

**Comments submitted by the
Center for Responsible Lending,¹
NAACP,²
National Council of La Raza,³
National Fair Housing Alliance,⁴
National Urban League,⁵ and
The Leadership Conference on Civil and Human Rights⁶**

RE: Proposed Rulemaking on Credit Risk Retention Requirements

Office of the Comptroller of the Currency Docket Number OCC-2013-0010 RIN 1557-AD40	Securities and Exchange Commission Release No. 34-70277 RIN 3235-AK96
Federal Reserve System Docket No. R-1411; RIN 7011-AD70	Federal Housing Finance Agency RIN 2590-AA43
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¹ **The Center for Responsible Lending (CRL)** is a non-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, one of the nation's largest non-profit community development financial institutions. Self-Help has provided \$6 billion in financing to 70,000 homebuyers, small businesses, and non-profits and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California and Chicago.

² **The NAACP**, founded in 1909, is the nation's oldest and largest civil rights organization. From the ballot box to the classroom, the thousands of dedicated workers, organizers, leaders and members who make up the NAACP continue to fight for social justice for all Americans.

³ **The National Council of La Raza (NCLR)** is the largest national Hispanic civil rights and advocacy organization in the United States and is a private, nonprofit, nonpartisan, tax exempt organization that works to improve opportunities for Hispanic Americans. NCLR serves all Hispanic subgroups in all regions of the country and has regional offices in Chicago, Los Angeles, New York, Phoenix, and San Antonio. Through its network of nearly 300 affiliated community-based organizations, NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia.

⁴ Founded in 1988, **the National Fair Housing Alliance** is a consortium of more than 220 private, non-profit fair housing organizations, state and local civil rights agencies, and individuals from throughout the United States. Headquartered in Washington, D.C., NFHA, through comprehensive education, advocacy and enforcement programs, provides equal access to apartments, houses, mortgage loans and insurance policies for all residents of the nation.

⁵ Founded in 1910, **the National Urban League** spearheads the efforts of its local affiliates through the development of programs, public policy research and advocacy. Today, the National Urban League has 95 affiliates serving 300 communities, in 35 states and the District of Columbia, providing direct services that impact and improve the lives of more than 2 million people nationwide.

⁶ **The Leadership Conference on Civil and Human Rights** is a coalition charged by its diverse membership of more than 200 national organizations to promote and protect the rights of all persons in the United States.

Introduction & Summary

Thank you for the opportunity to submit comments on the re-proposed rulemaking for the Qualified Residential Mortgage (QRM) definition. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 fundamentally improves the market for residential mortgage loans by prohibiting or severely restricting many of the risky lending features that were pervasive in the market in the lead up to the crash. In addition, Title XIV requires lenders to underwrite mortgages based on borrowers' ability to repay loans and creates incentives for lenders to originate "Qualified Mortgage" (QM) loans—safe mortgage products to enforce this requirement. To complement the mortgage protections in Title XIV, Title IX of the Dodd-Frank Act mandates that mortgage securitizers have "skin in the game" by retaining at least 5 percent of the risk for loans that are sold and packaged into private-label securities. The Dodd-Frank Act also created a category of mortgages called Qualified Residential Mortgages that would be exempt from the risk-retention requirements and required regulators to craft this definition.

We strongly support the regulators recently re-proposed rule to align the QRM definition with Qualified Mortgage standards. Our comment makes two main points:

- **Aligning the QRM standards with the QM standards appropriately implements the risk-retention requirement set out by the Dodd-Frank Act.** In defining QRM, the Dodd-Frank Act requires that federal regulators define QRM in a manner that is "no broader" than QM. In addition, the Act requires regulators to take into consideration "underwriting and product features that historical loan performance data indicate result in a lower risk of default." By aligning QRM with QM standards, which restrict risky loan features, regulators have appropriately fulfilled both of these requirements.
- **The final regulation should not adopt the QM-Plus alternative.** Adding down payment restrictions, as would occur under the "QM-plus" alternative mentioned in the re-proposal, would ignore the compensating factors frequently used in underwriting. Any final rule should not layer on down payment requirements and other factors on to the QRM definition. Low down payment loans did not cause the current foreclosure crisis—irresponsible underwriting and toxic loan terms did.⁷

I. **Aligning the QRM Definition with QM Standards Appropriately Implements the Statute.**

In 2011, financial regulators first proposed a set of QRM rules that were much narrower than the now-finalized QM definition. Most notably, the 2011 proposed rule included high down payment requirements that a wide range consumer, civil rights and industry groups opposed as being unnecessarily restrictive. The consequences of this proposal would be the denial of affordable credit to millions of responsible borrowers and the undermining of a fragile housing and economic recovery. The

⁷ In addition, including the suggested credit history metrics would also be problematic, because these are overly simplistic measures of a borrower's predictive mortgage performance.

current proposed rule, in which QRM is the same as QM, addresses the root causes of the housing crisis while protecting access to credit for qualified homebuyers. We strongly support this new proposal.

