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Re: Credit Risk Retention
October 29, 2013

Legislation and Regulatory Affairs Division
Office of the Comptroller of the Currency (OCC)
400 7th Street, SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket Number OCC-2013-0010

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and 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
RIN 3064-AD74

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

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
Constitution Center (OGC) 8th Floor
400 7th Street, SW
Washington, DC 20024

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

Sir or Madam:

My name is Laurie Goodman, and I am currently the Center Director at the Housing Finance Policy Center at the Urban Institute in Washington DC. Prior to my joining Urban earlier this year, I spent close to 30 years as a highly ranked mortgage backed securities analyst, and as head of securitized products research groups at a number of Wall Street firms. This has given me a front row seat on securitization through the years, as well as a unique perspective on the interaction between the capital markets and housing policy.

Thank you for the opportunity to share this perspective through comments on the proposed rules for risk retention under Section 941 of the Dodd-Frank Act. These rules were released by six regulatory Agencies (the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Securities Exchange Commission, the Federal Housing Finance Agency and the U.S.

Department of Housing and Urban Development) on August 22, 2013, with a comment period ending on October 30, 2013. In this comment letter, we focus on only one aspect of the proposal, the Qualified Residential Mortgage (QRM) definition for residential mortgage backed securities.

In the proposal, the Agencies recommended that QRM be equal to the Consumer Financial Protection Bureau's (CFPB's) definition of a Qualified Mortgage (QM). They also asked for comment on a much more restrictive alternative definition of QRM (Alternative QRM or QM Plus). We recognize that in formulating this set of rules, the Agencies were implicitly weighing a series of considerations:

- Requiring that securitizers retain an economic interest in the credit risk of the assets they securitize (risk retention) would better align the interests of securitizers with those of investors and consumers. An exemption from QRM was intended only for assets posing low credit risk.
- An overly narrow exemption from risk retention, exempting only the very highest quality assets, will impose significant constraints on mortgage credit availability.
- An overly broad exemption from risk retention may so limit the size of the non-QRM market that investors will demand a liquidity premium for securities backed by non-QRM loans, making it more difficult to transact in non-QM loans.
- There is a public interest in bringing private capital back into the housing finance system, and the low volume of new mortgage-backed securities issued in recent years (dubbed Securitization 2.0) has been disappointing. Policy should not magnify the impediments to a re-emergence of a sizeable PLS market.

In formulating their QRM recommendations, the Agencies have done an admirable job balancing these considerations: on one hand, they wanted QRM loans to have a low default rate; on the other hand, if QRM is too tight, it will impede efforts to bring private capital back into the market and will further restrict credit availability. The right balance would thus appear to be precisely where they have landed with their main proposal: that QRM equal QM. In this comment letter, we explain why we support the Agencies' main proposal and urge rejection of the alternative. In support of our position, we reference recent empirical work we have done at the Urban Institute.

Issue #1: What is Risk Retention Trying to Accomplish?

What is the goal of risk retention, and what are the most effective ways of achieving that goal? The Agencies state that risk retention is intended to better align the interests of securitizers and other market participants:

> However, when incentives are not properly aligned and there is a lack of discipline in the credit origination process, securitization can result in harmful consequences to investors, consumers, financial institutions and the financial system. During the financial crisis, securitization transactions displayed significant vulnerabilities to informational and incentive problems among various parties involved in the process. Investors did not have access to the same information about the assets collateralizing ABS as other parties in the securitization chain (such as the sponsor of the securitization transaction or an originator of the securitized loans). In addition, assets were resecuritized into complex instruments such as collateralized debt obligations (CDOs) and CDOs-squared, which made it difficult for investors to discern the true value of, and risks associated with, an investment in the securitization. Moreover, some lenders using an "originate-to-distribute" business model loosened their underwriting standards knowing that the loans could be sold through a securitization and retained little or no continuing exposure to the loans. (78 FR 58931)

Congress intended the risk retention requirement to help address these issues in the financial markets. There was a belief that if the securitizer has an economic interest in the securities he originates ("skin in the game"), the incentives of the securitizers will better align with those of investors and consumers.

