October 30, 2013

The Honorable Mary Jo White
Chair
Securities and Exchange Commission
Washington, D.C. 20549

RE: File Number S7-14-11—Credit Risk Retention

Dear Chairwoman White:

On behalf of Community Associations Institute (CAI),[1] I am pleased to submit the following comments on the Agencies'[2] jointly proposed credit risk retention regulation implementing Section 941 of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010.

Summary of Comments

» CAI members support extending "qualified residential mortgage" (QRM) status to mortgages meeting the requirements of "qualified mortgage" (QM) as defined by the Consumer Financial Protection Bureau

» CAI members support the elimination of a proposed credit qualifications matrix and maximum loan-to-value (LTV) ratio for the purpose of defining "qualified residential mortgage"

» CAI members support continued acceptance of state statutes granting limited lien priority for community associations

[1] CAI is the only international organization dedicated to fostering competent, well-governed community associations that are home to approximately one-in-five American households. For more than 40 years, CAI has been the leader in providing education and resources to the volunteer homeowners who govern community associations and the professionals who support them. CAI's more than 32,000 members include community association volunteer leaders, community managers, community management firms, and other professionals and companies that provide products and services to community associations.

[2] The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, the Federal Housing Finance Agency (FHFA) and the Department of Housing and Urban Development (collectively, the Agencies).

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» CAI members oppose adoption of the alternative approach to defining "qualified residential mortgage" designated by the Agencies as "QM-plus"

Support for Aligning Qualified Residential Mortgage and Qualified Mortgage

CAI members strongly support the Agencies' proposal to align the definition of "qualified residential mortgage" with the Consumer Financial Protection Bureau's "qualified mortgage" standard. As expressed in prior comment letters to the Agencies, CAI members believe a return to prudent mortgage underwriting standards is a necessary and appropriate response to the financial crisis. CAI members believe the robust underwriting standards codified in the Bureau's QM rule will protect consumers and community associations.

Financial Stability of Association Homeowners Promoted by QM Standard

CAI members have previously urged that community associations and association homeownership be protected within any final QRM definition. The proposed QRM standard accomplishes this necessary goal by incorporating QM standards as the baseline for determining QRM status of mortgage loans.

The QM rule requires mortgage originators to verify borrowers are able to pay all monthly mortgage-related obligations required to keep a mortgage in good standing. For borrowers purchasing a home in a community association, this includes verifying that borrowers have the ability to pay common expense assessments. Association assessments fund critical services and obligations that support the operation and governance of the community. Originators failing to determine a borrower has the ability to pay such monthly mortgage-related obligations are subject to substantial penalty under the Truth in Lending Act.

The QM rule's ability to pay standard is a critical improvement to the lax underwriting standards that led to the financial crisis and subsequent collapse in the market for non-government guaranteed mortgage backed securities. Additionally, penalties for originator violations of the QM standard are sufficient to substantially constrain the transfer of dangerous credit risk to investors. Further, the potential for repurchase demands and other sanctions for violations of the QRM verification standards contained in the underlying proposal build on the consumer and investor protections provided by the QM regulation.

For association homeowners, this will support long-term financial stability in housing costs and foster vibrant communities. Across the nation, association homeowners have been exposed to significant financial distress as owners in foreclosure or who abandoned their homes ceased paying their share of community expenses.

In the vast majority of associations, homeowner assessments are the sole source of revenue to support critical community services and operations. Foreclosures and property abandonment lead to substantial association budget deficits, forcing all other

homeowners in the community to account for lost revenues through higher assessments or other actions that may further threaten the stability of the community.

This scenario, which is unique to association homeowners, has created a downward cycle where high assessment delinquency rates lead to higher association assessments, which in turn perpetuate the cycle by leading to even greater assessment delinquency rates. The QM rule's ability to pay test will, in large measure, make future recurrences of this downward cycle much less likely. Accordingly, CAI members strongly support the Agencies' proposal to align the QRM and QM standards.

<u>QM Standard Addresses CAI Member Concerns Regarding Transfer Fees and Verification of QRM Status</u>

In comments submitted regarding the Agencies' prior proposed QRM definition, CAI members expressed concern regarding the QRM status of properties subject to a transfer fee as well as the process used to verify QRM status at origination. These concerns are also addressed in the Agencies' proposal to use the QM standard as the baseline for determining QRM status.

