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August 1, 2011

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Board of Governors of the
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Washington, DC 20551

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Ms. Elizabeth M. Murphy
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Office of the General Counsel
Department of Housing &
Urban Development
Washington, DC 20410

Office of the Comptroller of the Currency
Washington, DC 20219

RE: Proposed Rulemaking on Credit Risk Retention Requirements
Office of the Comptroller of the Currency
Docket Number OCC-2010-0002
RIN 1557-AD40

Federal Reserve Board
Docket No. R-1411
RIN 7011-AD70

Federal Deposit Insurance Corporation
RIN 3064-AD74

Securities and Exchange Commission
File Number S7-14-11

RIN 3236-AK96

Federal Housing Finance Agency
RIN 2590-AA43

Department of Housing and Urban Development
Docket Number FR–5504–P–01

Dear Sir/Madame:

On behalf of our members, Consumer Federation of America (CFA) appreciates this opportunity to comment on the above-referenced proposed rulemaking on behalf of our nearly 300 member organizations. CFA was founded in 1968 to represent the consumer interest through research, advocacy, and education. We also joined with other industry and consumer groups in a comment filed by the Coalition for Sensible Housing Policy.

The proposed rulemaking on credit risk retention and the definition of a proposed "Qualified Residential Mortgage (QRM)" as required by Title IX of the Dodd-Frank Act is an important step in the reconstruction of the nation's mortgage system. CFA was an early and frequent critic of the loose and ultimately calamitous underwriting and securitization system that emerged in the late 1990's. The lack of alignment between originators, borrowers, creditors and investors led to high inflation in house prices, the growth of an "originate to sell" model of loan-making that fostered poor credit decisions, and the failure of many loans with dire economic consequences for borrowers, investors and communities. In theory, requiring a level of risk retention by securitizers can act to increase their diligence and care when choosing mortgages for securities.

We note, however, that risk retention in and of itself is an imperfect tool for insuring that safe and appropriate lending standards are developed and followed.[1] During the recent mortgage boom, many securitizers held significant portions of risk, greatly in excess of the amounts that would be required under this proposed rulemaking. Holding this risk alone did not generate the level of care that would have avoided the failure in hundreds of billions of dollars in these securities. Likewise, investors generally looked to rating agency grades on these mortgage bonds to assess their likely risk as a substitute for relying on counterparty risk-holding to

[1] "Before the financial crisis, many investment banks held a significant amount of the credit risk in their securitizations. To get many of these issues to market, banks needed to invest in the securities' so-called equity tranches— the pieces most exposed to default.[2] Banks were also attracted to the high returns of these risky tranches. Thus, despite having lots of skin in the game, the securitizers still made huge errors. Requiring them to hold 5% of the credit risk may not hurt mortgage rates or credit availability, but it will also do little to improve the quality of securitization." *Skinny on Skin in the Game*, Mark Zandi and Christian deRitis, Special Report, Moody's Analytics, March 8, 2011, p. 2

mitigate investor exposure. But these investors soon found that the agencies themselves had done little or very poor due diligence to justify their ratings, and they ultimately were useless.

We believe that the causes of the massive failures in subprime and Alt-A mortgages that have driven the housing market's collapse were clear and obvious well before the bonds backed by the mortgages actually failed. These included faulty appraisals; dangerous and unstable mortgage features like interest only loans, prepayment penalties, balloon payments, negative amortizations, and teaser ARM rates; fraudulent underwriting where incomes and assets – where assessed – were doctored, and well-known risk factors were layered together to create combustible loans that consumers were unlikely to be able to repay. Risk retention is one means of creating more accountability and alignment in the financing system. But we do not believe it alone is adequate to ensure safe securitizations. Far more important, we believe, is close regulation of mortgage underwriting, appraiser licensing and regulation, the compensation models through which loan originators are paid, servicing requirements focused on effectively and swiftly resolving delinquencies, and the product features that can be offered to consumers.

We note that the Federal Reserve Board has contemporaneously promulgated a proposed rulemaking implementing Dodd-Frank's so-called "ability to pay" provisions in Title XIV. We consider these to be far more important than the risk retention rules in encouraging safe and stable mortgage lending. They apply at the point of contact with consumers, when loan terms are negotiated and agreed upon. They are designed to regulate loan originators' behavior and discourage them from selling consumers product features that are dangerous and not in the consumer's best interest. They will be universal in their coverage, applying to all loan originations regardless of their ultimate destination in a security or a portfolio. The inclusion of the so-called "qualified mortgage (QM)" provision to provide a rebuttable presumption of compliance with the ability to repay rules should create a clear and, we believe, appropriate bucket of loans whose performance is well-documented. Long history in the mortgage finance field has shown these sensible standards, especially the exclusion of unstable product features, to be reliable and dependable.

We note with interest that although this proposed QM and ability to pay regulation specifically covers loan underwriting, the Board consciously chose not to include hard-and-fast underwriting standards in either the general requirements or the proposed QM. Rather, the Board chose to directly exclude product features that have been proven to increase credit risk. It would direct lenders to rely on generally accepted, documented and verified underwriting standards in meeting the ability to repay tests. These standards historically have used a dynamic process of evaluating complementary credit risks, including down payment, debt ratios, liquid assets, and the ability to meet the projected payments and other required homeownership costs with the borrower's documented and verified income. In contrast, the proposed QRM rule would require borrowers to meet *every one* of these tests, at specific and static levels. We do not doubt that such a application would result in qualifying only very high credit quality loans. But we do not believe it was Congress' intent to set the bar so high. Moreover, doing so will restrict access to credit for a wide swath of prospective homeowners to a more expensive and possibly less accessible market.

We strongly urge the regulators to delay final adoption of the QRM rule until the Consumer Financial Protection Bureau has promulgated a final QM/Ability to Repay rule. Once the rules for underwriting mortgages have been fully established we believe it will be easier to develop a consistent approach to the QRM, and regulators will be better able to assess the value of incorporating the QM requirements by reference as the QRM standard, a course of action that would greatly simplify the system while restricting the use of the types of mortgage features that we believe caused the greatest damage to the mortgage system.

In addition, because of the statutory exemption of mortgages insured or guaranteed by FHA and VA, and the regulators' decision – correct in our view – to consider the guarantees currently provided by Fannie Mae and Freddie Mac while under conservatorship to meet the overall risk retention requirements, a rule that excludes large portions of the mortgage market from the QRM could have the perverse effect of driving even more lending into government programs and coverage. Low wealth borrowers in particular will be driven, we believe, to rely on FHA, where the US Government takes 100 percent of the credit risk, rather than encouraging private capital to do so.

