, they most certainly would not have used the phrase "no broader than" to accomplish that objective.

The intent behind QRM was to create an incentive for borrowers to demand, and for lenders to originate, well-underwritten mortgages with consumer-friendly features such as a fixed rate, fully-amortizing loan, or an adjustable rate loan with appropriate annual and lifetime interest rate caps, with no negative amortization features and no balloon payments. The intent was not to ration the lowest cost credit to a small sliver of borrowers, nor was it intended to create a "large, liquid, non-QRM" market, as some have argued.

We had such a situation in the 2004-08 time period, with mortgages that were eligible for purchase or securitization by Fannie Mae and Freddie Mac as the equivalents of QRM-eligible loans, and the alt-A, subprime and alternative loans that were bundled up into private-label securities as the equivalent of non-QRM loans. There was certainly a broad, deep and liquid market for securities backed by these higher-risk, non-QRM equivalent loans, and we all know had badly that ended for consumers, investors and the mortgage market in general.

Properly constructed, the QRM should provide strong market incentives for lenders, investors and borrowers to return to the traditional underwriting and product standards that served the market well in the decades prior to the mid-2000's. Relatively low interest rates and common-sense underwriting, documentation and product standards served the housing and mortgage markets very well through the 1990s and early 2000s. By eliminating the excesses, without over-correcting, the QRM standard should balance availability of mortgage credit to prospective buyers, with underwriting and product standards that will provide investors in QRM-backed securities with assurances that the loans have safe and stable underwriting and product features. In contrast, a narrow QRM designed for a very small segment of the market would be bad for consumers, bad for the mortgage market and completely contrary to Congressional intent in enacting the QRM exemption.

II. Summary of Comments

A. Proposed QRM Standards

1. Proposed Down Payment Requirements are contrary to Congressional intent and will restrict access to lowest cost conventional credit to creditworthy borrowers and will have little impact on default levels.
2. Proposed debt-to-income ratios are unduly restrictive, based on antiquated approaches to credit underwriting and represent single-factor analyses that can result in denial of access to lowest cost conventional credit for many creditworthy borrowers.
3. The proposed consumer credit history standards will unduly penalize many creditworthy borrowers and are not a true indication of a consumer's demonstrated willingness and ability to pay their financial obligations.
4. The 3% points and fees cap on QRMs unnecessarily duplicates provisions required in Title XIV regarding Qualified Mortgages. Moreover, the inclusion of this cap as a QRM requirement is

not supported by any data or analysis indicating such a cap would result in a lower risk of default, a touchstone for the QRM framework.

5. The proposed QRM loan servicing standards are unsupported by the statue, unworkable, represent a radical upending of well-settled debtor-creditor legal obligations and an end-run around bankruptcy law. Again, the regulators have provided no data indicating that these standards will reduce the frequency of default.

B. Risk Retention Requirements

1.The premium capture provisions should **be eliminated because they will significantly reduce mortgage securitizations and are totally unnecessary to achieve the objective of risk retention.** 2. There should be no provision permitting the shifting of risk retention to originators because the unequal bargaining power between originators and issuers makes the idea of a "voluntary" agreement to share risk retention a myth. Originators already have significant incentives in the form of an affirmative statutory duty to determine a borrower's ability to repay the mortgage obligation they are undertaking. In addition, repurchase obligations by originators under their representations and warranties to securitizers serve as 100% risk retention for loans that do not meet investor standards.

3 The proposed time period for internal controls evaluation of issuers used to determine if they have an effective mechanism in place to determine QRM and non-QRM loans is much too restrictive. Annual evaluations should be more than sufficient.

III. Detailed Discussion and Analysis

A. Down Payment Requirements

Our argument against the proposed QRM down payment requirements of 20% for purchase mortgages, 25% for rate and term refinance mortgages and 30% for cash-out refinance mortgages is based upon the negative impact on consumers, the housing market and the structure of the mortgage market.

Consumer Impact of Proposed QRM Down Payment Requirement

By imposing excessively high down payment standards regulators are denying millions of responsible borrowers access to the lowest rate loans with the safest loan features. The only beneficiaries of the proposed QRM definition are those consumers with higher incomes who can afford to make large down payments or who already have ample equity in their homes.

For example, a National Association of REALTORS® (NAR) analysis indicates a much higher cost of risk retention than the unofficial 10-15 basis points estimate put forth by Regulators in recent Congressional testimony. According to NAR, risk retention could raise rates for non-QRMs – which the proposed rule establishes as the predominant product in the market – by as much as 80 to 185 basis points. Similarly, a June 20, 2011 analysis by Mark Zandi of Moody's Analytics estimates "conservatively" that borrowers of non-QRM mortgages would be saddled with interest rates 75-100 basis points higher than QRM-eligible borrowers.[2] In other words, today's 4.5 percent contract rate for

a 30-year fixed-rate loan that did not meet the QRM requirements would become a 5.25 percent rate, at best, and could go as high as 6.35 percent based on these estimated ranges.