When defining QRM, the Dodd-Frank Act requires federal regulators to define QRM in a manner that is “no broader” than QM. In addition, the Act requires regulators to take into consideration “underwriting and product features that historical loan performance data indicate result in a lower risk of default.” The proposed regulation appropriately fulfills both of these requirements.

Obviously, if QRM is equal to QM, regulators have satisfied the first requirement. To answer the question of whether this definition results in a lower risk of default, however, it is important to understand how far the broad mortgage protections of the Dodd-Frank Act combined with QM restrictions go in eliminating the abusive terms and practices that cause the foreclosure crisis.

A. Background.

The U.S. housing market is beginning to emerge from the worst housing crisis since the Great Depression. Since September 2008, approximately 4.5 million foreclosures have been completed and 3 million more borrowers are seriously delinquent or in the foreclosure process.⁸ These foreclosures have undercut the economic progress and security of families across the country. Importantly, the damage has not been limited to those families who have been directly displaced from their homes and neighborhoods. Rather, the devastation has spread throughout communities, destabilizing neighborhoods with vacant and vandalized houses, reducing the home equity wealth of neighbors and starving municipalities of property tax revenue.

At its core, the foreclosure crisis was caused by harmful mortgage features and lending practices that pervaded the pre-crisis mortgage market. In 2006, a CRL report estimated that predatory subprime lending would lead to approximately 2.2 million foreclosures.⁹ At the time, this report was denounced by the mortgage industry as overly pessimistic. As we all now know, the system was actually loaded with far more risk and the 2006 estimates were actually extremely conservative.

A 2011 CRL report, *Lost Ground: Disparities in Mortgage Lending and Foreclosures*,¹⁰ highlighted the link between risky mortgage features and foreclosure rates. For mortgages originated between 2004 and

⁸ Corelogic National Foreclosure Report, August 2013 (available at <http://www.corelogic.com/research/foreclosure-report/national-foreclosure-report-august-2013.pdf>).

⁹ Ellen Schloemer, Wei Li, Keith Ernst and Kathleen Keest. *Losing Ground: Foreclosures in the Subprime Market and their Cost to Homeowners*, December 2006. (available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosure-paper-report-2-17.pdf>).

¹⁰ Debbie Gruenstein Bocian, Wei Li, Carolina Reid and Roberto Quercia. *Lost Ground, 2011: Disparities in Mortgage Lending and Foreclosures*, (available at <http://www.responsiblelending.org/mortgage-lending/research-analysis/Lost-Ground-2011.pdf>).

2008, this report showed that loans originated by a mortgage broker, containing hybrid or option ARMs, having prepayment penalties, and featuring high interest rates (i.e., subprime loans) had much foreclosure rates than loans without these features. *Lost Ground* also demonstrated that, while the majority of foreclosures have affected white borrowers, African Americans and Latinos have suffered foreclosures rates roughly twice that of whites, likely reflecting the fact that borrowers of color were much more likely to receive loans with risky loan features, even after controlling for credit score.¹¹

The specific harmful features that fueled the crisis include the following:

- **Hybrid ARMs:** Hybrid adjustable rate mortgages (ARMs) – such as “2/28s” and “3/27s” where initial “teaser” rates reset after the first few years – were widespread leading up to the foreclosure crisis. These types of ARMs led to payment shocks for many households who were unprepared for higher monthly payments once the interest rates increased. A related product called interest-only (IO) ARMs let borrowers make only interest payments during an introductory period, jeopardizing any ability to build equity and causing payment shocks for borrowers once loans started amortizing over a reduced loan life. Even more dangerous were payment option ARMs that were not underwritten at their fully amortizing payment and that allowed borrowers to make monthly payments that did not even cover the full amount of interest due, resulting in negative amortization. As of February 2012, 25% of hybrid ARMs that were originated between 2004 and 2008 had been foreclosed or were serious delinquent compared to 11 percent for fixed-rate or standard ARM mortgages.¹²
- **Prepayment penalties:** Many borrowers facing payment shock from increased interest rates once an introductory period ended faced penalties when trying to refinance out of the product or to sell the property. Prepayment penalties were present in the great majority of subprime mortgages and are associated with a higher likelihood of default.¹³ A typical prepayment penalty was equal to six months’ interest on 80 percent of the balance—typically 3.5 percent to 4 percent of the loan amount. Because most borrowers did not have the cash to cover

¹¹ For example, African-American and Latino borrowers with FICO scores above 660 were three times as likely to have a higher interest rate mortgage than white borrowers in the same credit range.

