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Reply To:

June 3, 2011

Mr. Edward J. Demarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Dear Mr. Demarco:

I am writing in reference to the proposed rulemaking concerning implementation of Section 941 of the Dodd Frank Wall Street Reform and Consumer Protection Act as it applies to a "Qualified Residential Mortgage" (QRM). We wish to take this opportunity to express our profound concern about the definition of a QRM as described in the proposed rule. The adoption of the proposed QRM rule is detrimental to the best interest of consumers, the economy and lenders and is not a viable policy option. This letter identifies and comments on many of the unintended consequences of the impending rule making. We are hopeful that you will adopt our position and work to amend the rule.

Howard Hanna Holdings is a full-service company offering real estate, mortgage, title and insurance services to thousands of homebuyers each year. We are the fourth largest real estate company in the United States and operate in Pennsylvania, Ohio, New York and West Virginia. Last year, our company sold 34,000 homes, provided mortgage financing to 6,400 customers and closed over 7,000 title transactions. Everyday, we assist Americans in achieving the American Dream of Home Ownership but that dream is threatened. Adoption of the current QRM will make home ownership unobtainable for millions of Americans. It will harm working class families, and first generation college graduates and eliminate most minorities from the home buying process. The effects will reverberate through the entire housing market. Traditionally, first time home buyers apply the equity built up in their first home as a down payment for future purchases. The rule will inhibit that first time homeowner from meeting their future housing needs as their families grow while at the same time depriving senior citizens and other move up buyers of a viable marketplace to sell their homes.

As you know, The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) was signed into law on July 21, 2010. The intent of the legislation was to align the interests of the public, lenders and investors to restore and strengthen underwriting practices and ensure the safety and soundness of the lending environment. In an effort to encourage responsible lending and limit excessive risk taking the Act required that creditors retain a 5% interest in any loan that securitized for sale as a mortgage backed security. Section 941 of the Act provides that lenders issuing mortgage-backed securities retain a 5% credit risk. The intent of this "skin in the game" was to restore and strengthen underwriting practices and ensure that lenders were diligent in qualifying a borrower based on their creditworthiness. The public policy objective was to structure a lending environment that allowed lenders to offer these loan products but at the same time to limit the risk of default.

During the legislative process, lawmakers recognized that there were mortgage products with features that demonstrated historical performance with a lower risk of default and allowed that these mortgage products would be exempt from the risk retention requirement. This category of mortgage products was designated as "Qualified Residential Mortgages" or QRMs. Congress did not define the criteria for QRMs leaving the definition to the regulators. While legislative intent was to provide a broad definition of a QRM to allow for traditional lending, the regulators have issued a proposed rule that has a narrow definition encompassing an expansive range of traditional mortgage products.

The unintended consequences of the rule, as proposed, are detrimental to the economy, the mortgage industry and to the goals of home ownership. A summary of the detrimental consequences highlight the negative impact of the rule making. If the rule were adopted as proposed, the following consequences would result:

- The pool of borrowers that are eligible for a QRM will be dramatically reduced effectively eliminating millions of borrowers from the marketplace.

- The availability of mortgage products to consumers will decrease substantially limiting options and forcing borrowers into higher cost loans.

- Mortgage interest rates will be subject to increases of as much as 3% over rates under the existing structure. Under current market conditions, that means that a typical conventional mortgage now offered at 5% would likely rise to 8%. Total principal and interest on a conventional thirty-year fixed rate loan at $100,000 would rise from $193,256 to $264,153 an increase of $170,897 or 36% over the 30-year term.

- Despite the fact that the majority of the borrowers will be eliminated from the mortgage market there will only be a marginal decrease in default rates.

- The rule is inconsistent with the legislative intent of its congressional sponsors. It does not accomplish the intent of the Dodd Frank to restore and strengthen sound underwriting practices rather it places arbitrary barriers to home ownership.

- A narrow definition of QRM is discriminatory; it penalizes the credit worthy borrower and has a particularly adverse effect on the working classes. It reduces the opportunity for home ownership for first time homebuyers and virtually eliminates financing for minorities.

- First time homebuyers will be forced to postpone the purchase of a home for years. Computations based on even the most optimistic savings rate conclude that a borrower may have to save for 14 years to obtain the down payment and closing costs needed to purchase a median priced home.

- Existing homeowners are negatively impacted since for many it removes the opportunity to restructure their finances and take advantage of improvements in the interest rate environment.

- By allowing regulators to establish debt to income ratios and credit parameters underwriting flexibility is reduced. It does not allow for the consideration of compensating factors as part of the underwriting process. This could be harmful to individuals that are responsible but that have been adversely affected by medical emergencies or other extenuating circumstances.

