AMI ASSOCIATION OF MORTGAGE INVESTORS

August 1, 2011

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Re: Credit Risk Retention

Implementation of Section 941 (regulation of Credit Risk Retention) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 for RMBS

RIN 3064-AD74
RIN 7100-AD-70
RIN 2590-AA43
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Dear Sir or Madam:

The Association of Mortgage Investors ("AMI") appreciates the opportunity to comment upon the proposed risk retention methodologies and a definition of a Qualified Residential Mortgage (QRM) for residential-mortgage backed securities (RMBS) pursuant to section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2011 (hereinafter "Dodd-Frank" or the "Act").[1] The Association of Mortgage Investors (AMI) seeks the development of meaningful public policy initiatives in an effort to restore the securitization industry and bring back a well-balanced residential housing finance and mortgage system.

The AMI was organized as the primary trade association representing investors in mortgage-backed securities, including university endowments and pension funds. The AMI was founded to play a primary role in the analysis, development, and implementation of mortgage and housing policy to help keep homeowners in their homes and provide a sound framework that promotes continued home purchasing. Since its formation, the AMI has been developing a set of policy priorities that we believe can contribute to achieving this goal. We are an investor-only group comprised of a significant number of substantial institutional investors in commercial and residential mortgage-backed and other asset-backed securities. Hence we are the only investor-only trade association and are un-conflicted by other industry segments. Together our members manage a collective investment in ABS in excess of $300 billion.

[1] Public Law No. 111-203 (July 21, 2010).

I. Qualified Residential Mortgage (QRM) Rule-making Proposal

The members of AMI believe that much of the dysfunction in the U.S housing finance system can be eliminated by the adoption of a well-balanced QRM definition in line with the legislative intent and the letter of statute enacted by its Congressional proponents. AMI supports the laudable goals of the Act and this corresponding rule-making that are evident from its legislative consideration. AMI believes that the goals of promoting the health and stability of the U.S. housing finance system and providing home ownership for a broad cross section of the public pursuing the American Dream are entirely compatible. Further, these goals were envisioned by the framers of the Dodd-Frank Act. During consideration of the Dodd-Frank Act, Members of Congress sought the creation of a "'gold standard' for securitization that encourages responsible liquidity for loans with underwriting standards and product features that provide consumers with stable, affordable home mortgage financing and produce lower defaults and foreclosures."[2]

In connection with the rule-making, Chairman Bernanke recently testified before the U.S. House of Representatives earlier this year. He explained the following regarding the policy balance between the market structuring and consumer interests:

> *On the 20 percent down, I think you're referring to the qualified residential mortgage, the QRM. This is a rule which we have out for comment and we're still listening to the comment.*
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> *The idea here was that Congress passed a risk retention requirement of 5 percent, that, if you sell a securitized package of mortgages, you have to keep 5 percent of that as a guarantee, essentially, that you have -- you know, that you're guaranteeing those mortgages as being of good quality.*

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[2] See Joint Regulator Advance Notice of Rulemaking, http://www.sec.gov/rules/proposed/2011/34-64148.pdf.

> *The QRMs are the mortgages that Congress intended to be exempt from that requirement, so presumably that should be* ***mortgages that are of very high quality****.*
>
> *We looked at the criteria that affect mortgage delinquency rates and high down payments. One of the things that really stood out as being one of the factors to keep delinquency rates down, because people have a lot more cushion if they have a big down payment -- we don't think that this would necessarily block home ownership because there would still be a large market subject to the risk retention requirement, where down payment requirements would be set by the originators, as is now the case.*[3]

AMI urges the Joint Regulators that it is crucial to view the forthcoming QRM criteria in their proper context for U.S. housing and our capital markets. One goal underlying Congress' statutory directive and this rule-making is establishing a category of ABS-backed residential loans, that would be exempt from the risk retention requirements of the Proposed Regulations, when satisfying the regulatory QRM criteria. It is regrettable that this issue is being conflated with other worthy goals, such as affordable housing for low and moderate-income households. In contrast, the rule-making's purpose is neither to create a category of loans which may never be securitized nor to punish any demographic or income class of borrowers. We can assure you that the so-called "imperfect borrower" (*e.g.,* offering a zero down payment, less than perfect credit scores, etc.) will still be able to enter the U.S. housing market and achieve financing, albeit on fairly priced terms. Outside of the Risk Retention/QRM rule-making context, AMI supports other government and community-based housing initiatives to help millions of responsible borrowers enhance their creditworthiness and obtain alternate financing for a home purchase.