Equally devastating on consumers would be the impact of the amount of time it would take the average consumer to save a 20% down payment. Based on 2010 income and home price data, it would take more than 9 years for the typical American family to save enough money for a 10 percent down payment, and fully 16 years to save for a 20 percent down payment (Table 1), *assuming that the family directs every penny of savings toward a down payment, i.e. nothing for their children's education, retirement or a rainy day.*

Table 1
Years for Median Income Family to Save for Down Payment
(Assuming all savings are directed toward home purchase)

	20% Down Payment	10% Down Payment	5% Down Payment	3.5% Down Payment
2010 Median Sales Price	$172,900	$172,900	$172,900	$172,900
Down payment + Closing Costs (est. @ 5% of loan amount)	$41,496	$25,071	$16,858	$14,394
# of Years Needed to Save @ National Savings Rate (5.2% of gross household income = $2,625 per year)	16 years	9.5 years	6.5 years	5.5 years

Sources: Home Sales Price: NAR 2010 median sales price for condos and single-family homes. Household Income: NAR estimate of 2010 median before-tax household income ($50,474). Personal Savings Rate: Estimated as a percentage of gross income based on 2010 data from the Bureau of Economic Analysis, *Personal Income and Outlays.* These figures are conservative because they assume 100% of family savings are dedicated towards a down payment and closing costs.

The lengthy time needed to save a 10 or 20% down payment will encourage first time buyers to forego the stable, affordable QRM-eligible products and secure either an FHA-insured mortgage or a riskier non-QRM mortgage. While FHA-insured mortgages are stable and consumer-friendly, a continued preference by many first-time and even repeat buyers for FHA-insured mortgages will mean that a reduction in the Federal Government's presence in the mortgage market will be extremely difficult to achieve. If Congress decides to enact measures to curtail the ability of consumers to participate in the FHA program in the future, then a 20 percent down payment requirement for the QRM means that even the most creditworthy and diligent first-time homebuyers will not qualify for the lowest rates and safest products in the market. Even 10 percent down payments create significant barriers for borrowers, especially in higher cost markets as demonstrated in Table 1 below.

Minority households will be particularly hard hit by the proposed narrow QRM standard. As highlighted in a recent paper by Lewis Ranieri and Ken Rosen, these families already have

[2] Mark Zandi and Cristian deRitis, Moody's Analytics Special Report, "Reworking Risk Retention," June 20, 2011.

significantly lower before tax family incomes and net worth than white households, which translate into sharply lower homeownership rates.[3] Ranieri and Rosen note that current underwriting standards are already unduly restrictive, and that private capital, along with the GSEs and FHA, should be "encouraged to return to active lending for all creditworthy borrowers." Unfortunately, the proposed QRM cuts sharply against this important recommendation.

The impact of the proposed rule on existing homeowners is also harmful. Based on "negative equity" data from CoreLogic Inc., nearly 25 million current homeowners with mortgages would be denied access to a lower rate QRM to refinance their home because they do not currently have 25 percent equity in their homes (Table 2). Many of these borrowers have paid their mortgages on time for years, only to see their equity eroded by a housing crash and the severe recession. Even with a 5 percent minimum equity standard, more than almost 14 million existing homeowners – many undoubtedly with solid credit records – will be unable to obtain a QRM. In short, the proposed rule moves creditworthy, responsible homeowners into the higher cost non-QRM market.

Table 2
Equity Position of U.S. Homeowners with Mortgages

47.9 million U.S. homeowners with mortgages:	**30% equity**	**25% equity**	**20% equity**	**10% equity**	**5% equity**
# with less than…	27.5 million	24.8 million	21.9 million	16.3 million	13.5 million
% with less than…	57%	52%	46%	34%	28%

Source: Community Mortgage Banking Project; based on data from CoreLogic Inc.

As now narrowly drawn, the proposed QRM ignores compelling data that demonstrate that sound underwriting and product features, like documentation of income and type of mortgage, have a larger impact on reducing default rates than high-down payments.

A further analysis of loan servicing and performance data from CoreLogic Inc.[4] on loans originated between 2002 and 2008 shows that boosting down payments in 5 percent increments has only a negligible impact on default rates, but it significantly reduces the pool of borrowers that would be eligible for the QRM standard. Table 3 and Chart 1 show the default performance of a sample QRM based on the following attributes of loans:

- Fully documented income and assets;
- fixed-rate loans, or 7 year or greater ARMs;
- no negative amortization;
- no interest only loans;
- no balloon payments;

[3] Plan B, A Comprehensive Approach to Moving Housing, Households and the Economy Forward; April 4, 2011, by Lewis Ranieri, Ken Rosen, Andrea Lepcio and Buck Collins. Figures 14 shows that minority households in 2007 had median before tax family income of about $37,000, compared to about $52,000 for white families. Similarly, Figure 15 shows minority family net worth in 2007 of almost $30,000, compared to more than $170,000 for white families.

[4] Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm, conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008.

- 41% total debt-to-income ratio;
- mortgage insurance on loans with 80% or greater loan-to-value ratios; and
- maturities no greater than 30 years.

This is a transparent, objective eight-factor definition of a QRM that lenders would find relatively simple to comply with, and for which compliance would be easy to verify (for certification purposes to ensure all loans are QRMs). These QRM criteria were applied to more than 20 million loans originated between 2002 and 2008, and default performance is measured by origination year through the end of 2010.

While loans with 5% down payments (or 5% equity) are certainly riskier than loans with 20% down/equity, the data in Table 3 show that low down payment loans that follow the strong underwriting and product standards outlined above can be exempted from risk retention without exposing investors or the broader housing market to undue risk. In other words, once you apply the strong underwriting standards in the sample QRM definition, moving from a 5 percent to a 10 percent down payment requirement reduces the overall default experience by an average of only two- to three-tenths of one percent for each cohort year.