- Although there is a specific QRM exemption for Fannie Mae and Freddie Mac, the current climate of change does not guarantee that the exemption will continue if the GSEs are restructured or eliminated.

- There is also an exemption for FHA under the current QRM rule; however, this would lead to the FHA being flooded with more, not fewer, loans. Loan options for borrowers will be limited forcing them into FHA or VA guaranteed loan programs. These already stressed agencies could become overburdened. It is not in the public interest for a government insurance program to dominate the market.

- It creates a detrimental impact on the housing recovery. Eliminating potential buyers from the market place will stagnate the housing inventory in an already fragile recovery.

- The 5% risk retention will favor large lenders and place small and mid-size lenders at a disadvantage. These smaller lenders compete on thin margins and may not be able to offer affordable products in the market place. This will reduce available choices to the consumer and provide an advantage to the top five lenders that will allow increased cost to the consumer to say nothing about the job loss numbers relative to the closures of small and mid-sized mortgage companies.

- The adoption of the "Ability to Pay Standard" establishing a 3% threshold for "points and fees" inclusive of affiliated company fees is discriminatory to lenders with affiliated services despite evidence that affiliated service providers offer more cost effective service to a the consumer.

The proposed rule as published will jeopardize the ability of many Americans to purchase a home and minimize the public's ability to achieve the American Dream of Home Ownership. If the QRM should be passed, the negative impact shall be felt for years. The proposed QRM has economic and social repercussions that cannot be overstated. Sound public policy dictates the rule cannot be adopted as proposed.

Howard Hanna's recommendation is that the proposed rule be amended to conform to the original legislative intent to include a broad range of traditional mortgage products. This solution would still allow prudent underwriting and product standards, yet continue to provide lender incentives to offer affordable mortgages. The opportunity for home ownership is fundamental to the American way of life. Providing stable affordable housing creates a strong citizenry, strengthens the nation and builds for our future. Please act now to guarantee Americans the continued opportunity for home ownership. A more reasonable, less restrictive application of the rule would benefit the consumer and preserve the pursuit of the American Dream for all Americans.

I appreciate the opportunity to express our concerns and views regarding the rule and have attached a White Paper supporting our contentions. Should you have any questions, I would be pleased to discuss the matter further.

Sincerely,

Howard W. Hanna III
Chairman and CEO

Detrimental Impact of Proposed Rules on Qualified Residential Mortgages
White Paper Prepared by Howard Hanna Mortgage Services

Introduction

The adoption of the proposed QRM Rule is harmful to the public interest. It discriminates against classes of individuals and severely constraint the majority of Americans from participating in the American Dream of homeownership. It eliminates mortgage options for consumers, greatly increases cost and does not achieve Dodd Frank's objective of decreasing default ratios while encouraging responsible lending and sound underwriting practices. It harms credit worthy borrowers and is not a viable policy option. The list of detrimental consequences stemming from the rules adoption provides cogent argument against its adoption.

Consequences of Proposed QRM Rule as it affects the Consumer

The purpose of QRMs was to create a lending environment that encouraged lenders to offer more traditional mortgage products and limit the institutions appetite for risk with loan products that offered high risk and negative features to consumers. The definition of QRMs to include mortgage products that have historically demonstrated performance with low default rates harms consumers and threatens the American dream of homeownership. The importance of the QRM exemption cannot be overstated and will govern who will qualify for homeownership for years to come.

Cost

The Mortgage Bankers Association perspective stated in a letter to Federal regulators "few loans to ordinary customers are likely to be made outside the QRM construct; the loans that are made will be costlier and more likely made only to more affluent customers."[1] A broadened definition of a QRM will force borrowers into loan products with greater risk to the lender. This additional investor risk will be passed on to the consumer in the form of more cost and higher rates. J.P. Morgan Chase concluded that the 5% risk retention requirement could increase rates on non-QRM loans as much as three percentage points. Under current market conditions, that means that a typical conventional mortgage now offered at 5% would rise to 8%. Total principal and interest on a conventional thirty-year fixed rate loan at $100,000 would rise from $193,256 to $264,153 and increase of $170,897 or 36% over the 30-year term. Funds that in the past may have been used to purchase consumer goods will now be earmarked solely for mortgage payments. The economy as a whole will suffer.