CAI members worked cooperatively with the FHFA to prohibit abusive transfer fees that required homebuyers to pay fees to third parties with no interest in the real estate securing the underlying transactions. CAI is proud of this collaboration which ended what was little more than an equity-stripping scheme employed by unscrupulous developers. The QM standard acknowledges the role of community transfer fees in the financial stability of community associations and does not discriminate against communities with transfer fees that provide a direct benefit to the underlying real estate.

In response to the Agencies' prior credit risk retention proposed rule CAI members expressed significant concern regarding verification of QRM status at the point of origination. CAI members were concerned with the potential for new legal liability and related costs to mitigate any new operational risks associated with providing data used in QRM status verification. The QM standard provides community associations and originators reasonable means to verify association assessment obligations and other relevant ability to pay information. The Agencies' proposal incorporates the QM association assessment verification methodology and will greatly ease the process of verifying QRM status at origination.

The Agencies' proposed definition of QRM addresses the key concerns of CAI members and CAI strongly supports the proposal to align the QRM definition with the QM standard.

Support for Elimination of Individual Credit Criteria and Downpayment Requirement

CAI members expressed significant concern regarding the Agencies' original proposal to establish a matrix of borrower credit qualification and establish maximum loan-to-value ratios for QRM compliant mortgages. CAI members understand the Agencies intended to ensure that QRM compliant mortgages be of the highest credit quality. Notwithstanding this laudable policy goal, CAI members believed the proposal failed to strike the appropriate balance between prudent regulation and access to credit.

Individual Credit Criteria Matrix

CAI members commend the Agencies' decision to abandon efforts to construct a matrix of individual borrower credit qualification. The proposed credit matrix was intended to avoid enshrining proprietary credit qualification systems owned by private corporations in a final risk retention rule. While an understandable proposition, CAI members were concerned that originators would be unable to evaluate individual borrowers and mitigate credit risk through other prudential actions in the context of the QM ability to pay test. Further, CAI members were concerned that establishing credit criteria for individual borrowers in federal regulation could lead to unintended consequences where creditworthy borrowers would be denied access to credit simply by federal rule.

CAI applauds the Agencies for the determination that creating a credit criteria matrix posed more challenges than it resolved. Accordingly, CAI supports this aspect of the Agencies' proposed rule.

Elimination of Proposed 20 Percent Minimum Downpayment and LTV Ratios

CAI members were strongly opposed to the minimum cash contribution requirements for purchase money mortgages included in the Agencies' initial QRM definition. CAI members also opposed LTV and CLTV standards on rate and term or cash out refinance mortgages. CAI applauds the Agencies' determination that risks associated with LTV/CLTV ratios may be mitigated through other underwriting factors. As a member of the Coalition for Sensible Housing Policy, CAI also strongly endorses comments the Coalition submitted to the Agencies concerning the elimination of LTV/CLTV criteria (attached).

CAI members strongly support the Agencies' determination to avoid creating a credit matrix for individual borrowers in regulation and to avoid establishing a variety of LTV/CLTV standards within the QRM definition.

Support for State Statutes Granting Limited Priority for Association Liens

A basic and foundational element of the community association model of housing in state statute is that association assessments are mandatory and lien-based. Association assessments fund trash removal, road maintenance, wastewater management systems,

bridges, insurance premiums, and utilities such as water, electricity, and heating systems, among other things. If association assessments did not have this protection enshrined in state law, the community would not be able to fund these critical services.

Currently, at least 23 states have taken steps to strengthen association lien priority by granting limited priority to association liens over a first mortgage.[3] While the level of protection afforded to community association liens varies by state, associations in these jurisdictions have the ability to recover an amount of delinquent assessments (and in some instances other related charges) incurred when a homeowner has ceased paying their share of community costs.

Assessment delinquencies have a devastating effect on community association homeowners and are a source of additional downward pressure on property values in a distressed market. Permitting the recovery of a defined amount of delinquent association assessments through an association's enforcement of a lien promotes the financial stability of other homeowners in the community and ensures that property values are preserved. Fannie Mae, Freddie Mac, and the Federal Housing Administration each acknowledge state statutes granting limited priority for association liens and have implemented policies requiring mortgage servicers and mortgagees to comply with state lien priority statutes.[4]

The QM rule, which will serve as the baseline qualifying criteria for satisfying the proposed QRM standard, is silent on the question of limited priority for association liens. Thus, mortgages secured by real property subject to association governance in a priority lien state meet the Agencies' proposed QRM definition. CAI strongly urges the Agencies to acknowledge that first mortgages secured by real property in priority lien states are encompassed within the QRM definition. This will ensure that the millions of American homeowners living in community associations in priority lien states will have access to mortgage credit on terms that are equal to all other consumers.[5]

First mortgages in states granting limited lien priority for association assessments must be clearly qualified for QRM status otherwise access to credit in community associations across the country will be significantly curtailed.

