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David L. Ledford  
Senior Vice President

October 30, 2013

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Executive Secretary  
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[comments@FDIC.gov](mailto:comments@FDIC.gov)

Board of Governors of the  
Federal Reserve System  
20th Street & Constitution Ave, NW  
Washington, DC 20551  
Attn: Robert deV. Frierson, Secretary  
Federal Reserve Docket No. R-1411  
RIN 7100-AD70  
[regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Federal Housing Finance Agency  
Constitution Center  
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400 7<sup>th</sup> Street, SW  
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[RegComments@FHFA.gov](mailto:RegComments@FHFA.gov)

Department of Housing and Urban  
Development  
451 7th Street, SW  
Room 10276  
Washington, DC 20410-0500  
Attn: Regulations Division,  
Office of the General Counsel  
HUD: RIN 2501-AD53  
[www.regulations.gov](http://www.regulations.gov)

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090  
Attn: Elizabeth M. Murphy, Secretary  
SEC File Number S7-14-11  
RIN 3235-AK96  
[Rule-comments@sec.gov](mailto:Rule-comments@sec.gov)

Office of the Comptroller of the  
Currency  
400 7<sup>th</sup> Street, SW  
Suite 3E-218  
Washington, DC 20219  
OCC Docket No. OCC-2013-0010  
RIN 1557-AD40  
[regs.comments@occ.treas.gov](mailto:regs.comments@occ.treas.gov)

***Credit Risk Retention; Proposed Rule***

Submitted via Electronic Delivery to: <http://www.regulations.gov>

Dear Sir/Madam,

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to submit comments on the above-referenced proposed rule<sup>1</sup> issued jointly by the Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Fed), Federal Deposit Insurance Corporation (FDIC),

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<sup>1</sup> [Credit Risk Retention](#), 78 Fed. Reg. 57928 (September 20, 2013) [hereinafter, "proposed rule" or "re-proposed rule"]

Federal Housing Finance Agency (FHFA), Securities and Exchange Commission (SEC) and Department of Housing and Urban Development (HUD), (collectively, the “Agencies”) to implement the credit risk retention requirements of section 15G of the Securities and Exchange Act of 1934 (15 U.S.C 780-11), as amended by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act<sup>2</sup> (“Dodd-Frank Act”, or the “Act”).

NAHB is a Washington-based trade association representing more than 140,000 members involved in a wide variety of housing activities, including the development and construction of single-family for-sale housing; the development, construction, ownership, and management of affordable and market-rate multifamily rental housing; and, the development and construction of light commercial properties.

The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation’s economic growth is dependent on an efficiently operating housing finance system that provides adequate and reliable credit to home buyers and home builders at reasonable interest rates through all business conditions. The securitization of residential mortgage loans is a critical component of the housing finance system ensuring that sufficient capital exists for home loans and has allowed for a more consistent flow of credit throughout the country. Additionally, the commercial mortgage backed securities (CMBS) market has been an important component of the commercial real estate finance market, including financing of multifamily rental properties.

## **Background**

Section 941 of the Dodd-Frank Act regulates credit risk retention by requiring loan originators and securitizers to hold at least five percent of the credit risk, with noted exemptions – one of which is the qualified residential mortgage (QRM) exemption. The genesis of this risk retention requirement is the belief that the credit crisis occurred because lenders and securitizers did not have “skin in the game” and therefore did not ensure that there were sound loans and creditworthy borrowers backing mortgage securities.

In April 2011, the Agencies released a proposed rule<sup>3</sup> to implement Section 941 of the Dodd-Frank Act. NAHB had significant concerns with several provisions of the original proposal and expressed these concerns in a comment letter filed on August 1, 2011. The narrow definition of a Qualified Residential Mortgage (QRM) would have had a severe adverse impact on the availability and cost of residential mortgages. The originally proposed requirements on Qualified Commercial Real Estate (QCRE) loans would have been virtually impossible to meet and would have had a wide-spread and detrimental impact on financing the development of multifamily and commercial properties. The originally proposed premium capture cash reserve account (PCCRA) had the potential to distort the securitization market and create a disincentive for private investors.

In addition to submitting an individual comment letter, NAHB joined with a coalition<sup>4</sup> of real estate professionals, consumer advocates, civil rights organizations and other housing market participants in opposing the definition of the QRM as originally proposed because the 20

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<sup>2</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or the “Act”), Pub. L. No. 111-203, §941(b), 124 Stat. 1376, 1890 (2010)

<sup>3</sup> [Credit Risk Retention](#), 76 Fed. Reg. 24117 (April 29, 2011)

<sup>4</sup> Coalition for Sensible Housing Policy ([www.sensiblehousingpolicy.org](http://www.sensiblehousingpolicy.org))

percent downpayment provision and other conservative underwriting criteria would have left homeownership out of the reach of many creditworthy borrowers.

On August 28, 2013, the Agencies released an updated proposal, which revises the rule as proposed in April 2011 and addresses many of NAHB's concerns.

### **Treatment of Government-Sponsored Enterprises**

In the original proposal, the Agencies proposed that the guarantee (for timely payment of principal and interest) by Fannie Mae and Freddie Mac (the "Enterprises") while they operate under the conservatorship or receivership of FHFA with capital support from the United States would satisfy the risk retention requirements with respect to the mortgage-backed securities (MBS) issued by the Enterprises. Similarly, an equivalent guarantee provided by a limited-life regulated entity that has succeeded to the charter of an Enterprise, and that is operating under the authority and oversight of FHFA, would satisfy the risk retention requirements, provided that the entity is operating with capital support from the United States.

NAHB supports the proposed treatment of the Enterprises, which was included in the re-proposed rule without modification. NAHB supports the Agencies' determination that the Enterprises are already satisfying the proposed risk retention requirements. Given that the Enterprises account for three-quarter of recent MBS issuance<sup>5</sup>, this determination will cushion the impact of imposing a risk retention requirement on participants in the residential mortgage market and multifamily and commercial development.

NAHB remains concerned, however, with the Agencies predetermining how a successor agency would be treated with respect to risk retention. NAHB appreciates the Agencies' acknowledgement that the rule will probably have to be revisited and, if appropriate, modified after the future of the Enterprises, and the statutory and regulatory framework for the Enterprises, becomes clearer.

### **Treatment of Government Programs**

The re-proposed rule includes an exemption from the risk retention requirements for any securitization transaction that is collateralized solely by residential, multifamily, or health care facility mortgage loan assets insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States. Also, the new proposal exempts any securitization transaction that involves the issuance of asset-backed securities (ABS) if the ABS are insured or guaranteed as to the payment of principal and interest by the United States or an agency of the United States and that are collateralized solely by residential, multifamily, or health care facility mortgage loan assets, or interests in such assets. These exemptions were also included in the original proposal.

NAHB supports the exemption created by the legislators and included in the proposed rule for the government-backed mortgage programs, including the programs administered by the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA) and the U.S.

