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Office of the Comptroller of the Currency:
regs.comments@occ.treas.gov,
Docket Number OCC-2010-0002

Federal Reserve Board
regs.comments@federalreserve.gov,
Docket No. R-1411

Federal Deposit Insurance Company,
Comments@FDIC.gov,
RIN 3064-AD74

Securities and Exchange Commission,
rule-comments@sec.gov,
File Number S7-14-11.

Federal Housing Finance Agency,
RegComments@fhfa.gov,
RIN 2590-AA43

Department of Housing and Urban Development,
www.regulations.gov,
Docket Number FR–5504–P–01

RE: Credit Risk Retention, Docket Number OCC-2010-0002; Docket No. R-1411; RIN 3064-AD74; File Number S7-14-11; RIN 2590-AA43; Docket Number FR–5504–P–01

Dear Regulators:

Advocates for Basic Legal Equality urges you to alter significantly your proposed Qualified Residential Mortgage (QRM) rule in order to preserve homeownership as a realistic option for moderate- and middle-income Americans who are creditworthy but lack savings for large down payments. We approve of credit risk retention, but are concerned that the regulators have overreacted with this proposal. We urge you to remove bad loans, rather than the less affluent but potentially creditworthy borrowers, from the mortgage market.

Who We Are

ABLE is a not-for-profit law firm that provides free legal services in civil matters to the low income and elderly who can not afford to pay for a lawyer. We serve thirty-two counties in Northwest and Western Ohio from offices in Dayton and Toledo. ABLE is a participant in Ohio's "Save the Dream" program, in which we provide legal assistance in order to save the homes of borrowers in foreclosure. We also have years of experience helping clients who received predatory mortgage loans. We are a member of the National Community Reinvestment Coalition (NCRC) and urge you to consider their comments, as well as those of other consumer advocates dedicated to preserving and expanding homeownership.

Background to the Mortgage Crisis

Ohio and America are suffering through an economic crisis that was triggered by an explosion of reckless and often predatory mortgage lending. While the abusive lending practices incubated in the "subprime" mortgage market, they were not a necessary consequence of the worthy goal of expanding homeownership to borrowers would otherwise have been excluded by incomes and credit history. Instead, this mortgage lending crisis was a consequence of the dangerous and deceptive mortgage products with which the industry chose to serve that market.

The mortgage crisis was enabled by dysfunctional regulation of dangerous and deceptive mortgage products, perverse incentives for the lending industry to make and securitize such mortgage loans, and corruption of private institutions who were supposed to guarantee integrity, such as appraisers and bond rating agencies. However, a major factor was the evasion of accountability due to misuse of the financial device of loan securitization. Loan originators could rid themselves of the consequences of bad loans by passing the loans on to others, who often were left with little practical or legal recourse. In fact, investment banks are accused of profiting more by betting in the credit default swap market that the loans they were securitizing would fail than attempting to have them succeed.

Qualified Residential Mortgages Should Be Low-Risk Loans

Congress has passed the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") to prevent a recurrence of the activities that lead to the financial crisis. When Congress was drafting the Dodd-Frank Act, lawmakers were concerned that risky subprime and non-traditional loans were issued in large volumes because institutions did not experience financial consequences for high default rates. Dodd-Frank promoted responsible lending by requiring financial firms to retain 5 percent of the credit risk when they sell loans to investors. This 5 percent credit risk requirement was intended to change the perverse incentives by giving financial firms a stake in the loans' performance, commonly referred to as "skin in the game."

Congress's 5 percent risk retention requirement targets subprime and non-traditional loans, but should not also target prudently underwritten loans with low down payments. Thus, financial institutions will be exempt from the 5 percent risk retention requirement on certain types of mortgages, known as Qualified Residential Mortgages (QRMs). QRMs contain loan terms and practices that the regulatory agencies have determined are less likely to end up in default. The regulatory agencies have appropriately specified a series of risky loan terms and practices that cannot be in QRMs such as prepayment penalties and a lack documentation of borrower income.

A Requirement for 20% Down Payments Will Exclude Credit-Worthy Borrowers

However, the agencies have also proposed down payment requirements of up to 20 percent for QRMs. This requirement will effectively disqualify large numbers of moderate- and middle-income families from buying homes. The proposed guidelines for debt-to-income ratios are also unduly restrictive and will shut out broad segments of the population.