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[3] To view a list of states that have adopted an association priority lien statute, visit the following link: https://www.caionline.org/govt/advocacy/Pages/AssessmentPriorityLienStatutesbyState.aspx

[4] Agency priority lien policies:

- Freddie Mac Seller/Servicer Guide, Volume 2, Chapter 71.18: Reimbursement of condominium, HOA, PUD fees, assessments, and ground rent
- Fannie Mae Servicing Guide, Part III, Section 202: Special Assessments and Part VII, Section 110: Expenses During Foreclosure Process
- Mortgagee Letter 2013-18: Updated Clarification Regarding Title Approval at Conveyance

[5] *Foundation for Community Association Research Statistical Review 2012: http://www.cairf.org/foundationstatsbrochure.pdf*

Opposition to the "QM-plus Alternative"

CAI members overwhelmingly oppose the Agencies' "QM-plus Alternative" (QM+). Accordingly, CAI reiterates support for comments submitted on behalf of the Coalition for Sensible Housing Policy, which offer detailed analysis of the harm the QM+ proposal would visit upon consumers and the real estate market, generally.

The proposed QM+ alternative retains many features of the Agencies' prior proposed QRM definition that were overwhelmingly opposed by CAI members. By way of example, the QM+ alternative would seek to require a minimum 30 percent downpayment for purchase mortgages and at least a 70 percent CLTV for refinances involving a junior lien. Further the QM+ alternative retains the unnecessary and ill-advised individual credit criteria matrix as an additional condition of QRM approval.

The QM+ alternative would also seem to prohibit (or at the very least impede) QRM status for loans secured by real estate in a community association. As previously stated, community association assessments, in all 50 states, are lien-based. In many instances the association's lien exists from the moment the community's declaration is recorded. The QM+ alternative would cast doubt on the basic eligibility of mortgages on property in a community association to meet the QRM standard, thereby severely damaging the economic stability of the more than 63 million Americans who call a community association home.

It is obvious on its face that the QM+ alternative has not been thoroughly vetted and that there is no consensus among the Agencies for its adoption and implementation. The proposed rule pointedly notes that the Agencies considered the QM+ alternative but ultimately did not believe it to be the preferred policy. CAI strongly supports the Agencies' preferred policy option, which will align the QM and QRM standards. This is the most efficient and prudent means to protect consumers and investors while ensuring a robust and healthy housing finance system and real estate market.

CAI members overwhelmingly oppose the QM+ alternative, which could disqualify all first mortgages secured by property in a community association from achieving QRM status.

Conclusion

CAI members appreciate the difficult task undertaken by the Agencies in developing the proposed credit risk retention rule. The Agencies are to be commended for the deliberative and data-based approach to this rulemaking. Further, the Agencies have prudently balanced the need of consumers to access to credit with the need to protect consumers and investors from fraudulent business practices.

Finally, on behalf of all homeowners living in a community association, CAI must once again reaffirm strong support for state laws granting limited priority for association liens and strong opposition to any policy that would weaken or impede the enforcement of such laws.

Sincerely,

Dawn Bauman, CAE
Senior Vice President, Government and Public Affairs
Community Associations Institute

Attachment: Coalition for Sensible Housing Policy QRM White Paper

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, 2103

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
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
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
Mortgage Insurance Companies of America
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, 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. <u>HISTORY OF QRM</u>

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.[6]

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.[7] 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

[6] 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.

[7] 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.

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.

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."[8]

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.[9]

ii) Strong Opposition to First Proposed Rule (2011)

Upon review of the rule, 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."[10]

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:

[8] 156 Congressional Record S3518

[9] 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.