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<sup>5</sup> Federal Housing Finance Agency. FHFA Quarterly Performance Report of the Housing GSEs. (Second Quarter 2013). p. 4. Retrieved from: <http://www.fhfa.gov/webfiles/25515/2Q2013QuarterlyPerformanceReport091913.pdf>

Department of Agriculture (USDA) Rural Development agency. This will ensure the flow of capital to the housing market through loans with features that historically have performed well.

### **Qualified Residential Mortgage (QRM)**

The purpose of the QRM is to create a robust underwriting framework that provides strong incentives for responsible lending and borrowing. The intent is to establish criteria associated with favorable mortgage loan performance that will assure investors that the loans backing the securities meet strong standards proven to reduce default experience.

The Agencies are proposing a revised definition of a QRM that would equate with the definition of the Qualified Mortgage (QM) included in the Ability to Repay (ATR) standard promulgated by the Bureau of Consumer Financial Protection (CFPB) that is scheduled to go into effect on January 10, 2014<sup>6</sup>. The Agencies propose to cross-reference the definition of QM, as defined by the CFPB, in its regulations, as may be amended from time to time, to minimize potential for future conflicts between the QRM standards in the proposed rule and the QM standards adopted under the Truth in Lending Act (TILA).

The QM provides sound underwriting criteria and excludes risky products, such as negative amortization and no-documentation loans. Importantly, the QM does not include a downpayment requirement.

#### NAHB supports the proposal to align QRM with QM.

NAHB supports steps to ensure that mortgage lending occurs in a safe and sound manner, with appropriate underwriting, prudent risk management and sound consumer safeguards and disclosure. NAHB believes that loans should be carefully underwritten and adequately disclosed. NAHB also believes that it is critical that mortgage lending reforms are imposed in a manner that causes minimum disruptions to the mortgage markets, while ensuring consumer protections. NAHB appreciates the Agencies' careful consideration of these factors to avoid further adverse changes in liquidity and affordability.

The QM standard establishes sound and transparent underwriting criteria and requires borrowers' applications to be adequately reviewed and verified to ensure home buyers have the means to repay their loans. The QM also excludes risky products that left borrowers with loans they did not understand and could not repay.

Aligning the QRM with the QM has many benefits. Establishing one streamlined regulation, instead of having two separate sets of underwriting criteria, will alleviate confusion in the marketplace and will provide clarity and transparency for home buyers, lenders, investors and other housing market participants. Additionally, the underwriting criteria and product limitations contained in the QM will promote more prudent lending and will provide investors with an assurance that the loans are sustainable.

Also, removing the downpayment requirement comports with the congressional intent of the QRM provision: to encourage sound lending behaviors that support a housing recovery, attract private capital and reduce future defaults without punishing responsible borrowers and lenders.

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<sup>6</sup> [Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act \(Regulation Z\); Final Rule](#), 78 Fed. Reg. 35429 (June 12, 2013)

*Coalition for Sensible Housing Policy*

NAHB has again joined the Coalition for Sensible Housing Policy (Coalition) in submitting comments on the re-proposed rule. NAHB strongly supports the points covered in the Coalition's white paper, a copy of which is attached. As per the white paper, NAHB agrees that the data indicate that the underwriting and loan product limitations that are mandated by QM loans effectively limit the risk of default without excluding large numbers of creditworthy borrowers.

*2013 ATR Final Rule: Points and Fees Included in the QM Definition*

While aligning the QRM with the QM streamlines the underwriting criteria, NAHB remains concerned about the cap on points and fees in the ATR Final Rule. The Dodd-Frank Act and the final ATR rule define a QM as a loan for which the total points and fees do not exceed three percent of the total loan amount. The final ATR rule includes closing charges paid to affiliated settlement service providers in the three percent cap on points and fees. NAHB objects to the inclusion of affiliate charges in the three percent cap, and we have expressed these concerns to the CFPB. The current definition of fees and points in the ATR discriminates against affiliated relationships and NAHB strongly supports an affiliate exception as it would allow consumers access and choice in determining their mortgage products.

NAHB strongly opposes the QRM alternative approach, QM-plus.

The Agencies stated that aligning the QM with QRM is their preferred approach but are seeking comments on an alternative proposal, referred to as "QM-plus", which would limit QRMs to loans that meet the following requirements:

- The core QM criteria adopted by the CFPB, except loans that are QM because they meet the CFPB's provisions for GSE-eligible covered transactions, small creditor exceptions, or balloon loan provisions
- Secured by one-to-four family properties that constitute the principal dwelling of the borrower
- First-lien mortgages only
- Borrower could not be currently 30 or more days past due on any debt obligation, had not been 60 or more days past due on any debt obligations within the preceding 24 months, and have not had, within the preceding 36 months, bankruptcy or foreclosure
- The loan-to-value (LTV) ratio at closing could not exceed 70 percent

NAHB strongly opposes the alternative QRM approach. As highlighted in the attached Coalition white paper, we collectively contend that high downpayment and equity rules along with excessive underwriting requirements will not have a meaningful impact on default rates but will tighten lending rules to the point where millions of creditworthy home buyers would not be able to qualify for a mortgage. NAHB and the Coalition are concerned that responsible consumers who maintain good credit and seek safe loan products will be forced into more expensive mortgages under the terms of the alternative proposal simply because they do not have 30 percent or more in downpayment or equity. Further, many borrowers would not qualify to obtain such loans.

Additionally, NAHB is concerned that this alternative approach would strengthen the Enterprises' dominance of the securitization market at the expense of a vibrant RMBS market which includes private label securities. As noted earlier, the Agencies have proposed that the

Enterprises would not have to comply with the additional risk retention requirements while they operate in conservatorship. This treatment, coupled with the FHFA's restriction that the Enterprises only purchase QM loans<sup>7</sup>, would give the Enterprises a significant competitive securitizing advantage under the QM-plus proposal. NAHB agrees with the SEC's comment in the proposal that a less restrictive QRM criteria would enhance the competitiveness of private securitizations and reduce the need to rely on low-downpayment programs offered by the Enterprises<sup>8</sup>.

Also, reports are surfacing about the challenges that lenders are experiencing in preparing their systems for operation under the ATR and QM regulations. Layering the QM-plus proposal over the QM criteria would undercut the housing market recovery as lenders will have to create additional lending platforms which would be costly and time-consuming.

Finally, NAHB agrees with the SEC that except in the case where exemptions are applicable (e.g., the QRM exemption), the proposed risk retention requirements likely will impose new constraints on these securitizers<sup>9</sup>. Under the QM-plus proposal, most loans would not qualify as a QRM; and therefore, the new constraints would be significant. NAHB remains very concerned that capital will be further limited if such a large universe of mortgages requires securitizers to hold capital instead of being able to put that capital to work in the housing finance system.

