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June 3, 2011

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

Dear Ms. Johnson:

This letter is written in response to the request for comment on the proposed Credit Risk Retention rule (Docket No. R-1141), which implements section 15G of the Securities Exchange Act of 1934, as amended by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requiring a securitizer of asset-backed securities to retain not less than five percent of the credit risk of the assets collateralizing the asset-backed securities.

We are supportive of the flexible manner in which the agencies drafted the credit risk retention requirements. We believe that methods available are appropriate and allow a sponsor to determine the best method for retaining credit risk relative to its operations. We also believe that the proposed disclosure requirements for each method of retention are appropriate. Disclosing the manner and amount of retention to potential investors will create a transparent process and allow investors to factor the amount of retention into a purchase decision.

We are also supportive of section 13 of the proposed rule governing the allocation of risk retention to an originator and encourage the agencies to adopt the rule as it is currently drafted. We believe that the agencies struck the proper balance which allows a sponsor to allocate some of its credit risk back to an originator while still requiring the sponsor to retain some risk. Sponsors should only be allowed to allocate a portion of the credit risk back to originators that contribute significantly to a securitization. We believe that establishing a 20% minimum retention amount and requiring the allocated amount not to exceed the originator's proportionate share of originated assets to the total of all assets in the securitization is appropriate. Loosening these proposed standards could have the effect of essentially allowing a sponsor to effectively hedge against its credit risk, which is contrary to the purpose of the statute. We recognize that some sponsors may change the methods employed to securitize assets in order to allocate the majority of the credit risk retention back to originators. There will be a cost to conducting business in this manner, and it is possible that some originators will decide to no longer originate these loan products. We believe that the market will correct this over time. However, there may be a negative impact in the near term that could hinder economic recovery should this practice become prevalent.

In order to minimize the impact of any change in business practices that would effectively allow a sponsor to hedge all of its risk retention, the agencies could adopt a maximum amount of risk retention that could be allocated back to originators. For example, it may be appropriate to adopt a maximum allocation of 40% or 60% of the sponsor's risk retention requirement. This would ensure that some risk remains at the sponsor level, while minimizing potential liquidity and interest rate risk for smaller originators.

Our primary concern lies with the proposed definition of qualified residential mortgage (QRM) under section 15(c). We believe that the definition is too narrow for the purposes of qualifying for the exemption. We encourage the agencies to study the broader mortgage reform effort required under Dodd-Frank prior to applying such a restrictive definition for the purposes of risk retention only. Creating a rule with too narrow of an exemption can have the unintended consequences of limiting the availability of credit to otherwise credit worthy customers through increased interest rates, borrower cash requirements and reduced liquidity for originators and sponsors. This in turn can have a negative impact on the overall economy long term.

Our understanding of the primary purpose of section 941 of the Dodd-Frank Act is to ensure that all players in a securitization have some real risk should the securitization have credit issues. In addition, it is intended to encourage proper underwriting standards while discouraging inappropriate risk taking. Title XIV of the Dodd-Frank Act also tackles this issue by creating an ability to repay requirement for all consumer mortgage loans and by restricting the terms that can be offered when originating higher-priced or high cost mortgage loans. Ability to repay is the primary indicator of the credit risk associated with any non-collateral dependent loan. Collateral based lending is now expressly prohibited by law in the consumer residential mortgage lending market, so ability to repay is the primary factor that must be considered.

Section 941 allows the agencies to exempt qualified residential mortgages from the risk retention requirement through rule writing that takes into consideration factors that would result in a "lower risk of default." This is important to note, because while the agencies are charged with establishing underwriting standards that are indicative of low credit risk, the section governing exemptions for a QRM in the statute doesn't indicate Congress considered actual loss sustained by investors to be a concern. They were focused on the borrower defaulting on the transaction due to the inability to make payments. The statute then lists out various data that the agencies may consider in promulgating the exemption, which again focuses on the ability of the borrower to repay the debt and not on potential for losses likely to be incurred as a result of default. It further restricts the agencies from applying a broader standard than the qualified mortgage standards incorporated into the ability to repay standards under the Truth-in-Lending Act and its implementing regulations. The proposed rule definitely did not create a broader standard for the exemption. To the contrary, the proposal is significantly more restrictive than the Truth-in-Lending standards.

The proposed QRM standards incorporate loan-to-value (LTV) restrictions in determining the availability for the exemption. We do not believe that there should be any restrictions based on LTV. The agencies have proposed three different standards, depending upon the purpose of the transaction. All require a low LTV. However, LTV is a credit loss mitigation factor and not a default mitigation factor. A loan originated with a 50% LTV ratio has a low likelihood of loss given default, but it does not reduce the likelihood of default should the borrower not be able to make payments. Ultimately, it is the borrower's ability to repay the debt that mitigates the likelihood of default. We do agree that a low LTV may allow a borrower to sell a property to avoid foreclosure should the need arise, but this still is not a mitigating factor concerning likelihood of default.