However, the increase in the minimum down payment from 5 percent to 10 percent would eliminate from 7 to 15 percent of borrowers from qualifying for a lower rate QRM loan. Similarly, increasing the minimum down payment even further to 20 percent, as proposed in the QRM rule, would amplify this disparity by knocking 17 to 28 percent of borrowers out of QRM eligibility, with only small improvement in default performance of about eight-tenths of one percent on average. This lopsided result compromises the intent of the QRM provision in Dodd-Frank, which is to assure clear alignment of interests between consumers, creditors and investors without imposing unreasonable barriers to financing of sustainable mortgages.

Table 3
Sample QRM: Impact of Raising Down Payments Requirements on Default Rates and Borrower Eligibility

Origination Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Reduction in default rate* by increasing QRM down payment **from 5% to 10%**	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
Proportion of borrowers **not eligible** for QRM at 10% Down	7.6%	6.6%	9.0%	8.4%	10.9%	14.7%	8.4%
Reduction in default rate* by increasing QRM down payment **from 5% to 20%**	0.6%	0.3%	0.7%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers **not eligible** for QRM at 20% Down	19.2%	16.7%	23.0%	22.9%	25.2%	28.2%	20.7%

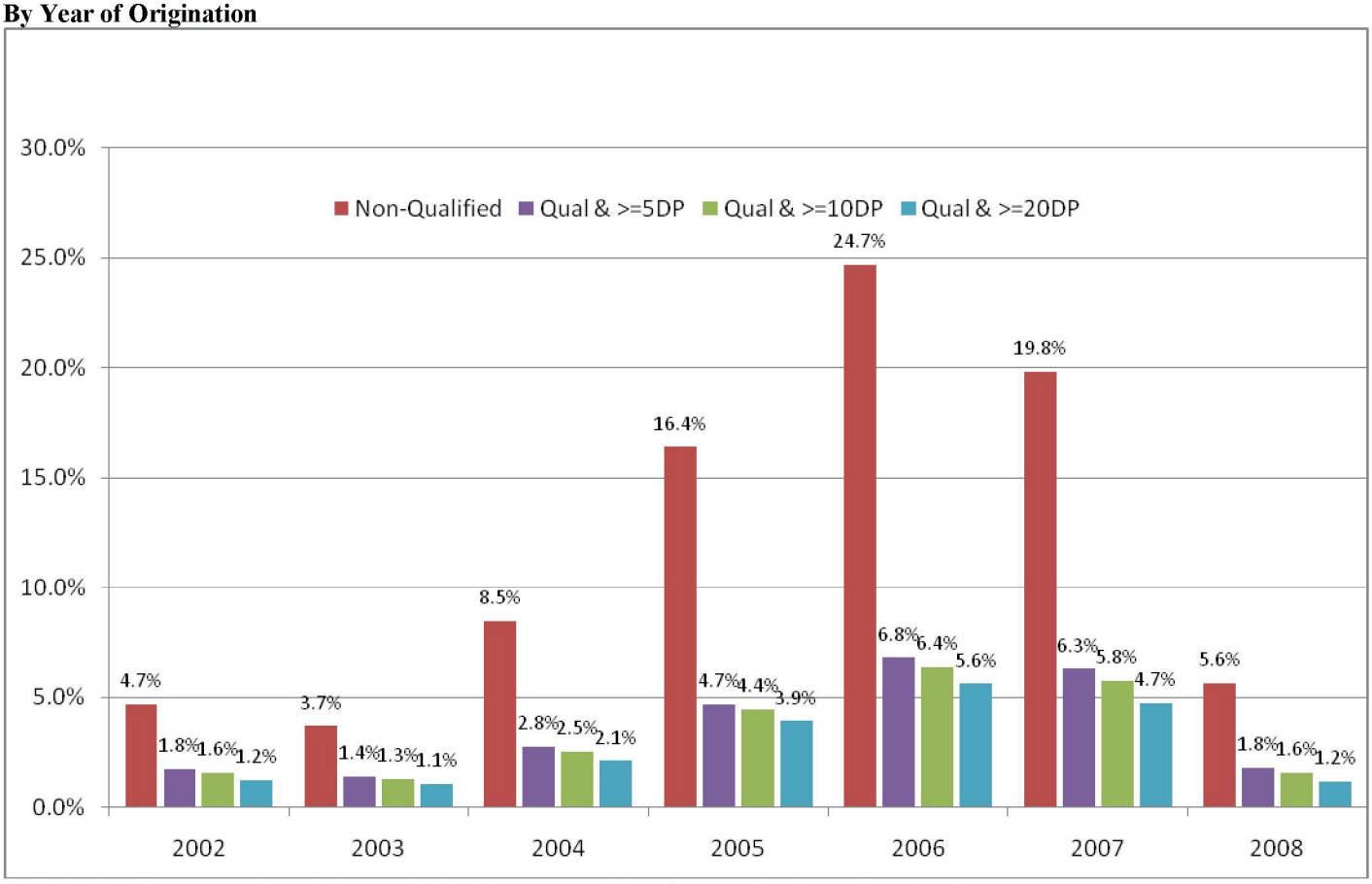
* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.