The proposed definition of QRM in this rule also excludes product features with proven negative credit impacts. We applaud this decision and strongly support it. However, we are concerned with the inclusion in the QRM definition of certain underwriting standards that we believe will do significantly more harm to consumers than is justified by the benefits their inclusion may provide.

In particular, we are deeply concerned with the proposed requirement that only loans with a down payment of 20 percent of more may qualify for the QRM exemption. We strongly urge the regulators to remove LTV and down payment requirements from the QRM definition for a number of reasons.

1. The test will disproportionately affect people of low wealth, even if they have strong income and exemplary histories of repaying their debts, by consigning them to a more expensive and potentially less accessible part of the mortgage market.
2. These households are likely to include significantly higher percentages of African-Americans, Hispanics, and low and moderate income Americans. We are concerned this will regenerate a "dual credit market" through which these groups are overwhelmingly served by limited programs such as FHA. In turn, we believe this

could encourage the re-creation of credit monocultures in minority and other underserved communities, which will reduce the role of private credit and restrict choice and options for their residents.

3. The benefits of including such a high down payment hurdle through reduction in default risk are not commensurate with the number of households it would cause to be excluded from the highest quality, lowest cost mortgages.
4. The inclusion of down payment requirements could influence market and other regulatory participants to assume these are necessary and appropriate for safe lending, and encourage their adoption across the mortgage market, which experience does not support.
5. The proposed QRM includes other criteria such as credit history and debt to income ratios. These are characteristics that consumers can consciously work to improve. Counselors can and should help aspiring home buyers to reduce their other debts and credit lines, and develop a strong history of repayment in order to help them qualify for the best priced and featured loans. Borrowers also may choose not to defer applying for a mortgage and opt for a higher priced mortgage outside of QRM. But this is not true for down payments. Unless a family already is wealthy, or has family that can contribute to the down payment, renters can do little to accumulate a 20 percent down payment. This will arbitrarily exclude them from the best priced and highest quality mortgages under the proposed rule. We agree that equity is an important aspect of mortgage lending, and we encourage prospective buyers to save in order to invest in their home.[2] But we do not agree that a hard and fast limit like that proposed in the rule is either necessary or appropriate.
6. For those who already own a home, the proposed requirement for 25 or 30 percent equity for rate and term and cash-out refis, respectively, also creates an unreasonable barrier that could prevent current owners from taking advantage of falling rates that could bolster their ability to pay and therefore reduce the credit risk of their mortgages.

Homeownership is an Important Factor in Household and Community Wealth and Asset Building

Homes remain the single largest asset that most households own, even after the steep value losses of the last several years. The Federal Reserve's Survey of Consumer Finances documented that in 2007 only about 53 percent of all US households held a retirement account of some kind; only 11 percent of the households in the lowest income quintile had them. For those in the second and third quintiles the numbers were 36 percent and 55 percent, respectively. Overall, these accounts were worth a median of $45,000 for all families; and $6,500 for the lowest quintile, $12,000 for the second, and $24,000 for the third.

[2] CFA sponsors America Save, a nationwide campaign to encourage savings with state and local campaigns operating in 61 locations around the country.

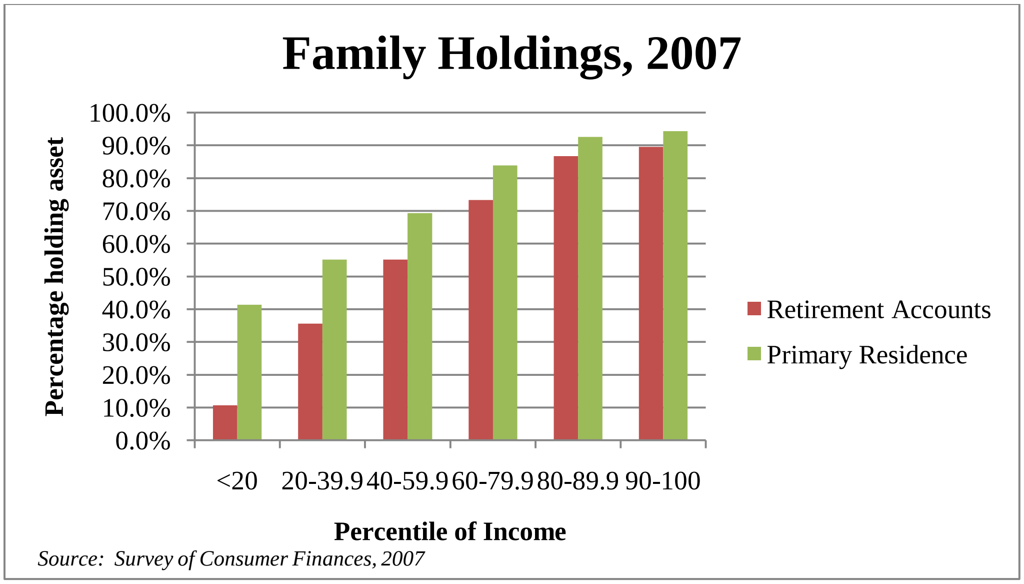
In contrast, 69 percent of all US households in the survey owned their primary residence. In the lowest quintile, this figure was 41 percent, or more than three times the share holding retirement accounts. In the second quintile 55 percent owned their home, more than 50 percent greater than the share holding retirement accounts, and in the third quintiles, 69 percent did, more than 20 percent greater.

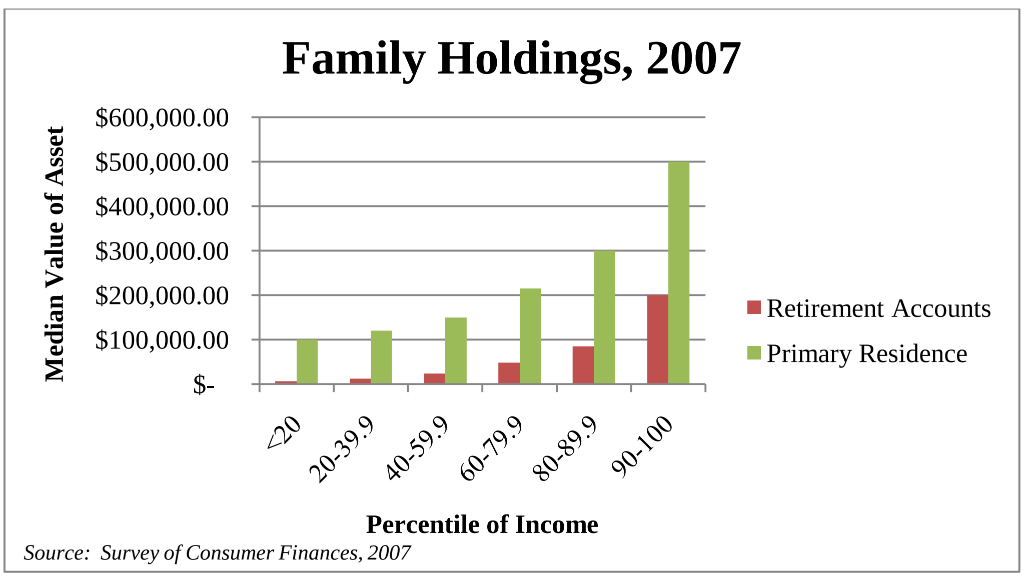
The value of primary residences also far exceeded that of retirement accounts, with a median of $200,000 overall, and $100,000 for the lowest quintile; $120,000 for the second and $150,000 for the third. These figures do not take into account the debt that households have on the properties; their equity in the homes would obviously be smaller than the total value of their principal residence. In spite of that, while these values undoubtedly have declined since 2007, and some share of these owners have lost their equity and possibly their homes, the difference in both participation rates and overall asset size documented in these figures is striking. Homeownership has and likely will continue to be the single most valuable asset for families as they age, and home equity represents the most significant source of potential retirement savings they are likely to have.