Establishing specific, low LTV standards will unnecessarily restrict the availability and/or cost of obtaining credit for consumers. The availability and pricing of credit will be impacted by whether a loan meets the definition of QRM and therefore exempt from the retention requirements. Those that do not meet the QRM definition will likely carry a pricing premium due to the illiquidity created by the mandatory retention requirement and due to the misperception that the loan carries a higher risk of default. Many creditors manage interest rate risk and desire to offer mortgage products based upon the ability to sell loans in the secondary market. Creditors that are required to retain risk relative to loans normally sold will have to assess whether it makes sense to continue offering products. Smaller community based lenders may decide to exit the business, which will reduce competition and drive pricing higher.

It is equally important to note that a lender is prohibited from considering equity in the consumer's dwelling as a mitigating factor from a financial resource perspective in making a credit decision under the new ability to repay rules. Placing LTV restrictions in the QRM proposal will put lenders in a difficult position, as they will be required to look at equity position in the collateral for the purposes of determining QRM status but exclude it for the purposes of ability to repay. Having two separate standards creates confusion and could open the lender up to potential liability. If the ultimate credit decision is made based on the ability to sell a loan without needing to retain a portion of the credit risk, then the creditor is making its decision based in part on the equity available in the consumer's dwelling. Should a loan go into default, the borrower may assert a claim that the lender violated the ability to repay standards. The lender would be placed in the unfortunate situation of needing to defend the practice of looking at equity for the purposes of QRM while arguing that it wasn't considered as a financial mitigating factor. If the agencies believe that some LTV requirement is necessary, the rule should provide an explicit safe harbor indicating that meeting the LTV standards for QRM cannot give rise to a cause of action under the ability to repay standards.

We do believe that all borrowers should have some financial investment in the property in the form of down payment or tangible equity and that the amount should be based on the lesser of purchase price or appraised value. If the agencies determine that some restriction on LTV must be included under the exemption in the final rule, then we would encourage the agencies to allow for credit enhancements to be considered when determining ultimate LTV. Private mortgage insurance is an appropriate credit enhancement tool that allows consumers to obtain financing with lower down payments or equity investment and effectively lowers the credit risk associated with the loan. While this does not reduce default risk by itself, the borrower must essentially be qualified under two sets of underwriting standards. The first is the originator's underwriting standards as will be amended by the ability to repay standards, including the ability to make the mortgage insurance premium payment. The second is the underwriting standards of the mortgage insurance company itself, whose goal is to mitigate risk of non-payment. If a borrower meets the underwriting standards of both parties, they should not be potentially penalized in the form of higher rates or lesser credit options merely because they don't have a minimum 20% down payment or built up equity.

We are very concerned that including a LTV standard, without the allowance for mortgage insurance or other form of credit enhancement, will reduce the availability of credit disproportionately for low and moderate income borrowers over time. These borrowers often have sufficient income to qualify for a mortgage based on repayment ability, but they will lack sufficient funds to get into a mortgage by requiring such a high down payment. Products will still be available, but the number of programs will be reduced with likely liquidity and credit risk premiums being added to account for the risk retention requirement and perceived risk associated with the loans. The ability to repay standards under TILA and the proposed payment terms within this proposal adequately mitigate default risk by excluding loan structures that carry higher risk of default. We strongly encourage the agencies to allow for a reduction in down payment requirements to a minimum of three percent of the lower of appraised value or purchase price, provided an appropriate credit enhancement is in place and the borrower meets the ability to repay standards.

To provide some data for consideration, our institution's loss history for mortgage loans originated between 2002 and 2008 represent 0.36% by number and 0.095% by dollar. Please note that these figures include all residential mortgage loans, including loans involving rental properties. Losses peaked for loans originated in 2007, where mortgage loan losses represented 0.96% by number and 0.476% by dollar. The losses occurred on both loans having mortgage insurance and those that did not. In addition, we have always had what we consider to be good underwriting standards based on ability to repay, which contributes to the low loss history. The average LTV on all of the defaulted loans, as of the origination date, is 78.8%. The dollar amount of loss attributed to loans with mortgage insurance represents approximately three percent of total losses. We did not sustain a loss on any loan originated in 2007 where mortgage insurance was present. The remaining 97% of losses incurred related to loans without mortgage insurance. When property values decline, the LTV at origination becomes less relevant and is not a mitigating default factor. However, it is a mitigating credit loss factor.