Rather than simply comparing default risk on 5 percent down loans to 20 percent down loans, this analysis takes into account the impact on the performance of the entire cohort of the sample QRMs that would result from moving from a 5 percent minimum down payment requirement on QRMs, to a 10 percent and a 20 percent minimum down payment requirement. Chart 1 demonstrates clearly that low down payment loans that meet other standards for quality underwriting and safe, stable product

features can be included in a QRM construct without exposing the housing market to excessive default risk.

Chart 1
Impact Of Increasing Minimum Down Payment On Default Rates
For Loans That Meet Sample QRM Standard

Cumulative
Default Rate
By Year of Origination



* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.

Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm conducted this analysis for Genworth Financial using loan performance data maintained by First American CoreLogic, Inc. on mortgages originated between 2002 and 2008. Default rates are by origination year, through the end of 2010. The sample QRM in this analysis is based on fully documented income and assets; fixed-rate loans or 7-year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; 41% total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years.

The red bar shows the performance of mortgages originated from 2002 – 2008 that do not meet all of the standards and features outlined below in the note. The other bars show the performance of mortgages that meet all of the sample QRM product and underwriting features. Within this second group of "QRM" bars, the blue bar shows how loans performed that met all these standards, plus had a 20 percent down payment or more; the green bar shows loans that the met all the standards plus had a down payment of at least a 10%; the purple bar shows these loans with at least 5% down. Naturally, loans with strong standards and at least 20% down performed best. However, the chart also shows clearly that lower down payment loans can be included in a strong QRM framework without exposing investors or the broader market to excessive risk.

The bottom line is that requiring a 10 or 20% down payment as an overlay to already-strong underwriting standards produces only minor improvement in market-wide default performance, but has a major adverse impact on access by creditworthy borrowers to the lower rates and safe product features of the QRM. The CMBP believes this is an unnecessary trade-off that would have a disproportionate impact on moderate income and minority families and would undermine efforts to create a sustainable housing recovery.

Further proof of the absence of a definitive linkage between down payment and loan performance can be found in the delinquency rate of loans guaranteed under the Veteran's Administration Home Loan Guaranty program (VA-guaranty loans). The overwhelming majority of VA-guaranty loans are low-down payment mortgages, i.e. 5% down payment or less, and many with no down payment. Yet the delinquency rate for VA-guaranty loans in the first quarter of 2011 was 4.52%, compared to a delinquency ratio for *all prime* mortgages of 5.85%, according to the Mortgage Bankers Association of America Quarterly Delinquency Survey. This was not an isolated instance either. The delinquency performance of VA-guaranty loans has consistently out-performed all prime mortgages for the last several years according to the survey.

What accounts for this performance is the fact VA loans are predominantly fixed-rate mortgages without negative amortization, interest-only or balloon payment features. In addition, income must be documented and must not exceed "back end" debt ratios and residual income standards set by the VA. This experience reiterates the value of strong underwriting and product features in mitigating the risk of lower down payments, and demonstrates that high down payments will unnecessarily exclude many creditworthy families from obtaining lower cost credit.

Housing Market Impact of Proposed QRM Down Payment/Equity Requirement

Strong and sustainable national economic growth will depend on creating the right conditions needed for a housing recovery. The high minimum down payment/equity requirements and other narrow provisions of the proposed QRM will impair the ability of millions of households to qualify for low-cost financing, and could frustrate efforts to stabilize the housing market. To date, regulators have not provided an estimate of the cost of risk retention to the consumer. The regulators have informally suggested that risk retention will result in "only" a 10 to 15 basis point increase in rates for non-QRMs compared to exempt QRMs (although no methodology for this estimate is provided).[5] However, most private estimates of the cost of risk retention on non-QRMs are several orders of magnitude higher.

As referenced above, the NAR and Moody's Economy.com have estimated that non-QRM mortgages could carry an interest rate differential over QRM mortgages of some 75 – 185 basis points. A one-percentage point increase in interest rates could be devastating to a fragile housing market. According to estimates from the National Association of Home Builders, every 1 percentage point increase in mortgage rates (e.g., from 4.5 percent to 5.5 percent) means that 4 million households would no longer be able to qualify for the median-priced home. In terms of actual housing activity, the Zandi analysis translates this impact as follows: "… a 100-basis point increase in 30-year fixed mortgage rates reduces the pace of new- and existing-home sales by nearly 425,000 units per year, lowers median

[5] *"FDIC's Bair Would Rather Eliminate QRM From Risk Retention Rule,"* American Banker, June 10, 2011.

existing-house prices by 8.5%, and drops the homeownership rate by a full percentage point. Moreover, any increase in rates that results from broad application of risk retention to most borrowers would be *in addition to* a general increase in interest rates forecast by most economists over the next 12-18 months.

For those markets already hardest hit by the housing crisis, the proposed narrow QRM definition will exacerbate conditions. For example, the five states most adversely impacted by the proposed QRM rule are Nevada, Arizona, Georgia, Florida and Michigan (see Table 4). As a result of price declines already suffered in these states, at least two out of three homeowners do not have at least 25 percent equity in their homes that would allow them to refinance with lower rate QRM. Six out of ten would not be able to move and put 20 percent down on their next home.