Moreover, research conducted by the Center for Community Capital at UNC Chapel Hill concluded that,

> The results indicate that these low-income borrowers *(participants in the Community Advantage loan program)* have experienced considerable home price appreciation since they purchased their homes, and that they have also accumulated and retained considerable equity, despite the most recent changes in economic conditions and the housing market. The timing of purchase has been a key factor in determining the growth rate of household wealth, as have the geographic locations in which these borrowers chose to purchase housing. These observations suggest that homeownership continues to make sense as an investment for low-income borrowers in CRA mortgages but is likely to be most effective as a wealth-building avenue for this population when it is purchased as a long-term investment.[3]

[3] *Navigating the Housing Downturn and Financial Crisis*, Sarah Riley, Allison Freeman, Roberto Quercia, in *The American Mortgage System, Crisis and Reform*. Edited by Susan M. Wachter and Marvin M. Smith,University of Pennsylvania Press, Philadelphia, 2011, pp 187-208





Homeownership has been a reliable and important means of generating and passing on wealth. The continuing difference between homeownership rates among minority and White households remains an important driver of the wealth disparities between these groups.

A 2004 Working Paper published by Freddie Mac concluded that,

> The homeownership rate for families with income below the median was 52 percent in 2003 while only 28 percent held stock market assets. Poterba (2000) reported that in 1998 the top 1 percent of stock equity investors held about one half of total stock market wealth, while the 1 percent of households with the greatest holdings of real estate owned only 15 percent of all real estate. In fact, about three quarters of all stock market wealth is held by the highest decile of income earners in the U.S. and almost none by families whose earnings fall in the lowest third of the income distribution, whereas home equity wealth has a more equal distribution across income groups, as shown in Exhibit 1. Because home equity wealth is more evenly distributed, lower-, middle-, and higher-income families all benefit from a general rise in home equity.[4]

Homeownership also is an important factor in neighborhood stability. The federal government has invested many billions of dollars in the last 25 years to help state and local governments stabilize communities through rehabilitation and homeownership strategies. Communities without a significant portion of homeownership are more likely to suffer from disinvestment and neglect, along with decreasing amounts of civic involvement.

The Proposed Rule will Increase Costs and Potentially Decrease Access for Non-QRM Borrowers

Because loans outside the QRM will be subject to the risk retention requirements, they are sure to have higher costs for consumers as investors and securitizers pass the added costs along. Although this point is accepted by all, the degree of cost increase is the subject of some debate. While regulators have asserted that the difference in price would be 10 basis points or less, other, independent analysts have reached different conclusions.

An analysis by the National Association of Realtors, for example, suggests that non-QRM loans could cost between 80 and 185 basis points more than QRM loans.[5] Economists Mark Zandi and Christian deRitis estimated in a special paper[6] for Moody's Analytics that exclusion from the QRM alone could cost consumers between 30 and 50 basis points. Other requirements in the proposed rule, such as treatment of premium capture, could add another 10-15 basis points, for a potential total if the rule is adopted as proposed of 40-65 basis points. Zandi also speculates that the mortgage market will change significantly with resolution of Fannie Mae's and Freddie Mac's conservatorship and the resulting market dynamics could add an additional 35 basis points in cost.

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[4] *Refinance and the Accumulation of Household Wealth,* Freddie Mac Working Paper #04-02, Frank E. . Nothaft and Yan Chang, February 2004, p. 4

[5] *Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery*, Coalition for Sensible Housing Policy, June 22, 2011.

[6] *Reworking Risk Retention*, Moody's Analytics Special Report, June 20, 2011

The fact that these analyses reach widely different results suggests that the cost consequences of the QRM exemption are not settled, but that in any scenario consumers' mortgage costs will be higher for non-QRM mortgages.

We are also concerned that a further consequence of the QRM exemption will be to reduce investor demand and increase risk and liquidity premiums for non-QRM loans. This will both raise costs higher and potentially reduce access at any price to non-QRM loans. In particular, we are concerned that the proposed 20 percent down payment requirement – indeed, *any* down payment requirement -- will send a strong signal to the market that loans with lower down payments are significantly less safe. While the data we discuss below strongly suggest this is not true, we fear that the effect of a government-adopted standard will be to become a benchmark beyond which other investors will be unwilling to venture.

Moreover, we are concerned that the adoption of the down payment requirement will signal to other regulators and Congress that this is an acceptable and effective level to adopt for all mortgage lending. The QRM's purpose is not to establish underwriting criteria. It is to delimit a portion of the market exempted from Dodd-Frank's risk retention rules because the nature and performance of the loans is well known and acceptable to investors. Yet by adopting specific underwriting criteria in defining the QRM, the regulators have created a *de facto* series of underwriting standards that, if adopted more widely by the lending industry, will further decrease access to mortgage credit, or raise its cost, to families that are credit worthy and well qualified to purchase a home. We note that in drafting its proposed rule for Dodd-Frank's ability to pay and QM standards, which are explicitly meant to delineate acceptable underwriting standards at the loan origination level, the Federal Reserve Board explicitly *did not* identify any specific cut-offs. Instead, the proposed rule directs originators to use "widely accepted" underwriting standards. It would be a perverse outcome if rules to govern origination practices were trumped by those designed to guide secondary market investors and led to less available credit as a result.