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[3] House Financial Services Committee, *hearing on the Federal Reserve Semiannual Monetary Policy Report*, 112th Sess. of Congress, July 13, 2011 (testimony of Federal Reserve Chairman Benjamin Bernanke) (emphasis added).

a. QRM Criteria

AMI agrees with other investor organizations in support of a robust, strict QRM definition. We urge that such a QRM definition include clear, bright-line formulas with definite requirements such as a 20% cash down payment (that is documented and at least one-half comes from the borrower), low underwriting ratios, and the other criteria enumerated below. We believe that such bright-line QRM eligibility tests provide clear, objective, and relatively easy implementation. (In the past, a 30% down payment toward a home purchase was often required).[4] Notably, our views in support of such a robust, strict QRM-eligibility definition align with Securities Industry and Financial Markets Association Asset Management Group (SIFMA-AMG) and the American Securitization Forum (ASF) investor members.[5] A prospective borrower's ability to provide a down payment is a substantial factor regarding the ultimate performance of the loan.

Any QRM definition should require that the borrower make a 20% down-payment. We believe that the primary source of the down payment should be the borrower him or herself

[4] Teinowitz, Ira, *Lenders find unlikely allies in risk retention fight*, DAILY DEAL (Jan. 21, 2011) ("In November, Bank of America Corp. in a letter to financial regulators suggested that loans with a 30% down payment be considered to be qualified residential mortgages and banks be required to retain a portion of loans that don't meet that test."); O'Leary, Daniel, *Wells Plan Draws Fire On Troubled Non-Agency RMBS*, Total Securitization and Credit Investment (Jan. 7, 2011) (Wells Fargo calls for regulators to set a 30% down-payment for less risky mortgages).

[5] "Our investor members generally support the definition of QRM proposed by the Joint Regulators. While the proposed definition is restrictive, the investor members believe that a clear, bright line rule is preferred to a definition that is overly complex, especially if the Joint Regulators are seeking to make the QRM the exception and not the rule." ASF June 8, 2011 letter to the Joint Regulators at 24.

individually, and hence at least fifty percent should be from his or her savings and not from a gift. We believe that the vast amount of research will prove that borrowers who can demonstrate the ability to save such a down payment sum will be far less likely to default than other more risky groups. Further we urge any definition be limited to mortgages with a loan-to-value (LTV) of no greater than 80%, even with the use of credit enhancements, such as mortgage insurance. Accordingly, we believe that in addition to a substantial down payment, a combined loan-to-value ratio cap should be enforced and maintained for the life of the loan to maintain the QRM status and eliminate over leverage of the underlying property. We recommend a 90% loan-to-value cap for this purpose.

b. Down Payment as an Essential Element

A substantial body of evidence across the academic literature, history, and governmental views developed for this rulemaking, supports the view that residential mortgage loans which originate with a reasonable down payment are far less likely to result in a default.[6] It is uncontroverted that a down payment requirement is essential for enhancing a borrower's credit and minimizing the risk of a borrower's default.[7] Scholars and economists note the irony of dismissing the importance of this element of a QRM standard:

> "'[R]esearch conducted by Freddie Mac has concluded, that low down-payment loans pose legitimate concerns for lenders because they are known to trigger greater losses than loans with a larger equity cushion'.[8] The research also showed that delinquencies and

[6]*See* Rosner, Joshua, *Housing in the New Millennium: A Home Without Equity is Just a Rental with Debt* (June 29, 2001). Available at SSRN: http://ssrn.com/abstract=1162456.