Table 4
Proportion of Existing Homeowners that Do Not Meet QRM Equity Requirements
Top 5 States with Highest Percentages

State:	Proportion of homeowners with less than **30% equity**	…less than **25% equity**	… less than **20% equity**
Nevada	85%	83%	80%
Arizona	75%	72%	68%
Georgia	71%	65%	59%
Florida	70%	66%	63%
Michigan	68%	64%	59%

Source: Community Mortgage Banking Project, data from CoreLogic Inc.

For those borrowers that have already put significant "skin in the game" through down payments and years of timely mortgage payments, only to see their equity eroded by the housing collapse, the proposed QRM definition tells them they are not "gold standard" borrowers and they will have to pay more. In effect, the proposed QRM would penalize families who have played by the rules, scraped each month to pay their bills, kept their credit clean, and saved for a modest down payment. In fact, a 10 or 20% down payment requirement for a QRM mortgage may serve as a further disincentive to such families and encourage them to default on their current mortgage obligations if they are unable to access the lowest cost mortgage loans, with consumer-friendly features.

With major regional housing markets ineligible for lower cost QRMs under the proposed rule, many states and metropolitan areas that have seen the sharpest price declines will face higher interest rates, reduced investor liquidity, and fewer originators able or willing to compete for their business. These areas face long-term consignment to the non□QRM segment of the market.

It is important to emphasize that the adverse impact of the proposed narrow QRM is entirely unnecessary. Well-underwritten low-down payment loans can and should play an essential role in a sustained housing recovery. As noted by economist Mark Zandi in a detailed report on the QRM issue, "low down payment mortgages that are well underwritten have historically experienced manageable default rates, even under significant economic or market stress."[6]

Clearly, an unduly narrow QRM would exacerbate housing market conditions and could undercut the broader economic recovery. In light of the potential economic harm, and the wide disparity between private estimates and the agencies' informal and undocumented estimate of the increase in mortgage rates from risk retention, **the CMBP strongly recommends that if the regulators continue to pursue a narrow QRM, a complete analysis of the impact on the cost of credit should be provided for public notice and comment, and the rule should be re-proposed.**

Market Structure of Proposed QRM Down Payment Requirement

The proposed narrow QRM rule discourages development of a renewed, robust and diversified private lending market. Under the restrictive QRM rule, the regulators acknowledge that the vast majority of loans will be non-QRMs subject to the higher costs of risk retention, yet it is not clear whether investors will view risk retention as providing sufficient protection that would encourage them to invest significantly in non-QRM mortgage securities.

Moreover, with a statutory exemption for FHA and VA, government-backed loans will have a significant market advantage over fully private loans. As noted previously, the purpose of the QRM exemption was to attract ***private capital*** back to secondary market. However, this proposed regulation will frustrate that goal and perhaps create a difficult choice for policy-makers – render the features of the FHA and VA programs designed to aid lower and moderate income consumers to attain home ownership much less useful and attractive, or accept a permanently enlarged Federal role in the mortgage market place. This is exactly the type of situation that the QRM was designed by Congress to avoid. A very narrow QRM definition, as proposed, will allow very few potential homeowners to qualify. As a result, it will complicate the withdrawal of the Government's guarantee of the mortgage market and delay the re-entry of capital necessary for the re-establishment of a fully private securitization market."

Although the treatment of the GSEs in the proposed rule mitigates the immediate adverse impact of the rule on the housing market, it is not a viable long-term solution, and does little to establish the certainty needed for a strong private secondary mortgage market to develop based on sound underwriting principles and product standards. Rather than rely solely on a short-term fix, the regulators should follow Congressional intent and establish a broadly available QRM that will create incentives for responsible liquidity that will flow to a broad and deep market for creditworthy borrowers.

Finally, it is not clearly evident that risk retention itself will attract investors to securitizations backed by non-QRMs. If investors do not find non-QRM securities attractive, or issuers find that the costs of the risk retention rule render securitization unviable, the large non-QRM market created by the rule will be dominated by portfolio lending. This likely means reduced market liquidity, a shift away from 30-year fixed rate loans, and a move toward more portfolio products like ARMs and hybrid ARMs (e.g., a fixed rate for 5 years that converts to a one year ARM).

If this occurs, the risk retention rule will have inadvertently tilted the market further toward large banking institutions that have the balance sheets to handle it. In 2000, the top 5 lenders accounted for

[6] Moody's Analytics Special Report, "The Skinny on Skin in the Game," March 8, 2011, by Mark Zandi (page 3).

less than 29 percent of total mortgage originations. Today, just three FDIC-insured banks control nearly 55 percent of all single-family mortgages originations. By creating such a narrow QRM market, the proposed rule could reduce competition from community-based lenders that are unlikely to have (or be willing to allocate) sufficient capital to hold significant mortgage portfolios under the QRM rules. The result would be to further accelerate consolidation of the mortgage finance market. In short, the proposal creates real systemic risk, while doing little to relieve it.

B. Proposed Debt-to-Income Ratios and Credit History Standards

The proposed bright line standards in the draft regulations for the Debt-to-Income ratios and the consumer credit history represent an obsolete, single-factor approach to credit underwriting. The CMBP recommends the regulators adopt the approach embodied in the Federal Reserve Board's proposed regulations on the "ability to repay standard" required under Title XIV of the Dodd Frank Act. This approach has two benefits – first, it avoids creating multiple standards in federal rules for determining a borrower's ability to repay, and second, the Fed proposed rule adopts a more up to date and holistic approach to credit underwriting.