The Use of Down Payments In the QRM is Arbitrary and Not Supported by the Legislation

The Dodd-Frank legislation directs the regulators to develop a QRM standard "...taking into consideration underwriting and product features that historical loan performance data indicate result in a *lower risk of default*…"(emphasis added) (Sec. 15G(e)(4)(b)) The law does not specify a particular level of credit risk on which the exemption should be based, and while the following text suggests specific characteristics that regulators should take into account, these do not include down payments or LTVs. Indeed, despite several attempts to include LTV and/or down payment explicitly in the criteria, Congress chose not to do so. We recognize that the regulators have the latitude to consider features not mentioned in the statute. But we believe that the inclusion of the down payment requirements as proposed in the rule exceeds the direction intended by Congress and is not justified by the facts.

The legislation directs the regulators to establish the QRM based on data that indicate a "lower risk of default." Yet in the proposed rule the regulators state that their intention in creating the criteria for the QRM exemption was to emphasize "very low credit risk," "very high credit quality," and "very conservative standards." The introduction notes that the QRM requirements are designed "…to ensure that QRMs are of *very high* credit quality consistent with their exemption from risk retention requirements *(emphasis added)*."

The deleterious consequences of including the proposed down payment and LTV requirements in the QRM demonstrate, we believe, that the regulators' declared intention to set the credit performance bar very high exceeds the direction provided in the statute to the detriment of low wealth borrowers. Data we will explain later show that while down payments do affect credit performance, they do not do so to a degree that justifies the extreme treatment proposed in the rule. There is a long history of success over many years with well-underwritten loans with down payments as low as 3 percent.[7]

The Benefits of High Down Payments Do Not Justify Their Cost And Are Not Consistent with Congressional Intent

The proposal includes down payment as a QRM standard on the grounds that it is a reliable and important indicator of credit risk. We do not disagree that loans with higher down payments generally perform better than those with lower down payments, when all other characteristics are the same. But we note that a number of studies, including data included in the development of the proposed rule show that the actual influence of down payments on mortgage performance is quite small when other factors in the QRM, especially product features, are constant.

Indeed, FHFA data[8] for the years 1997-2008 show that down payments and loan to value ratios have very little incremental influence on credit performance, while significantly affecting access to credit. This is especially true in the 1997-2004 period, when Fannie Mae and Freddie Mac – from whose loans the FHFA data is drawn – required full documentation and verification of income and assets, and did not finance loans with unstable terms, such as negative amortization, interest only, balloon payments and the like. Since the proposed rule would bar these features as well, we believe this dataset gives a valid picture of how QRM loans would be likely to perform.

While this data show that the impact on cumulative delinquencies would be small in most years, it shows that the number of loans that would be excluded through the down payment requirement is much larger, up to a 17 percent difference.

[7] *The Skinny on Skin in the Game,* Mark Zandi and Christian deRitis, Moody's Analytics, March 8, 2011, p. 3

[8] "Mortgage Market Note 11-02: Qualified Residential Mortgages," April 11, 2011, Federal Housing Finance Agency. These and other data analyses compiled by the Mortgage Bankers Association from FHFA and other data sources titled *Impact of Risk Retention Rules on the Mortgage Market* are included as an attachment to this comment letter.

Similarly, a study[9] by Vertical Capital Solutions examined mortgage data from First American CoreLogic including 30 million mortgages originated between 2002 and 2008. When comparing loans that would have met a QRM-like test (no unstable features; fixed rate or 7-year ARMs; 41 percent DTI; loan terms no greater than 30 years; and including mortgage insurance), the study found that the difference in performance between mortgages outside of this definition and *all* mortgages that did meet it was striking and large. But the relative differences in defaults between the QRM-like loans with LTVs of 80, 90 and 95 percent varied much less. For 2006 originations, this study found that the loans outside the QRM-like definition had a 24.7 percent default rate. Loans with 95 percent LTVs ran to 6.8 percent, and those with 80 percent LTVs ran to 5.6 percent. While this is a 21 percent difference between the latter two buckets, it is a very small nominal difference overall (120 basis points), and pales in comparison to the roughly 300 percent (17.9 percentage points) difference between the 95 LTVs and the non-QRM-like loans. (See Figure 1, below.) Although this study did not examine down payments smaller than 5 percent, we do not believe the relative results would be significantly different. These data show that down payments have only a negligible influence on credit performance, when other important underwriting requirements are maintained. This strongly supports our position that down payment should not be included as part of the QRM qualification.

While the increase in credit performance attributable to higher down payments is small, the impact on low-wealth communities is much larger. Increasing the minimum down payment in the CoreLogic dataset from 5 percent to 10 percent reduced the number of households that would qualify for a QRM loan from 4 to 7 percent over the studied years. Raising the down payment to 20 percent would knock out between almost 15 percent to more than 20 percent of borrowers in the CoreLogic pool from the QRM[10] (see Table 1, below). In all of these cases, the gain in credit performance is slight while the exclusion of households is high, even with a 5 percent down payment requirement. Once again, the pattern suggests that this same cost-benefit relationship would apply for loans with down payments less than 5 percent. Again, we believe these disparate results strongly support our recommendation that down payments be removed from the QRM qualifications because they simply are not a significant enough relative driver of credit performance to justify the harm that their inclusion would create.

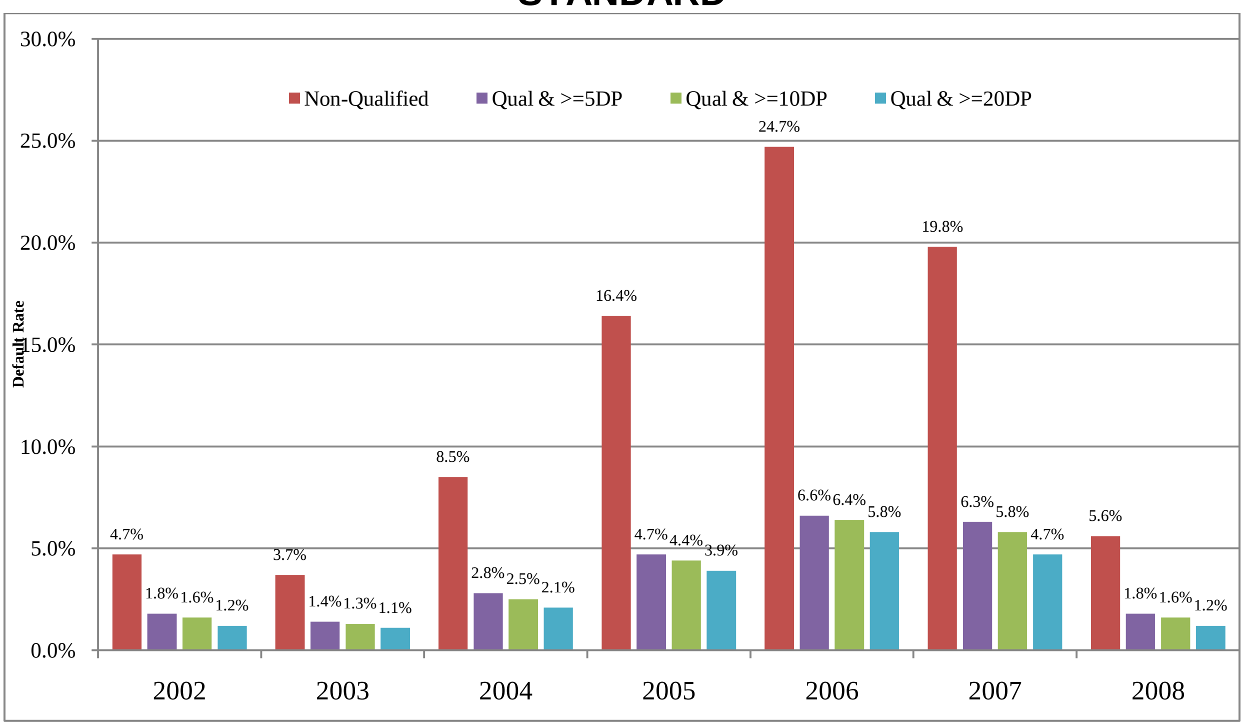
[9] Coalition for Sensible Housing Policy, op cit
[10] *Ibid*, p. 6