[7] "[A] down-payment requirement of some sort is clearly essential." Jeremy C. Stein, Prices and Trading Volume in the Housing Market: A Model with Down-Payment Effects, Quarterly Journal of Economics at 385 (May 1995).

[8] Harvard University Center for Housing Studies, State of the Nations Housing 2000 Home Page

> defaults mount when several underwriting standards are eased at the same time. Put simply, a home owner with little or no equity has less reason to maintain his/her obligations."[9]

The question before the Joint Regulators is not whether a down payment requirement is prudent and merited, but rather whether it is part of the appropriate balance in light of the statutory risk retention framework and the corresponding legislative goals. The value of the down payment requirement is described extensively in economic journals, including:

> *In structuring mortgage contracts, financial institutions require a down payment for a number of reasons. First, households with an equity stake in a home share the down-side risk of a market-wide decline in house prices with the lender. Second, the down payment reduces the moral hazard problem in the care that occupying households take in maintaining the value of the property . . .*[10]

> *"[A] family must put up some money ahead of time to occupy a new house. If not, there would be nothing to prevent the defaulter types to from occupying a house (thereby fully depreciating it) and then walking away."*[11]

As the Agency Joint Rule making notes, any QRM-eligibility plan will preserve the ability of average home-borrowers to enter the market:

> *While many creditworthy homebuyers seeking to purchase a home will likely not have the 20 percent down payment required for a QRM, sound underwriting of these loans may well require the prudent use of judgment about the borrower's ability to repay the loan and other risk mitigants that are likely to change over time and vary from*

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http://www.gsd.harvard.edu/jcenter/Publications/State%20of%20the%20Nation%27s%20Housing%201999/Text/Son99.pdf

[9] *See* Rosner, *supra*, at note 6.

[10] Gary V. Englehardt, *Consumption, Down Payments, and Liquidity Constraints,* 28 JOURNAL OF MONEY, CREDIT, AND BANKING, at 256 (1996).

[11] Stein, QUARTERLY JOURNAL OF ECONOMICS, at 396.

> *borrower to borrower. Such judgments are difficult to incorporate accurately and effectively into a rule without introducing substantial complexity and cost."*[12]

The requirement for a reasonable down payment is supported by several additional public policy arguments. First, the down payment requirement actually helps the average consumer, as a zero (or nominal) down payment contributes to an artificial inflation of housing pricing in a substantial number of markets. Accordingly this housing price inflation makes it more difficult for first-time buyers and low-to-moderate income people to make purchases. Second, we seek to rebut the new rhetoric that a reasonable down payment is a barrier to a first-time purchase, *inter alia*, that in some cases it will require the borrower to save for many years to obtain such a sum (*e.g.,* it is argued in some cases in excess of ten years to sufficiently save the necessary amount). Again, we contest this argument, as it presents a false choice. As investors, we are confident that the capital markets will make loans to responsible credit worthy borrowers who lack a down payment. Responsible borrowers will be able obtain to obtain a mortgage. However, as these high-LTV loans are historically associated with sufficient risk of default, they should not be within the QRM safe harbor, as part of any risk retention regime.

The dysfunction and fragility of today's housing finance and mortgage markets can be traced to several sources, *inter alia*, poor underwriting standards and significant total aggregate consumer debt. We believe that the development of a proper QRM standard to define "a gold plated mortgage" standard will only affect a small portion of all loans and will not limit the availability of financing for a majority of borrowers. In turn, this advances the Congress' goals of increasing the availability of stable, affordable home loans to the larger consumer base,

[12] Joint Regulators, ANPR, at 121, n. 145.

decreasing the loan costs for all consumers, all while minimizing the risk of re-default and foreclosures. The following summarizes AMI investor members' views concerning the other proposed QRM eligibility criteria:

c. Scope

In accordance with our view that § 941 must be interpreted such that the QRM definition is interpreted narrowly, we envision that only well structured mortgages to strong, creditworthy borrowers will qualify. This subset of loans should comprise the traditional loan types where the home is owner-occupied; certainty regarding the term and interest rate; and, the evidence of a willingness and ability to pay, including, a full documentation loan with a 20% cash down payment, an LTV no greater than 80%, and a 20% cash down payment made by the borrower.

