Colorado Mortgage Lenders Association

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June 8, 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:

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 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

[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", distributed in June 2011 by 27 real estate, mortgage lending, and civil rights organizations. The complete "White Paper" is appended to this comment letter.

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 7% to 15% reduction), and increasing the minimum down payment to 20% would reduce eligible borrowers by 17% to 28%, 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 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

[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)

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

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

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

Attachment: "Proposed Qualified Mortgage Definition Harms Creditworthy Borrowers while Frustrating Housing Recovery" White Paper

Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery

Prepared by:

American Land Title Association

Asian Real Estate Association of American

Black Leadership Forum

Center for Responsible Lending

Community Reinvestment Coalition of North Carolina

Community Mortgage Banking Project

Community Mortgage Lenders of America

Consumer Federation of America

HomeFree USA

International Association of Official Human Rights Agencies

Mortgage Bankers Association

Mortgage Insurance Companies of America

National Association of Federal Credit Unions

National Association of Hispanic Real Estate Professionals

National Association of Home Builders

National Association of Human Rights Workers

National Association of Real Estate Brokers

National Association of Realtors®

National Community Reinvestment Coalition

National Fair Housing Alliance

National Housing Conference

National NeighborWorks Association

National Urban League

North Carolina Institute for Minority Economic Development

Oak Park Regional Housing Center and West Cook Homeownership Center

Real Estate Services Providers Council

Worldwide ERC

Proposed QRM Harms Creditworthy Borrowers While Frustrating Housing Recovery

Summary

As part of the financial reform legislation, Congress designed a clear framework for improving the quality of mortgage lending and restoring private capital to the housing market. To discourage excessive risk taking, Congress required securitizers to retain five percent of the credit risk on loans packaged and sold as mortgage securities. However, because across-the-board risk retention would impose significant costs on responsible, creditworthy borrowers, legislators also created an exemption for "Qualified Residential Mortgages," defined to include mortgages with product features and sound underwriting standards that have been proven to reduce default.

Unfortunately, regulators have drafted proposed Qualified Residential Mortgage (QRM) rules that upset the important balance contemplated by Congress. Rather than creating a system of penalties to discourage bad lending *and* incentives for appropriate lending, regulators have developed a rule that is too narrowly drawn. Of particular concern are the provisions of the proposal mandating high down payments. Other aspects of the proposal – such as the proposed debt-to-income ratios and credit standards – will also raise unnecessary barriers for creditworthy borrowers seeking the lower rates and preferred product features of the QRM. Additional analysis of these issues will be addressed in updates to this White Paper.

The proposed QRM exemption requires a high down payment – proposed at 20 percent, with even higher levels of minimum equity required for refinancing – **despite the fact that Congress *considered and rejected* establishing high minimum down payments because they are not a significant factor in reducing defaults compared to other underwriting and product features. In fact, the three sponsors of the QRM provision have sent letters to the regulators saying that they intentionally did not include down payment requirements in the QRM.**

Requiring down payments of 20 percent or more is deemed by some as "getting back to basics." However, well-underwritten low down payment home loans have been a significant and safe part of the mortgage finance system for decades. The proposed QRM exemption ignores these data and imposes minimum down payments of 20 percent, and equity requirements for refinancing borrowers of 25 percent or 30 percent.

As a result, responsible consumers who maintain good credit and seek safe loan products will be forced into more expensive mortgages under the terms of the proposed rule simply because they do not have 20 percent or more in down payment or equity. These mortgages will be more expensive for consumers because the capital and other costs of retaining risk will be passed onto them, if the private market chooses to offer loans outside of the QRM standard at all. **In other words, the proposal unfortunately penalizes qualified, low-risk borrowers**.

The QRM should be redesigned to align with Congressional intent: **encourage sound lending behaviors that reduce future defaults without harming responsible borrowers and lenders.** With respect to credit availability for high loan-to-value lending, the statute specifically recommends eligibility for the QRM standard provided the loans are covered at the time of origination by mortgage insurance, or other credit enhancements, to the extent these protections reduces the risk of default.