Table 1: Sample QRM Analysis: Impact of Raising Down Payments Requirements on Default Rates and Borrower Eligibility

Origination Year	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
Reduction in default rate* by increasing QRM down payment **from 5% to 10%**	0.2%	0.1%	0.3%	0.3%	0.2%	0.5%	0.2%
Proportion of borrowers **not eligible** for QRM by moving from 5% to 10% Down	5.2%	4.3%	5.5%	4.6%	4.8%	6.7%	5.7%
Reduction in default rate* by increasing QRM down payment **from 5% to 20%**	0.6%	0.3%	0.7%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers **not eligible** for QRM by moving from 5% to 20% Down	16.9%	14.5%	19.4%	19.2%	19.1%	20.1%	18.0%

* Default = 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed.
Source: Data from CoreLogic, Inc. Analysis by Vertical Capital Solutions for Genworth Financial and the Community Mortgage Banking Project.

Figure 1: IMPACT OF INCREASING MINUMUM DOWNPAYMENT ON DEFAULT RATES FOR LOANS THAT MEET SAMPLE QRM STANDARD



Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008. Note: Default rates are by origination year, through the end of 2009. Default means 90 or more days delinquent, plus in process of foreclosure, plus loans foreclosed. The sample QRM in this analysis is based on fully documented income and assets; fixed-rate or 7-year or greater ARMs; no negative amortization; no interest only loans; no balloon payments; 41% total debt-to-income ratio; mortgage insurance on loans with 80% or greater loan-to-value ratios; and maturities no greater than 30 years.

The chart above graphically shows that cumulative default rates among mortgages that did not meet the product feature and full documentation tests of the QRM had poor credit performance. But the relative differences in credit performance for larger or smaller down payments were negligible.

Low down payment loans have been made successfully over a long period of time. The FHA, VA, and, starting in the 1990's, depositories and Fannie Mae and Freddie Mac all guaranteed and originated loans with down payments of 5 percent and lower without experiencing high levels of delinquencies or defaults. These loans did not perform as well as loans with higher down payments, but as economist Mark Zandi pointed out in a policy brief on the proposed QRM rule, "While there is no question that larger down payments correlate with better loan performance, low down payment mortgages that are well underwritten have historically experienced manageable default rates, even under significant economic or market stress."[11] Zandi and deRitis analyzed data from Mortgage Guaranty Insurance Corporation (MGIC) for origination years 2006-2007 (at the height of the subprime/Alt-A mortgage boom). Looking only at loans with full documentation, standard features, owner-occupied, prime credit, purchase and rate/term refis, and DTI's below 45 percent, they found that cumulative foreclosure rates for loans with 30 percent down payment were 0.2 percent, while the rate for loans with only a 3 percent down payment was 4.7 percent.[12] This is clearly a very wide difference. But the most important point from this analysis is that even with very low down payments, more than 95 percent of the loans succeeded.

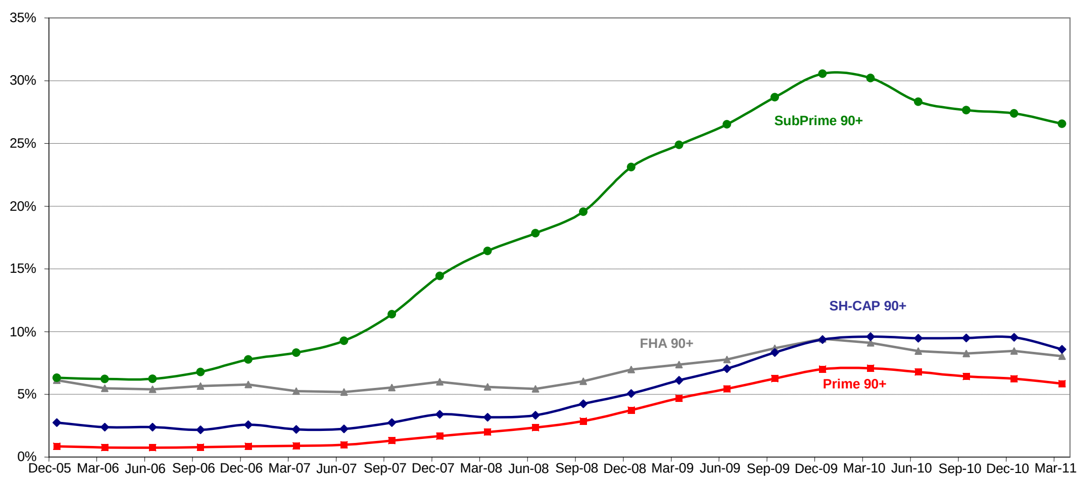
The Center for Community Capital at the University of North Carolina – Chapel Hill has been studying a large group of roughly 9,000 loans made from 2003-2006 through a partnership between Self Help Venture Fund and Fannie Mae. The Community Advantage Program (CAP) mortgages were sourced from originators in a wide geographic area. All of the loans were made to borrowers with incomes at or below 80 percent of area median income. All were fully documented, standard long term fixed rate loans. Most were to minority borrowers and had very low down payments. In comparing the performance of these loans with other loans to similarly situated borrowers, the Center found that the most compelling driver of loan failure was not down payment or credit history, but the features of the loans themselves. They noted that "…the

[11] *Zandi and deRitis, op cit, p. 3*
[12] Ibid, p. 3

results of this study clearly suggest that mortgage default risk cannot be attributed solely to borrower credit risk; the high default risk is significantly associated with the characteristics of loan products. "[13] They further noted that in the samples used in this analysis, "…3.21 percent of our sample of community lending borrowers were 90-days' delinquent or in foreclosure process in the second quarter of 2008. This was slightly higher than the 2.35 percent delinquency rate on prime loans but well below the 17.8 percent on subprime loans nationwide. Especially, over 27 percent of subprime ARMs were in foreclosure or serious delinquency, which was almost nine times that of community lending loans."[14]

Even today, after two years of extraordinary recession and high unemployment rates have disproportionately strained low income families, 8.6 percent of CAP loans were in default, as compared with 25.6 percent of subprime, and 5.9 percent of prime.