Essentially the Fed's proposed ability-to-pay regulations set out a process for the creditor to assess a consumer's ability to pay the proposed loan obligation and requires verification of certain data relied upon by the creditor in making the determination, including income, assets and employment. The proposed regulations also specify certain items that the creditor must take into account when making the determination of the consumer's ability to pay, including total debt-to-income ratio, using the full amount of housing related expense including principal, interest, taxes and insurance, and the consumer's credit history.

Without endorsing the specifics of the proposed ability-to-pay regulations (which may change considerably before being promulgated in final form) we believe the proposed QRM standard should be revised to state that if a creditor makes a determination of the borrower's ability-to-pay in a method and manner that complies with the ability to pay regulations (including originating a Qualified Mortgage as defined in those regulations), then the underwriting requirements for QRM eligibility have been satisfied. We see no need to have two separate and different underwriting standards in federal regulations with the same objective: ensuring that consumers are matched with loans that fit both their needs and their means. Two separate standards create needless complexity, heighten compliance risks, and ultimately would increase costs to borrowers. We would further suggest deleting the specific debt-to-income ratios and the consumer credit history standards in the proposed regulations in favor of this revised approach.

All residential mortgages originated in the U.S. on or after the effective date of the ability-to-pay regulations must conform to the ability-to-pay regulations (including the Qualified Mortgage safe harbor). Pursuant to the Dodd Frank Act, and the enabling regulations, the creditor must have made a good faith determination of the borrower's ability to repay the mortgage obligation they are proposing to accept. That is the very essence of good underwriting, which was a key principle behind the QRM exemption. We strongly recommend that as long as a creditor has underwritten a residential mortgage in accordance with the ability-to-pay regulations (including originating a Qualified Mortgage as defined in those regulations) the creditor should be deemed to have satisfied the underwriting standards

of the QRM exemption. This approach will also ensure that the QRM standards remain bound ("no broader than") by the standards of the QM, as required by statute.

C. Loan Servicing Standards

The proposed regulation contains a series of mandatory loan servicing standards and documentary provisions regarding a borrower's right to a loan modification in the event of financial difficulty. CMBP is opposed to the inclusion of loan servicing standards in the QRM exemption. First, there is no evidence that Congress intended the inclusion of loan servicing standards in the QRM. In fact the plain statutory language points to the opposite conclusion: Congress directed the regulators to examine existing loan product features "that historical loan performance data indicate result in a lower risk of default". There is no reference to loan servicing standards and there is no mention of granting the regulators authority to create new loan features that the regulators estimate, or project, may lower the risk of default. The statutory reference is to existing loan features, not loan features newly created by regulatory mandate.

Additionally the statutory direction is for consideration of loan product features that historical loan performance data indicate result in a lower risk of default. There is no historical loan performance data to indicate that the proposed loan servicing standards result in a lower risk of default since such servicing standards do not now exist, hence there can be no historical measurement of their performance. Moreover, the regulators express the view that the statutory references to default risk apply only to a lower "frequency of default." While we do not necessarily agree with the narrow interpretation of "default risk," using the regulators chosen definition to determine the QRM standards would preclude the inclusion of servicing standards in the QRM since, by definition, the loss mitigation actions called for only come into play ***after*** a loan is delinquent.

We see numerous additional problems with the specific QRM servicing standards, as proposed:

- The rule places the obligation to ensure servicing standards on the "mortgage originator," as defined in the DFA. Practically speaking, this is the loan officer or mortgage broker. It is simply unworkable to have a loan officer responsible to make sure the creditor *(his/her employer)* includes in the "mortgage transaction documents" servicing standards that are binding on a subsequent purchaser/servicer of the note. Those are obligations an employee loan officer or mortgage broker simply cannot reasonably be expected bear.

- The concept of including the specific loan servicing standards in the mortgage transaction documents (i.e., the promissory note and deed of trust) is a radical departure from the well established debtor-creditor legal framework in which the borrower, in return for a loan from the lender, affirms in writing their obligation to repay the loan and encumbers their home in support of their obligation to repay the loan.

- Under the proposed servicing standards, the borrower will have a right to have their loan serviced according to certain standards contained in the loan documents. In itself this is a bizarre notion since the loan is the property of the lender and an obligation of the borrower. By rights the owner of the loan should be making the decision on how their asset should be serviced, not the party that is obligated to repay the loan. Giving borrowers a contractual right

to a loan modification creates massive moral hazard concerns that will undermine 1st lien secured lending and sharply increase costs for consumers on new loans. The proposed standards would:

- provide borrowers with automatic loss mitigation if there is a positive NPV – the standard does not mention anything about qualifications, hardship, etc.
- allow borrowers to use the threat of walking away to get lenders to modify first lien mortgages so the borrower can continue to make their other unsecured or junior lien debt payments,
- debase the value of being the most secured creditor in the chain.

- Further the transaction documents – the note and deed of trust or mortgage – are subject to state law. Since these mortgage servicing standards will be embodied within the mortgage transaction documents, the standards will also be subject to state law and the varying interpretations that can take. So rather than having uniform servicing standards for QRM loans, we will end up with varying interpretations of how the servicing of QRM loans should be done.

