



July 25, 2011

Department of the Treasury  
Office of the Comptroller of the Currency  
250 E Street, SW., Mail Stop 2-3  
Washington, DC 20219  
Docket No. OCC-2011-0002, RIN 1557-AD40

Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090  
Attn.: Elizabeth M. Murphy, Secretary  
RIN 3235-AK96  
Release No. 34-64148; File No. S7-14-11

Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551  
Attn: Jennifer J. Johnson, Secretary  
Docket No. 2011-1411, RIN 7100-AD-70

Federal Housing Finance Agency  
Fourth Floor  
1700 G Street, NW  
Washington, DC 20552  
Attn.: Alfred M. Pollard, General Counsel  
RIN 2590-AA43

Federal Deposit Insurance Corporation  
550 17th Street, NW  
Washington, DC 20429  
Attn.: Comments, Robert E. Feldman,  
Executive Secretary  
RIN 3064-AD74

Department of Housing and Urban  
Development  
Regulations Division  
Office of General Counsel  
451 7th Street, SW, Room 10276  
Washington, DC 20410-0500  
RIN 2501-AD53

*Re: Credit Risk Retention Proposed Rule*

To Whom It May Concern:

The proposed rule on credit risk retention serves a laudable end—reducing systemic financial risk through better regulation. As part of that regulation, it defines the Qualified Residential Mortgage (“QRM”) as mandated by the Dodd-Frank legislation. Many parts of that definition are effective and welcome additions, particularly the restrictions on product type to exclude no-documentation, negative amortization, payment shock, and other unsustainable loan features. We at the National Housing Conference are concerned, however, that the proposed rule unnecessarily sacrifices homeownership opportunities for many Americans—in effect, overcorrecting for the housing bubble. We therefore propose defining the QRM pool primarily as safe and sound mortgage products that include responsibly structured low-downpayment options without creating an unintended government underwriting standard.

In summary, our recommendations are:

1. Remove downpayment and LTV requirements. Reducing the downpayment requirement to 10% would be significantly worse than the proposed level of 20%, for reasons outlined below.
2. Consider removing or relaxing debt-to-income ratio requirements. Much like downpayment restrictions, these are underwriting criteria evaluated in the context of a full analysis, not a stand-alone bar to be crossed. If enshrined in regulation, they can become an unintended focal point that unnecessarily excludes responsible borrowers.
3. Exempt downpayment assistance and shared equity assistance programs created by government entities and designated, legitimate nonprofits, whether structured as loans, grants, or lower sales prices with resale restrictions.
4. Consider delaying implementation until other aspects of the mortgage finance system are resolved, or making provisions now to require that regulators revisit the rule when other major changes to mortgage finance occur. At a minimum, it would make sense to resolve the larger Qualified Mortgage rule before defining the subset of Qualified Residential Mortgages. Requiring reassessment of the rule when, for instance, legislation setting a future path for Fannie Mae and Freddie Mac is enacted (or within, say, two years) would also be very helpful given the high level of uncertainty.

The National Housing Conference (NHC) represents a diverse membership of housing stakeholders including tenant advocates, mortgage bankers, non-profit and for-profit home builders, property managers, policy practitioners, realtors, equity investors, and more, all of whom share a commitment to a balanced national housing policy. Since 1931, NHC has been dedicated to ensuring safe, decent and affordable housing for all Americans—that commitment bringing together our broad-based membership has earned us a reputation as the **United Voice for Housing** engaging in nonpartisan advocacy on housing issues.

### **Prevent QRM from becoming an unintended government underwriting standard**

QRM is coming before many other, broader changes to mortgage finance system: the Qualified Mortgage rule, potential changes to FHA, and the future of the GSEs. Because QRM is coming first, it will have impact far beyond its immediate scope.

At least at first, QRM will not apply to FHA, and Fannie Mae and Freddie Mac are deemed to qualify as satisfying risk retention as long as they are under conservatorship. Since these account for more than 90% of new originations in home mortgages currently, QRM would not immediately apply to most of the home mortgage market.