Comparison of Loan Performance of Self-Help Community Advantage Program (CAP) 30 year fixed-rate loans and other loan types *(Source: Center for Community Capital, UNC-Chapel Hill)*



A basic premise of rulemaking should be to equitably balance the benefits and costs of a particular policy choice. Based on these analyses, we believe the proposed rule making has costs that far exceed its benefits. Moreover, we believe that these analyses strongly illustrate that mortgages with low down payments have historically demonstrated a low risk of default, especially compared with other characteristics and features that the proposed rule appropriately

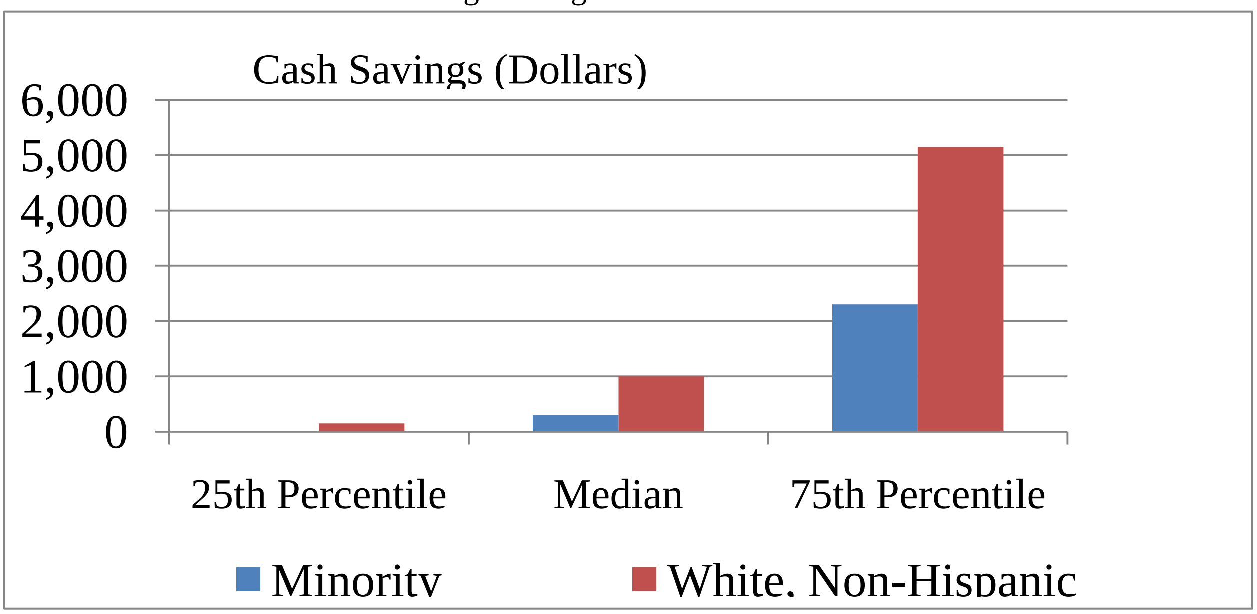
[13] *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models,"* Roberto Quercia, et al, Center for Community Capital Working Paper, May 17, 2010
[14] Ibid, 15

excludes from QRM. Congressional direction was clear – the QRM should encourage securitizers to support loans with "lower risk of default," not *no* risk or *lowest risk possible.* Yet by including the down payment requirement regulators have adopted an approach that would exclude large numbers of well performing loans and borrowers with a standard that is too high.

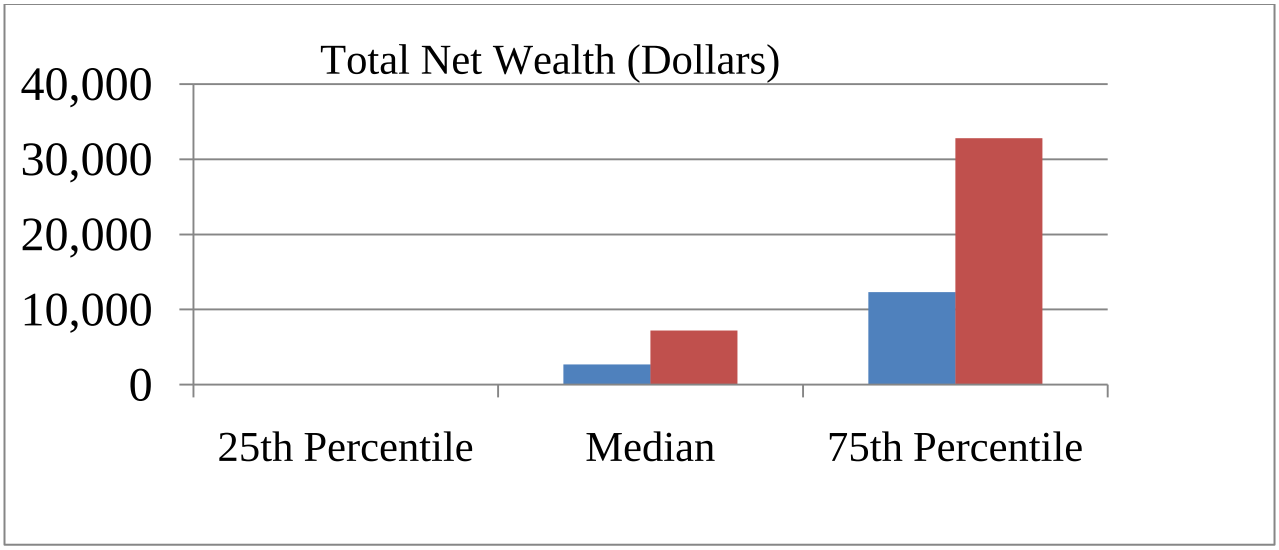
High Down Payment Requirements Will Restrict Credit to Large Numbers of Renters

Most renters in America today have little savings or cash on hand. The imposition of large down payment requirements to access the best priced mortgage credit will place an unreasonable burden on lower and moderate income prospective homeowners, and this cost will not be justified by a significant increase in loan performance, as noted above.