¹² Center for Responsible Lending, *State of Lending in America and Its Impact on U.S. Households*, December 2012, page 37, (available at <http://www.responsiblelending.org/state-of-lending/reports/3-Mortgages.pdf>).

¹³ See, e.g., Lei Ding, Roberto G. Quercia, Wei Li, Janneke Ratcliffe, *Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models*, at 49 (Working Paper: May 17, 2010) (stating “[w]e also found that subprime loans with adjustable rates have a significantly higher default rate than comparable CAP loans. And when the adjustable rate term is combined with the prepayment-penalty feature, the default risk of subprime loans becomes even higher.”) Available at <http://www.ccc.unc.edu/documents/Risky.Disaggreg.5.17.10.pdf>.

prepayment penalties and refinancing fees, they were forced to roll them into the new loan, thus stripping equity even when home prices were rising. Of loans with prepayment penalties originated between 2004 and 2008, 29.2% had been foreclosed or were seriously delinquent as of February 2012, compared to just 11.5% of loans without prepayment penalties.¹⁴

- **No-doc or low-doc loans:** The practice of failing to document a borrower's income and assets was also prevalent in the years leading up to the housing collapse. Low-doc and no-doc loans comprised 71 percent of Alt-A loans and 35 percent of subprime loans securitized between 2003 and 2007.¹⁵ By 2006, no-doc or low-doc loans made up 27% of all mortgages.¹⁶ Loans without full documentation were frequently underwritten with inflated statements of the borrower's income.¹⁷
- **Yield Spread Premiums:** The proliferation of mortgages with the above harmful features was driven in significant part by the use of yield spread premiums (YSPs) as a way to compensate mortgage brokers. Because YSPs paid mortgage brokers higher payments when a mortgage had a higher interest rate than the borrower qualified for or other revenue generating features such as prepayment penalties, mortgage brokers were incented to steer borrowers into loans that were more expensive and riskier than they qualified for. In fact, many borrowers who received subprime loans could have qualified for better, more sustainable loans.¹⁸ Additionally, because

¹⁴ Ibid.

¹⁵ Christopher J. Mayer, Karen M. Pence and Shane M. Sherlund, *The Rise in Mortgage Defaults*, Federal Reserve Board Finance and Economics Discussion Series, 2008, page 33 (available at <http://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf>).

¹⁶ Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* at 165 (Jan. 2011) [hereinafter *FCIC Report*], (available at http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf).

¹⁷ Over ninety percent of a sample of stated income loans exaggerated income by 5 percent or more and almost 60 percent exaggerated income by over 50 percent. Mortgage Asset Research Institute, Inc, *Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association* at 12 (April 2006), (available at http://www.mortgagebankers.org/files/News/InternalResource/42175_Final-8thAnnualCaseReporttoMBA.pdf).

¹⁸ For example, a *Wall Street Journal* study found that 61 percent of the subprime loans originated in 2006 that were packaged into securities and sold to investors "went to people with credit scores high enough to often qualify for conventional [i.e., prime] loans with far better terms." See Rick Brooks & Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy As Housing Boomed, Industry Pushed Loans To a Broader Market," *Wall Street Journal* at A1 (Dec 3, 2007). Freddie Mac estimated in 2005 that more than 20 percent of borrowers with subprime loans could have qualified for prime. See Mike Hudson & E. Scott Reckard, *More Homeowners With Good Credit Getting Stuck With Higher-Rate Loans*, Los Angeles Times, Oct. 25, 2005. (available at <http://articles.latimes.com/2005/oct/24/business/fi-subprime24>).

transactions using YSPs are more complex and, therefore, less transparent, borrowers found themselves in loans where they essentially paid the broker twice – first through upfront fees and second through an increased interest rate that provided the funds for the lender to make a backend payment.

- **No Escrows for Taxes and Insurance:** To attract borrowers with deceptively low monthly payments, subprime lenders commonly did not escrow for taxes and insurance. This practice increased the risk of default or equity-stripping refinancing twice a year when the tax and insurance bills came due.

The research demonstrating the relationship between these loan terms and practices and defaults is substantial. Ambrose, LaCour-Little and Husza find elevated rates of default attributable to the initial payment adjustments of 3/27 ARMs.¹⁹ Pennington-Cross and Ho also find a positive and significant association between hybrid ARMs and default rates. In addition, they find significant increases in defaults for loans with limited documentation levels.²⁰ The impact of reduced documentation levels is further supported by LaCour-Little and Yang, who find a significant increase in defaults associated with stated income loans and no documentation loans.²¹ Jiang, Nelson and Vytlačil find higher default rates for broker-originated loans, after controlling for other risk factors, and suggest that this is the result of misaligned incentive structure resulting the compensation structure of brokers. The authors also find a positive and significant association between low documentation and default.²² A 2011 report by the University of North Carolina at Chapel Hill, in its analysis of the relative risk rates of subprime loans and Self-Help's portfolio of purchased community reinvestment loans for a comparable set of borrowers, found that the subprime loans had worse performance because they were more likely to be originated by brokers and had a higher incidence of adjustable rates and prepayment penalties. All of these links were confirmed by the Department of Housing and Urban Development (HUD) in its final report to Congress on the causes of the foreclosure crisis, which found that, while softening housing prices were clearly a triggering factor, the foreclosure crisis itself was “fundamentally the result of rapid growth in

¹⁹ Brent W. Ambrose, Michael LaCour-Little and Zsuzsa Huszar, “A Note on Hybrid Mortgages,” *Real Estate Economics* 33 (4): 765-782.