#### *Regulatory Flexibility Act*

In compliance with the Regulatory Flexibility Act (RFA), the Agencies have certified that the credit risk retention rule as proposed, including the QRM proposal, will not have a significant impact on small entities. The RFA, as amended by the Small Business Regulatory Enforcement Fairness Act, requires agencies to either prepare an Initial Regulatory Flexibility Analysis describing the impacts the proposal will have on small entities, 5 U.S.C. §603, or certify that the proposal will not have a "significant economic impact on a substantial number of small entities," 5 U.S.C. §605(b).

However, no such certification has been made for the "QM-plus" alternative proposal. If the Agencies were to change course and adopt the QM-plus alternative, a RFA analysis of this element of the proposal must be performed to ensure that the Agencies' certification of no impact remains valid. Given the severe limitations in scope that the QM-plus alternative would impose on the applicability of QRM, it is likely that more small entities will become subject to credit retention requirements and experience economic impacts. NAHB urges the Agencies to adopt the proposal to align QRM with QM. If the Agencies determine that the QM-plus alternative warrants further examination, NAHB urges the Agencies to develop the required Initial Regulatory Flexibility Analysis to accurately assess the impact that the QM-plus alternative would have on small entities.

#### NAHB Supports Broad Access to Safe, Affordable Mortgage Credit

NAHB is supportive of ensuring safe, well documented, and soundly underwritten loans without limiting the availability, or increasing the costs of credit to borrowers. Aligning QRM with QM levels the playing field, promotes liquidity in the mortgage market and allows access to credit for

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<sup>7</sup> Federal Housing Finance Agency. (2013). FHFA Limiting Fannie Mae and Freddie Mac Loan Purchases to "Qualified Mortgages". [Press Release]. Retrieved from <http://www.fhfa.gov/webfiles/25163/QMFINALrelease050613.pdf>

<sup>8</sup> [Credit Risk Retention](#), 78 Fed. Reg. 58017 (September 20, 2013)

<sup>9</sup> Id. at 58009

a diverse range of home buyers, particularly first-time and low- to moderate-income home buyers. If the QRM is too restrictive, this important group of home buyers will have to rely on government programs or potentially risky mortgage products for low downpayment options. Encouraging private capital to provide mortgages with reasonable terms to a broad range of home buyers is imperative to support a sustained housing market recovery.

At a time when housing is at affordable levels for most median income families and interest rates are at historic lows, more buyers should be encouraged to enter the housing market. However, many creditworthy borrowers are not able to take advantage of these opportunities. As evidenced in the current tight lending environment, first-time homebuyers and low- to moderate-income buyers are adversely impacted by the stricter underwriting standards and the increasing cost of credit available for low downpayment mortgages. For example, first-time buyers accounted for 28 percent of September 2013 sales, well below the historical average of about 40 percent<sup>10</sup>. Additionally, the share of low- to moderate-income borrowers with access to mortgage credit has decreased disproportionately in recent years<sup>11</sup>. As evidenced in the recent trends in mortgage lending, when only the home buyers with the most pristine credit histories have been able to access credit, opportunities for homeownership suffer, particularly for low- to moderate-income families and first-time home buyers.

### **Commercial Real Estate**

The re-proposed rule continues to define commercial real estate (CRE) loans to include multifamily mortgages (i.e., loans secured by five or more residential units). The proposed rule also sets forth the underwriting standards for qualified commercial real estate loan (QCRE), which is presumed to be a low-risk loan. Similar to the QRM, commercial mortgage-backed securities (CMBS), including multifamily CMBS, that consist of QCRE loans would not be required to meet the five percent risk retention requirements.

#### *Qualified Commercial Real Estate (QCRE)*

NAHB opposed the originally proposed QCRE standards because an overwhelming majority of loans would not be able to meet them, as acknowledged by the Agencies in the 2011 proposal.

In the re-proposed rule, the Agencies are proposing some modifications to the QCRE standards. The debt service coverage will be set at 1.25 for multifamily properties instead of 1.50 as previously proposed. The updated QCRE standards would allow for a 30-year amortization period for multifamily properties instead of 20 years as previously proposed. The modified combined loan-to-value (CLTV) may be less than or equal to 70 percent, with a maximum LTV of 65 percent for all CRE loans. The Agencies had originally proposed that the CLTV cannot be more than 65 percent. If the cap rate used in the appraisal is less than the 10-year interest rate swap rate plus 300 basis points, the maximum LTV is 60 percent to mitigate the effect of an artificially low cap rate.

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<sup>10</sup> NAHB Eye on the Economy. (October 21, 2013). Existing Sales Decline. [Web log post]. Retrieved from: <http://eyeonhousing.wordpress.com/2013/10/21/existing-sales-decline/>

<sup>11</sup> Sharygin, Claudia Ayanna. (October 2013). "[Class and Color in the Credit Crunch. Mortgage Lending to Low- and Moderate-Income Borrowers and Borrowers of Color during and after the Great Recession](#)". Urban Institute.

NAHB supports the proposed modifications and urges the Agencies to make further adjustments.

NAHB appreciates and supports the Agencies proposed modifications. However, NAHB remains concerned that the Agencies did not make distinctions among the different asset types included in CRE loans (hotel, retail, multifamily, office, etc.) in setting underwriting standards, except for the debt service coverage and amortization period of the loan. NAHB believes that it is not appropriate to apply the same standards to different classes because there are significant differences in property features, lease structures, tenant characteristics, etc., that affect how a CRE property is underwritten.

NAHB reiterates its comments that the underwriting standards employed by the Enterprises for multifamily loans have proven to meet the safety and soundness requirements of their regulator, FHFA, and have resulted in extremely low default rates, generally below one percent. The Enterprises' LTV requirements vary, depending on various factors including property type, geographic location, and term of the loan (e.g., five, seven or ten years), and range from 65 to 80 percent. The Agencies are proposing the lowest maximum LTV in that range and applying it to all CRE loans. NAHB suggests that the Agencies should differentiate multifamily from other CRE loans and allow for a higher CLTV and LTV than proposed specifically for multifamily loans.

In addition, the proposed rule prohibits a borrower from obtaining a loan secured by a junior lien on any property that serves as collateral for the CRE loans, unless such loan finances the purchase of machinery and equipment pledged as additional collateral for the loan. NAHB opposes this prohibition, as it fails to consider that many multifamily and other commercial loans use multiple layers of financing, and it is not unusual to have subordinate loans in the financing package. With such a restriction, borrowers could have trouble refinancing, repositioning or upgrading properties to higher energy efficiency standards. NAHB again suggests that the Agencies revise this prohibition to allow for such circumstances.

NAHB supports a stable and liquid market for multifamily financing.

NAHB believes the QCRE is an important component of the credit risk retention requirements and setting an appropriate QCRE standard will be key to minimizing the impact on borrower financing costs for multifamily borrowers. To the extent that risk retention requirements raise multifamily financing costs, there will be an impact on rents. Higher rents have an immediate impact on renter households' budgets. For aspiring homeowners, higher rents also mean that it will take longer to save for a downpayment on a home. In addition, for other types of commercial properties, higher rents affect companies' ability to grow, and thus negatively impact job creation.