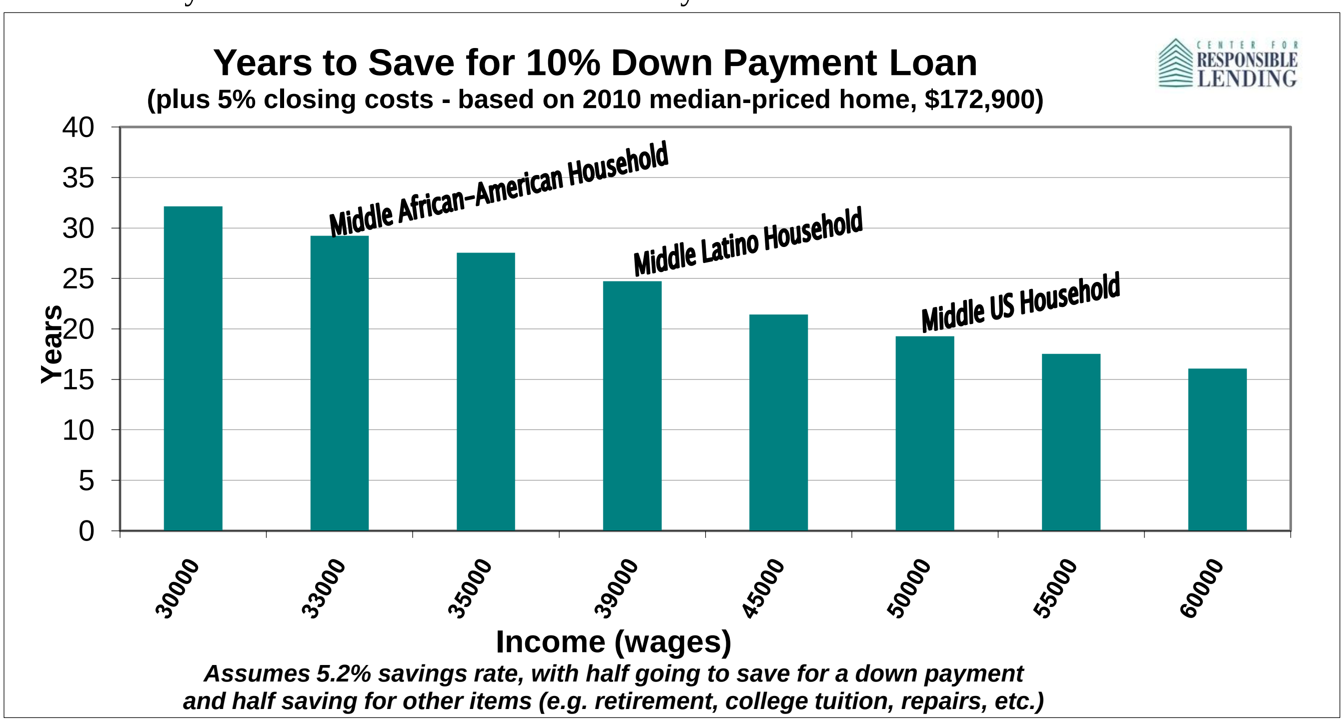
The Joint Center for Housing Studies at Harvard University recently published data showing that the median White, non-Hispanic renter has about $1,000 in cash savings, while minority renters have cash savings of less than $500. The charts below illustrate the stark and significant differences in wealth and cash savings among renters.[15]



[15] *Lending to Low Income Communities,* Presentation to FDIC March 2011, Eric S. Belsky, Joint Center for Housing Studies, Harvard University



With the 2010 median US house price around $172,900, these savings are manifestly inadequate to make a 20 percent or even a 10 percent down payment, around $34,000 and $17,000 respectively. The regulators propose to require not only a large down payment, but for consumers to bring closing costs to the table as well, further increasing the cash amount necessary under the rule. The chart below, prepared by the Center for Responsible Lending, illustrates how difficult saving for such large down payments for the 2010 median priced home in the US today would be for American families today.



Refinances

The proposed rule would require borrowers seeking to refinance their loan to have at least 25 percent equity for a straight rate and term refi, and 30 percent for a cash-out refinance. We strongly oppose the proposed down payment requirement for rate and term refinances. Nationally, about one-quarter of all mortgaged owners are underwater on their mortgages. This large national figure masks significant variations across the country; more than one-half of underwater borrowers live in 10 states.[16] Nevertheless, there are only a handful of states where negative equity is an insignificant problem. The decline in value for many of these households is the result of larger economic forces beyond their control. The unprecedented decline in home values has damaged those who started with significant positive equity as well as those whose loans required only small down payments. Other owners who continued to make their mortgage payments on time have found themselves underwater through no fault of their own, except for having the bad luck to have bought at the peak of the market.

The high equity requirements in the proposal would prevent these borrowers from taking advantage of the most favorable terms to take advantage of lower rates. Increasing their costs perversely erodes and might negate the positive credit result likely from a lowering of current interest payments on a performing mortgage. Recognizing this fact, both Fannie Mae and Freddie Mac offer refinances to current borrowers up to 125 percent of appraised value. The proposed rule takes the opposite tack and would make it more difficult for owners to reduce their costs.

We strongly urge the regulators to remove the proposed down payment requirement for rate and term refinances to qualify for QRM.

Cash out refinancings can become a dangerous and destabilizing tool when they are used to lure homeowners into trading the equity in their home for cash. There has been much evidence that lenders in the last 10 years aggressively marketed such refinancing to newly minted borrowers, as well as cash-strapped older borrowers, and used these techniques to charge and finance high fees that ended up putting consumers in more expensive loans with less equity. These loans carried higher amounts of credit risk, and therefore should receive different treatment with respect to QRM than straight rate and term refinances. We recommend that cash-out refinances not be eligible for inclusion in the QRM, except where the amount of cash out is used only to cover fees and charges incurred in the refinancing itself. We recommend the regulators research more carefully whether there also should be some allowance for cash-out refis where the proceeds will be used to finance capital improvements in the property.

[16] *Q1 2011 Negative Equity by State and Top 50 Negative Equity Markets by CBSA*, CoreLogic, http://www.corelogic.com/about-us/researchtrends/asset_upload_file406_4275.xls

Down Payments Should Not be Included in the QRM Criteria

Because of the reasons laid out above, we strongly urge the regulators to remove LTV and down payment requirements from the QRM definition altogether. Their inclusion does not materially increase the likely credit performance of the loans, while significantly increasing costs for credit worthy borrowers. It risks establishing a new standard for both government-supported and private lending that will further restrict access to mortgage credit by low wealth borrowers if it is seen as identifying low risk, high quality mortgages. It runs counter to the guidance provided in the proposed QM rule promulgated by the Fed, and could, if not changed, use secondary market criteria to trump primary market underwriting judgments.