²⁰ Anthony Pennington-Cross and Giang Ho, “The Termination of Subprime Hybrid and Fixed Rate Mortgages,” *Real Estate Economics* 38(3): 399-426.

²¹ Michael LaCour-Little and Jing Yang, “*Taking the Lie Out of Liar Loans*,” 2009. (available at http://www.fhfa.gov/webfiles/15048/website_lacour.pdf).

²² Wei Jiang, Ashlyn Aiko Nelson and Edward Vytlačil, *Liar's Loan? Effects of Origination Channel and information Falsification on Mortgage Delinquency*, (available at http://www.columbia.edu/~wj2006/liars_loan.pdf).

loans with a high risk of default—due both to the terms of these loans and to loosening underwriting controls and standards.”²³

B. Mortgage Reforms in the Wall Street Reform and Consumer Protection Act.

Recognizing that the housing crisis was caused by irresponsible terms and practices, Congress drafted the Dodd-Frank Act to contain several layers of protections against these abuses and strategies for preventing new abuses from arising in the future. These include: (1) explicit bans or restrictions on specific risky loan features and lending practices; (2) an “ability-to-repay” standard that all loans must meet, in addition to incentives for lenders to originate “qualified mortgages”; and (3) risk retention for mortgage securitizers.

The Dodd-Frank Act’s mortgage provisions are designed to reorient the market back to the kind of well-underwritten, sensible mortgages that have traditionally been used to build wealth for American families. It disfavors the specific types of loan features that had been common in the private-label securities market and that caused so many of the foreclosures of the past few years. The explicit mortgage restrictions include:²⁴

- **Documentation of Borrower Income:** Lenders are now required to fully document the income and assets of borrowers for all mortgage originations.
- **Expanded HOEPA Protections:** The Dodd-Frank Act lowers the limit on up-front points and fees to 5% for loans to be considered “high-cost” under the Home Ownership and Equity Protection Act (HOEPA) and extended these protections to purchase loans.²⁵
- **Restrictions on Yield-Spread Premiums:** The law prohibits lenders from paying brokers or loan officers compensation that varies with the terms of the loan (other than loan amount) and requires that YSPs be included in the points and fees definition.
- **Significant Restrictions on Prepayment Penalties:** The Dodd-Frank Act bans the use of prepayment penalties on all adjustable rate mortgages and all loans with APRs that exceed the

²³ U.S. Department of Housing and Urban Development, Office of Policy Development and Research (2010). *Report to Congress on the Root Causes of the Foreclosure Crisis*, page 29. (available at http://www.huduser.org/Publications/PDF/Foreclosure_09.pdf).

²⁴ Other restrictions include bans on single-premium credit insurance and mandatory arbitration.

²⁵ The Home Ownership and Equity Protection Act (HOEPA, 1994) mandates additional requirements and disclosures for “HOEPA loans” that meet at least one of the following two conditions: (1) points and fees that exceed a given threshold; and (2) an annual percentage rate (APR) that exceeds a given rate. Dodd-Frank lowered the points and fees threshold from 8% to 5% and kept the APR spread essentially the same, moving from 8 points over a Treasury note of comparable maturity to 6.5 points over the average prime offer rate (for first liens).

conventional rate by more than 1.5%. . Even for fixed rate loans below this APR cutoff, prepayment penalties are limited in amount and duration and are counted towards points and fees.

- **Required Escrowing of Taxes and Insurance for Higher-Priced Mortgages.** Lenders can no longer lure borrowers into higher-priced loans with artificially low monthly payments that exclude taxes and insurance (there is an exception for certain small, rural creditors).
- **New Underwriting Requirements for Adjustable-Rate Loans:** The Dodd-Frank Act now requires that all adjustable-rate loan affordability be assessed based on the fully-indexed rate, not just the initial “teaser” rate.

In addition to these restrictions, the Dodd-Frank Act requires that loan originators must make a “reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan, according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance) and assessments.”²⁶ Ensuring that a borrower can repay a loan is such a basic tenet of sound lending that, historically, most lenders would not have dreamed of deviating from it. But modern securitization arrangements that rewarded lenders based on volume rather than performance provided incentives for lenders to depart from this principle.