i. Excluded Loan Types

In furtherance of the Act's goals, certain loan types should be expressly excluded from the QRM definition, including interest-only loans, negative amortization, balloon payments, terms in excess of 30 years, and other exotic loans. We strongly believe that Adjustable Rate Mortgages (ARMs) that adjust less than three years after origination should also be excluded.

ii. Verification of Income and Other Borrower Financial History

The use of robust underwriting is an essential component of mitigating the risk pursuant to this section. This underwriting includes the documented verification of essential information about a borrower. We urge that the borrower must provide written documentation of their income, employment history, and tax records and the information must be valid as of the last 90 day period.

iii. Additional Credit Reporting

Additionally, we support the use of credit reporting *post facto* for example a credit report at a sufficient period either three or six months after the origination.

iv. Debt-to-Income (DTI) Ratios

AMI members have spoken to this issue previously in many contexts. We strongly believe that the housing crisis today is a result of a national, consumer debt crisis. Accordingly we strongly believe that both front-end and back-end DTI demonstrate the probability of a borrower's disposition to default.[13] As AMI explained to federal regulators in August 2010, back-end DTI is a critical criterion in evaluating a borrower's likelihood to default based on the ability to meet all of one's monthly budget and debt obligations. AMI's comments to the Treasury Department explain, that quality underwriting requires one must consider all,

> *[the] factors directly linked to consumer debt (i.e., back-end DTI, FICO, etc). Further the use of front-end DTI can be useless outside of the given context. For example, consider the case of two families, with the identical mortgage and debt, but whom each have different household sizes (e.g., a varying number of children or elderly dependents). In this context, the households have the identical DTIs, however the respective whole family budgets will have a significant impact on the probability of default.* [14]

*v. **Asset Reserves***

In light of the risks to the credit markets, borrowers must be expected to have sufficient assets in reserves, specifically no less than six months of liquid assets for mortgage payments, taxes, and insurance ("PITI") after the deduction of the 20% cash down payment. The borrower must provide documentation evidencing the down payment debit and the remaining six months of reserves.

[13] *See* AMI NPV 4.0 Default Model letter to the Treasury Department, Department of Microeconomic Analysis (Aug. 10, 2010) (on file with AMI, at http://www.the-ami.org).

[14] *Id.*

vi. Additional Criteria

We urge placing a reasonable time limit on the use of an appraisal, no more than two months within the closing of the loan. Any home appraisal must be performed by a licensed professional appraiser in the state where the property resides. Any appraisal must be done in-person to ascertain the value of the property based on an interior and exterior inspection, as opposed to the use of computer model (*e.g.,* AVM) or a drive-by evaluation.

vii. Recourse

We urge Congress and the Joint Regulators to establish a nationwide recourse remedy for lenders and investors. Only by assuring such a remedy on a national, uniform basis will investors have the confidence of widely restoring private capital to the U.S. mortgage market.

d. The Inclusion of Servicing Standards

The proposed rule-making solicits comment on whether the definition of QRM should include servicing requirement. As an initial matter, AMI has prided itself on aligning with the best interest of consumers and distressed borrowers, including calling upon the Joint Regulators to promulgate national servicing standards.[15] We do not believe, however, that the hard-wiring of even the most consumer-centric servicing standards in mortgage loan documentation is a sound policy. Again, this is another example of a well-intentioned provision which could have the unintended consequences of harming consumers, *e.g.,* by imposing increased costs that will make many securitizations economically unfeasible, given a prohibitively low return on capital for securitizers. This stems from the possible interaction of these hard-wired loss mitigation

[15] *See* AMI Dec. 2010 letter to the Joint Regulators, on file at http://www.the-ami.org.

strategies of some borrowers ignoring their financial responsibilities, taking on additional debt obligations, all without risk of the consequences. We caution the regulators against including provisions that explicitly state that any loss mitigation practices be included as part of the contract between the borrower and the lender. Otherwise, borrowers may risk default as a strategy to take advantage of explicit loss mitigation policies, such as seeking to reduce the rate, rather than because of an ability to pay.