If risk retention were the only way to align interests among securitizers, investors and consumers, it would be appropriate to maximize the number of loans subject to risk retention. However, if there are other ways to align incentives, the better policy outcome is likely to be to limit the number of loans subject to risk retention, by adopting a broader definition of QRM, so that undue constraints are not imposed on mortgage credit availability or the return of private capital to the mortgage markets.

We believe there are indeed better ways than risk retention to address each conflict of interest among securitizers, investors and consumers. Moreover, there are real questions whether risk retention actually reduces the conflict.

Originators who are also portfolio lenders may be incented to adversely select loans for securitizations. If an originator makes a marginal loan, and has the ability to choose whether to put it into a securitization with 5 percent risk retention or hold it in portfolio with 100 percent risk retention, the loan is apt to go into a securitization. Requiring 5 percent risk retention does little to affect the math in that decision; compared to 100 percent risk retention, the difference between zero and 5 percent is insignificant.

Informational asymmetry—originators and underwriters (deal sponsors) are generally incented to select loans to maximize profit. In earlier years, and especially during the bubble, there was huge informational asymmetry between loan originators on one hand and investors on the other. Consumers were urged to overstretch by lenders who knew those loans could be sold into the markets, to the detriment of both consumers and investors. Now, the ability-to-repay rules require full documentation and a full assessment of a borrower's ability to pay. No documentation loans, where the informational asymmetries are the largest, are a relic of the past.

Moreover, the amount of information disclosed to investors on the characteristics of securitized loans at origination is much greater than it was during the crisis years. Project RESTART, sponsored by the American Securitization Forum, brought together issuers and investors and produced a list of loan and pool-level data elements that should be disclosed for each deal; this disclosure package has been adopted by the industry. Project RESTART also suggested a standardization of monthly reporting, outlining the critical fields, increasing the amount of information available to investors. The disclosure package helps investors appreciate the degree of risk layering in the loans that compose the underlying pool of securities. Again, requiring 5 percent risk retention does not appear to add much protection here, particularly given that a bank originator would still opt to put a risky loan into a security rather than hold it in portfolio.

Originators were not incented to do adequate due diligence. The protection that representations and warranties (reps and warrants) was supposed to afford investors has been ineffective because of a breakdown in incentives and information among originators, trustees and investors. Trustees were responsible for the enforcement of reps and warrants, but servicers were the only ones with information to detect the violations. Risk retention does not address the problem, as it does not incent the servicer to more proactively enforce the reps and warrants, particularly when the originator, the servicer and the deal sponsor are the same party. The servicer/sponsor is not going to actively opt to put loans back to itself. Given these inherent

conflicts of interest, Securitization 2.0 deals generally require (1) heavy up-front due diligence, (2) automatic review of any loan that goes 120 days delinquent, and (3) binding arbitration to settle disputes. Some deals also require an independent entity who represents investor interests in the up-front due diligence, in the loan file review and in the put-back process. While the up-front due diligence and reps and warrants repurchase process will be further refined as Securitization 2.0 begins to build momentum (and we would like to see more deals use an independent entity representing investors' interests), it is clear the intent is to make originators liable for their manufacturing defects, and to have an enforcement mechanism that requires originators to make good on their obligations.

The interests of servicers and investors often conflict. The servicer may be a second lien investor or own various default management services. These services include such items as property inspection services, property preservation services, broker price opinion (BPO) services, and real-estate owned (REO) management and brokerage. A servicer that owns the second mortgage is less likely to agree to a short sale (as the second lien is wiped out entirely). The servicer that owns property preservation services is more likely to charge an over-market, but still acceptable, price for its services. This strategy clearly does not maximize the net present value of the loans, thus disadvantaging investors. Borrowers are also at a disadvantage in these situations. A servicer holding a second lien has an incentive not to do a short sale even when it would be the preferred outcome for both the borrower and investor. Similarly, a servicer that owns a BPO operation may charge more than is necessary to value the property in order to determine whether the borrower should receive a modification. If a modification is received, this amount will be capitalized into the outstanding balance on the loan. Again, risk retention does not address either of these inherent conflicts.

