Massachusetts Bankers Association

August 1, 2011

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
**Docket Number: OCC–2011–0002**

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary
**File Number S7–14–11**

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
**Docket No. R–1411**

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attn.: Alfred M. Pollard, General Counsel
**RIN number 2590–AA43**

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attn.: Comments, Robert E. Feldman, Executive Secretary
**RIN 3064–AD74**

Department of Housing and Urban Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
**Docket Number: FR–5504–P–01**

**Re: Proposal to Establish Credit Risk Retention Requirements**
**76 Federal Register 24090**

To Whom It May Concern:

On behalf of the Massachusetts Bankers Association's (MBA) more than 190 commercial, savings, cooperative banks and savings and loan associations in Massachusetts and New England, we appreciate the opportunity to comment on the joint proposal by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation; the Securities and Exchange Commission; the Federal Housing Finance Agency and the Department of Housing and Urban Development (collectively, the "Agencies") on the Agencies' joint proposal to implement section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DFA). Section 941 requires institutions that securitize asset-backed securities (ABS) to retain an economic interest in a portion of the credit risk of those transactions. DFA also requires the Agencies to develop exceptions to the risk retention requirements that are designed to be an incentive to market participants to originate soundly underwritten loans and align the interests of participants with investors, consistent with improving access to credit on reasonable terms.

MBA understands the challenge the Agencies face in writing and implementing extraordinarily complex regulations within a compressed timeframe mandated by DFA and we appreciate the amount of time and resources the Agencies have devoted to developing this proposal. However, we believe the current proposal is unworkable, must be withdrawn, and substantially revised before it is re-issued for further comment. In particular, we believe the agencies' proposal goes well beyond Congressional intent and many of the fundamental concepts are so unclear that it is impossible for the banking industry to provide informed comments.

Most importantly for our member institutions, the "qualified residential mortgage" (QRM) exception to the risk retention requirements is so narrowly constructed that it will have a devastating impact on the residential mortgage securitization market and the availability of credit to homebuyers. Given the importance of a robust mortgage lending market to the nation's economy and the health of the banking industry, we urge the Agencies to conduct a more thorough economic analysis of the proposed rule prior to reissuing the proposal.

In addition, we believe the Agencies must view the risk retention rules as an integrated part of many other mortgage-related rulemakings. Banks are already facing a host of new regulatory requirements, including the Federal Reserve/Consumer Financial Protection Bureau's proposed rule imposing new underwriting standards. The widely differing requirements under these two complex proposals will make implementation of these rules extraordinarily difficult, particularly for smaller institutions. The lack of a coordinated strategy on these rulemakings almost ensures that banks will be faced with confusing and contradictory regulatory requirements.

Finally, we are deeply concerned with the potential regulatory risks inherent in the proposal. We strongly believe that institutions seeking to make loans that fall outside the QRM definition will be subject to more stringent oversight and possibly higher capital requirements – even if the loans they are originating are held in their portfolios and are underwritten to robust standards. Banks that seek to serve low- and moderate-income borrowers, first-time homebuyers, and other specialized groups will endure most of this increased regulatory scrutiny – contrary to the intent of the Community Reinvestment Act.

Our comments will focus primarily on the QRM standard and the risk retention requirements for residential mortgage loans.

## Background

Section 941 of DFA granted the Agencies significant discretion when promulgating regulations to establish the scope of the QRM exemption, and to employ a range of amounts of retained economic interests from zero percent to five percent that would be reflective of the underwriting standards of particular assets. Congress also provided the authority to exempt entire classes of assets where warranted.

In an effort to incentive strong underwriting standards, Section 941 also requires the Agencies to jointly implement rules to require securitizers to retain an economic interest of not less than five percent of the credit risk for any asset-backed security unless the originator meets underwriting standards to be prescribed by the Agencies. The sponsor may not hedge the retained interest with respect to credit risk.

Unfortunately, the proposed rule imposes the strictest risk retention requirements on the greatest number of loans through a narrowly crafted QRM exemption. The five percent retention will become the standard, leading to a constriction of credit for otherwise creditworthy borrowers.

## MBA Comments

- **The QRM Should be Redefined & Coordinated with the QM Rulemaking**

As we stated above, Congress gave the Agencies authority to define QRM. Securities backed exclusively by assets meeting the QRM definition will be exempt from risk retention requirements. The law requires regulators to take into consideration "underwriting and product features that historical loan performance data indicate result in a lower risk of default."