To help enforce this ability-to-repay standard, the Dodd-Frank Act created a preference against risky loan terms through a category of safe loans called “Qualified Mortgages” (QMs). Lenders who originate QMs receive litigation advantages from the ability-to-repay provision. To qualify as a QM loan, a loan must meet the following criteria (in addition to the explicit protections for all loans already mentioned):

- **Must be fully amortizing** (i.e., no deferment of principal or interest).
- **Points and fees cannot exceed 3% of the total loan amount** (with adjusted thresholds for smaller loans).
- **Loan term cannot exceed 30 years and no balloon loans** (except for certain small portfolio lenders serving rural areas).
- **Adjustable rate loans must be underwritten to the maximum (not just fully-indexed) rate permitted during the first five years.**

In short, the Dodd-Frank Act and the QM definition address the loan-level risk factors that led to such poor PLS performance during the housing crisis.

²⁶ Dodd–Frank (2010), §1411(a)(2)

Research confirms how strong the impact of the QM protections are on reducing defaults. The 2012 report *Balancing Risk and Access: Underwriting Standards and Qualified Residential Mortgages* by the Center for Community Capital at the University of North Carolina at Chapel Hill and CRL analyzed nearly 20 million mortgages made between 2000 and 2008. The study found that, while the loans had an aggregate default rate of 11 percent, loans that met QM standards had a default rate of 5.8 percent, lower than that for conventional prime loans (7.7%) and a fraction of that of subprime loans (32.3 percent).

Furthermore, the default rate of QM loans is actually *overstated* by the UNC/CRL study for two reasons. First, the study was conducted before the QM rules were finalized. The final rules require meeting either a debt-to-income (DTI) ratio threshold or agency compensating factors, neither of which were included in the calculations above. Therefore, actual QM loans will have even greater affordability guidelines than the study suggests. Second, the UNC/CRL shows how QM loans performed in the boom/bust environment that was created by the reckless products and practices that are now banned or restricted by Dodd-Frank. In the absence of these abuses and the volatility they cause, QM loans will undoubtedly perform much better.

Therefore, setting the QRM standard equal to the QM standard appropriately implements the Dodd-Frank Act by only exempting safe loans from risk-retention.

II. The Final Regulation Should Not Add Down Payment Requirements Through the QM-Plus Alternative.

The original proposed QRM rule, which came out in 2011, called for a QRM standard that was much narrower than the QM definition. Specifically, the original proposed rule included a 20 percent down payment requirement for home purchase loans and even higher down payments—25 and 30 percent—for term and cash-out refinances. The original proposal also included derogatory measures intended to act as proxies for credit risk. We strongly opposed these requirements, as they would have resulted in significant and unnecessary barriers to access to affordable credit that would have far outweighed any marginal reductions in default rates.

We also oppose the so-called “QM-plus” alternative – which mimics the original QRM proposal but requires a 30 percent down payment instead of 20 percent – included in the re-proposal. The QM-plus alternative would prevent lenders from using traditional underwriting practices – including the use of compensating factors – when evaluating borrowers with a down payment of less than 30 percent. Designating low-down payment loans that use compensating factors as “non-QRM” would needlessly add costs for borrowers who can afford a mainstream mortgage.

Borrowers in well-underwritten loans can succeed in mortgages with lower down payment amounts. For example, Laurie Goodman of the Urban Institute points out, for example, that even a hard 5 down payment percent cutoff is not the best way to address default risk, since compensating underwriting

factors are more important.²⁷ Any good underwriter knows that some borrowers who can only put 3 percent down are a lower credit risk than others who can put 20 percent or even 30 percent down. However, the QM-plus alternative does not attempt to incorporate any of these compensating factors. Instead, it includes a blunt – and very high – down payment requirement that would place additional costs on borrowers that fall short of the cutoff.

For decades, low down payment loans have been used with great success to promote sustainable homeownership, particularly for low- and moderate-income and minority families. For example, in the last 17 years, CRL's affiliate Self-Help has operated a national secondary market home loan program that has purchased 52,000 mortgages worth \$4.7 billion.²⁸ Seventy-two percent of borrowers of these mortgages made less than a 5 percent down payment. In addition, 41 percent were female-headed households, 40 percent were from minority households and median income was \$30,792. These loans have performed well: they have a median annualized net return on borrower equity of 24 percent and have increased borrower equity by \$18,000 through the crisis.²⁹ Self-Help's cumulative loss rate has been approximately 3 percent. The vast majority of these loans did not have private mortgage insurance, or losses would have been much lower. The loans were originated by 35 lenders in 48 states, and *virtually all would meet the qualified mortgage requirements.*

Persistent wealth disparities for African-American and Latino households would make down payment