Consumer Impact of Proposed QRM

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.

Based on 2009 income and home price data, it would take almost 9 years for the typical American family to save enough money for a 10 percent down payment, and fully 14 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*. A 20 percent down payment requirement for the QRM means that even the most creditworthy and diligent first-time homebuyer cannot 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 (See Attachment 1). This will significantly delay or deter aspirations for home ownership, or require first-time buyers to seek government-guaranteed loan programs or enter the non-QRM market, with higher interest rates and riskier product features without adding a commensurately greater degree of sustainability overall.

Table 1
Years for Median Income Family to Save for Down Payment

	20% Down Payment	10% Down Payment	5% Down Payment	3.5% Down Payment
Median Sales Price	$172,100	$172,100	$172,100	$172,100
Down payment + Closing Costs (est. @ 5%)	$43,025	$25,815	$17,210	$14,628
# of Years Needed to Save @ $3000 per year	14 years	9 years	6 years	5 years

Source: Center for Responsible Lending Issue Brief, "Don't Mandate Large Down Payments on Home Loans." Based on NAR's 2009 median home price of $172,100, and median family income of $49,777. At $3000 per year, the savings rate in the example is 6%, equal to the current savings rate, which is at the highest annual level since the early 1990s. These figures are very conservative in that they assume 100% of family savings are dedicated towards a home down payment.

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 significantly lower before tax family incomes and net worth than white households, which translate into sharply lower homeownership rates. 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 data from CoreLogic Inc., nearly 25 million current homeowners 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 5percent minimum equity standard, more 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, 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 data from CoreLogic Inc. 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 in Attachment 2 show the default performance of a sample QRM based on the following attributes of loans: Fully documented income and assets; fixed-rate 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. 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.

As shown in Table 3 (and in Attachment 2), moving from a 5 percent to a 10 percent down payment requirement *on loans that already meet the defined QRM standard* reduces the default experience by an average of only two- or 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. Increasing the minimum down payment even further to 20 percent, as proposed in the QRM rule, would amplify this disparity, 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
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.

Importantly, this analysis takes into account the impact on the performance of the entire cohort of defined QRMs that would result from moving from a 5% minimum down payment on QRMs in that cohort, to a 10 percent and a 20 percent minimum down payment. As such, it shows the *broad market impact* of a QRM with a 5 percent down payment requirement compared to a QRM with a 10 percent or 20 percent down payment requirement, rather than simply comparing default risk on 5 percent down loans to 20 percent down loans. Clearly, moving to higher down payments has a minor impact on default rates market-wide, but a major adverse impact on access by creditworthy borrowers to the lower rates and safe product features of the QRM.

Housing Market Impact of Proposed QRM

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. This should be done before finalizing a rule that imposes 5 percent risk retention across such a broad segment of the market.

Some private estimates have concluded that 5 percent risk retention could result in a three-percentage point rise in interest rates for loans funded through securitization. In other words, today's 5 percent market would become an 8 percent interest-rate market. While that estimate may be high, even 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 5 percent to 6 percent) means that 4 million households would no longer be able to qualify for the median-priced home. A 3-percentage point increase would price out over 12 million households. 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.**

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."

Market Structure

The proposed narrow QRM rule discourages development of a renewed, robust and diversified private lending market. Under the restrictive QRM rule, the vast majority of loans will be non-QRMs subject to the higher costs of risk retention and without regulations that mandate sound underwriting standards. It is not clear whether investors view risk retention as a sufficient substitute for good underwriting, strong documentation, and well-structured mortgage products.

Moreover, with a statutory exemption for FHA and VA, government-backed loans will have a significant market advantage over fully private loans. As a result, the proposed rule will delay, or even halt, the return of fully private capital back into the market. This is contrary to the purpose of the QRM. Mortgage securitization pioneer Lew Ranieri has strongly supported efforts to reform the securitization process and improve the incentive structures in the market, but in response to the proposed rule, Ranieri has said: "The proposed very narrow QRM definition 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. I fear it will also delay the establishment of broad investor confidence necessary for the re-establishment of the RMBS 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 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.