The idea behind risk retention is that it would better align the interests of securitizers, investors and consumers, but as we have explained it is not actually well positioned to address the misalignments that exist among these parties. Fortunately, the market has done a substantial amount of alignment in the form of better disclosures (so investors can better evaluate layered risk) and better (albeit not perfect) protection for investors against manufacturing defects. On the consumer side, the ability-to-repay rule, and the penalties associated with a failure to perform due diligence, weaken the need for risk retention.

Given this set of facts, we believe that QRM should err on the side of meeting other policy objectives. Thus, we prefer the broadest possible definition of QRM: that QRM equal QM.

Issue #2: Impact on Accessibility and Affordability

It is clear that the proposal to equate QRM with QM was intended to balance a lower default rate with accessibility and affordability considerations. The Agencies note:

> Consistent with these statistical models, historical data indicate that mortgages that meet the QM criteria have a lower probability of default than mortgages that do not meet the criteria. This pattern is most pronounced for loans originated near the peak of the housing bubble, when non-traditional mortgage products and lax underwriting proliferated. For example, of loans originated from 2005 to 2008, 23 percent of those that met the QM criteria experienced a spell of 90-day or more delinquency or a foreclosure by the end of 2012, compared with 44 percent of loans that did not meet the QM criteria. In citing these statistics, the agencies are not implying that they consider a 23 percent default rate to be an acceptable level of risk. (78 FR 57989)

The Agencies go on to mention that the high default rate was caused by an "extraordinary macroeconomic environment" (78 FR 57989) and is not typical of what can be expected going forward. Moreover, the agencies are "concerned about the prospect of imposing further constraints on mortgage credit availability at this time, especially as such constraints might disproportionately affect groups that have historically been disadvantaged in the mortgage market, such as lower-income, minority, or first-time homebuyers" (78 FR 57991).

Indeed, the pre-crisis period was highly unusual. Moreover, in citing default numbers, the Agencies appear to be looking solely at loans that go 90+ days delinquent. But a huge number of loans that go 90+ days delinquent eventually cure (or are modified). Looking instead at loan termination—which we define as liquidation with a loss, REO, or no payment for 24 months—the negative outcomes are much smaller.

We recently examined default rates for private label securities (PLS), comparing mortgages that go 90+ days delinquent (D90+) and those that terminated, as defined above. Our analysis confirms the Agencies' conclusion that there is a significant difference in the default experience between QM and non-QM mortgages. Table 1 (page 8) shows that 2005 and earlier PLS loans had a default rate (as measured by D90+) of 15.92 percent; this was 9.97 percent for the QM-eligible loans and 19.0 percent for the non-QM-eligible loans. The numbers were clearly much higher for the 2006–08 period and negligible for the 2009 and later period. However, termination rates are much lower. For PLS loans originated in 2005 and earlier, the share of terminations was 9.78 percent, with 5.81 percent of the QM loans and 11.81 percent of the non-QM loans

terminated. Bottom line: based on the pre-2005 PLS experience and focusing in on loans likely to generate losses rather than on loans 90+ days delinquent, the QM default numbers are tolerable.

The definition of QRM under the Alternative Proposal (also referred to as QM Plus) is very narrow: the loan must be QM *and* have a loan-to-value (LTV) ratio of 70 or less; it must be secured by an owner-occupied property; and the borrower must have a very good credit history (not currently 30 days past due on any debt, not 60 days past due on any debt in the past 24 months, no bankruptcy of foreclosure in the past 36 months). Moreover, the first lien on a purchase loan is disqualified if there is a second lien.