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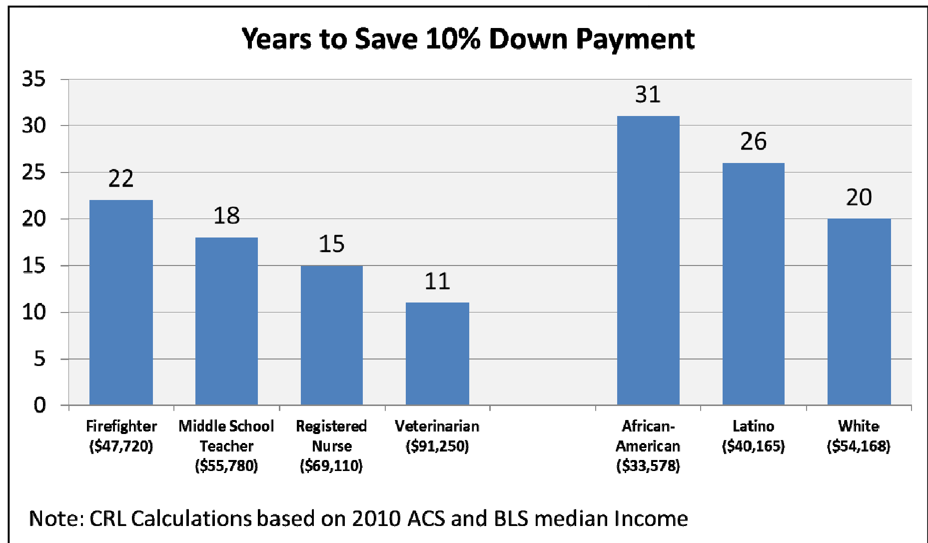
[10] http://www.federalreserve.gov/SECRS/2011/April/20110426/R-1411/R-1411_032311_69533_582721581887_1.pdf

"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 non-QRM loans would have increased the cost to consumers by an estimated 75 to 125 basis points.[11] 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"

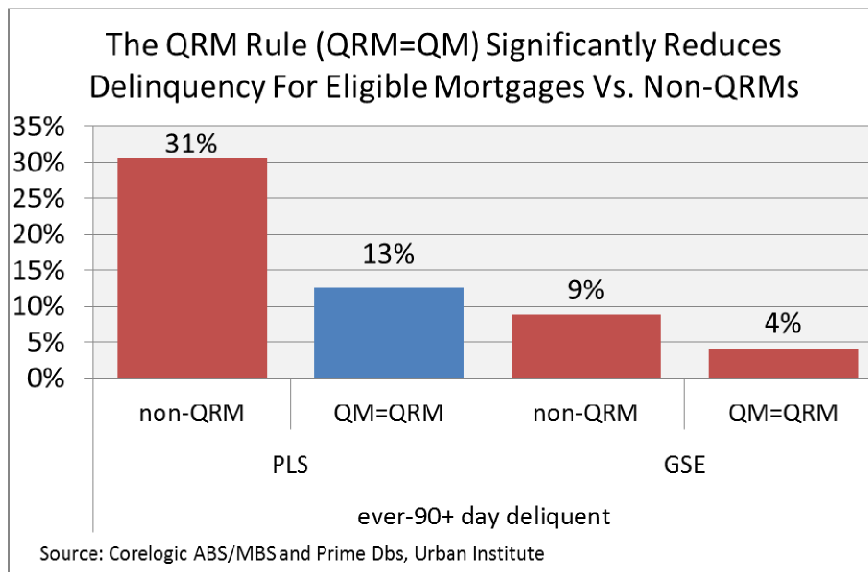
[11] See Zandi, Mark, Moody's Analytics. "Reworking Risk Retention." and "A Clarification on Risk Retention"; Goodman, Laurie. Amherst Securities, "The Coming Crisis in Credit Availability."; Jozoff, Mathew.(JP Morgan, "Securitization Weekly" December 11, 2009

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.

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 analysis by researchers at the Urban Institute[12] of mortgages in private label securities originated in or prior to 2013, 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[13]. 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 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 delinquency rates for PLS and GSE mortgages originated over this same period that fell 180 days or more delinquent were 7.87% and 1.43%, respectively. Furthermore, as pointed out by researchers at the UNC Center for Community Capital, several recent studies of performance for QM and non-QM loans 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.[14]

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.

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[12] 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

[13] 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.

[14] Reid, Carolina and Roberto Quertia. "Risk, Access, and the QRM Reproposal." UNC Center for Community Capital. September 2013.