Recent regulatory developments have constrained the ability of NAHB members to meet the growing demand for safe, decent, affordable rental housing. For instance, FHFA announced plans to contract the Enterprises' presence in the multifamily market by limiting their product lines, loan terms, and business activities and is further proposing to reduce their volume of new multifamily business by 10 percent relative to 2012. In addition, the FHA exhausted its authorized level of commitment authority for multifamily mortgage insurance programs before the end of FY2013, resulting in a large bulge in the loan application pipeline. The situation was worsened by the government shutdown, because no activity could occur during that period. The FHA multifamily mortgage insurance programs support the construction and rehabilitation of affordable rental housing for low- and moderate-income households; these projects contribute



jobs and revenue to the economy and provide much-needed rental housing throughout the country.

NAHB urges the Agencies to consider the impact the credit risk retention regulations will have in further restraining credit to the multifamily housing sector. Such disruptions in the market have the potential to slow down the job creation and monetary contributions to the economy that are currently fueled by multifamily construction.

### **Premium Capture Cash Reserve Account (PCCRA)**

The original proposed rule would have required the establishment of a premium capture cash reserve account (PCCRA) to address concerns that securitizers may try to compensate for the extra cost of risk retention by raising fees. The Agencies stated that, to achieve the goals of risk retention, they proposed to adjust the required amount of risk retention to account for any excess spread that is monetized at the closing of a securitization transaction. The PCCRA would contain any excess spread amount immediately recognized as a gain on the sale of the underlying assets by the sponsor and would not allow the sponsor to monetize the spread in the form of premium gross proceeds or interest only (IO) bonds. The Agencies have eliminated the PCCRA provision in the updated proposal.

NAHB supports the Agencies' decision to not include a PCCRA provision in the re-proposed rule. The Agencies state that, with a new proposal to use fair value to measure the amount of risk retention instead of par value in the original proposal, the ability of a sponsor to evade the risk retention requirements through the use of deal structures will be meaningfully mitigated. The Agencies also took into consideration the potential negative unintended consequences the PCCRA might cause for securitizations and lending markets. NAHB agrees with the Agencies that the elimination of the PCCRA should reduce the potential for the proposed rule to negatively affect the availability and cost of credit to consumers and businesses<sup>12</sup>.

### **Conclusion**

NAHB appreciates the Agencies thorough consideration of the market impacts of the credit risk retention rule and appreciates the Agencies making important adjustments in the re-proposed rule. As this rule will lay the groundwork for securitization and access to credit going forward, it is important to get the regulations right.

Housing is an important source of economic growth. As of the second quarter of 2013, housing's share of gross domestic product (GDP) was 15.6 percent<sup>13</sup>. A regulatory environment that provides an important balance between access to credit and consumer and investor protections will be a key factor in helping contribute to the national economy and a sustained housing recovery.

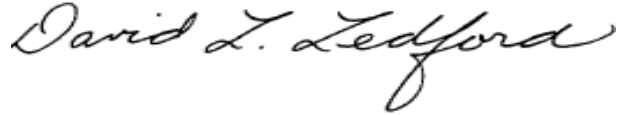
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<sup>12</sup> [Credit Risk Retention](#), 78 Fed. Reg. 58010 (September 20, 2013)

<sup>13</sup> NAHB Eye on the Economy. (October 3, 2013). Housing's Contribution to GDP: 2Q13. [Web log post]. Retrieved from: <http://eyeonhousing.wordpress.com/2013/10/03/housings-contribution-to-gdp-2q13/>

Thank you for your consideration of NAHB's comments. If you have questions, please contact Jessica Lynch, Assistant Vice President, Housing Finance & Regulatory Affairs at 202.266.8401 or email at [jlynch@nahb.org](mailto:jlynch@nahb.org).

Sincerely,

A handwritten signature in cursive script that reads "David L. Ledford". The signature is written in black ink and is positioned below the word "Sincerely,".

David L. Ledford  
Senior Vice President  
Housing Finance & Regulatory Affairs

Attachment

# The Coalition for Sensible Housing Policy



**UPDATED QRM PROPOSAL STRIKES BALANCE:  
PRESERVES ACCESS WHILE SAFEGUARDING CONSUMERS AND MARKET**

*As Submitted to Federal Regulators October 30, 2013*

**UPDATED QRM PROPOSAL STRIKES BALANCE:  
PRESERVES ACCESS WHILE SAFEGUARDING CONSUMERS AND MARKET**

**Prepared by:**

**The Coalition for Sensible Housing Policy**

American Bankers Association  
American Escrow Association  
American Financial Services Association  
American Land Title Association  
American Rental Property Owners  
and Landlords Association  
Asian Real Estate Association of America  
Black Leadership Forum  
Center for American Progress  
Center for Responsible Lending  
Coalition of US Mortgage Insurance  
Companies  
Colorado Mortgage Lenders Association  
Community Associations Institute  
Community Home Lenders Association  
Community Mortgage Lenders of America  
Community Reinvestment Coalition of  
North Carolina  
Consumer Federation of America  
Consumer Mortgage Coalition  
Council Of Federal Home Loan Banks  
Credit Union National Association  
Enterprise Community Partners, Inc.  
Habitat for Humanity International  
HomeFree USA  
Homeownership Preservation Foundation  
Housing Partnership Network  
Independent Community Bankers of  
America  
International Association of Official Human  
Rights Agencies  
Leading Builders of America  
Louisiana Bankers Association  
Manufactured Housing Institute  
Mortgage Bankers Association  
NAACP  
National Association of Federal Credit  
Unions  
National Association of Hispanic Real Estate  
Professionals  
National Association of Home Builders  
National Association of Human Rights  
Workers  
National Association of Neighborhoods  
National Association of Real Estate Brokers  
National Association of REALTORS®  
National Association of the Remodeling  
Industry  
National Community Reinvestment  
Coalition  
National Fair Housing Alliance  
National Housing Conference  
National NeighborWorks Association  
National Urban League  
National Real Estate Investors Association  
North Carolina Institute for Minority  
Economic Development  
Real Estate Services Providers Council  
Real Estate Valuation Advocacy Association  
The Realty Alliance  
Texas Bankers Association  
U.S. Conference of Mayors  
Worldwide ERC

# **UPDATED QRM PROPOSAL STRIKES BALANCE: PRESERVES ACCESS WHILE SAFEGUARDING CONSUMERS AND MARKET**

## **INTRO**

The Coalition for Sensible Housing Policy is a diverse coalition of 52 consumer organizations, civil rights groups, lenders, real estate professionals, housing organizations, mortgage insurers and local governments that share the goal of attracting private capital to the mortgage market while ensuring that creditworthy families, including those unable to afford a large down payment, are not unnecessarily excluded from homeownership opportunities.