Conclusion

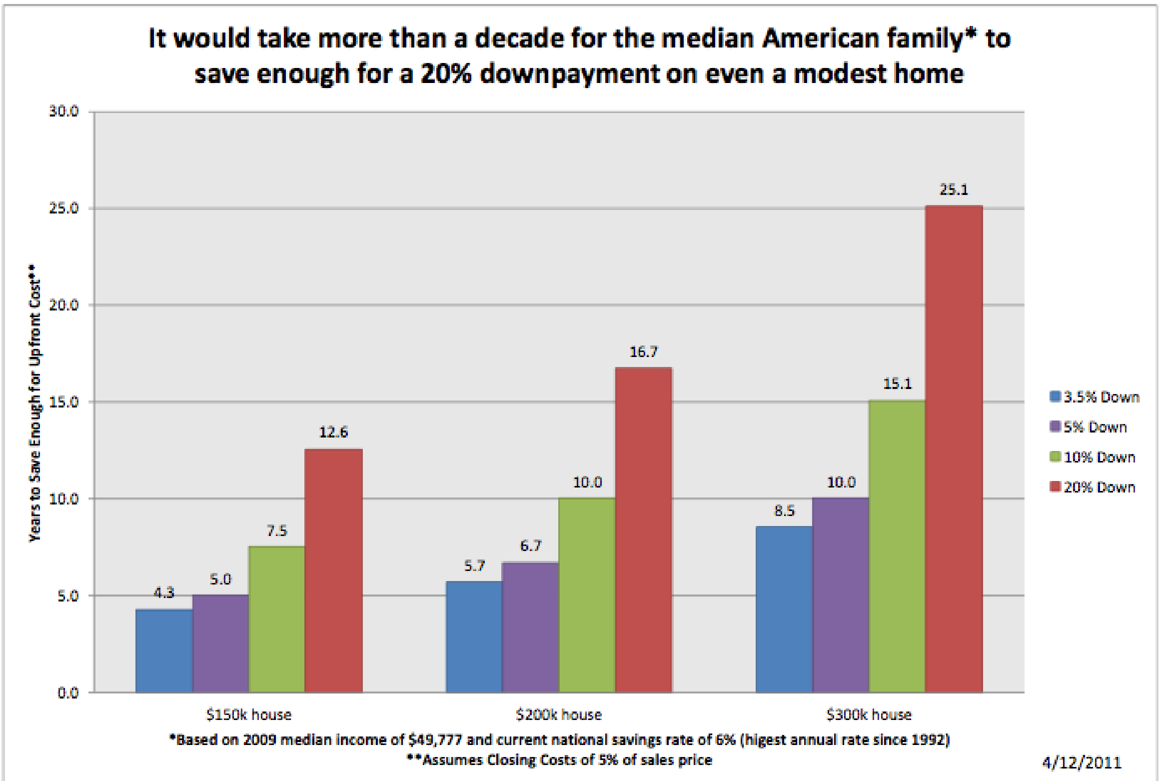
The proposed QRM rule is narrowly drawn, producing a requirement that is misaligned with three key pillars of Congressional intent:

- For consumers, the QRM was intended to provide creditworthy borrowers access to well-underwritten products. Although Congress intended for QRMs to be broadly available, the regulators acknowledge that they crafted this rule to make the QRM "a very narrow slice" of the market.
- Despite specific Congressional rejection of down-payment requirements in the QRM legislative provisions, a fact attested to by the QRM sponsors, the regulators have insisted upon a punitive down payment requirement, even when confronted with ample historical loan performance data that shows down payment is not a primary driver of a loan's performance provided the loan has been properly underwritten and has consumer-friendly features.
- For the housing market, the statutory intent of the QRM was to provide a framework for responsible liquidity provided by private capital that would be broadly available to support a housing recovery. However, the QRM definition in the proposed rule is so narrow that the vast majority of both first-time and existing homeowners will face potentially significantly higher interest rates, or have to postpone purchases and refinances.