**Over the medium to long term, however, QRM will define the mortgage finance space.** If the federal government draws a line that separates so-called “good” mortgages from “bad” mortgages, market participants and policymakers may well incorporate that definition into future policymaking. We are concerned that any QRM standard adopted now could be used to define the scope of future government mortgage market policy and become, essentially, the equivalent of a conforming loan requirement, FHA loan requirement, or de facto market baseline for privately financed mortgages.

Unduly restricting QRM to exclude low-wealth borrowers now could therefore exclude them from access to affordable mortgage finance for years to come. We should make sure not to do that simply in pursuit of marginal reductions in the average default rate of loans in the pool, particularly when product-type restrictions offer an effective bright-line standard.

### **All responsible borrowers should have access to affordable mortgages**

The components of a well-functioning economy—educational opportunities, good jobs, and a civil society—begin with healthy, affordable homes in safe neighborhoods. Those homes will necessarily include a mix of rental and homeownership tenures in single- and multifamily properties. As we reshape the mortgage finance system to make it more reliable and safer for consumers, investors, and taxpayers, we should be sure that we do not unfairly restrict affordable mortgage finance to a wealthier or higher-income subset of borrowers. The United States has proven through long practice that we can deliver mortgage capital efficiently via securitization. The benefits of that efficiency should be available to all credit-worthy homebuyers.

### **Downpayment and LTV requirements unnecessarily exclude low-wealth borrowers**

Downpayment has an intuitive appeal from a regulatory standard, since it is a simple, bright line with a correlation to default rate. However, it is only one factor among many in a full underwriting analysis, and on its own is neither a necessary nor sufficient condition for a good loan. Including it as a minimum threshold, moreover, powerfully disadvantages responsible low- and moderate-income homebuyers.

**A high downpayment threshold creates a powerful barrier to homeownership** for low-wealth families, one that is uniquely difficult to overcome. A family can improve its credit performance over time or pay down non-mortgage debt, but saving up \$20,000 or \$40,000 (even more in high-cost markets) for a downpayment can take decades. Making the accumulation of wealth a requirement for access to affordable mortgage finance in effect excludes Americans who do not already have individual or family

wealth. Not only is that fundamentally unfair, but it also **skews disproportionately against communities of color.**<sup>1</sup>

We know that **well-structured, low-downpayment loans to responsible borrowers perform well.** The best data on this come from the Center on Community Capital, which found that properly structured, low downpayment loans performed 3.5 to 3.99 times better than subprime loans to comparable borrowers, even during the height of the foreclosure crisis.<sup>2</sup> The well-structured low-downpayment loans perform with comparable stability to prime loans. Data illustrate the converse, too: in the fourth quarter of 2010, the percent of prime fixed rate loans in foreclosure was 2.67%, the highest level in the history of the Mortgage Bankers Association National Delinquency Survey. The rate for prime adjustable rate loans was a whopping 10.22%.<sup>3</sup> These data underscore that the housing crisis resulted from inherently risky mortgage features —exploding ARMs, no-doc loans, negative amortization—rather than loans with low-downpayments.

We further know that **downpayment assistance programs provided by localities and approved nonprofits generate low-risk loans.** Indeed, buyers with assistance from affordable homeownership programs have default rates well below local market averages, even with very low or no downpayment from the buyer’s own funds.<sup>4</sup> Homeownership assistance programs use public resources efficiently to create long-term affordable housing, often making the loans safer than some unassisted transactions. The proposed rule would allow such assistance if structured as a grant, but it would arbitrarily exclude those forms of government or non-profit assistance structured as second mortgages or which use the assistance to lower the purchase price and maintain affordability through resale restrictions. The proposed rule would there result in the counter-intuitive outcome of excluding downpayment assistance approaches which efficiently preserve public subsidy and, indeed, often are required by law.<sup>5</sup>

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<sup>1</sup> Plan B, A Comprehensive Approach to Moving Housing, Households and the Economy Forward; April 4, 2011, by Lewis Ranieri, Ken Rosen, Andrea Lepcio and Buck Collins. Figure 14 shows that minority households in 2007 had median before tax family income of about \$37,000, compared to about \$52,000 for white families. Similarly, Figure 15 shows minority family net worth in 2007 of almost \$30,000, compared to more than \$170,000 for white families.