The Coalition strongly supports the re-proposed rule's primary recommendation to incorporate the Qualified Mortgage (QM) standard to define the Qualified Residential Mortgage (QRM).

This approach achieves the twin objectives of protecting the marketplace while ensuring borrowers have access to safe mortgages. Investors will remain confident they can rely on the quality of mortgages underlying securitizations and creditworthy borrowers will be able to obtain access to conventional financing for safe, sustainable mortgages. At the same time, it also assures that loans with the highest risk – those with the product features explicitly excluded by QM – will be subject to the risk retention rules for asset backed securities. In releasing the re-proposed rule, regulators expressed valid concerns that establishing diverse standards for QM and QRM loans could result in an increase in complexity, regulatory burden and compliance costs that will be passed on to borrowers in the form of higher interest rates and restrictive credit standards.

The Coalition for Sensible Housing Policy strongly opposes the alternative "QM-Plus" approach in the proposed rule, which would require borrowers to make a 30 percent down payment to obtain a QRM loan. Such a restriction along with unduly difficult credit standards will restrict access to mortgage credit for far too many creditworthy borrowers.

In contrast, data that we describe in this paper indicates that the underwriting and loan product limitations that are mandated for QM loans effectively limit the risk of default without excluding large numbers of creditworthy borrowers.

## **1. HISTORY OF QRM**

### **a. BASICS of QRM**

As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Congress sought to design a framework for improving the quality of mortgage lending and restoring private capital to the housing market. To better protect investors and discourage excessive risk taking, Congress required securitizers to retain five percent of the credit risk on loans packaged and sold as mortgage securities. However, because across-the-board risk retention would impose significant (and unnecessary) restrictions on responsible, creditworthy borrowers, legislators also mandated an exemption for "Qualified Residential Mortgages (QRM)," that was to be defined by regulators to include mortgages with product

features and sound underwriting standards that have been proven to reduce the risk of default.<sup>1</sup>

## **b. PREVIOUS RULE**

In April 2011 regulators proposed a Qualified Residential Mortgage (QRM) rule that was inconsistent with the goals outlined by Congress of preserving access to mortgages while protecting against a repeat crisis.<sup>2</sup> Specifically, regulators developed a QRM definition with provisions mandating high down payments, stringent debt-to-income ratios and burdensome credit standards that would have raised unnecessary barriers for creditworthy borrowers seeking the lower rates and preferred product features of the QRM.

### **i) Legislative Intent**

The 2011 proposed rule required a high down payment - 20 percent with even higher levels of minimum equity required for refinancing – despite the fact that Congress considered and rejected establishing minimum down payments because loans have been shown to perform well without high levels of equity when there is strong underwriting and safe, stable product features.

The housing crisis was not caused by high LTV lending, but rather by a range of factors including an overheated housing market, lapses in solid underwriting, strong investor appetites, the inappropriate layering of risk, and the introduction of complex loan products that most consumers could not understand and over time could not afford.

The legislative history regarding QRM clearly demonstrates Congressional intent to avoid a minimum down payment requirement. During Congressional debate on the bill, a proposed amendment to require a down payment of five percent was voted upon and rejected by the Senate.

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<sup>1</sup> The statutory framework for the QRM requires the regulators to evaluate underwriting and product features that historical data indicate result in lower risk of default, including: documentation requirements; monthly payment-to-income standards; payment shock protections; restrictions or prohibitions on negative amortization, interest-only and other risky features; and mortgage insurance coverage or other credit enhancements obtained at origination to the extent they reduce default risk.

<sup>2</sup> Congress directed regulators to balance the need for credit standards against the need to improve access to credit, providing that exemptions from the risk retention rules shall “... improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors.” Section 15G(e)(2)(B) of the Securities and Exchange Act of 1934 (15 U.S.C. 78(a) et. seq.), as added by Section 941(b) of the Dodd-Frank Act.

Chairman Christopher Dodd (CT) argued that it could inappropriately and inadvertently cut off home ownership saying:

*The amendment “would have very serious consequences ... for first-time homebuyers, minority home buyers, and others seeking to attain the American dream of home ownership.”<sup>3</sup>*

Ultimately the Senate accepted an amendment from Senators Mary Landrieu (LA), Kay Hagan (NC) and Johnny Isakson (GA) that did not contain any down payment requirement and created an exception for Qualified Residential Mortgages. A version of this amendment was ultimately included in Dodd-Frank and became law.<sup>4</sup>

## ii) **Strong Opposition to First Proposed Rule (2011)**

Upon review of the rule, housing, financial and consumer groups mounted strong opposition to the proposal, arguing it would make it harder for borrowers, especially first time home buyers and members of underserved communities, to afford a down payment on a home.

As the Coalition wrote at the time:

*“Unnecessarily high down-payment requirements under QRM would make a near-term housing recovery almost impossible... thwarts the will of Congress, impedes the economic recovery and unnecessarily burdens American homebuyers.”<sup>5</sup>*

Further, a bipartisan group of senators (Isakson, Landrieu, Hagan) who drafted the language requiring the QRM rule in the 2010 Dodd-Frank Act wrote a letter to regulators urging them to drop a strict down-payment requirement:

*“Our intent as the drafters of this provision was, and remains, clear: to incent the origination of well-underwritten mortgages with traditional terms. We intentionally omitted a specific down payment requirement and never contemplated the rigid 20 percent or 10 percent as discussed in the March 2011 notice of proposed rulemaking.”*

The impact of the down payment requirements would have presented consumers with a difficult trade off – either pay a substantially higher rate for a non-QRM loan or wait significantly longer to purchase a home, if ever. By several estimates, risk retention for

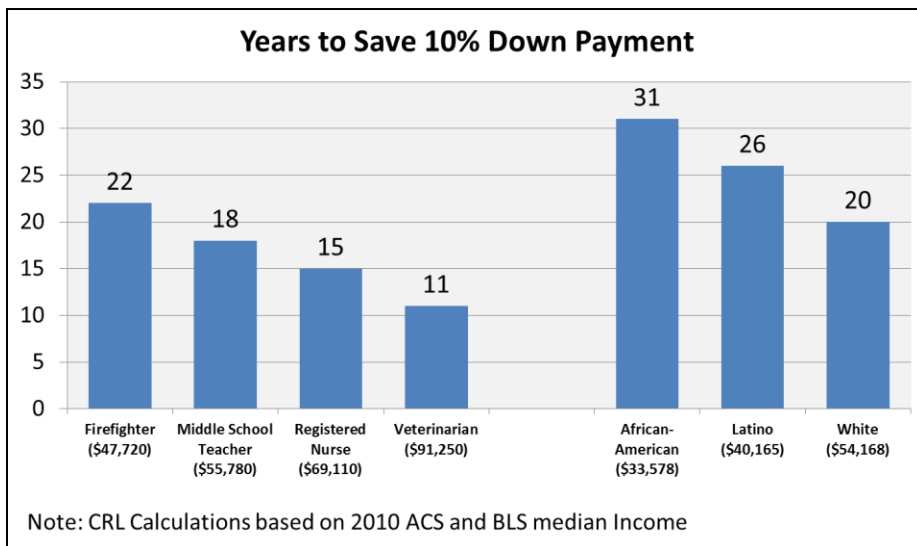
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<sup>3</sup> 156 Congressional Record S3518

<sup>4</sup> Amendment N. 3956, 156 Congressional Record S3575 (May 12, 2010). The amendment was co-sponsored by Senators Hagan, Warner, Menendez, Tester, Lincoln, Levin, Burr and Hutchison.

