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Mr. Alfred M. Pollard
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Mr. Robert Feldman
Executive Secretary
Federal Deposit Insurance
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Re. Joint Proposed Rule on Credit Risk Retention OCC RIN 1557-AD40; FRB RIN 7100-AD70; FDIC RIN 3064-AD74; SEC RIN 3235-AK96; FHFA RIN 2590-AA431 HUD RIN 2501-AD53

Dear Mr. deV. Frierson, Mr. Pollard, Mr. Feldman, Ms. Murphy and To Whom It May Concern:

I am contacting you on behalf of Woodstock Institute and the undersigned organizations regarding the re-proposed interagency rules implementing the credit risk retention requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Woodstock Institute commented in 2011 on the original proposed risk retention rules and noted our concern about unnecessarily strict underwriting requirements for the Qualified Residential Mortgage (QRM) that would risk overly restricting credit availability, particularly for low-wealth homebuyers and homebuyers of color. We strongly support the re-proposed rules redefinition of QRM underwriting standards that aligns with the Qualified Mortgage (QM) underwriting standards. This structure will protect both consumers and investors by promoting high-quality underwriting while not overly limiting credit in an already-tight credit market. We believe that this standard is preferable to the alternative QM-plus standard.

Ms. Elizabeth M. Murphy
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About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of fair lending, wealth creation, and financial systems reform. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Our key tools include: applied research; policy development; coalition building; and technical assistance.

Original QRM underwriting standards were too restrictive

The portions of the Dodd-Frank Act creating the QRM standard were intended to achieve an admirable goal: ensure that mortgage lenders have a stake in the long-term performance of the loans they originate. The mortgage foreclosure crisis was precipitated by notoriously lax underwriting standards, such as a lack of income documentation, and poor product features, such as teaser rates and payment options. Woodstock Institute research has demonstrated that high-cost, subprime mortgage lending was highly concentrated in communities of color and was a primary driver of foreclosures. Borrowers, particularly those of color, were steered into high-cost, subprime loans even in cases where they could have qualified for affordable 30-year, fixed-rate mortgages.¹

Since lenders that originated loans could securitize and sell the risk, they had little incentive to ensure that the loans they underwrote had good prospects for long-term sustainability. The rationale behind the risk retention requirements of Dodd-Frank was to change that incentive structure by requiring originating lenders to retain five percent of the risk, thereby giving originators an interest in the long-term performance of the loan. The QRM standards are intended to identify loans of high credit quality and low likelihood of default, which would justify exemption from risk retention requirements.

Woodstock Institute agrees that non-traditional products with features that significantly raise the likelihood of default should be subject to risk retention requirements. The five percent risk retention requirement would give originators an incentive to diligently underwrite their loans and limit the availability of risky products. Based on comments on the original proposed rules from advocates and the mortgage industry, it is clear that the definition of QRM will set standards for the entire mortgage market. Non-QRM 30-year fixed rate loans would be priced an estimated 75 to 400 basis points higher than QRM loans.² This price differential could limit wealth-building opportunities or cause some consumers to exit the homeownership market entirely.

Regulators must be especially cognizant of the risk that overly strict QRM standards would limit credit availability to a large portion of the market, especially low-wealth and first-time homebuyers. The original proposed rules, which included a 20 percent down payment requirement and maximum front-end and back-end debt-to-income ratios of 28 and 36 percent, would have produced loans with extremely low default risk, but also would have severely limited the availability of credit to the majority of potential homebuyers.

¹ See Immergluck, Dan and Geoff Smith. "Risky Business: An Econometric Analysis of the Relationship Between Subprime Lending and Neighborhood Foreclosures." Woodstock Institute. March 2004. See also settlements between Illinois Attorney General Lisa Madigan and mortgage lenders such as Countrywide/Bank of America ("Madigan, U.S. DOJ Reach \$335 Million Settlement With Countrywide/Bank Of America Over Discriminatory Lending." December 2011. www.illinoisattorneygeneral.gov) and Wells Fargo ("Madigan, U.S. DOJ Reach \$175 Million Settlement With Wells Fargo Over Discriminatory Lending." July 2012. www.illinoisattorneygeneral.gov)

² DeRitis, Cristian and Mark Zandi. "A Clarification on Risk Retention." Moody's Analytics. 2001. See also Lischer, Jeff. "Risk Retention/Qualified Residential Mortgage (ARM) Proposed Rule." National Association of Realtors. 2011.