The proposed rule appropriately excludes from QRM loans with unstable features, such as interest only payments, balloon payments, and negative amortization, and investor loans. We believe these are by far the largest contributors to poor loan performance in the last decade, and are the most important features to regulate in private label securities (PLS) that would be the most immediate objects of the proposed QRM rule.[17] We agree that borrower equity is an important part of an overall underwriting evaluation, and that borrowers should be encouraged to save and invest equity in their homes. But we do not believe that the narrow and arbitrary approach taken in the proposed rule is justified either by performance or by an analysis of its costs and benefits with regard to consumer access to credit.

Credit History

The proposed rule would exclude from QRM borrowers with any late credit payments of 60 days or more in the last 24 months, or, at the time of underwriting, any 30 day past due payments. The regulators note that they did not choose to use credit scores as the basis for inclusion in the QRM because of concerns about transparency and consistency among different credit scoring models, and how they might change over time. We strongly support the decision not to rely on credit scores. We agree with the regulators' reasoning and also note that low income and minority consumers in particular may have credit scores that fail to correctly represent their likelihood and propensity to repay debts. The Federal Reserve Board has conducted research into this matter and concluded from matching credit scoring data with Social Security data that there are wide disparities in credit scores among racial groups.[18]

Moreover, the standard proposed in the rule does not distinguish between different types of late payments, or take into consideration other factors relevant to credit performance, such as total credit outstanding, or percentage of available credit drawn. Credit scoring models, and mortgage

[17] "For the 2005-2007 origination years, the requirement for product-type (non-traditional and low documentation loans, or loans for houses not occupied by the owner) was the QRM risk factor that most reduced delinquency rates." FHFA, op cit

[18] Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit. Board of Governors of the Federal Reserve System. (August 2007). Available at http://www.transunion.com/docs/rev/business/clientSupport/legislativeUpdate/CreditScoreRpt.pdf

scoring models used by Fannie Mae and Freddie Mac, are both more inclusive and more discriminating in the factors they use to measure credit performance.

Regulators are proposing a single test of credit history to simplify the qualification of a loan for QRM status. In doing so we are concerned that access to the best-priced credit will be unnecessarily restricted. Regulators should defer a final decision on this until the QM rule has been finalized and secondary market restrictions can be synched correctly with primary market underwriting guidelines.

Debt to Income Ratios

The proposed rule would require QRM loans to have debt to income ratios not greater than 28 percent for mortgage debt and 36 percent for all debt. First, we note that many underwriters no longer identify front end, or mortgage debt, ratios as particularly helpful in underwriting mortgages. This is because other debts, included in the back-end ratio, can quickly overwhelm a borrower's ability to make the mortgage payment, no matter how much of its income must be dedicated to it.

As in the case of credit history, however, we note that the QM rule will establish clear standards for underwriting loans at origination based on a consumer's ability to pay that will include a dynamic assessment of all of the consumer's attributes. Final adoption of the QRM requirement should be delayed until final action on the QM rule has been taken.

Second Liens

The proposed rule would prohibit any second liens before or at consummation in order to qualify for QRM treatment. We recognize the burden that second liens can place on borrowers, and the pernicious role some forms of second mortgages played in increasing risk for both consumers and investors in the mortgage boom. We do not support the inclusion of *any* form of seller-financed down payment assistance, whether directly or through nonprofits established for this purpose, in the QRM definition. But we note that there are a host of so-called "soft second" mortgages that are funded by state and local governments to assist low wealth borrowers. These loans are repayable only when the consumer is able to pay them, and in many cases due only on sale. Such arrangements do not jeopardize the borrower's ability to pay the first lien mortgage, and in fact increase the likelihood of borrower success by using public resources to lower the overall amount of debt that must be serviced.

Unlike private second loans which may increase the risk of homeowner default, public and nonprofit purchase assistance programs ***significantly lower*** the buyer's default risk. As shown by recent research:

- An Urban Institute study in 2010 found that buyers that received assistance from affordable homeownership programs had default rates well below their local market average in spite of very low (or in some cases no) down payment coming from the buyer's own funds[19]. As stated in the report: "Although homeowners earn well below median incomes, very few had residential loans that were in delinquency or foreclosure. . In every program but one, the site's foreclosure rates were below that of their surrounding areas as of 2009."

- A survey of Community Land Trust programs found that just 0.6 percent of Community Land Trust mortgages at the end of 2009 were in the process of foreclosure, as compared to 4.6 percent of market-rate mortgages.

We strongly recommend, therefore, that the final rule specifically allow the use of such "soft-second" loans when administered by public entities or bona fide nonprofits.

Specifically, the definition should be written to ***specifically allow*** purchase assistance received from a public or nonprofit agency to count toward the QRM down payment or LTV requirement. Where purchase assistance is structured as a loan, the loan should be allowed to count as "eligible down payment assistance" so long as the buyer is not required to make any repayment for at least 5 years. In addition, second mortgages that carry any of the following features should be allowed under the QRM definition: no repayment until the home is sold; no repayment required for at least five years; repayment at an interest rate that is substantially below market; or a loan that is forgiven over time.

Where a public or nonprofit agency sells homes at a below market purchase price in order to assist targeted lower income buyers, the QRM should count this public "equity" (the difference between the sale price and the appraised market value) as"eligible down payment assistance" in the same way as if the homeowner had received a grant or deferred payment loan for that amount.

Servicing Standards are an Important Contributor to Loan Performance

One of the starkest lessons of the current crisis is the importance of uniform, enforceable and effective servicing standards. Some borrowers inevitably will find themselves in delinquency or default. When they do, effective servicing can reduce costs to consumers, investors and communities by applying standard, timely and equitable means of resolution.

The proposed rule includes a requirement that originators adopt and apply a minimal collection of standardized servicing rules for QRM loans. These include requirements to initiate actions if a borrower is 90 days delinquent and the net present value of modifications would exceed that of recovery through foreclosure.

[19] Urban Institute. *Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls*, October 26 2010.

We strongly support this proposed requirement. We recognize, as do the regulators, that other initiatives among the regulators are underway to adopt uniform servicing standards. However, because the purpose of the QRM is to provide investors with an easily identified set of criteria that are likely to reduce the mortgages' default risk, we believe it is appropriate to include these in the QRM rule.

Sincerely,

/s

Barry Zigas

Director of Housing Policy