The Joint Regulators must remain cognizant that the investors in mortgages are often public institutions, such as pensions, retirement systems, universities and charitable organizations. The unintended consequences of the inclusion of servicing requirements (including loss mitigation) in loan documents could be harmful to these vital public institutions. It is also important to note that not all mortgage products or borrowers can be serviced in solely one defined manner. Each mortgage is collateralized by an individual home and each borrower has an individual loan on that home. The characteristics of the borrower (*i.e.,* job, income, credit profile, home value, etc.) are different for each and every consumer and must be taken into consideration when making loss mitigation decisions. One set of servicing standards would be insufficient to service each consumer efficiently. Again, we support the central purpose underlying this rule-making, namely to exclude high caliber loans that pose minimal risk of default and loss from the risk retention requirement. Servicing requirements are an issue specific to the QRM, but instead rather apply to all mortgages. Accordingly, we urge that this be addressed in a more inclusive venue, such as the SEC's outstanding Regulation AB.

AMI aligns itself with MBS investor groups, such as the ASF investor members whom "believe that the inclusion of servicing standards in the QRM definition is inappropriate and support instead the development of national servicing standards that would apply to all residential mortgage loans . . ."[16] Again, for the reasons state above, we reiterate our public policy concerns with standards being delineated in the borrower-lender contracts.

Lastly, AMI believes that the inclusion of servicing standards is beyond the scope of the Act's mandate and its legislative history. In sum, we urge the Joint Regulators to remove this provision from any forthcoming, or any final, rule-making.

e. Three Percent Limit on Points and Fees

The Agencies have requested comment on all aspects of the proposed definition of "points and fees" for QRM purposes, *inter alia*, for an eligible QRM, the total points and fees payable by the borrower in connection with the mortgage transaction may not exceed three percent of the total loan amount, which would be calculated in the same manner as in Regulation Z. While AMI is front-and-center on protecting consumers from servicer abuses, we are skeptical of the inclusion of this provision in the QRM context. The three percent cap on up-front points and fees may not directly relate to the underlying provisions of the rule-making, namely providing for a "gold standard mortgage." Further we do not believe that the inclusion of such a provision is supported by the statutory mandate of the Act or its legislative history. We caution that any such regulatory cap could have unintended negative consequences on borrowers, securitizers, and the capital markets at-large. Hence, AMI concurs with other investor groups, such as SIFMA, in calling for the reconsideration of this provision as part of any forthcoming, or final, rule-making.

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[16] *See* comments by the American Securitization Forum, available at http://www.americansecuritization.com/uploadedFiles/ASF_Risk_Retention_Comment_Letter.pdf.

f. Exemption for GSE Securities (Fannie Mae and Freddie Mac)

The scope of the regulation will not include government securities, and hence exempt Fannie Mae and Freddie Mac, subject to certain conditions, such as the duration of the ongoing FHFA conservatorship. At this time, we will not attempt to discuss the policy justifications for the exemption of GSE securities. While the GSEs hold 100% of the risk, this issue is probably moot; however, should this relationship be altered then this exemption most probably should not survive. AMI has long advocated for long-term, effective, solutions to the housing finance and mortgage market crisis. As such, we advocate a level-playing field for the Private Label MBS market. Accordingly we believe that this exemption may in the future prove unnecessary, if not potentially harmful, and should be removed should the GSEs or some reconstituted entity no longer be in a first loss position for much of the losses.

In sum, AMI investors support the proposed QRM-eligibility criteria along with other key investor organizations as a balanced approach of restoring housing finance, rebuilding the U.S.'s securitization markets, and preserving opportunities for affordable housing choices for millions of first-time and average home buyers. We believe that the development of such clear, bright-line criteria support the statutory text and legislative history of the Dodd-Frank Act, while restoring our capital markets and making affordable housing available to millions.