[1] Letter to Federal regulators, Mortgage Bankers Association, Qualified Residential Mortgage Recommendations, November 11, 2010

Elimination of Potential Homebuyers from the Market

The implementation of a broadly defined QRM will eliminate the majority of homebuyers from the mortgage market with only a marginal decrease in default rates. Further, it would reduce the existing homeowner's ability to refinance and take advantage of a lower interest rate environment forcing borrowers to pay above market interest for an extended period. Cash out refinances would be further restricted reducing a consumers ability to access funds for remodeling or college expenses. QRM as currently defined would have a disproportionate impact on lower and middle-income borrowers. First time homebuyers would have to postpone purchases. As stated, the QRM unfairly penalizes credit worthy borrowers. Testimony from representatives from the Center for Responsible Lending before the U.S. House of Representatives expressed the belief that QRM loans should be broadly available to creditworthy borrowers.

> *"Ideally, these should be the loans of choice for most borrowers. Loans that do not meet these standards should remain available, but should be the exception, not the dominate product and should be subject to strict regulatory oversight to address abuses. We believe that was the intent of Congress.*
>
> *The proposed rule would do exactly the opposite of what we here suggest. It would create a category of responsible mortgages, but make them affordable to only a small proportion of creditworthy families. This is the result of down-payment, debt to income and credit history requirements so extreme they would exclude much of the middle class along with large numbers of credit worth families of color and low-and moderate income borrowers, from access to QRMs.[2]"*

A data analysis of 20 million loans demonstrated that a larger down payment is not required to ensure low default rates if private mortgage insurance and responsible underwriting standards are in place.[3]

> *"High down payment and equity requirements will not have a meaningful impact on default rates but, they will require millions of consumers, who are at low risk of default, to either put off buying a home or pay unnecessarily high rates. The government is penalizing responsible consumers, making homeownership more expensive or simply out of reach for millions. We urge regulators*

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[2] *Understanding the Implications and Consequences of the Proposed Rule on Risk Retention, Testimony of Ellen Harnick, Center for Responsible Lending*, Before the U.S. House of Representatives Subcommittee on Capital Markets and Government Sponsored Enterprise, April 14, 2011

[3] Community Mortgage Banking Project

to develop a final rule that encourages good lending and borrowing without punishing credit-worthy consumers."[4]

Studies completed by Core Logic support the contention that the implementation of the rule would severely constrain the ability of Americans to purchase a home.

High Down Payment Requirements will Deny Millions of Homeowners

Lower Rate Qualified Residential Mortgages[5]
Percent of Homeowners with less than 20% Equity

% of Equity	National
Equity < 20%	46%
Equity <10%	34%
Equity < 5%	28%
Negative Equity	23%

Statistical data provided by Core Logic supports the contention that many borrowers will be eliminated from the market. The adoption of a required downs payment of 20% eliminates 46% of the current homeowners in the market place while a 10% requirement reduces the pool of borrowers to 34%. Further, there is no evidence to support the contention that the increased down payment requirements will result in a significant decrease in default rates. In fact, empirical studies indicate that a large down payment requirement will only have a marginal impact.

QRM: Impact of Raising Down Payment Requirements on Default Rates and Borrower Eligibility

Year	2002	2003	2004	2005	2006	2007	2008
Reduction in default rate* by increasing 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 at 10% Down	7.6%	6.6%	0.1%	8.4%	10.9%	14.7%	8.4%
Reduction in default rate* by increasing down payment from 5% to 20%	0.6%	0.3%	0.1%	0.8%	0.8%	1.6%	0.6%
Proportion of borrowers not eligible for QRM at 20% down	19.2%	16.7%	23.0%	22.9%	25.2%	28.2%	20.7%

A review of default rates compared to down payment requirements clearly demonstrates that there is not a strong correlation between default rates and a

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4 Washington, DC – Statement issued by the Center for Responsible Lending, the Community Mortgage Banking Project, the Mortgage Bankers Association, the Mortgage Insurance Companies of America, the National Association of Home Builders and the National Association of Realtors in advance of the April 14th House Subcommittee on Capital Markets and Government Sponsored Enterprises hearing on the Qualified Residential Mortgage, April 13, 2011

5 Core Logic Report on Negative Equity

large down payment. The number of borrowers not eligible for a QRM ranges between 19.2% and 28.2% for the years 2002 through 2008. During this same period defaults ranged from 0.6% to 1.6%. The data clearly demonstrates that while there is a significant reduction in the pool of borrowers qualifying for a QRM there is only a marginal decrease in default rate.