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 it 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 LTV ratio above 80 percent, credit scores are a better predictor of default rates than LTV ratios."[15]

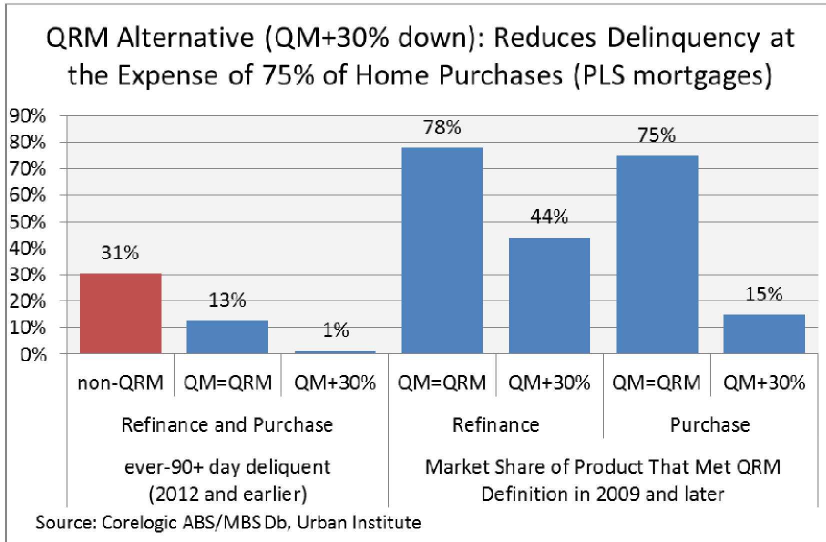
3. ALTERNATIVE: A STEP BACKWARD

In the revised proposal, the regulators ask for comment on the merits of a 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

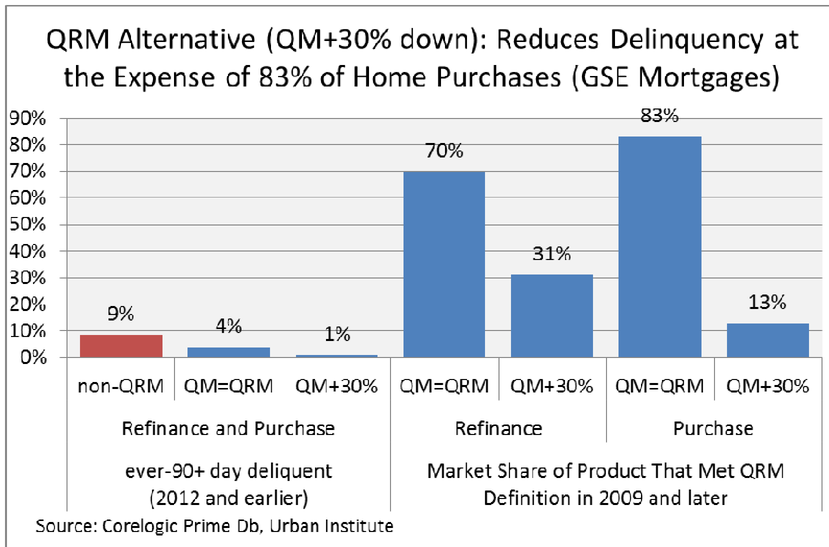
[15] See Laurie Goodman and Taz George, Fannie Mae reduces its max LTV to 95: Does the data support the move?, The Urban Institute, MetroTrends Blog (September 24, 2013) (available at http://blog.metrotrends.org/2013/09/fannie-mae-reduces-max-ltv-95-data-support-move/).

lenders, insurers and investors will already continue to require. Large down payment requirements would raise the cost of credit [16] for a large pool of

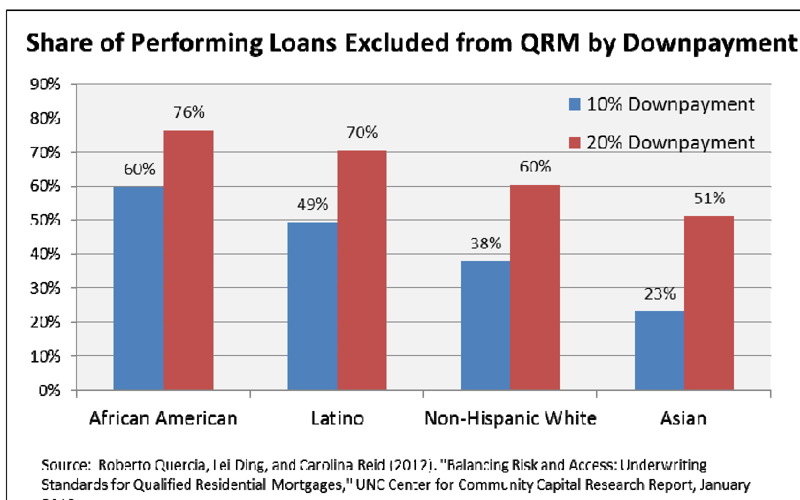


would-be homebuyers. As the graph above indicates, for mortgages in private label securities overlaying the 30 percent down payment and additional credit requirements on top of generally defining QRM as QM would reduce the risk of default for QRMs from 13 percent to one percent but it would significantly 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.