Woodstock Institute appreciates the regulators' response to concerns about the original QRM proposal's effects on the credit market. We believe that setting the QRM underwriting standards to QM standards will both encourage high-quality, low-default mortgages and allow for adequate availability of appropriate low-down-payment loans that make homeownership accessible for low-wealth and first-time homebuyers.

Matching QRM to QM will encourage high-quality lending

The goal of the QRM underwriting standards is to protect investors by ensuring that the only mortgages exempt from risk retention requirements are mortgages with low default risk. Similarly, the goal of the QM underwriting standards is to ensure that borrowers can repay their loans, which would also decrease the risk of default.³ These two goals align closely and cross-referencing the two underwriting criteria makes sense.

Lenders who make loans that qualify as QM loans are entitled to a presumption of compliance with ability-to-repay requirements. Lower-priced QM loans receive a conclusive presumption of compliance, or a "safe harbor," while higher-cost QM loans receive a lower standard of legal protection, or a "rebuttable presumption" of compliance. Borrowers who receive loans that do not comply with ability-to-repay standards can use noncompliance as a defense to foreclosure. The legal risk posed by non-QM loans clearly provides an incentive for lenders to originate QM loans.

One way that the QM final rule issued by the Consumer Financial Protection Bureau (CFPB) aims to ensure that borrowers can repay their mortgages is by codifying underwriting and product standards. These standards include documentation of the borrowers' debt and income; a cap of 43 percent on the borrower's back-end, debt-to-income (DTI) ratio; loan terms not exceeding 30 years; points and fees not exceeding three percent of the loan amount; and prohibition of risky product features such as negative amortization, interest-only payments, and balloon payments. These standards exclude many of the mortgages that prompted high default rates and the resulting foreclosure crisis.

Extensive research has demonstrated that, when coupled with sound underwriting standards such as the QM standards, low-down-payment mortgages can have low default risk. One report found that loans that met the originally-proposed QRM definition with a 20 percent down payment had a foreclosure rate of 0.14 percent, while lowering the down payment requirement from 20 percent to 3 percent only raised the foreclosure rate to 0.26 percent—much lower than the average foreclosure rate of 2.3 percent.⁴

Research from the University of North Carolina/Center for Responsible Lending (UNC/CRL) demonstrates that loans that meet QM product standards perform significantly better than non-QM loans.⁵ In their study, loans meeting QM standards that were originated between 2000 and 2008 performed better than all other classes of loans, including prime conventional loans. Loans meeting QM standards had a default rate of 5.8 percent, compared to 7.7 percent for prime conventional, 9.7 percent for FHA, 22.3 percent for Alt-A, and 32.3 percent for subprime conventional loans. The regulators' own analyses reinforce this conclusion, finding that 23 percent of loans that met QM criteria originated between 2005 to

³ Sherlund, Shane M. "The Past, Present, and Future of Subprime Mortgages." Federal Reserve Board. 2008.

⁴ Silver, Josh and Archana Pradhan. "The Impact of the Proposed Qualified Residential Mortgage Definition on Home Opportunity in America." National Community Reinvestment Coalition. July 2011.

⁵ Quercia, Roberto, Lei Ding, and Carolina Reid. "Balancing Risk and Access: Underwriting Standards and Qualified Residential Mortgages." Center for Community Capital at the University of North Carolina and Center for Responsible Lending. January 2012.

2008 experienced a 90-day delinquency, compared to 44 percent of loans that did not meet QM criteria.⁶ Both research findings show low default rates for all loans that would qualify as QM loans, including higher-priced QM loans that do not qualify for safe harbor. Therefore, we do not believe that it is necessary to limit the definition of QRM to QM loans that qualify for safe harbor.