II. Risk Retention Methodology Pursuant to the Rule-making

As a central focus of this rule-making process pursuant to the Act, the Joint Regulators (Agencies) have requested comments concerning the structure of risk retention policies. As a general matter, AMI members believe that the best risk retention in the RMBS space requires strong, thorough, and enforceable Pooling and Servicing Agreement (PSA) representations and warranties. The proposed rule-making, however, creates a series of questions regarding the quantity and methodology of any risk retention:

> A. *Quantity.* (i) The Agencies request comment on whether the minimum five percent risk retention requirement established by the proposed rules for non-exempt ABS transactions is appropriate, or whether a higher risk retention requirement should be established for all non-exempt ABS transactions or for any particular classes or types of non-exempt ABS; [and,] (ii) Whether a higher minimum requirement should be established? The Agencies note that the five percent risk retention requirement established by the proposed rules would be a regulatory minimum.
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> B. *Risk Retention Methodology.* The Agencies request comment on the possible risk retention methodologies, all subject to certain conditions, including (i) a "vertical" slice of the ABS interests, whereby the sponsor or other entity retains a specified pro rata piece of every class of interests issued in the transaction; (ii) a "horizontal" first-loss position, whereby the sponsor or other entity retains a subordinate interest in the issuing entity that bears losses on the assets before any other classes of interests; and (iii) an "L-shaped" slice whereby a sponsor may use an equal combination of vertical risk retention and horizontal risk retention as a means of retaining the required five percent exposure to the credit risk of the securitized assets. This form of risk retention derives its name because it combines both vertical and horizontal forms.

In response to the Agencies' request concerning the quantity, AMI members first believe that the minimum five percent risk retention requirement established by the proposed rules for non-exempt ABS transactions is appropriate. Beyond the quantity-in-question, AMI members have a number of concerns about the relevant methodologies for application by the industry.

a. Risk Retention Methodologies

In response to the second prong of the inquiry, AMI investors acknowledge the role of horizontal and vertical risk retention methods in balancing the structure of a securitization with the goals of the drafters of the Dodd-Frank Act. In essence, the rule-making is about balancing interests-- for example, between the sponsors (the original creditors who seek to obtain a reasonable return) and the investors (who seek high quality securitizations). It is also about aligning the incentives and interests of all parties to a securitization. Any risk retention regulation must preserve market incentives such that private capital will resume investment in RMBS and ensure that the sponsors can recoup their costs and investments and the investors can properly securitize. In general, AMI members support a horizontal residual interest ("slice") retained by the sponsor (or originator) which bears losses on the assets before any other classes of interests; and, a vertical residual interest ("slice") of at least five percent of each asset class of an ABS interest retained by the sponsor in new originations, in the case when the sponsor is also the servicer. Further, we wish to specify that the 5% be of value or proceeds and not the face value, specifically with respect to the "L" or the horizontal slice. We urge the regulators to consider the following issues arising with respect to the balance of interest among parties concerning the retention of the horizontal and vertical slices.

Any regulation striving to address risk retention will assign a designated quantity of residual interest with the sponsor's first loss position. We urge the Joint Regulators also acknowledge while the sponsor holds this risk slice, it also must be able to recoup reasonable investments, costs, and offer a return to the capital markets. Thus we respectfully caution the Joint Regulators to carefully examine the structure of a given securitization's tranches, spread, and cash flows, *e.g.*, premium, interest-only tranches, etc. We wish to ensure that any regulation or methodology acknowledge the working realities surrounding the sponsor's securitization structures, for example, the designated risk retained slice amortizing faster than the remaining tranches. In practice, this will chill investment in the RMBS space, hamper private capital returning to the market, and ultimate limit the availability of consumer credit. This defect is significantly highlighted with respect to the proposed premium cash reserve account. AMI aligns itself with the other investors groups that advocate for the deletion of the premium cash reserve account or, at least, to have regulations ensure that a methodology that does not harm sponsors, *inter alia*, the horizontal slices must amortize no faster than the remaining tranches.