According to former FDIC Chairman Sheila Bair, more than half of subprime loans securitized during 2006 and 2007 ended up in default. Problematic adjustable rate mortgages with payment options poorly explained to borrowers also ended up with high default rates impacting middle income communities. It was the risky and abusive features of subprime, adjustable rate, and other nontraditional loans that drove the crisis, not low down payments. Indeed, the Federal Housing Finance Administration concludes that the product type requirements of QRM such as prohibitions against loans not verifying borrower income is the QRM requirement that has the largest impact of reducing delinquencies.

In contrast to the high default rates associated with subprime and non-traditional loans, the regulators' analyses reveal that loans qualifying for QRMs with the exception of low down payments (less than 20 percent down) have default rates 1 to 2 percentage points higher than loans that qualify for QRMs and have 20 percent down. While default rates are modestly higher (a finding corroborated by noted economist Mark Zandi of Moody's Analytics), low down payments are not the major culprit of the crisis. Clearly, default rates on low down payment loans pale in comparison to the 50 percent default rates on subprime and other non-traditional loans.

Most Americans that are not affluent will have considerable difficulty coming up with 20 percent down payments even for homes that are modestly priced. Zandi documents that fewer than half of all loans originated in 2010 had loan-to-value ratios below 70 percent. For minorities and first time homebuyers of all races, the situation could be especially bleak. According to the Census Bureau, African-Americans had a median net worth of about $8,600 in the mid-2000s, which is clearly not enough to generate a 20 percent down payment on even a modestly priced home of $100,000. Moreover, according to Harvard University's calculations of the Federal Reserve's Survey of Consumer Finances, the median white renter had cash savings of about $1,000 and the median minority renter about one-quarter that amount in 2007.

Proposed PTI and DTI Ratios Are Too Low

An equaling troubling aspect of the QRM proposal is the ratios regarding housing payment-to-income (PTI) and debt-to-income (DTI). The agencies propose that loans would qualify for QRMs only if their PTI and DTI ratios are 28 and 36 percent, respectively. While high PTI and DIT ratios are problematic, the proposal is an over-reaction to the foreclosure crisis. Loans backed by the Federal Housing Administration (FHA) exhibit considerably lower default rates than subprime loans, and FHA loans have DTI ratio limits that can go up to 41 percent. The FHFA's data analysis shows that PTI and DTI limits disqualify more loans from QRM status than even the low down payment requirement. In addition, the FHFA analysis shows that loosening the PTI and DTI requirement significantly increases loans that qualify as QRMs while not significantly increasing default rates of QRM loans.

Prime conventional lending has plummeted for all borrowers but particularly for minorities during the last several years. NCRC's Home Mortgage Disclosure Act (HMDA) data analysis reveals a decline of 67 percent for whites and 85 percent of African-Americans and Hispanics in prime conventional home purchase lending from 2005 to 2009. Restrictive QRM standards will unnecessarily reduce lending even further. The present QRM proposal will not only shut out large numbers of modest and middle-income families from homeownership but could also thwart the shaky economic recovery that is currently being held back by difficulties in the lending and real estate industries.

We also note that proposed down payment requirement that was not even one of the explicit statutory factors listed by the Dodd-Frank Act for developing QRMs.

Conclusion

The regulatory agencies assert that many mortgages will continue to be made that are not QRMs. They state that institutions will either hold these loans in portfolio or retain 5 percent of the risk when they sell the loans. However, QRMs could very well set the standard for the entire market meaning non-QRM loans will either not be available or will be much more costly. This is what happened when regulators defined the loans that were subject to HOEPA requirements and when FNMA set terms in its form mortgage contracts. In real terms, this could mean significantly less credit or much more expensive credit for broad swaths of Americans.

We therefore urge the agencies to allow down payments of 3 to 5 percent and DTI ratios consistent with FHA guidelines to qualify as QRM. We also suggest that you give QRM status to simple fixed rate loans that lack non-traditional features that are difficult for borrowers to evaluate, in order to encourage the proliferation of such loans.

Thank you for your consideration of our comments.

Sincerely,

Stanley A. Hirtle
Attorney at Law
Advocates for Basic Legal Equality, Inc.

cc: National Community Reinvestment Coalition