Effect on First Time Homebuyers

Studies concluded by the Center for Responsible Lending indicates that the number of years required to save for a down payment are considerably extended by the adoption of a large down payment. Studies indicate that while a 5% down payment would require a family to save for 6 years, a 20% down payment requirement would raise the years needed to save to 14 years. The social ramifications are evident. Citizenship and property rights have always been associated. Many American will be deprived of the rights of property ownership and the nation will become a nation of renters.

Consequences of Proposed QRM Rule to Small and Mid-size Lenders

The proposed rule has consequences for small to mid-size lenders. Smaller institutions such as community banks and independent mortgage companies operate on narrow margins and a 5% risk retention would be problematic. The recent financial crises decimated many mortgage lenders and has created more of a monopoly in the mortgage industry. Five of the large remaining lenders originate 50% of all mortgage originations and many of these banks were recently on the Federal watch lists and accepted TARP funds. A decade ago, these same lenders generated 33%. Mortgage pricing will be driven by larger lenders and correspondingly will result in fewer choices to the consumer with a correspondingly higher rate and higher unit profits to the lender. The Mortgage Bankers Association predicts loans made outside the QRM framework "will be costlier and likely to be made only to more affluent customers."

Effect on Affiliated Companies

Dodd-Frank's "Ability to Repay" standard establishes criteria for a QRM by setting a 3% threshold on the total "points and fees" paid by the consumer in a transaction. The determination of points and fees includes fees retained by a mortgage lender's affiliated title, appraisal, and other settlement service companies but not fees paid to a third party. These fees are included even if the fees retained by an affiliated company are no more than or less than the charges made by an unaffiliated third party. Consequently, there is a high probability that any mortgage lender with an affiliated business relationship will exceed this threshold thereby classifying the loan as a QRM. Should the threshold be held in place services would be segmented and would result in market inefficiencies and increased cost to the borrower. Numerous studies over the years have demonstrated that the concept of an affiliated settlement service is more cost effective and delivers a higher level of service to the consumer.

Legislative Intent

The broaden definition of a QRM has been repeatedly challenged by members of Congress because it is inconsistent with the legislative intent. The QRM exemption was introduced into the Dodd-Frank Act with the intention of creating an underwriting framework to support responsible lending and borrowing. Legislative intent was to provide credit worth borrowers with the availably of affordable financing. Congressional guidance to the regulators stated that they should jointly define a QRM "taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default"[6] In a letter to the regulator in February 16, 2011, the sponsors of the QRM exemption, Senators Landrieu, Hagan and Isakson wrote:

> *"We are concerned that efforts to impose a high down payment requirement for any mortgage to meet the QRM exemption standard would be inconsistent with legislative intent. As the authors of the QRM provision, we can assure you that, although there was discussion about whether the QRM should have a minimum downs payment, in negotiations during the drafting of our provision we intentional omitted such a requirement"*

On April 5, 2011, the Congressional Black Caucus reaffirmed the intent of Congress to the same federal regulators. In reference to QRMs, they stated:

> *"This is not what Congress intended or what the data supported. It is abundantly clear from the record that Congress created the concept of a QRM to provide strong incentives for prudent loan underwriting that takes into account several key factors and the way they are layered together – not to establish arbitrary down-payment requirements. Strong documentation, income to support monthly payments for the life of the loan, reasonable total debt servicing loads, protections from payment shock, prohibitions on high risk loan feature like negative amortization and balloon payments, and inclusion of mortgage insurance or comparable credit enhancement for low down payment loans, are the core underwriting factors that will loser the risk of default."*[7]

Correspondence between the regulatory agencies and Congressional representatives demonstrates that the legislature is emphatic in their opposition to a large down payment requirement. The inclusion of the current criteria for the QRM exemption is expansive and beyond the scope of legislative intent.

[6] PL 111-203, Sec,941(b))
[7] Letter to Regulatory Agencies from Emmanuel Cleaver II, Chairman, Congressional Black Caucus, April 5, 2011

Conclusion

The preponderance of evidence supports the contention that the proposed definition of a QRM will eliminate the majority of American homeowners from participation in the American Dream of homeownership. It will reduce choice of mortgage options and increase consumer costs. The QRM as currently defined is discriminatory against classes of individuals and lenders. It forces first time homebuyers to postpone the purchase of a home and prohibits existing homebuyers from the opportunity for cost savings achieved through refinancing. It does not substantially reduce default rates yet at the same time; it threatens the housing recovery. The QRM proposal failed to consider the historical performance of traditional mortgages that have performed well for decades. Rather, it is arbitrary in nature. It clearly does not comport with Congressional intent and expands beyond its statutory authority. It relegates Americans to a renter status and deprives many in the middle class from achieving the American Dream.