Not surprisingly, the loans that meet the definition of QRM under Alternative QRM (QM Plus) have much lower default rates historically than do those that meet the broader definition in the main proposal. But QM Plus covers almost no loans. As shown above, QM-eligible 2005 and earlier loans had a 5.81 percent default rate (D90+). Loans that were QM Plus eligible had a default rate of 1.11 percent; those that were QM, but not QM Plus, eligible had a default rate of 11.40 percent. Similarly, when the definition of default is termination, the rate on the QM-eligible 2005 and earlier loans were 5.81 percent overall, 0.33 percent on the QM Plus–eligible loans and 6.71 percent on the loans that are QM, but not QM Plus, eligible. However, very few loans have been QM Plus eligible. For PLS loans issued in 2005 and earlier, only 2 percent of the entire universe qualified for QM Plus. Even for the very high quality 2009 and later origination, only 32 percent qualify, and these are disproportionately refinance loans. Only 15 percent of the 2009 and later purchase loans qualify, with the largest culprit in non-qualification being the 70 percent LTV requirement.

In balancing the trade-offs, we conclude (1) the default experience of QM loans is far better than of non-QM loans; (2) QM loans have an acceptable default rate if one eliminates the 2006–08 extraordinary experience, particularly when one uses a definition of default that is more predictive of actual losses than 90+ days delinquent; and (3) loans that qualify for QM Plus have a very low default rate, but very few loans actually qualify, and a disproportionate amount of these loans represent refinance activity.

Table 1. Private Label Securities Ever D90+ Rates and Termination Rates

Year	Type	QRM Count (%)	Alt QRM Count (%)	Ever D90+ Rates					Termination Rates				
				Total	New QRM		Alternative QRM (within QRM)		Total	New QRM		Alternative QRM (within QRM)	
					Yes	No	Yes	No		Yes	No	Yes	No
2005 and earlier	Purchase	31%	1%	17.83%	10.09%	21.15%	0.95%	10.80%	11.29%	6.15%	13.47%	0.27%	6.60%
	Refi	43%	7%	8.01%	4.26%	10.94%	0.73%	5.52%	4.64%	2.23%	6.51%	0.19%	2.96%
	Cash-Out Refi	40%	2%	18.55%	14.48%	20.55%	1.95%	16.03%	11.19%	8.36%	12.56%	0.64%	9.27%
	Other	36%	0%	13.69%	10.09%	15.61%	0.00%	0.00%	4.74%	3.05%	5.64%	0.00%	0.00%
	Total	37%	2%	15.92%	9.97%	19.00%	1.11%	11.40%	9.78%	5.81%	11.81%	0.33%	6.71%
2006–08	Purchase	13%	0%	53.34%	32.78%	55.81%	2.37%	35.63%	34.95%	22.86%	36.40%	0.87%	24.77%
	Refi	13%	1%	51.38%	28.23%	53.87%	5.34%	33.63%	32.64%	18.02%	34.22%	2.30%	21.37%
	Cash-Out Refi	19%	1%	53.83%	40.85%	55.77%	8.78%	43.95%	34.55%	26.97%	35.69%	3.93%	28.89%
	Other	4%	0%	59.88%	24.62%	61.50%	0.00%	0.00%	35.19%	8.76%	36.42%	0.00%	0.00%
	Total	16%	1%	53.26%	35.96%	55.51%	5.71%	39.33%	34.44%	24.25%	35.78%	2.48%	26.41%
2009 and later	Purchase	75%	15%	0.20%	0.17%	0.29%	0.00%	0.22%	0.03%	0.03%	0.03%	0.00%	0.04%
	Refi	78%	44%	0.19%	0.05%	0.67%	0.02%	0.10%	0.02%	0.01%	0.06%	0.00%	0.02%
	Cash-Out Refi	52%	25%	0.94%	0.34%	1.86%	0.08%	1.19%	0.19%	0.02%	0.45%	0.00%	0.10%
	Other	39%	0%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
	Total	73%	32%	0.26%	0.11%	0.67%	0.02%	0.19%	0.04%	0.02%	0.10%	0.00%	0.03%
Total	Purchase	27%	1%	27.25%	12.64%	32.11%	1.12%	13.56%	17.81%	8.14%	20.96%	0.34%	8.75%
	Refi	38%	6%	16.25%	5.38%	22.80%	0.87%	7.01%	10.30%	3.04%	14.55%	0.26%	4.03%
	Cash-Out Refi	35%	2%	28.66%	18.08%	32.62%	2.70%	19.93%	18.37%	11.16%	21.00%	1.01%	12.32%
	Other	35%	0%	15.65%	10.16%	18.41%	0.00%	0.00%	6.08%	3.08%	7.59%	0.00%	0.00%
	Total	32%	2%	25.50%	12.62%	30.60%	1.44%	14.43%	16.48%	7.87%	19.80%	0.48%	9.05%