For the following reasons, we also endorse the adoption of horizontal, vertical, and "L-shaped" slice option for the securitizer's retention of economic risk, subject to the context employed and as it may impact the incentives behind the structuring and offering of residential mortgage-backed securities.

b. Premium Capture Reserve Account

The proposed rule-making also includes another method of risk retention via establishing a premium capture cash reserve account. The Joint Regulators ask whether one believes "that the premium capture cash reserve account will be an effective mechanism at capturing the monetization of excess spread, promoting sponsor monitoring of credit quality, and promoting the sound underwriting of securitized assets."

The proposal states that the "'premium capture' [is a] mechanism designed to prevent a securitizer from structuring an ABS transaction in a manner that would allow the securitizer to effectively negate or reduce its retained economic exposure to the securitized assets by immediately monetizing the excess spread created by the securitization transaction." This proposal is in response to concerns over how a securitization sponsor may avoid other risk retention requirements on premium, interest-only tranches or other segments of a transaction. As already mentioned, AMI investors are deeply concerned about this provision and urge its deletion from any final rule. Along with the other major investor trade associations, we have a number of concerns which may summarized as follows:

This poses serious problems to the RMBS ABS market and the mortgage industry. It will erect financial obstacles to structuring housing finance, including residential mortgage back securities (RMBS), and undermines the economic incentives to invest in the mortgage market. These proposals will impose increased costs that will make many securitizations economically unfeasible, given a prohibitively low return on capital for securitizers;

While the proposed rule boasts that the proposal for a premium recapture reserve account will "reduc[e] the potential for the proposed rules to negatively affect the availability and costs of credit to consumers and businesses," we find the practical result for the capital markets and potential borrowers will be the opposite. The result will be less capital for the mortgagemarket. . . .

In sum, in its current form this proposed provision does not carry out the objectives following from the plain text of the Dodd-Frank Act or the corresponding legislative history.

AMI Supports Adoption of L-Shaped Risk Retention

In connection with the proposal for a premium capture cash reserve account, an "L-shaped" risk retention slice best aligns and balances the interests of all parties. The goal of investors is consistent with the underlying purpose of the Risk Retention rule-making, whereby the sponsor of securities may be economically incented to participate in the capital markets and of the investors who seek reasonable returns on these investments. In the hybrid model, the sponsor derives some benefits at the beginning of the securitization process; likewise, the investor can enjoy revenues through a defined period of the investment. The "L-shape" reflects a hybridized combination of a horizontal and vertical form of risk retention. The resulting methodology combines a vertical slice, namely, a percentage (5%) of either the actual face value of the securities and the proceeds from the sale of the (underlying) securities; combined with a horizontal slice, namely a pre-determined percentage of the sales proceeds in excess of the securities' face value.

Our investor members join with the ASF[17] and SIFMA-AMG in support of the "L-shaped" hybrid slice as a narrowly-tailored solution in this context for restoring balance in the capital markets and protecting business and consumers against excess risk.

a. Enforcement

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[17] The ASF supports the "L-shaped" slice risk retention methodology as a general matter, but urges regulators to preserve flexibility such that the percentages of retention at the vertical and horizontal levels may vary.

The currently proposed risk retention regulations do not address any of a variety of enforcement issues, including which regulators or other entities will have jurisdiction pursuant to the final rule, the scope of their powers, and potential remedies. We ask that any subsequent, if not final, regulation speak to these issues.

b. REMIC Exclusion

AMI investors request that any forthcoming regulation revises the definition of "ABS interest" to provide a limited exclusion from any REMIC ("Real Estate Mortgage Investment Conduits") residual interests that are entitled to receive no cash flows or only nominal cash flows.