By granting consumers a right to have the terms of their loan modified pursuant to a net present value test, mortgage investors will face greater uncertainty both as to prepayment speeds on the mortgages underlying their securities as well as potential losses to principal should these modified mortgages re-default and go to foreclosure despite the modification. That uncertainty will be reflected in the returns investors will demand on the mortgage securities they are willing to buy, in turn will increase mortgage interest rates for consumers – again, an outcome contrary to the goals of QRM for stable, affordable mortgage products for creditworthy consumers.

Finally there is a vague requirement in the proposed QRM loan servicing standards that "servicing compensation arrangements have to be consistent with QRM servicing standards." Beyond the fact that that there numerous interpretations that can be ascribed to this phrase, this requirement does not seem to recognize that loan servicers cannot unilaterally determine what their compensation for the servicing of loans is to be, it is set by the owner of the assets or more likely by the securitizers and there may or may not be an opportunity for give and take between the securitizer and servicer over the compensation level.

Rather than embarking down a road that can produce a confused and fragmented approach, particularly when there is no statutory support for the inclusion of such standards in the QRM requirements, let alone in the actual mortgage transaction documents, we suggest deletion of these standards from the QRM in recognition that there will soon be a Federal interagency proposal for uniform loan servicing standards that will apply to both bank-affiliated and non-bank lenders as well. This uniform, national approach is far preferable to the fragmented and only partially applicable approach that would be obtained through inclusion of servicing standards in the QRM regulations.

If the final rule includes any servicing standards, they should apply to all residential mortgage securitizations, not simply QRMs, and should be incorporated as part of the securitization documents (i.e., pooling and servicing agreement), and NOT create a contractual borrower right to a loan modification.

D. Miscellaneous QRM Provisions

There are several miscellaneous provisions within the QRM standards that we would like to address:

1. Down payment assistance – we are concerned that the wording in the regulation and appendix to the regulation with respect to down payment assistance appears to create a loophole for indirect down payment assistance from home sellers through charitable organizations. Such a practice, which created significantly negative default experience within the FHA-insured portfolio, would be directly contradictory to the QRM statutory mandate to consider loan features and underwriting standards that historical loan performance data indicate reduces the risk of default. We strongly recommend that this language be tightened considerably to prohibit, direct or indirect seller down payment assistance, even in the form of a contribution from a seller to a charitable organization that in turn provides down payment assistance to the borrower.

2. Interest and investment earnings – the language in the appendix, that deals with what items lenders should consider as income for the borrower, in the calculation of the debt-to-income ratio, appear to exclude interest and investment income, including stock dividends. While we oppose a bright-line debt-to-income ratio, should the regulators choose to include such a requirement, we urge that the definition of income be revised to include interest and investment income as well as stock dividends.

3. Fees and points cap - There is no historical loan performance data that supports the inclusion of a 3% cap on fees and points to be collected by lenders for QRM-eligible loans and we urge that such requirement be dropped from the final regulation. However if regulators determine to include such a cap, we urge that the QRM standards simply incorporate by reference the fees and points calculation and definition that is ultimately adopted in the ability-to-pay regulations so that lenders do not have to deal with two difference definitions and two difference calculations.

E. Premium Capture Reserve

We recommend that the proposed provisions in the regulations that would establish rules on the establishment and treatment of a Premium Capture Reserve should be eliminated from the final rule for several reasons:

1. The impact of the premium capture reserve provisions will be to significantly reduce mortgage securitizations because they will eliminate the financial incentives for sponsors to issue securities backed by mortgages.

   Sponsors of mortgage securitizations will typically earn their profits through the securitization of the excess interest rate spread in the issuance and the monetization of that spread through a sale of those interests to investors. The proposed requirement that sponsors place the proceeds of the sales of the excess spread interests into a premium capture reserve, which will then be in a first loss position, means that an issuer will be placing their profit from the organization and sale of the issuance completely at risk. This will be in addition to the 5% risk retention requirement imposed by the regulations, which presumably the issuer will have to fund from their own equity.

The business model created by the proposed regulations is similar to a start-up where the organizers of the business place capital at risk and generate no profits either for a period of time, or never if the business is not successful. The difference however is that as envisioned by the proposed regulations securities issuers would be in a perpetual start up mode, placing capital at risk and generating little or no profit for the first 7 – 10 years or more of each and every securitization they issue. It is difficult to conceive why any profit-making enterprise would willingly adopt such a business model. And in fact few, if any, will. Unless this provision is eliminated we would expect to see the only securitizations that are done are issuers financing assets they already own. Absent the incentive to monetize assets already on balance sheet, the regulations would eliminate any other financial motivation to engage in the business of organizing and issuing asset-backed securities since the regulations would not permit issuers to realize any profits from the activity for many years, if ever.

2. The premium capture reserve provisions as written do not take into account the very common practice among mortgage originators to offer consumers the option of financing their mortgage closing costs through the premium pricing of mortgages. As such the consumer's cash requirement to close their mortgage will be considerably increased, which will further restrict the availability of mortgage credit.

Loan originators will typically offer consumers the opportunity to finance their loan closings costs (for title insurance, escrow fees, etc.) through an above par interest rate on the loan, rather than have to come out of pocket with the cash at closing. Consumers, particularly first time buyers, will often avail themselves of this option in order to provide themselves with some additional financial flexibility to deal with unexpected expenses and contingencies following a home purchase. Originators are able to offer consumers this option because securitization sponsors will pay originators above par prices for loans with premium interest rates.

