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CORRESPONDENCE ASSIGNMENT

OC 11-0081

ASSIGNED TO:
FINANCIAL REFORM
COMMENTS

DATE: 02/08/2011

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MR NAQVI OF PNC MORTGAGE, AN AFFILIATE OF PNC BANK, WRITES OF HIS CONCERNS OVER THE DEFINITION OF A QUALIFIED RESIDENTIAL MORTGAGE,

THE ATTACHED CORRESPONDENCE HAS BEEN ASSIGNED TO FINANCIAL REFORM COMMENTS FOR INFORMATION.

IF YOU HAVE ANY QUESTIONS RELATING TO THIS ASSIGNMENT, PLEASE CONTACT THE CORRESPONDENCE UNIT OF THE OFFICE OF LEGISLATIVE AFFAIRS AT 898-7055.

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OFFICE OF THE CHAIRMAN

January 31, 2011

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue
Washington, DC 20551

The Honorable Shaun L.S. Donovan
Secretary of Housing and Urban Development
United States Department of Housing and Development
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John G. Walsh
Comptroller of the Currency (Acting)
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The Honorable Mary L. Schapiro
Chairman
United States Securities and Exchange Commission
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The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
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Acting Director
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Acting Director
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Subject: The Definitions of Qualifying Mortgages (QM) and Qualifying Residential Mortgages (QRM) under the Dodd-Frank Act of 2010, Sections 1412 and 941, respectively

Dear Ladies and Gentlemen:

PNC Mortgage, a division of PNC Bank, National Association appreciates the opportunity to provide comments on the definition of the QRM, a very important provision of Title IX of the Dodd-Frank Act. While it is obviously the provision that will determine the parameters for "skin in the game", it will also influence the structure of the residential mortgage industry in the post GSE conservatorship era. This letter also provides comments on the relationship between the definitions of QRM and QM, and briefly discusses the definition of QM that the Federal Reserve is responsible for defining.

PNC supports the position published by the Housing Policy Council of the Financial Services Roundtable that provides for a private/public hybrid model for conventional mortgage backed securities (MBS) with an explicit federal guarantee wrapped around the credit enhancements at both the loan level and the pool level. Notwithstanding this view, our comments are offered independent of the final resolution of the Federal government's role in housing finance. In addition, PNC fully supports the Dodd-Frank approach of credit risk retention for residential mortgages in order to better align the interests of the investor and the securitizer/originator and to promote more responsible lending.

The QM Should Not Be Used to Define the QRM

Given the Section 941 requirement that QRM be defined no more broadly than the definition of QM resulting from Section 1412, there has been much discussion about how closely linked these two terms should be. In analyzing definitions of the QRM and the QM, it is important to first recognize the conceptual differences between the two concepts. Those differences compel different types of definitions to ensure the purpose of the QRM and the QM are achieved.

The primary purpose of the definition of QM was to reduce burdens on lenders by giving them a presumption that a broad set of mortgages meet the "ability to repay" standard of Dodd-Frank. However, the statutory definition of QM does not exclude types of loans that have demonstrated a higher risk of default. Since Section 941 directs your agencies to consider loan features that present a lower risk of default, the QM definition should not be used to guide your agencies' determination of the definition of QRM.

The presumption that QMs meet the "ability to repay" test, creates incentives for lenders to underwrite loans to QM standards. Thus, the QM definition that the Federal Reserve is directed to define must strike a balance between conservative underwriting standards designed to ensure that safe loans are made, and the need to ensure that all deserving Americans have access to residential mortgage credit. Setting the QM underwriting standards at too conservative a level would likely cause many moderate and lower income borrowers to have to seek loans from lenders who are willing to lend outside of the QM standard. This is an incentive to push such borrowers to less careful lenders, who will not set standards or develop processes with an eye toward the ability to repay standard. Further, because loans that are outside the QM definition lose the presumption that they meet the ability to repay requirements, lenders would price such loans to take that extra risk into account, increasing the cost of borrowing for many middle income and lower income borrowers.

Thus, the QM definition should include a broad enough underwriting standard to ensure that QMs are available for deserving borrowers. Of course, the standards must not be so broad as to include "fringe" loans that clearly are unsafe.

The QRM definition has different issues associated with it. The risk retention exception for QRMs is designed to create an incentive for lenders who sell in the secondary market to make sound loans that do not threaten investors and guarantors with undue risk. It is likely that the final structure of any new housing finance regime will include some sort of (at least limited) federal government guarantees or backstop for securitized transactions. Accordingly, the QRM definition must take into account the essential goal of protecting American taxpayers. Therefore, the QRM definition must be narrow enough to make the use of any federal government guarantee or backstop less likely, while helping to develop an active secondary market for truly safe loans. In other words, a narrow definition for QRM will allow for a meaningful secondary market while protecting taxpayers.