Sources: CoreLogic Securitized (MBS/ABS) databases and Urban Institute calculation

Issue #3: Impact on Market Composition

It is clear the Agencies have given a lot of thought to the composition of the market. See for example,

> The agencies recognized that aligning the QRM and QM definitions has the potential to intensify any existing bifurcation in the mortgage market between QM and non-QM loans, as securitizations collateralized by non-QMs could have higher funding costs due to risk retention requirements in addition to potential risk of legal liability under the ability-to-repay rule. The agencies acknowledge this risk, but judge it to be smaller than the risk associated with further segmentation of the market. (78 FR 57991)

> [T]he agencies' analysis of mortgage market data led the agencies to conclude that an approach that aligns QRM with QM covers most of the present mortgage market, and a significant portion of the historical market, putting aside non-traditional mortgages related primarily to subprime lending and lending with little documentation. The QM-plus approach would cover a significantly smaller portion of the mortgage market. (78 FR 57994)

> [T]he agencies are considering the factors that will drive the incremental cost of risk retention. If the non-QRM market is small relative to the QRM market, investors might demand a liquidity premium for holding securities collateralized by non-QRMs. Investors might also demand a risk premium for holding these securities if non-QRMs are perceived to be lower-quality mortgages. If the scope of the non-QRM market is sufficiently broad to avoid these types of premiums, the factors impacting cost will be the amount of additional risk retention that would be required under the rule, above current market practice and the cost to the securitizer of funding and carrying that additional risk retention asset, reduced by the expected yield on that asset. (78 FR 57994)

Given a concern for market composition, it is worth considering what the market will look like under two different regimes. If QRM = QM, there will be a small number of non-QM loans that may be securitized and hence subject to risk retention. The number of non-QM loans will be small, as the potential liability associated with such loans is perceived to be

significant. Either these loans must be ultra-safe owing to compensating risk factors (e.g., compensate for a high DTI with a very low LTV), or the mortgage rate will be very high, as that is the price originators will require to absorb the litigation and default risk on non-QM mortgages.

The securitization market for these loans will be even smaller because of the "assignee liability" issue. That is, under the ability-to-repay rules, an investor could be responsible if a non-QM/QRM mortgage or a QM/QRM mortgage subject to a rebuttable presumption fails and the borrower did not in fact have an ability to repay. Many investors will have a problem taking responsibility for an item that they cannot monitor and is beyond their control. It is conceivable that investors can be made whole through reps and warrants from the originator, but the investor is then taking counterparty risk, that is, the risk that the originator is financially insolvent, and hence unable to pay any claims. We believe the only non-QM loans that are likely to be securitized, at least in the near term, are those that have compensating factors sufficient to insure an ultra-low probability of default. A market will exist for more risky non-QM product, originated at a much higher mortgage rate, but this is apt to be the province of specialty lenders.