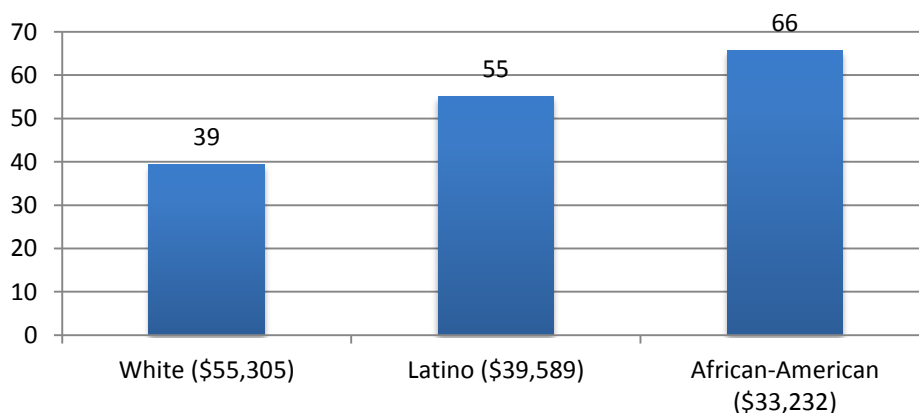
²⁷ See Laurie Goodman and Taz George, *Fannie Mae reduces its max LTV to 95: Does the data support the move?*, The Urban Institute, MetroTrends Blog (September 24, 2013) (available at <http://blog.metrotrends.org/2013/09/fannie-mae-reduces-max-ltv-95-data-support-move/>).

²⁸ See Quercia, Freeman and Ratcliffe, *Regaining the Dream: How to Renew the Promise of Homeownership for America's Working Families*, UNC Center for Community Capital (2011).

²⁹ See Allison Freeman and Janneke Ratcliffe, *Setting the Record Straight on Affordable Homeownership* at 4- 8 (May 2012); see also Christopher Herbert, Daniel McCue, and Rocio Sanchez-Moyano, *Is Homeownership Still an Effective Means of Building Wealth for Low-income and Minority Households? (Was it Ever?)*, Joint Center for Housing Studies, Harvard University, at 48 (September 2013) (stating that “[o]verall, owning a home is consistently found to be associated with increases of roughly \$9,000-\$10,000 in net wealth for each year a home is owned. . . . Even after the tremendous decline in housing prices and the rising wave of foreclosures that began in 2007, homeownership continues to be a significant source of household wealth, and remains particularly important for lower-income and minority households. As has become painfully clear, owning a home is not without risk. But even during a time of excessive risk taking in the mortgage market and extreme volatility in house prices, large shares of owners successfully sustained homeownership and created substantial wealth in the process (at least through 2009). While African-American and lower income households were somewhat less likely to sustain homeownership, these groups also experienced sizeable gains in net wealth on average that was associated with owning, while renters saw few gains. Owners who failed to sustain homeownership did suffer substantial loss in wealth, but much of the wealth was associated with the move into homeownership, so these households essentially fell back to their initial wealth levels. At least in terms of household wealth, failed attempts at owning do not appear to leave the typical household worse off than when they started.”) (available at http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/hbtl-06_0.pdf).

mandates particularly harmful for these communities.³⁰ In addition to taking years longer to save for a down payment, the wealth gap makes it less likely that African-American and Latino families could get financial help from family members.³¹ This combination could leave many individuals – who could be successful homeowners³² – with restricted access to credit and would thus exacerbate the country’s already enormous racial and ethnic wealth gap. As demonstrated in the below chart, it would take the typical African-American family 66 years to save 30 percent plus closing costs to purchase the median priced house and the typical Latino family 55 years.

Years to Save 30% Downpayment + Closing Costs



Source: CRL Calculation³³

³⁰ See e.g., Thomas Shapiro, Tatjana Meschede, and Sam Osoro, *The Roots of the Widening Racial Wealth Gap: Explaining the Black-White Economic Divide*, Institute on Assets and Social Policy (February 2013) (available at <http://iasp.brandeis.edu/pdfs/Author/shapiro-thomas-m/racialwealthgapbrief.pdf>).

³¹ See *The State of the Nation’s Housing*, Joint Center for Housing Studies, at 3 (2013) (available at <http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/son2013.pdf>).

³² See *Setting the Record Straight on Homeownership*, UNC Center for Community Capital, Research Brief (2012) (available at http://www.wilsoncenter.org/sites/default/files/Ratcliffe_Janneke_0.pdf).