The UNC/CRL authors found that adding additional underwriting standards above and beyond QM criteria, such as high down payments and strict credit score requirements, lower default rates at the cost of restricting credit to a very high percentage of qualified borrowers, especially borrowers of color and low- and moderate-income borrowers. For example, requiring a 20 percent down payment for QRM status would reduce default rates by less than two percent relative to the default rate on loans meeting QM standards, while excluding 60 percent of all QM loans from the QRM definition. Under a strict QRM definition, with a 20 percent down payment, FICO above 690, and 30 percent DTI ratio, 12 performing QM loans would be excluded for every one default prevented.⁷

Research indicates that including strict down payment, DTI, and credit score standards would have disproportionately restricted credit from people of color, potentially exacerbating the racial wealth gap. Under the strict standards mentioned above, 85 percent of all borrowers would be excluded from the QRM market while 93 percent of African Americans and 91 percent of Latinos would be excluded.⁸ Other research found that loans in communities of color are half as likely to qualify for a strict QRM definition as loans in predominantly white communities.⁹ Given the history of government practices that restrict access to credit and housing to people of color, regulators must be particularly mindful of the risk of enacting policies that would result in even more inequality of opportunity.

The down payment standards originally proposed for the QRM rules, including a 20 percent down payment requirement, would have lowered default risk only minimally, but would have substantially limited credit access to low-wealth borrowers, borrowers of color, and first-time homebuyers. The final QM underwriting standards, which do not include that requirement, are sufficiently rigorous to produce loans with low default risk, even if the loans have a low down payment. Cross-referencing QM underwriting standards for the QRM standards strikes an appropriate balance between preserving credit access for creditworthy borrowers and promoting high-quality mortgage lending and risk management.

QM-plus is an inferior proposal

In addition to the primary QRM definition that cross-references QM underwriting standards, the regulators included an alternative proposed definition called “QM-plus.” The QM-plus proposal would define QRM loans as QM loans if they meet additional requirements, including a limitation to loans on one-to-four family principal dwellings and first-lien loans, strict standards for the borrower’s credit history, and a 30 percent down payment requirement. The logic behind the QM-plus proposal was to significantly limit the number of loans that would be exempt from risk retention standards. Theoretically, mortgage lenders would not be able to base their business solely on QRM loans under this definition because such a small fraction of borrowers would be able to qualify for them, and therefore lenders would be encouraged to continue making non-QRM loans and retain risk on a greater proportion of mortgages.

As demonstrated by the research cited above, well-underwritten mortgages with low down payments are not appreciably riskier than high-down-payment mortgages. Estimates consistently show that non-QRM loans will be considerably more expensive than QRM loans. Given the impact QRM standards will have

⁶ See analysis of data in current QRM proposed rule: Credit Risk Retention, 78 FR 57989. September 20, 2013.

⁷ Quercia *et al.*

⁸ Quercia *et al.*

⁹ Silver and Pradhan 2011.

on access to credit, underwriting requirements should be included in QRM rules only if they are significantly predictive of default risk above and beyond the default rate of QM-qualifying loans. The alternative QM-plus proposal fails to follow this principle by requiring an extremely high down payment, which would raise costs for the vast majority of borrowers without an accompanying reduction in default risk. We are concerned that the non-QRM market would not be as large as regulators posit under the QM-plus proposal, given the risk-averse mortgage lending behavior exhibited after the recession. There is a risk that, in the face of requirements for retaining risk on the majority of their portfolio, lenders may exit the market entirely and shift to other lines of business. The drastic limitation in access to credit under the QM-plus proposal vastly outweighs the limited reduction in default rates and would disproportionately exclude low- and moderate-income homebuyers, first-time homebuyers, and homebuyers of color.

Regulators should align QRM standards with QM standards

We thank the regulatory agencies for responding to concerns of consumer organizations and the mortgage industry that the original QRM proposal would have unduly limited credit to creditworthy borrowers, particularly low-income borrowers and borrowers of color. The re-proposed rules deftly balance enforcing prudent risk management and underwriting standards with allowing adequate access to credit. We urge regulators to pursue the primary QRM proposal that aligns with QM standards rather than the QM-plus proposal.

Sincerely,



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Executive Director, Partners in Community Building

Rob Breymaier
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