<sup>2</sup> Lei Ding, Roberto G. Quercia, Wei Li, Janneke Ratcliffe, “Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Property Score Models” Center for Community Capital Working Paper, May 17, 2010. Available at <http://www.ccc.unc.edu/documents/Risky.Disaggreg.5.17.10.pdf>.

<sup>3</sup> The survey is available at <http://www.mortgagebankers.org/NewsandMedia/PressCenter/75706.htm>.

<sup>4</sup> Urban Institute. *Balancing Affordability and Opportunity: An Evaluation of Affordable Homeownership Programs with Long-term Affordability Controls*, October 26 2010.

<sup>5</sup> See 24 CFR 92.254, which requires resale or recapture provisions in homeownership programs funded through HUD’s HOME Investment Partnerships Program.

## 10% downpayment would be worse

The proposed rule asks specifically whether a 10% downpayment requirement would be a better alternative. In fact, it would be worse, for four reasons:

1. **Barrier to low-wealth borrowers.** For low-wealth borrowers, 10% is still a very challenging standard to meet, one that would require many years of savings. Using national median income and home sales price data, it would take a family 9 years to save the more than \$25,000 needed for a 10% downpayment, assuming that all available savings went to that purpose. In high cost markets, such as San Francisco, it could take as long as 16 years.<sup>6</sup>
2. **Looks like an underwriting standard.** Lowering the downpayment requirement only somewhat would actually reinforce the misperception of QRM as an underwriting standard, making it more likely to become an unintended focal point for the home lending industry broadly.
3. **Less liquidity.** The non-QRM loan space, that is, the set of loans that fall outside the QRM requirements, would be even smaller.<sup>7</sup> It may well be so small and heterogeneous that it could not support an efficient secondary market, much less a TBA market. Costs for low-wealth borrowers would therefore be even higher, and would be subject to more sudden loss of availability when private capital retreats from less liquid investments perceived as higher risk.
4. **Greater burden on government.** FHA would become the only alternative for many borrowers, increasing the burden on government, both to process loans and to assume full credit risk.

## QRM should not substitute for underwriting

Underwriting is a process of evaluating many interactive elements to determine whether a loan is a sound investment. Each element on its own—equity contributed, borrower’s income, value of the real estate, etc.—is rarely sufficient to consider a loan secure. An underwriting standard sets forth a set of parameters and a means for evaluating and weighing them in the context of a given loan. QRM is not designed to be such a standard—indeed, it specifically anticipates mortgage lenders creating their own

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<sup>6</sup> Coalition for Sensible Housing Policy, “Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery,” 2011, p. 3 citing data from the Center for Responsible Lending and the National Association of Realtors. Further calculations presented in “Impact of Risk Retention Rules” p. 9.

<sup>7</sup> From a securitization perspective, this would be loans that meet the QM standard but not the QRM standard. From a general mortgage liquidity perspective, it would also include non-QM loans held in portfolio, which are even less liquid almost by definition.

underwriting standards and processes for mortgage lending inside and outside of QRM. However, the proposed rule looks like such a standard, because it specifies LTV, downpayment level, debt-to-income ratios, minimum credit history, and more. That is dangerously confusing, because **what should be a clear boundary to contain careful, independent underwriting looks like a replacement for the underwriting altogether.**

As an example, choosing 20% as the downpayment threshold resonates with existing underwriting practice—for instance, 20% down is the Fannie Mae threshold for requiring mortgage insurance. For average Americans, 20% is familiar as either the actual or aspirational amount for a traditional downpayment (despite the prevalence for decades of mortgage lending at well below 20% down using mortgage insurance, downpayment assistance loans, and other approaches). In other words, choosing this number at this time in this rule makes the proposed downpayment standard an unintended focal point that looks like the government-approved downpayment to many audiences.

**Congress specifically rejected including downpayment** as one of the factors in the statute.<sup>8</sup> Not only should that guide regulation affirmatively (why put in what Congress rejected?), it should also relieve concerns that regulators need to weigh without legislative guidance the social harm of excluding low-wealth borrowers against the value of tightening the QRM standard. Congress has weighed the two and come down against using a downpayment requirement.