³³ Years-to-save calculations are based on purchase of a 2011 median priced house (\$173,600) by borrower with median income in 2011 (\$50,502). Median income for 2011 is from American Community Survey. We assume an annual savings rate dedicated for down payment of 2.6%. This savings rate assumption is derived from an average of the monthly Bureau of Economic Analysis’s personal savings rate (the 1-year average of the BEA’s personal savings rate from July 2012-July 2013 is 4.9 percent; the 20-year average was 5.0 percent). However, the BEA’s personal savings rate is based on take home, not gross, income. Therefore, a 5.0 personal savings rate translates to a 3.6 percent rate for gross income, assuming a combined federal, state and local tax rate of 28 percent (see effective tax burden for the middle http://www.nytimes.com/2012/11/30/us/most-americans-face-lower-tax-burden-than-in-the-80s.html?pagewanted=all&_r=2&). We assume that, of this 3.6 percent savings, 1 percentage

Furthermore, most borrowers do not default simply by virtue of being underwater (or having lower equity) but, rather, when there is also a negative “trigger” event that makes monthly payments unaffordable.³⁴ These triggers can be life events, such as unemployment, illness or divorce, or a payment shock created by risky loan terms themselves. The product restrictions of QM that will automatically become the standard of the secondary market will help decrease the incidence of payment shocks by restricting the availability of loans with teaser rates, interest-only and negative amortization. Other Dodd-Frank Act reforms, such as requiring income documentation and requiring escrow for taxes and insurance, will also help ensure the overall affordability of originated mortgages and will, therefore, also decrease the impact of default triggers.

III. Additional Comments.

The proposed rule seeks comment on whether, in aligning the QRM and QM definitions, there should be any distinction between loans that receive a “safe harbor” versus a “rebuttable presumption” status under QM. We do not think such a distinction is appropriate and would strongly oppose this. Instead, we support the regulator’s proposal to make no distinction between safe harbor and rebuttable presumption QM loans, including allowing these loans to be pooled in the same security.

Additionally, the proposed rule seeks comment on whether to allow blended pools of QRM and non-QRM loans. We support allowing blended pools, where the amount of risk retention is proportional to the percentage of non-QRM loans in the pool; as such, we do not believe there should be a minimum amount of risk retention required for all pools. Adopting this position would contribute to the liquidity of non-QRM loans while also supporting the goals of risk retention.

point must be used by families for retirement, college, and emergencies, leaving 2.6% available for homeownership savings.

³⁴ There are two basic theories of mortgage default: the “default option model” and the “double trigger model.” In the default model, borrowers simply seek to maximize their wealth by defaulting when their home is worth less than their outstanding mortgage. Specific types of default models vary in their assumptions about the transaction costs and alternative housing options of defaulting borrowers, but all basically predict that borrowers will default when the negative equity in their homes reaches or exceeds a specific threshold. By contrast, the “double trigger” theory of loan default holds that negative equity, while necessary, is not a sufficient condition for default. Rather, there must be an additional “trigger” event that makes the monthly payments on the mortgage unaffordable. Such triggers can be internal to the loan product (such as a payment shock caused by a rate reset, negative amortization schedule, or prepayment penalty) or external, such as unemployment, illness or divorce. Empirically, the double trigger theory appears to have more validity. See Campbell and Cocco (2010) “A Model of Mortgage Default” NBER Working Paper #w17516; Schelkle (2011) “Mortgage Default During the U.S. Mortgage Crisis” London School of Economics Job Market Paper; Bhutta, Dokko and Shan, “The Depth of Negative Equity and Mortgage Default Decisions,” Federal Reserve Board of Governors, May 2010.

Conclusion

When defining QRM, Congress directed the regulatory agencies to balance the need for improved standards against the need to improve access to affordable credit on reasonable terms. Title IX provides that exceptions to 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.”³⁵ The clear Congressional objective was to achieve the balance between ensuring that mortgages are safe and sound and within a reasonable range of default risk and ensuring that affordable mortgages are accessible to credit-worthy borrowers. By proposing that the QRM definition be equal to the QM standards, the regulators have struck the right balance.

For additional information or to ask questions about this comment, please contact Eric Stein (eric.stein@self-help.org) or Debbie Gruenstein Bocian (debbie.bocian@responsiblelending.org).

³⁵ Dodd-Frank 941(e)(2)

Appendix: Flawed Analysis by SEC Economists

In a report released last month, *Qualified Residential Mortgage: Background Data Analysis on Credit Risk Retention*, Securities and Exchange Commission (SEC) economists Joshua White and Scott Bauguess analyze the impact of the QM rules and the initial set of proposed QRM rules on loan performance. While they find that while the QM rule does significantly reduce default rates compared to non-QM loans, the default rate they estimate for QM loans is 34 percent, much higher than the 5.8 percent found in the UNC/CRL study. In addition, the authors find that additional restrictions, such as FICO and CLTV requirements, result in large and significant reductions in serious delinquencies. However, significant flaws in the SEC data and methodology call into question these results:

- **The authors incorrectly allow loans with hybrid-adjustable rates and prepayment penalties into their QM universe.** Among the most harmful abuses of the subprime market was the widespread use of adjustable, short-term “teaser” interest rates, which lenders sold to borrowers without regard to their long-term affordability. Very few of these loans would now be allowed because Dodd-Frank requires them to be underwritten to their fully-indexed rate. In order to meet QM guidelines, the hurdle is even higher -- such adjustable-rate loans would have to be underwritten to their maximum rate for the first five years, plus they would have to meet a 43 percent DTI (unless they qualify for agency or government backing). Virtually no hybrid ARMs that were sold during the time period studied, if any, would have met the QM DTI limit. And, while we do not know what percentage of the authors’ QM sample is comprised of these loans, we do know that such loans made up a large proportion of the subprime PLS market during these years.³⁶ As a result, many poor performing subprime loans that would be ineligible for QM status are nonetheless included in QM performance statistics in the SEC paper, leading to an artificially high QM default rate.

Similarly, loans with prepayment penalties should have been excluded from the QM universe but were not. Prepayment penalties are now illegal on ARM loans and on higher-priced mortgage loans; these two classes comprise the vast majority of PLS mortgages at the time. In addition, any loan with a prepayment penalty above 2 percent is now classified as a HOEPA loan, and would be unlikely to be securitized because of the unlimited assignee liability that attaches to these loans. The two most common prepayment penalty forms were 6 months interest on 80 percent of the balance, which is above 2 percent, and a 3-2-1 penalty, which likewise is above 2 percent. Further, because prepayment penalties are now counted towards points and fees and because QM points and fees are capped at 3 percent, virtually no loans with prepayment penalties that were issued during the time frame studied would have qualified as QM, adding in upfront origination and affiliate fees.

³⁶ Over 77 percent of securitized subprime mortgages originated between 2004 and 2006, the years for which the SEC data is concentrated, were hybrid ARMs. In addition, over 60 percent of securitized Alt-A loans were adjustable rates. See Christopher J. Mayer, Karen M. Pence and Shane M. Sherlund, *The Rise in Mortgage Defaults*, Federal Reserve Board Finance and Economics Discussion Series, 2008, page 33 (available at <http://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf>).

The misclassification of hybrid ARMs and loans with prepayment penalties in their QM definition not only overinflates the default risk of the QM market, it they likely overestimate benefits of other QRM restrictions. Since there is a strong correlation between these loan features and credit profile, such as FICO and CLTV, a large share of the reduction in default that the SEC paper ascribes to stricter QRM standards should actually be attributed to the product restrictions of QM.

- **The authors exclusively analyze a small sample of mortgages secured by private-label securities (PLS), which is not representative of the broader mortgage market or even the PLS market.** The authors rely on small subset of data exclusively comprised of mortgages from PLS pools. As the authors themselves point out, PLS loans have much higher default rates across the board than GSE loans. However, given FHFA's and Congressional GSE reform proposals' commitment to encouraging private capital and the fact that guaranty fees are increasing and loan limits will likely fall, it is likely that many future PLS loans will more closely resemble GSE loans than they have in past. Consequently, the UNC/CRL's paper, which includes GSE loans and estimates a 5.8% default rate for QM loans, is much more indicative of how the overall market will perform under the QM restrictions. Furthermore, the SEC authors admit that only 16 percent of their PLS data had enough information to analyze and that this subsample is not representative of their larger PLS dataset. Critically, their own analysis suggests that, as a result of this lack of representativeness, the impact of CLTV on delinquency rates may be overstated even for the PLS market.³⁷
- **The authors measure the “cost” of a more narrow QRM definition in total dollar volume rather than number of loans.** The authors correctly acknowledge the regulators' interest in not only managing default risk with their QRM definition, but in also maintaining adequate access to mortgage credit. That is, they recognize the need to measure not only the benefit of a narrow QRM definition (in terms of lowered default rate) but also the “cost” in terms of decreased access to credit. However, the authors use the total dollar volume, not the number of loans, that would be excluded under the proposed QRM guidelines to measure the cost. Consequently, under their methodology, the cost of a proposed restriction that cuts off access to ten \$100,000 loans would be the same as another restriction that cuts off one \$1,000,000 loan. However, in policy terms, do we think that cutting out ten families who want \$100,000 loans is just as bad as cutting out one family who wants a \$1,000,000 loan? If the additional QRM restrictions that they analyze disproportionately affect families with lower loan levels, as FICO and CLTV likely do, using loan volume as the cost metric will underestimate the true cost of impaired access.

These methodological shortcomings are substantial enough to throw the authors estimations and policy conclusions into doubt. For a more detailed account of problems with the study, see Carolina Reid and Roberto Quercia's *Risk, Access and the QRM Reproposal*, available at <https://ccc.unc.edu/contentitems/risk-access-and-the-qrm-reproposal/>.

³⁷ See page 29-30