<sup>5</sup> [http://www.federalreserve.gov/SECRS/2011/April/20110426/R-1411/R-1411\\_032311\\_69533\\_582721581887\\_1.pdf](http://www.federalreserve.gov/SECRS/2011/April/20110426/R-1411/R-1411_032311_69533_582721581887_1.pdf)

non-QRM loans would have increased the cost to consumers by an estimated 75 to 125 basis points.<sup>6</sup> A higher down payment requirement would have exacerbated the costs further. As illustrated below, typical consumers might take 10 to 22 years to save for a 10 percent down payment (and nearly double the time for 20 percent).



Furthermore, as shown, the down payment requirement is more difficult to accumulate for borrowers of color.

## 2. CURRENT RULE: PROPER BALANCE

In August 2013, the six Federal Regulators published a revised proposed rule that would equate QRM with the soon-to-be implemented “ability-to-repay” Qualified Mortgage (QM) mortgage and underwriting standard issued by the CFPB.

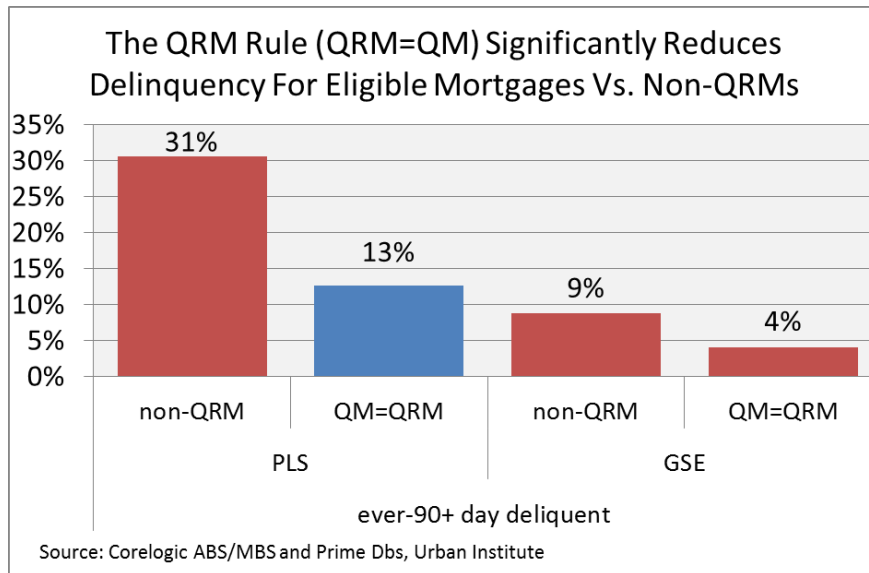
Under the QM standard, which was finalized earlier this year and will take effect in 2014, loans must meet product features and underwriting standards to qualify. Borrowers must document the income used to qualify for a loan, and creditors must verify this and other important borrower qualifications. Borrowers cannot have debt-to-income ratios above 43 percent (unless it meets Fannie Mae, Freddie Mac, or Federal Housing Administration underwriting criteria for seven years or until GSE reform). Loans with risky product features most closely associated with the housing crisis such as negative amortization, interest-only payment features, or loans with amortizations longer than 30 years are excluded from the QM definition.

<sup>6</sup> See Zandi, Mark, Moody’s Analytics. “Reworking Risk Retention.” and “A Clarification on Risk Retention”; Goodman, Laurie. Amherst Securities, “The Coming Crisis in Credit Availability.”; Jozoff, Mathew.(JP Morgan, “Securitization Weekly” December 11, 2009



In synchronizing both definitions, the revised rule encourages safe and financially prudent mortgage financing while also ensuring creditworthy homebuyers have access to safe mortgage financing with lower risk of default. In addition, consistency between both standards reduces regulatory burden and gives mortgage professionals much-needed clarity and consistency in the application of the important mortgage standards required pursuant to Dodd-Frank.

By equating the QRM with the QM, regulators have provided clear rules that allow for robust markets that meet the needs of creditworthy borrowers in a safe and sound manner. The new proposed QRM will reduce the risk of default and delinquency as illustrated below.



An Urban Institute<sup>7</sup> of mortgages in private label securities originated in or prior to 2013 found that the “ever 90-day delinquency rate” (loans that have ever been 90 days or more delinquent) for all loans that did not meet the re-proposed QRM standard was 30.6 percent.

The delinquency rate for purchase and refinance loans that met the new QRM proposal was nearly two thirds lower at 12.6 percent<sup>8</sup>. Loans purchased by Freddie Mac and Fannie Mae that met the re-proposed QRM standard had default rates of 4.1 percent as compared to 8.7 percent

<sup>7</sup> See blog post by Laurie Goodman and Ellen Seidman and Jun Zhu. “QRM, Alternative QRM: Loan default rates.” [http://blog.metrotrends.org/2013/10/qrm-alternative-qrm-loan-default-rates/?utm\\_source=feedburner&utm\\_medium=feed&utm\\_campaign=Feed%3A+MetrotrendsBlog+%28MetroTrends+Blog%29](http://blog.metrotrends.org/2013/10/qrm-alternative-qrm-loan-default-rates/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+MetrotrendsBlog+%28MetroTrends+Blog%29)

<sup>8</sup> To account for prepayment penalties, the authors of the Urban Institute’s study filtered from their QM definition mortgages with prepayment penalties incurred more than three years after origination, but they were unable to screen those mortgages with penalties that exceeded the limit of 2 percent of the amount prepaid. Likewise, data limitations precluded their ability to screen hybrid ARM products for a maximum rate reset in the first 5 years. Mortgages with these features may have been screened from the QM definition for other reasons, but some were likely included and thus estimates for delinquency rates should be considered conservative.

for mortgages that did not qualify for QM status. The study's authors point out that using an alternative measure of performance such as the 180-day delinquency rate or a measure of default would more accurately portray borrower behavior. The termination rates for PLS and GSE mortgages originated over this same period that were liquidated with loss (e.g. short sales, deeds in lieu transactions, and REO sales), REO, or for which no payment had been made in a 24 month period were 7.87 percent and 1.43 percent, respectively. Additional research completed by the UNC Center for Community Capital and the Center for Responsible Lending also shows reduced default rates for loans meeting QM product features.<sup>9</sup> Furthermore, a recent review by the UNC Center for Community Capital of several recent studies of performance for QM and non-QM loans found that these studies may vary in scope by time frame and mortgage features included, but all indicate that the QM standard significantly reduces risk, while providing broader access to credit than a QRM that includes a down payment requirement.<sup>10</sup>

The alignment of the QM definition with the QRM definition results in a construct that excludes risky product features and low or no-documentation lending that are closely correlated with increased probability of default. Appropriately, the definition of QM is not limited based on down payment. Although data show that the risk of default increases as down payments decrease, this does not necessitate the inclusion of down payment in QRM. Much like the private market operates today, investors can choose to package QRMs based on down payments if they choose to. Aligning QRM with QM allows market participants to assess and allocate risk within boundaries that will ensure stability to the market and a wide degree of credit access.