When losses started to increase, we evaluated whether to change our underwriting requirements as had been done by other lenders. There were several loans involving low-to-moderate income borrowers that ultimately went into default. However, when we looked at the specific loans, the underwriting was not a factor in the ultimate loss. The borrowers had the ability to repay the loans at origination, but their employment situations changed as the economy turned. They were unable to continue making payments on any of their debts, and that is why the loans went into default. Declining property values due to changing market conditions also contributed to the losses. As a result of our analysis, we did not make any changes to our underwriting standards.

A second item of concern we have with the proposed exemption standards relates to the proposed debt-to-income ratios. We do not believe that specific ratios or government program underwriting standards, including specific documentation and verification standards, should be included in the final rule. We believe that this is overly prescriptive, and by including these in the regulation, they may not be adjusted as the mortgage market changes over time. It is our understanding that the agencies did intend to "lock" these standards in place. However, if other government program standards change over time, any private market that may exist should not be placed at a competitive disadvantage due to the governmental program exemptions contained in the law. In addition, the proposal will not allow sufficient time for the other restrictions that have come around as a result of the Dodd-Frank Act to take effect.

The proposed ability to repay rules under TILA do not contain specific debt-to-income standards. They rightfully allow for lenders to have flexibility in underwriting transactions. We are concerned that being overly prescriptive in the proposed rule will have a disparate impact on low-to-moderate income borrowers. The affordable housing products offered have allowed housing debt and all debt to exceed the thresholds proposed in the rule. Our underwriting standards use a sliding scale based on debt service and residual income. For the lower income borrowers, we essentially have a total monthly debt ratio of 40%. As noted above, our underwriting standards demonstrate that borrowers have the ability to repay their debts with low risk of default and loss. At a minimum, we would encourage the agencies to eliminate the specific housing ratio and raise the total debt ratio to 40%. If the agencies feel that some housing ratio must be included in the final rule, then we would recommend a 36% ratio as opposed to the proposed 28%. This should mitigate the risk that credit will be unduly restricted or become more costly for lower income borrowers. We also believe that if the loans are structured according to proposed payment terms, points and fees restrictions, and meets the ability to repay requirements under TILA, the risk of default will be appropriately mitigated and the need to include such prescriptive standards for the purposes of the exemption will be unnecessary.

We would encourage the agencies to conduct a thorough analysis of the potential for disparate impact on borrowers of different demographic characteristics prior to implementing such a restrictive exemption. As a mortgage lender at both a portfolio and secondary market level, we have concerns that the potential for a reduction in product availability and cost of obtaining credit may inadvertently create a disparate impact based on demographics. The agencies are in the best position to study the potential impact, given their access to broad economic and loan data. Lenders that are attempting to manage liquidity and interest rate risk should not be subject to potential claims of disparate treatment or impact, because they decide to only offer loans that meet the restrictive proposed QRM exemption standards or offer non-QRM loans that carry higher pricing for the consumer.

Our final concern with the proposed conditions of QRM relates to the default mitigation standards. While the law provides some flexibility for the agencies to add requirements, it seems rather far reaching to require specific default mitigation standards within the definition of QRM. We really don't believe that the agencies have the authority to impose such a standard for the purpose of the exemption. In addition, having a mitigation procedure in place after a borrower has already defaulted is not an underwriting factor or product feature that leads to a lower likelihood of default. As an originator, we are unable to control the business processes of a subsequent servicer after sale, and we generally don't have the ability to dictate specific standards to a purchaser. We sell the majority of our long-term, fixed rate mortgages for interest rate risk management purposes. If we were unable to sell the loans, we would have to give strong consideration to exiting this line of the mortgage business.

It is also somewhat confusing as to why the agencies would seek to impose such a standard for purposes of defining QRM. These loans, by definition, carry low risk of default and also low credit risk. Providing additional protections solely to borrowers that are least likely to default is counterintuitive. This will also disparately impact low-to-moderate income borrowers as proposed, because the majority of those loans will not meet the proposed QRM definition anyway. They would end up with less protection, as their loans would not contain these provisions. While we understand the desire to create some servicing standards, it is more appropriate to let Congress act if they believe such standards are necessary. Congress did include some mortgage servicing standards in the Dodd-Frank Act, but they did not include any provisions related to requiring specific default mitigation standards. If they believed that such standards were necessary, they would have put a provision in the Act and given express authority to the Agencies to craft such rules. In addition, we are aware of the fact that negotiations are proceeding with regulators, state attorneys general and the largest servicers. Those proceedings should be allowed to conclude before mandating specific processes as part of the risk retention requirements.