If QRM = QM Plus, there will be a trifurcated market: (a) loans that are QM and QRM loans; (b) loans that are QM but not QRM; and (c) loans that are neither. We believe that the first two segments can both be liquid enough for an operating market. However, if a large portion of the market requires risk retention, that portion of the market could be off limits to non-depository originators, who generally do not have the capital or portfolio for risk retention. Non-depository originators already have an increasing share of the market, growing from 14.6 percent of originations in 2009 to 19.3 percent in 2012. And the non-depository share is likely to grow more in the years ahead as increased Basel III capital requirements make retention of mortgages in portfolio more expensive, and the onerous capital requirements on mortgage servicing rights raise the cost of originating for securitizations. While non-depositories can participate in non-agency securitizations by partnering with a REIT that becomes the deal sponsor and retains the risk, this is likely to make securitization of these loans more expensive. Our fear is that mortgage rates to non-QM Plus borrowers (including in particular purchasers without 30 percent down payments) will be driven up considerably. This is not a problem in the near term: most over-70 percent

LTV production is going either to the GSEs or to FHA and is exempt from risk retention. Adopting QM Plus is likely to make it more difficult to shrink the government footprint.

Issue #4: QRM and an Ever-Changing Housing Finance Landscape

Another reason to prefer the QRM = QM definition is that it is more flexible in accommodating changes in the housing finance landscape, which are inevitable over the next several years. The QM rule, which reduces litigation risk in connection with determining a borrower's ability to repay the loan, is in the sole jurisdiction of the CFPB. The QRM rule, governing risk retention for securitizations, requires six agencies to agree on a definition. As the timeline of the QM and QRM rules has demonstrated, a single agency has more flexibility to respond in a timely manner to changing conditions. In any case, notice and a comment period would obviously be required, providing all parties an opportunity to participate in the rulemaking.

One of the likely changes is the end to GSE conservatorship. The CFPB defined the QM rule such that Fannie and Freddie loans are automatically QM for the shorter of seven years or when the conservatorship ends. Once that period is over, and unless the CFPB writes similar rules covering any successor system, a much larger portion of loans will be tested under regular QM standards. Similarly, the QRM proposal makes it clear that Fannie and Freddie securities are exempt from risk retention only as long as the GSEs are in conservatorship or receivership. Describing the original proposal, the agencies note:

> With respect to securitization transactions sponsored by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (jointly, the Enterprises), the agencies proposed to recognize the 100 percent guarantee of principal and interest payments by the Enterprises on issued securities as meeting the risk retention requirement. However, the recognition would only remain in effect for as long as the Enterprises operated under the conservatorship or receivership of FHFA with capital support from the United States. (78 FR 57933)

The current proposal states that this section stands as originally written:

> Accordingly the agencies are now proposing the same treatment for the Enterprises as under the original proposal, without modification.

> Consistent with the original proposal, if any of the conditions in the proposed rule cease to apply, the Enterprises or any successor organization would no longer be able to rely on its guarantee to meet the risk retention requirement under Section 15G of the Exchange Act and would need to retain risk in accordance with one of the other applicable sections of this risk retention proposal. (78 FR 57961)

This suggests that if/when the Enterprises are wound down or replaced; the QRM rules would apply to mortgages securitized by whatever mechanism comes after them. If the Alternative QRM proposal is adopted, a huge number of additional new mortgages would be subject to risk retention (and the attendant costs) at a time when the system would be coping with a major adjustment (the replacement of the GSEs), and borrowers would be faced with higher mortgage rates as a result of that adjustment. And, if at that point there was a desire to change the Alternative QRM, it would require all six regulatory agencies to agree, while they too are trying to make other adjustments to cope with the new system.