Under the proposed regulations on premium capture reserve this option would vanish, since sponsors would not have the ability to pay above par prices for loans. This loss of ability would occur because the sponsor's funding source – monetization of excess spread – would have to be locked up in the premium capture reserve and placed at risk. Instead of having the option of financing closing costs through premium pricing consumers would have to come up with additional cash to close, a requirement many could not meet. For those who could meet it, they will no longer have the financial flexibility afforded by premium pricing, which will leave them vulnerable to an unexpected expense that could place their ownership in jeopardy. How this will help consumers, or the mortgage market, is difficult to see.

3. The ability of originators to offer consumers the option to lock the interest rate on their loans at the time of application will be curtailed. If not eliminated, by the proposed premium recapture provision because originators will not be able to realize the gains on the loan's pricing in a rising rate environment, which offset the costs of the hedge.

Originators will often offer consumers the ability to lock the interest rate on their loan at the time of application. In a volatile rate environment this is often a very valuable benefit for

consumers because it permits them to fix their financial eligibility for the loan, since their interest rate, and hence their monthly payment, is a known quantity that will not change between application and closing.

Originators are able to offer interest rate locks because they can hedge their interest rate exposure, with the cost of the hedge offset by the increase in the value of the loan in a falling rate environment, and an increase in the value of the hedge offset by a fall in the value of the loan in a rising rate environment.

However if the premium capture reserve proposed rules become final, sponsors will no longer be able to pay premium prices to originators because the excess spread proceeds that fund those premium prices will be locked up in the premium capture reserve and be placed in a first loss position. So the financial benefits of the premium pricing cannot be passed through to consumers, hence if consumers want to lock their interest rates between application and closing they will have to come out of pocket for the expense of the interest rate lock. Again, an added out of pocket expense to consumers at a time when they can ill-afford it and a further blow to the housing market at a time when it can ill-afford it.

4. These provisions are unnecessary because securitization sponsors, because of the risk retention regulations, will, no matter what their cash investment may be in each issuance, still retain balance sheet exposure on each issuance equal to the required 5% risk retention exposure.

The proposed premium capture reserve provisions confuse cash position with overall risk retention exposure. Even though a securitization sponsor may be able to generate an immediate profit on the securitization, together with being able to pay premium prices for mortgages that in turn facilitate the offer of closing costs financing and interest rate locks, through the monetization of excess spread, that does not relieve them of the balance sheet exposure of the 5% risk retention requirement.

That balance sheet exposure, which is a first-loss exposure, aligns the interests of the sponsor with the investors on each and every issuance. A loss on the risk retention exposure will be reflected in the sponsor's income statement and balance sheet just as surely as if they had actual cash at risk, thus giving the sponsors every incentive to securitize assets whose actual quality matches the quality represented to investors.

F. Risk Retention Transfer

We oppose the draft provisions that would permit the transfer of the risk retention obligation from issuer to originator provided that certain conditions are met, chief among them being that the transfer is "voluntary." Given the unequal bargaining power that is typically present between issuers and originators, the use of the term "voluntary" to describe the transaction is implausible to say the least. In addition, due to other Dodd Frank Act provisions, originators now must meet a statutory duty to determine a consumer's ability to pay the debt obligation they are incurring through the loan. This statutory obligation will do more than any risk retention provision would in ensuring that lenders have every incentive to originate well-underwritten loans with consumer-friendly features, thus making the

possibility of a shift in risk retention requirements redundant to the lenders. Issuers, on the other hand, face no such affirmative duty with respect to the soundness of the assets they are securitizing, save and except for their risk retention obligation. Thus the responsibility for risk retention should stay at the issuer level, in order to impose a duty for the safety and soundness of the assets being securitized upon the issuer as well and not permit the issuer to shift those duties to another party.

G. Internal Controls Evaluation

We believe the proposed requirement, that issuers evaluate the internal controls that are used to determine which loans meet the QRM standards, within 60 days of the issuance will result in excessive cost to issuers, which in turn will be reflected in the price of credit to consumers. We believe such frequency is unnecessary and urge that you revise the frequency to an annual requirement.

IV. Recommendations

A. On the QRM Definition

1. The down payment requirements in the QRM standards are unnecessary and should be deleted from the final regulations;
2. The debt-to-income ratios and credit history standards should be deleted and replaced with a requirement that the lender shall have determined the consumer's ability to pay according to the final ability to pay regulations;
3. The fees and points cap in QRM should be deleted because it has no demonstrable relation to default rates and it duplicates requirements under the "ability-to-repay" rules. Alternatively, the requirement should state that lender compliance with the fees and points cap in the ability-to-pay regulations will be considered compliance with the QRM standard;
4. The proposed loan servicing standards should not be included in the QRM-eligibility requirements because they are not supported by statute or congressional intent, are operationally unworkable as proposed, and have the potential to dramatically undermine the traditional creditor-debtor legal framework.
5. The language regarding down payment assistance should be tightened to prohibit indirect seller assistance through charitable organizations;
6. The definition of income for purpose of calculating debt-to-income ratio should be revised to include investment, interest and stock dividend income;

B. On Risk Retention Provisions

1. The Premium Capture Reserve provision should be eliminated.
2. The provisions that would permit the voluntary transfer of risk retention requirements from issuers to originators should be deleted from the final regulations.
3. The internal controls evaluation requirement should be revised to an annual requirement.

Thank you for this opportunity to comment.

Sincerely,

Glen S. Corso
Managing Director