Recent market trends show that the QRM rule is unlikely to lead to a flood of zero down payment loans, as some critics of the proposed rule have suggested. Creditors currently are requiring borrowers to put significant amounts down in order to qualify for a loan before any risk retention rules are in effect yet. Both Fannie Mae and Freddie Mac recently raised their minimum down payments for most loans to five percent, and charge significant premiums and require mortgage insurance for those with down payments below 20 percent. The inclusion of a down payment requirement in the QRM rule is, therefore, unnecessary. Nonetheless, if a down payment requirement were included it would set a rigid standard not amenable to adjustment by individual securitizers based on experience and market trends. Moreover, it would give the government's imprimatur to an underwriting factor. That was not Congress's intent and would exclude far too many borrowers from QRM loans. As Laurie Goodman of the Urban Institute states, "The default rate for 95 to 97 percent LTV mortgages is only slightly higher than for 90 to 95 LTV mortgages, and the default rate for high FICO loans with 95 to 97 LTV ratios is *lower* than the default rate for low FICO loans with 90 to 95 percent LTV ratios. . . . For mortgages with an

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<sup>9</sup> When defining the loans meeting QM product requirements, this research excludes loans with prepayment penalties and hybrid ARMs, among other non-QM product features, and finds a default rate of 5.8 percent for these QM compliant loans. See Roberto G. Quercia, Lei Ding, Carolina Reid, Balancing Risk and Access: Underwriting Standards for Qualified Residential Mortgages<sup>^</sup>, Center for Community Capital and Center for Responsible Lending (Revised March 5, 2012).

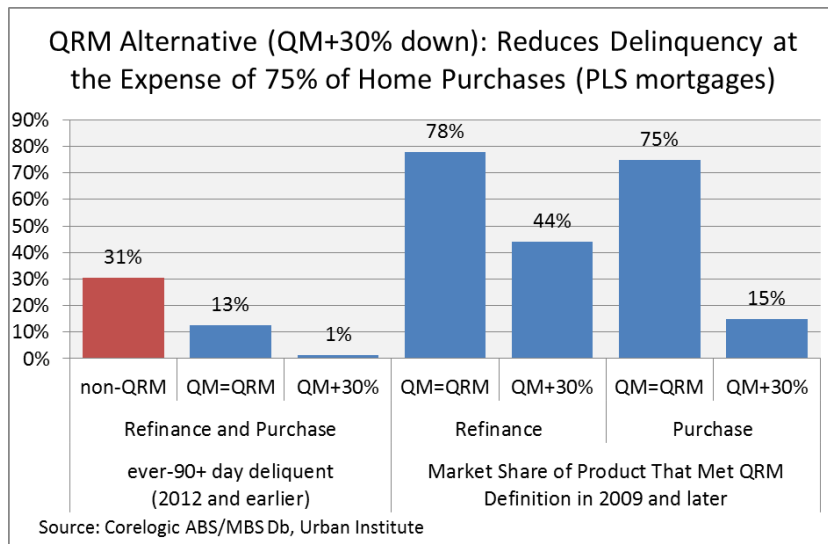
<sup>10</sup> Reid, Carolina and Roberto Quercia. "Risk, Access, and the QRM Reproposal." UNC Center for Community Capital. September 2013.

LTV ratio above 80 percent, credit scores are a better predictor of default rates than LTV ratios.”<sup>11</sup>

### 3. ALTERNATIVE: A STEP BACKWARD

In the revised proposal, the regulators ask for comment on the merits of adding a 30 percent down payment and credit requirements in addition to QM as an alternative for QRM. This proposal is a response to the overwhelming opposition voiced to the original proposed rule’s requirement for a 20 percent down payment, as well as its proposed question of a 10 percent alternative.

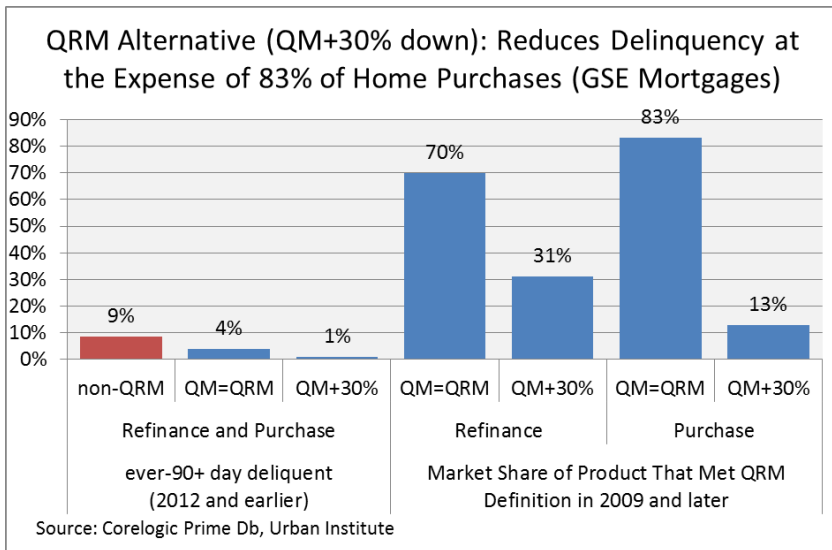
However, combining the definitions of QM and QRM together will make thorough underwriting and low risk mortgages the overwhelming standard in the market, without imposing down payment requirements above and beyond what lenders, insurers and investors will already continue to require. Large down payment requirements would raise the cost of credit <sup>12</sup> for a large pool of