[16] *See* 78 Fed. Reg. 183, 58013 (September 20, 2013).

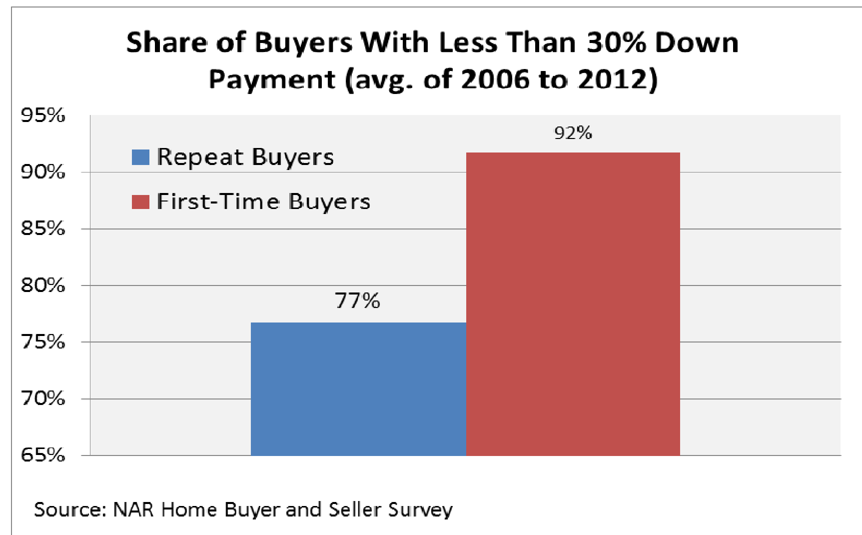


Likewise, as depicted above the delinquency rate for purchase and refinance originations purchased by the GSEs that met the alternative QRM requirement was 4.1 percent as compared to 1 percent for mortgages that just met the QM standard. However, the impact on market share of purchase mortgages originated after 2009 is more dramatic as the eligible share of the market falls from 83% to 13%.

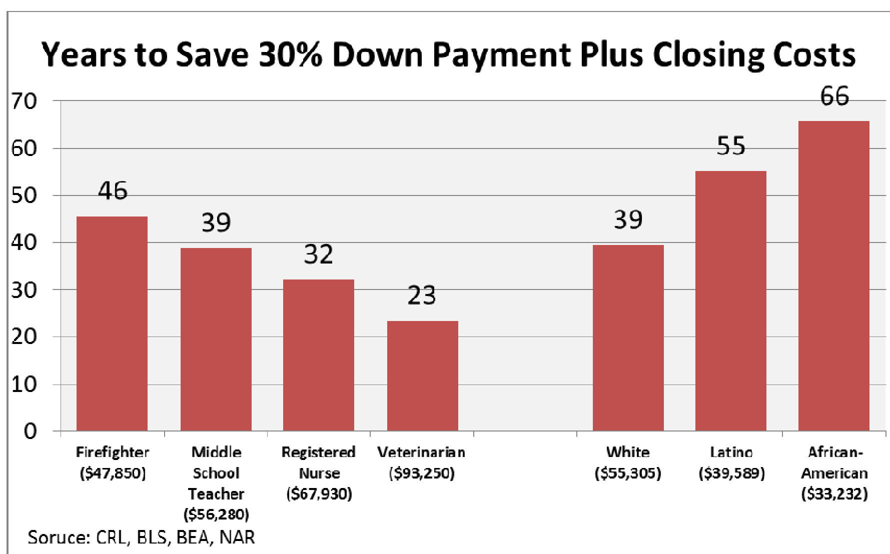


Furthermore, as highlighted in prior research, the impact of a 10 percent or 20 percent down payment would be disproportionately borne by borrowers of color. Additionally, the impact would only increase for a 30% down payment. First time buyers are also

constrained by down payments. On average, 92% of first time home buyers put down less than 30% between 2006 and 2012.



As indicated by authors of 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 roll on effects to 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 Administation – 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.



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 (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 mortgage lending 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, synchronizing the definition of QRM with QM rule 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.