We would like to request that the agencies consider allowing some type of grandfathering of consumer residential mortgage loans originated prior to the effective date of the final rule or allow for loans that have performed for a predetermined period of time to qualify for the QRM exemption. Many insured institutions that carry a portfolio of mortgage loans have viewed the portfolio as a potential source of liquidity, whether primary or contingent. The ability to sell the loans in the future will be impacted in multiple ways due to the new retention requirements. Not only will the institution face pricing risk due to changes in interest rates over time, it will also likely incur additional losses upon sale due to perceived higher credit risk if the loans do not meet the proposed limited definition for QRM. This will negatively impact capital, often at a point in time when an institution is trying to preserve capital. In addition, the institution may not have a sufficient number of loans in the sale to retain a five percent sample, so they may be required to take risk retention through one of the other mechanisms, creating a potentially longer-term, illiquid asset on its balance sheet.

If the agencies revise the QRM definition to be more in line with the proposed ability to repay standards, then this would be less of a factor in the future for loans originated subsequent to the effective dates of the rules. We still believe that it would be prudent to grandfather existing loans or allow for an exemption on seasoned loans. We believe that a prudent standard for seasoning could include the requirement for the loans to meet the ability to repay standards, have had a minimum of 12 months of payments, and have not had any payment delinquencies during that time.

We also have concerns that, as proposed, it will make the ability for the government to resolve FNMA and Freddie more challenging. The limited QRM exemption definition, along with the risk retention requirement will present significant barriers to entry for new market participants. New participants must be able to manage and withstand the requirement to hold illiquid assets on its books while generating sufficient return and capital to fund loans. It is doubtful that many players will enter, which could be what Congress intended to limit through this requirement. However, there appears to be a desire to limit the taxpayer's liability relative to these mortgage entities and the mortgage market in general. Prohibitive barriers to entry will only cause the largest players to get even larger and require the government to continue playing a significant role in guaranteeing mortgage debt. Resolving the larger institutions will likely become more difficult, as they will all be systemically important to the economy. Either way, the taxpayer will be impacted negatively. However, if the exemption is crafted appropriately, a competitive environment can be achieved over time, reducing the reliance on the taxpayer to fund losses on government guaranteed loans or providing support to systemically important institutions.

The final area for which we would like to comment relates to the "low risk" underwriting standards proposed for all of the asset classes. We do originate all types of loans covered in the proposal, but we only sell residential mortgage loans as noted elsewhere in this letter. We believe the agencies have done a good job of identifying very low credit risk characteristics for each of the classes. We also believe that it is appropriate to only identify the standards for the classes of assets in the proposal, and the agencies should not seek to prescribe underwriting standards for other assets at this point in time. We do have a couple of concerns with the proposed standards and the potential for unintentional consequences or application of the standards by the agencies for purposes other than which the rule was drafted.

We want to encourage the agencies to take the time to study the market and the potential impact the proposed standards will have on the availability of credit. While we do not sell the majority of our loans, the supply of adequate funding minimizes negative impacts on collateral values and provides stabilization in the economy of the markets in which we operate. Given restrictions on concentrations of credit, especially in the area of commercial real estate, reliance on local funding alone would not provide sufficient funding for the demand. The secondary market for these loans is crucial to economic stabilization. We believe that the agencies could ease the underwriting requirements somewhat and still maintain "low" credit risk standards and trust that prudent standards will be implemented without negatively impacting the flow of credit.

We recognize that the agencies are required by the Dodd-Frank Act to promulgate these rules and "low" risk standards for the purposes of risk retention requirements. We are somewhat concerned that once these standards are placed in regulations, there may be a tendency over time for an examiner to compare a portfolio lender's underwriting standards to these requirements. To the extent that a lender's standards do not meet these proposed very "low" risk standards, there may be a feeling that an institution should hold additional capital to account for the perceived higher risk compared to the agencies' underwriting standards, even if the institution meets the capital requirements and its underwriting standards present no more than normal credit risk. It should be made clear in the rule that these standards are solely to be used for determining the risk retention requirement and not intended to be used for establishing capital adequacy for insured depositary institutions. Such language should be included in the authority, purpose and scope section of the final rule to ensure that it is not improperly applied elsewhere in the future.

Thank you for taking our comments into consideration as part of this rulemaking. We appreciate the time and effort that goes into the process and the short time period for which Congress gave the agencies to issue a proposal. If you have any questions or would like clarification on any item in this letter, please contact me at (303)235-1321.

Sincerely,

David A. Kelly, CRCM
Executive Vice President