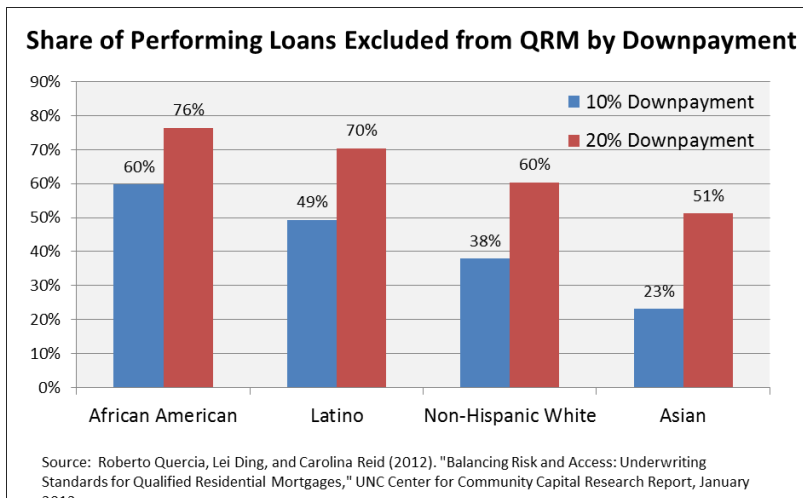
would-be homebuyers. As the graph above indicates, for mortgages in private label securities overlaying the 30 percent down payment and additional credit requirements on top of generally defining QRM as QM would reduce the risk of default for QRMs from 13 percent to one percent but it would significantly reduce the portion of the market that is QRM and exempt from the higher cost of risk retention, particularly on the purchase side which would decline from 75 percent to 15 percent.

<sup>11</sup> See Laurie Goodman and Taz George, Fannie Mae reduces its max LTV to 95: Does the data support the move?, The Urban Institute, MetroTrends Blog (September 24, 2013) (available at <http://blog.metrotrends.org/2013/09/fannie-mae-reduces-max-ltv-95-data-support-move/>).

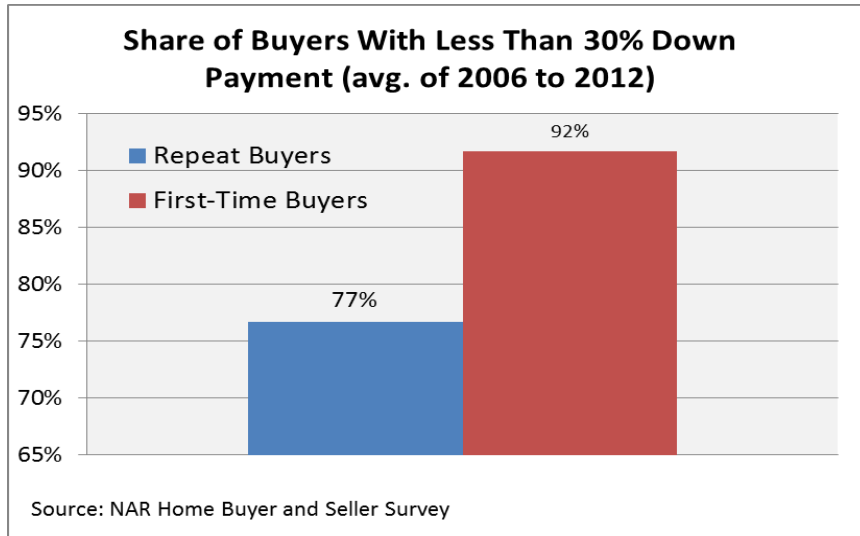
<sup>12</sup> See 78 Fed. Reg. 183, 58013 (September 20, 2013).



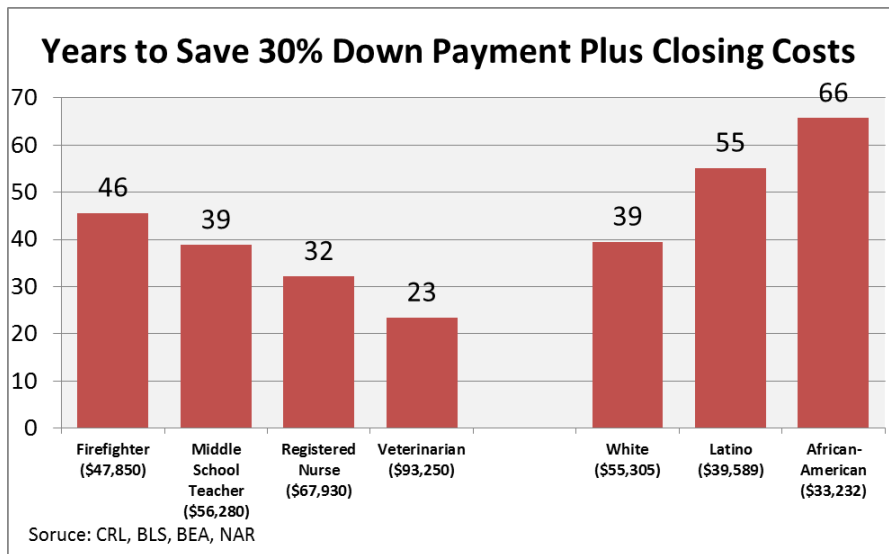
Likewise, as depicted above the delinquency rate for purchase and refinance originations purchased by the GSEs that met the alternative QRM requirement was 1 percent as compared to 4 percent for mortgages that just met the QM standard. However, the impact on market share of purchase mortgages originated after 2009 is more dramatic as the eligible share of the market falls from 83percent to 13percent percent.



Furthermore, as highlighted in prior research, the impact of a 10 percent or 20 percent down payment would be disproportionately borne by borrowers of color. Additionally, the impact would only increase for a 30 percent down payment. First time buyers are also constrained by down payments. On average, 92 percent of first time home buyers put down less than 30 percent between 2006 and 2012.



As indicated by the proposed rule, a non-minimal cost of up to 30 basis points would be passed onto the consumer under the proposed alternative. This cost could add up to billions of dollars on an annual basis, constraining consumer spending and homeownership, which would have implications for the greater economy. Alternatively, consumers might opt for a cheaper 100 percent guaranteed FHA alternative, which instead of drawing more private capital back into the mortgage market – a stated goal of the Administration – would have the unintended consequence of driving more activity to the government-insured program. For those potential buyers who choose to save the required down payment, the time to save is staggering as indicated in the chart below.



#### 4. CONCLUSION

Should the proposed ‘preferred’ QRM rule be finalized, federal regulators would take a big step forward in strengthening the housing market and economy while also adequately addressing the root causes of

the crisis (e.g. lapses in solid underwriting and by the introduction of complex loan products). The proposed alternative that requires borrowers to put down 30 percent to qualify for a QRM loan will constrain the availability of private mortgages for many creditworthy borrowers. Additionally, the high down payment requirement in the alternative proposal would add expense to otherwise high quality mortgages with lower down payments, restricting credit that will be needed to meet the housing credit needs of a rising generation of new households, without providing a commensurate increase in risk reduction for investors.

In summary, by synchronizing the definition of QRM with QM, the revised rule will encourage safe and financially prudent mortgage lending, while also creating more opportunities for private capital to reestablish itself as part of a robust and competitive mortgage market. Most importantly, it will help ensure creditworthy homebuyers have access to safe mortgage financing with lower risk of default.