Issue #5: QRM Should Be Countercyclical

As home prices ran up during the bubble preceding the financial crisis, lending standards loosened, fueling a further run-up in house prices. Housing finance policy should be countercyclical, to encourage an expansion of the credit box when home prices are low and borrower affordability is relatively high, and discourage an expansion of the credit box when home prices are high and borrower affordability is low. And if policy cannot be countercyclical, at a minimum it should not be pro-cyclical. We believe that Alternative QRM is pro-cyclical, while QRM = QM is neutral.

Why is Alternative QRM pro-cyclical? Alternative QRM requires 30 percent down; on a refinance loan, 30 percent down is much easier to achieve after years of robust home price appreciation. Alternative QRM also requires very good credit, much easier to attain when the economy is doing well and interest rates are relatively higher. But as a matter of economic policy, we should want to encourage refinancing when rates are relatively low, the economy is doing less well, and home prices are relatively lower.

Even more stark is the impact of Alternative QRM on home purchases—again, an activity one would want to encourage when house prices are low and the economy is not

doing so well. It is very hard for purchase loans, particularly from first-time home buyers, to qualify for Alternative QRM, as very few first-time buyers have the necessary 30 percent down payment. Table 1 above shows that 37 percent of pre-2005 PLS loans would be eligible if QRM = QM (31% for purchase loans), 16 percent would be eligible in the 2006–08 period (13% for purchase loans) and 73 percent in the 2009 and later period (75% of the purchase loans). Thus, there is only a modest difference in the eligibility rates between purchase loans and refinance loans. Virtually no pre-2009 PLS loans of any sort would have qualified under Alternative QRM. But from 2009 on, there is a large difference in Alternative QRM eligibility: 32 percent of the loans in the 2009 and later period are Alternative QRM eligible, but only 15 percent of the purchase loans. As shown in other recent Urban Institute research, the primary reason purchase loans are disqualified as Alternative QRM in the most recent period is the 70 percent LTV requirement.

The numbers for GSE loans are very similar. Table 2 (next page), drawn from Freddie Mac data, shows that 66 percent of the GSE loans originated in 2005 and earlier would have been QM eligible, 57 percent in 2006–08, and 85 percent from 2009 and later. There was only a modest difference between purchase loans and refi loans. Looking at Alternative QRM eligibility, however, 12 percent of the 2005 and earlier loans qualify (5% for purchase loans), 11 percent of the 2006–08 cohort (5% of the purchase loans), and 29 percent of the 2009 and later production, but only 10 percent of the purchase loans. These observations divide purchase loans from refinance loans. If we could identify first-time home buyers, the pattern we describe here would be even more pronounced. If one does not want to place additional obstacles in the way of first-time home buyers, it would be a mistake to adopt Alternative QRM.

The bottom line is that the Alternative QRM proposal is very pro-cyclical, essentially encouraging refinancing during periods of high home prices, which could also encourage cash-out refinances, a situation that set many bubble-era borrowers up for serious trouble as house prices declined. In contrast, very few purchase mortgages, and even fewer, if any, first time home buyers could qualify for Alternative QRM at any point in the cycle.

Table 2. Freddie Mac Loans, Percent of QRM, Percent of Alternative QRM

Year	Type	New QRM	Alternative QRM
2005 and earlier	Purchase	70%	5%
	Refi	71%	22%
	Cash-Out Refi	55%	18%
	Total	66%	12%
2006–08	Purchase	55%	5%
	Refi	57%	15%
	Cash-Out Refi	60%	17%
	Total	57%	11%
2009 and later	Purchase	84%	10%
	Refi	86%	31%
	Cash-Out Refi	83%	43%
	Total	85%	29%
Total	Purchase	75%	9%
	Refi	84%	30%
	Cash-Out Refi	77%	36%
	Total	80%	26%

Sources: eMBS data and Urban Institute calculations.

Conclusion

We wholeheartedly support the proposal that QRM be equal to QM. In establishing this recommendation, the Agencies carefully weighed the evidence and the trade-offs. They should be applauded for doing so in such a thoughtful manner.

Respectfully submitted,

Laurie Goodman

Director, Housing Finance Policy Center