The QRM Definition

Some of the recent proposals that promote very broad definitions of the QRM will defeat the goal of Dodd-Frank to promote responsible lending and will once again shift the risks associated by irresponsible lending to the investor and ultimately the taxpayer.

The QRM should represent loans that carry minimal risk to the credit provider. As noted above, our presumption is that the credit enhancer will be at least in part the federal government, and thus ultimately the American taxpayers in some form. This means that only the safest loans should qualify and the criteria should be clearly stated with minimal, if any, underwriting discretion afforded to the originator. Once subjective elements are introduced into the lending process with no commensurate risk retention by the entity making those judgments, the chances of irresponsible behavior increase. In the crisis facing the economy today, we are witnessing the damaging effects of this type of risk transfer from the lender to the investor, and ultimately to the taxpayer.

The statute directs your agencies, in defining the QRM, to consider loan terms and features that "lower the risk of default". It further directs you to consider specific definitional features, all of which we support. Thus, to lower the risk of QRM defaults and avoid placing excessive risk on credit enhancement guarantors, including the federal government, the QRM definition should require (1) sufficient borrower income to afford the monthly payment of principle, interest, taxes and insurance; (2) adequate stability of income measured by tenure on the job; and (3) a demonstrated track record of the borrower handling credit responsibly. In order to ensure these requirements are met, the definition should also specify clear and conservative debt to income ratios and FICO score requirements. For the same reasons, there should be a requirement that substantial collateral in the form of equity in the home be available to support the loan. Additionally, QRMs should be expressly limited to borrowers who are buying or refinancing a primary residence. Finally, QRM loans should have a reasonable loan limit amount, perhaps $400,000. In this spirit, we also fully support the existing Dodd-Frank Title IX exclusions on prepayment penalties, negative amortization, financed credit life insurance, and other specified loan characteristics.

It has been suggested that a narrow definition of the QRM will drive a disproportionate amount of volume to the FHA. Such an argument presumes that there are no effective ways to limit FHA market share other than making QRMs an attractive alternative. We reject such an argument. If needed, FHA market share can be limited in a variety of ways, including realistic limits on eligible loan amounts and FHA underwriting guideline restrictions that control FHA market share without denying lower income borrowers who are reasonable credit risks access to FHA.

Further, any argument that a narrow definition of QMR will drive up the cost to consumers presumes that the Federal government will adopt a policy of subsidizing the housing industry to the same extent as it did in the past. Because of the uncertainty of the government's ultimate policy, we believe that that policies and definitions that result in appropriate risk based pricing for QRMs and QMs is the only effective means of avoiding a repetition of past mistakes. As noted below, if QRMs are defined in an appropriately narrow manner, lenders should be wiling to make non-QRM loans that qualify as QMs to appropriate lower income borrowers.

The QM Definition

As discussed, the definitions of QRM and QM should not be the same, and there is a need to have a QM market that meets the needs of all credit worthy Americans of any income level. Accordingly, in originating QMs, lenders need to ensure that borrowers meet the "ability to repay" standard required by Dobb-Frank but should be permitted to use their judgment in the application of their underwriting criteria.

The QM should be available for financing primary residences, second homes and investor-owned properties. As with QRM, we believe that the definition of QM should include restrictions on prepayment penalties, negative amortization or financed credit life insurance.

In order to effect these changes, we support the approach outlined in the Congressional Budget Office study ***Fannie Mae, Freddie Mac and the Federal Role in the Secondary Market,*** December, 2010, suggesting that limits on eligible loan amounts or other parameters should be phased in over a period of years to minimize disruption to the housing financing market.

Conclusion

In summary, PNC supports a definition for QM eligibility that is broad and allows for flexibility in the underwriting process and a QRM definition that is very precise with no deviations from the guidelines. Underwriting discretion for residential mortgages should be aligned with credit risk retention. This approach will meet the objectives of the Dodd-Frank Act in aligning the interests of the originator and the MBS investor and in promoting responsible lending.

PNC also fully supports the important goals of preserving an efficient TBA market for conventional MBS and recognizes that credit risk retention and transparency are two important components for ensuring this. It is with this in mind that we support clear definition of what constitutes a QRM, differentiated from the definition of QM.

Please feel free to contact us with any questions.

Sincerely,

Sy Naqvi

Saiyid Naqvi
President & CEO