MBA strongly believes the Agencies must redefine and re-propose the QRM standard to conform more closely to the Qualified Mortgage (QM) standard, proposed by the Federal Reserve Board and now under the jurisdiction of the Consumer Financial Protection Bureau (CFPB). DFA requires that the QRM definition cannot be broader than the QM definition and we have serious concerns with the Agencies' rush to finalize the QRM definition prior to a final QM rule being issued. We would suggest that a better public policy approach would be to ensure that a workable QM definition was in place before attempting to implement a final QRM.

We also believe that the QRM definition in the proposal is skewed towards somewhat arbitrary requirements such as a 20 percent down payment and away from the strong underwriting standards in the QM's "ability to repay" standard. It is our belief that Congress intended QRM loans to be high quality, low risk mortgages – similar to the vast majority of loans originated by our member institutions today. MBA believes that well-underwritten performing mortgages should not be subject to additional risk-retention, and ultimately, capital standards.

In addition, the QM proposal provides lenders far more flexibility in making underwriting decisions than the prescribed approach in the QRM. For example, while the QM proposal requires banks to document a borrower's ability to repay using a range of measurements – including debt to income ratios, employment status and history and credit history, the QRM rule uses a hard and fast formulation – including a minimum 20 percent down payment, strict debt-to-income ratios, and extreme credit history restrictions. The QRM approach replaces sound underwriting with a narrow formula. This can potentially result in outcomes where borrowers who are a poor credit risk nevertheless qualify for QRM status while others who are good credit risks cannot qualify because of lack of down payment funds.

Comments on the various provisions in the proposed QRM definition are below:

- <u>Down Payment Requirements</u>

The proposal requires a high down payment requirement of 20 percent, with even higher levels of 25 percent for refinance loans and 30 percent for cash out refinance loans. We strongly believe these requirements are contrary to Congressional intent. During debate on DFA, Congress considered and rejected including a down payment requirement in the statute.

Nevertheless, the proposal included the down payment requirement, which the Agencies justify with the argument that, "default rates increase noticeably among loans used to purchase homes with loan-to-value ("LTV") ratios above 80 percent. The precise size of this increase and the LTV ratio at which it occurs are likely to vary over time. Nonetheless, lenders have long experience underwriting loans with LTV ratios of 80 percent or less and there is substantial data indicating that loans with LTV ratios of 80 percent or less perform noticeably better than those with LTV ratios above 80 percent."

Unfortunately, the Agencies have not released the data referenced in this statement to the public or the industry. While it may be true that loans with higher LTVs have poorer performance than those with lower LTVs, we find it difficult to believe that LTV is the only determining factor in the performance of these loans.

Borrowers who maintain good credit but who lack substantial down payments will be forced to pay more for their mortgage loans under this proposal. Loans falling outside the QRM designation will require more capital and additional costs associated with the retention of risk. These costs will be passed on to borrowers (if the private market even offers loans outside of the QRM standard).

In Massachusetts, a higher-cost state than much of the nation, the QRM down payment requirements would be a significant impediment to many borrowers, particularly first time homebuyers. According to recent data from the Massachusetts Association of Realtors, the median home price in the state is more than $300,000. That means a homebuyer would need more than $60,000 in savings to qualify for the lowest cost mortgage. With many areas of the Commonwealth having even higher home prices, the QRM requirements would price a large number of borrowers out of the market.

Based on the significant negative impact on the housing market and the ability of homebuyers to access the lowest-cost mortgages, MBA strongly urges the Agencies to eliminate the rigid down payment requirement and focus instead on a robust, but more flexible underwriting standard.

- Debt to Income Ratios

The proposed QRM definition requires a borrower to have a "front-end" debt-to-income ratio that does not exceed 28 percent. The borrower's back end ratio cannot exceed 36 percent. MBA believes that this standard to too narrow and that lenders should have more flexibility in setting these ratios, similar to the proposed QM standard. Under the QM standard, banks must assess the borrower's ability to repay the loan using DTI as one factor, but does not set a restrictive minimum standard.

- Credit History

The proposed rule contains extremely strict credit history restrictions that MBA believes are unwarranted and unworkable. Any borrower who is 30 days late on any debt would be ineligible for a QRM loan. Borrowers that were more than 60 days delinquent on any debt within the last two years would also fail to qualify.