- For the structure of the housing finance market, the QRM was intended to help shrink the government presence in the market, restore competition and mitigate the potential for further consolidation of the market. Again, the proposed rule is likely to have the opposite impact.

Regulators should redesign a QRM that comports with Congressional intent: **encourage sound lending behaviors that support a housing recovery, attract private capital and reduce future defaults without punishing responsible borrowers and lenders.**

ATTACHMENT 1

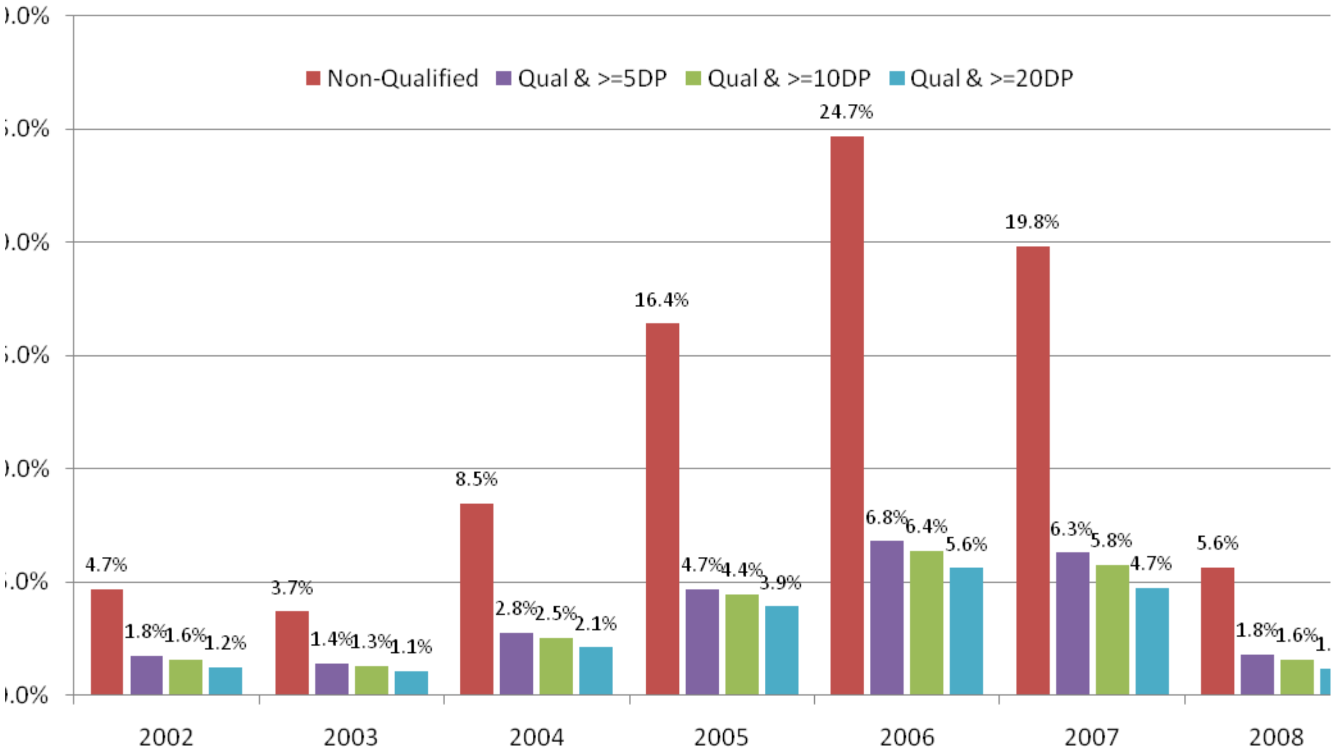


Source: National Association of Realtors®

ATTACHMENT 2

IMPACT OF INCREASING MINIMUM DOWNPAYMENT ON DEFAULT RATES FOR LOANS THAT MEET QRM STANDARDS

Low Down Payments not a Major Driver of Default when Underwritten Properly



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. The QRM in this analysis is based on fully documented income and assets; fixed-rate 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.