In practice, in accordance with federal income tax laws, a REMIC transaction may separately designate certain classes of residual interests. In the case of a "non-economic" class, it will either have no entitlement to cash flows or merely that it has only an entitlement to a nominal payment (*e.g.*, a single $100 payment of principal). While these classes are used for structuring purposes, it is both impractical and unreasonable to require a sponsor to retain 5% of any such non-economic residual. We note that this class does not fit clearly into the proposed definition of "ABS interest." We join other investor organizations, including ASF, in raising this issue before the Joint Regulators and seeking a clarification in any future, if not final, promulgated regulation.

c. Representative Sample

The Joint Regulators also seek comments on a proposed risk retention methodology option that permits the sponsor of a securitization transaction to satisfy its regulatory requirements through a so-called representative sample, *e.g.*, a randomly selected representative sample of assets which are securitized. As an example of the representational sample, the rule-making notice uses auto loans as an example of an asset class employed within a broader funding portfolio plan.

While AMI investors support the concept of the representative sample in general, we do not believe it is appropriate for certain asset classes, such as residential mortgage loans. The rule-making suggests that the representative sample is useful, *inter alia*, in selecting a random set of assets such that their quantitative size and default risk are statistically or representational characteristic. We do not believe that this risk retention methodology lends itself appropriately to assets in the housing finance, mortgage, and RMBS space which are not aggregated in a larger portfolio or funding vehicle. Hence AMI aligns itself with other investor groups such as SIFMA and the ASF-investors who "'oppose the representative sample form of risk retention set forth in the Proposed Regulation because they believe it will be impossible to ensure that the sample of loans selected is in fact random or that it adequately represents the overall risk credit of the loans that are securitized . . .'"

In sum, we urge the Joint Regulators to exclude RMBS from the final rule regarding risk retention and from the representative sample, unless the RMBS assets are included as part of a broader portfolio of assets and collateral.

d. Mortgage Investor Recommendation

The proposed regulations reflect Congress' goals in restoring the U.S. housing market and ABS system while balancing a complex array of values. Overall, the proposed regulations advance the goals reflected in the Congressional mandate, but do not adequately address the needs or concerns of ABS investors. In sum, we request that the Joint Regulators re-propose these regulations, reflecting the concerns expressed herein, such as eliminating the premium recapture cash reserve account. Further, the newly proposed rule-making should be subject to a next round of public notice and comment.

III. Conclusion

As the Joint Regulators try to restore balance to the ABS market in accord with the mandates of the Act, mortgage investors agree with observers who believe that "[R]egulators 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."[18]

AMI is comprised of large fixed income institutional investors who support the reemergence of a healthy and balanced ABS market. We are very keenly aware, through our RMBS ABS' investment portfolios performance since the financial crisis, of the excesses and oversights embedded in the current market. We believe that our comments, if properly implemented, will expedite the return of these critical capital markets through additional disclosure; the assurance of the reliability of such information with consequences for responsible parties; and, a general alignment of interests among sponsors, originators and the investment community. The past is prologue. The experience leading to the financial crisis, vast amount of economic research and common-sense dictates that the Agencies should promulgate a QRM rule with a strict bright-line standard, including a 20% down payment. In truth, such a rule will promote mortgage products and securities that reflect the best policy initiative for prospective borrowers, existing homeowners, and the housing market at-large. As such, the QRM rule does

[18] Coalition for Sensible Housing Policy White Paper at 10 (June 22, 2011) *available at* http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/Coalition-QRM-White-Paper-1.pdf

not represent the demarcation line for the accessibility of mortgage credit. The QRM-eligibility rules, rather, refer to mortgage product of sufficient quality such that investors can agree bears little or no credit risk. Therefore they do not need the added protection of risk retention, which serves as motivation to ensure that the information provided and the underwriting represented is correct. The U.S. housing market is facing a fragile recovery. A return to the "wild west" of the past mortgage and securitization practice could be detrimental for all persons in the housing space.

On behalf of our membership, let us express again our appreciation for giving us this opportunity to comment on the development of a QRM safe harbor and risk retention

methodologies, in general. Please do not hesitate to contact us should either you or any of your colleagues have any questions regarding our views, please contact me at katopis@the-ami.org or 202-327-8100.

Very Truly Yours,

Chris J. Katopis

Executive Director