**Product-type restrictions can create an effective QRM standard without excluding low-wealth borrowers.** Analysis of FHFA's data on Fannie/Freddie mortgages from 1997 to 2009 shows that removing the LTV requirement from the proposed rule would increase the pool of QRM loans by as much as 17% with very little increase in delinquency. Furthermore, analysis the same data shows that relying on the product-type restrictions already in the proposed rule would reduce delinquency, particularly in the years where we saw the worst abuses, with a much smaller impact on the size of the QRM pool.<sup>9</sup> Put simply, regulation of product type provides an effective bright line without creating an unintended government underwriting standard.

The final rule should make it explicit that it is not intended to be a general underwriting standard, nor does it substitute for full underwriting of loans. Clarifying statements would be helpful, but even more

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<sup>8</sup> The evidence here is quite strong, as confirmed by the February 16, 2011 letter from Senators Landrieu, Hagan and Isakson to the QRM regulators stating their explicit rejection of minimum downpayment in the statute. Even more recently, over 340 members of Congress have joined with the National Association of Realtors to urge regulators to eliminate the 20% downpayment requirement (see [http://www.realtor.org/topics/grm/thankyou\\_congress\\_ad](http://www.realtor.org/topics/grm/thankyou_congress_ad)).

<sup>9</sup> Mortgage Bankers Association, "Impact of Risk Retention Rules on the Mortgage Market: Presentation Materials" 2011, available at <http://www.mbaa.org/files/Advocacy/2011/RiskRetentionPresentation.pdf>.

important would be elimination of underwriting-like requirements such as the LTV and downpayment restrictions. Lenders, borrowers, mortgage insurers, and others will take far more direction from the substance of the rule than from the preamble.

The Qualified Mortgage (QM) rule now under development may well provide a clarifying example, and better coordination between QM and QRM may be a productive path for regulators to pursue, particularly since the QM will set an outer bound for the size of the QRM space.

### **Recommendations: regulate product type rather than underwriting**

The challenge from a regulatory perspective is to distinguish responsible low-downpayment loans from the irresponsible loans made during the run-up to the crash. Put differently, we should choose a point of distinction that balances the need to reduce the rate of default within the QRM pool against the social cost of excluding responsible borrowers who fall outside the bright line established by the QRM standard. **The most effective point of distinction with the least social cost is product type.** Excluding negative amortization, no-documentation, exploding ARMs, balloons, and other forms of payment shock and irresponsible lending would eliminate the bulk of problematic loans while excluding much fewer responsible borrowers.

Based on the above analysis, NHC therefore requests several changes in the proposed rule:

1. Remove downpayment and LTV requirements. Reducing the downpayment requirement to 10% would be significantly worse than the proposed level of 20%, for reasons outlined above.
2. Consider removing or relaxing debt-to-income ratio requirements. Much like downpayment restrictions, these are underwriting criteria evaluated in the context of a full analysis, not a stand-alone bar to be crossed. If enshrined in regulation, they can become an unintended focal point that unnecessarily excludes responsible borrowers.
3. Exempt downpayment assistance and shared equity assistance programs created by government entities and designated, legitimate nonprofits, whether structured as loans, grants, or lower sales prices with resale restrictions.
4. Consider delaying implementation until other aspects of the mortgage finance system are resolved, or making provisions now to require that regulators revisit the rule when other major changes to mortgage finance occur. At a minimum, it would make sense to resolve the larger Qualified Mortgage rule before defining the subset of Qualified Residential Mortgages. Requiring reassessment of the rule when, for instance, legislation setting a future path for



Fannie Mae and Freddie Mac is enacted (or within, say, two years) would also be very helpful given the high level of uncertainty.

NHC appreciates the hard work of all of the regulators in preparing the proposed risk retention rules. We believe that with the necessary changes, the risk retention rules can strengthen America's mortgage finance system.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Maureen Friar', with a long horizontal flourish extending to the right.

Maureen Friar  
President