We are also very concerned about the potential compliance challenges inherent in the proposed rule. For example, because the rule would effectively replace automated underwriting that includes the use of a credit score with a manual review of credit reports, lenders would be subject to higher expenses, slower processing times and the risk of human error.

For these reasons, we recommend that the credit history criteria be eliminated from the definition of QRM and we recommend that the model in the QM proposal be adopted instead. Under the QM proposed rule, creditors may look to widely accepted governmental and non-governmental underwriting standards to define and verify "credit history." Creditors may consider factors such as the number and age of credit lines, payment history, and any judgments, collections, or bankruptcies.

The proposed QM standard provides lenders with a number of options for verifying credit history, and most importantly, does not require replacement of credit scoring mechanisms with specific credit history requirements, which will increase compliance burden and likely reduce accuracy, transparency and effectiveness of credit history reviews.

- **Greater Coordination of Mortgage-related Rulemakings is Needed**

MBA strongly believes that the Agencies must take into consideration the interaction of the myriad of mortgage-related rulemakings that will have a significant impact on banks, borrowers, and the economy. The affects of the risk retention proposal cannot be isolated from the numerous other rules that have been adopted that have strengthened the underwriting requirements for all mortgage loans. These include the QM provisions in DFA, mortgage loan officer compensation restrictions, new escrow requirements, appraisal regulations, TILA changes and many others.

We urge the Agencies to take a more holistic approach to mortgage lending regulation as the QRM/risk-retention rule is revised and re-issued for public comment. Regulators should conduct additional studies on the impact these rules will have on banks, borrowers, and the overall housing market. In particular, the Agencies should be especially mindful of the affect of these rules on smaller banks.

- **Regulatory Risk**

As we noted above, we are deeply concerned that QRM loans will become the new standard for all lenders, including those that originate loans for their own portfolios. We believe that institutions originating safe and sound mortgage loans that perform well and have a very low history of default should not be subject to increase regulatory scrutiny simply because their mortgage products do not meet the restrictive and inflexible QRM definition.

Massachusetts and New England have a large concentration of banks that specialize in mortgage lending. Strong underwriting criteria, compliance with federal and state consumer protection laws and robust internal controls and policies ensure that the loans made by our member banks are successful for the bank and the borrower. In fact, even now when delinquencies and foreclosures are driven more by high unemployment than particular loan features, Massachusetts and New England banks have far lower delinquency rates than many other regions of the country (1.6% vs. 4.71% nationally). This is a testament to the safe and sound underwriting procedures our member banks continue to practice.

The QRM standard as proposed will restrict the ability of these institutions to offer innovative products to serve their communities because of a fear of regulator reprisals. This will only serve to restrict access to credit and make mortgage loans more expensive for all consumers – not the outcome Congress intended when it enacted the risk retention provisions of DFA.

- **Impact on Resolution of the Conservatorship of the GSEs**

Finally, we provide comments on the rule's broad exemption for loans sold to Fannie Mae and Freddie Mac while they remain in conservatorship. While we acknowledge that this exemption blunts the impact of the QRM given the market share of the Government-Sponsored Enterprises (GSEs), we also believe that it could delay much-needed revisions to the QRM definition.

The proposed rule will make it vastly more difficult to end the conservatorship of Fannie Mae and Freddie Mac and to develop an alternative – whether public or private. If lenders have the option to sell to Fannie or Freddie without retaining risk and without meeting the QRM standards, the market will certainly continue to favor the GSEs – at least as long as they remain in conservatorship, which we believe is unsustainable over the long term.

At some point, the GSEs will be replaced by an alternative mortgage finance system. When that happens, the QRM rules will apply to a very large segment of the mortgage market. Fewer borrowers will then qualify for loans to purchase or refinance a home.

We would recommend that the GSEs be subject to a substantially revised QRM standard that mirrors the QM standard and current GSE eligibility standards. This would not only strengthen the GSEs portfolios, but would subject the mortgage market to far less disruption when the conservatorship ultimately ends.

**Conclusion**

Based on the issues we noted above, MBA strongly urges the Agencies to withdraw the proposed rule re-propose it following the finalization of the QM rule. As we have stated, the final risk retention/QRM rules should mirror the flexibility of the "ability to repay" approach in that proposal.

Thank you again for the opportunity to comment on the proposed rule. If you have any questions or need additional information, please contact me at (617) 523-7595 or via email: jskarin@massbankers.org.

Sincerely,

Jon K. Skarin
Director, Legislative & Regulatory Policy