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OCC-2011-0002

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Docket No. R-1411

Robert E. Feldman
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Attention: Comments/Legal ESS
RIN 3064-AD74

Ms. Elizabeth M. Murphy
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Securities and Exchange Commission
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File Number S7-14-11

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Regulations Division
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Washington, DC 20410-0500
Docket No. FR-5504-P-01

Re: Credit Risk Retention Proposed Rule

To Whom It May Concern:

The Housing Policy Council[1] ("the Council") is pleased to respond to the proposed rule on risk retention. It is supportive of efforts generated by the agencies to implement sec. 941 of the Dodd-Frank Act, a proposal designed to ensure that originators engage in prudent underwriting of residential real estate mortgage loans. The Council recognizes that there are other kinds of securitization covered by the section and by the proposed rule, but its

[1] The Housing Policy Council of The Financial Services Roundtable consists of thirty-two of the leading national mortgage finance companies. HPC members originate, service, and insure mortgages. We estimate that HPC member companies originate approximately 75% and service two-thirds of mortgages in the United States. HPC's mission is to promote the mortgage and housing marketplace interests of member companies in legislative, regulatory, and judicial forums.

comments are limited to those associated with residential real estate. The Financial Services Roundtable will submit a separate letter on risk retention for other types of assets.

The proposed rule is a complicated one, and presents the Council with two distinct options for comments (two proposed definitions of Qualified Residential Mortgages). We share with the regulators a belief that there is a need for supporting the participation of securitizers and investors in the mortgage market in order to enhance liquidity for residential mortgage finance, and as we have noted, also support the need for providing reasonable and affordable mortgage finance that is based on prudent underwriting.

If the intent of the regulation is to focus on the need to provide risk retention on many loans, some conservatively underwritten and some more aggressively underwritten, we believe our comments in Section I below provides a method for achieving that while providing sufficient liquidity to ensure a well-functioning secondary market in both segments. Elimination of the premium capture cash reserve account is necessary to accomplish those goals.

On the other hand, the intent of the proposed rule may be to ensure affordable, prudential lending and address risk retention by banning nontraditional product types and aggressively underwritten loans that present additional risks. While we recommended two options for protecting risk retention without the use of a premium capture cash reserve account, you may choose to accept neither of those options. Maintaining that portion of the rule will effectively eliminate a non-QRM securitization market, and the increase in interest rates would be substantial. If the agencies keep the premium capture cash reserve account as is, we propose an alternative definition for QRM, which is detailed in Section II.

<u>Summary of our Section I and Section II Recommendations</u>

HPC supports the goal of the proposed rule to strengthen the origination and securitization process for residential mortgages, but urges some substantive changes in the proposal.

Section I Recommendations Summary:

1) **Premium Capture Cash Reserve Account:** The highest priority is the need to change the premium capture proposal to one that acts in concert with the general risk retention provisions to ensure that appropriate risk is retained in a manner that will not stifle the development of a private label market. On that, we make two alternative recommendations:

   a) The amount of risk retained should be measured against the full proceeds of the sale, not against the par value, and the requirement for use of a premium capture account should be eliminated when that measurement is used, or

b) The requirement for a premium capture account should be removed in those cases in which the securitizer utilizes either the vertical slice or the random sample method of securitization.

While changes to the premium capture cash reserve account are our highest priority, we would also strongly urge the agencies to make the following modifications:

2) **Definition of QRM:** Adopt all aspects of the recommendations of the Alternative proposal found in Subpart IV E of the Supplemental Information.

3) **Servicing Standards:** Remove the servicing provisions in this rule and utilize other methods for creating a uniform national servicing standard.

4) **Commingling of QRM and non-QRM loans:** Modify the rule to permit commingling of QRM loans and non-QRM loans within a single securitization without the loss of the QRM exemption only for the loans that are QRM qualified.

5) **Duration:** Terminate the risk retention period 48 months after security issuance.

If the recommendations in Section I, number 1 (a) and (b) are not implemented, then the Council has an alternate recommendation that is detailed in Section II.

Section II Recommendations Summary:

1) **QRM Definition Should Be Equal to QM Definition:** Modify the Rule to allow the QRM definition to reflect the definition Congress created to ensure prudently underwritten loans.

2) **Servicing Standards:** Remove the servicing provisions in this rule and utilize other venues for creating a uniform national servicing standard.

3) **Duration:** Terminate the risk retention period 48 months after security issuance.

A more detailed discussion of these recommendations appears below.

General Discussion

We appreciate that the regulators have been given broad authority in sec. 941 of the Dodd-Frank Act to implement the statutory language in order to provide alignment between mortgage originators, securitizers and investors, and to encourage the origination of prudently underwritten residential mortgage loans. We share those goals, and believe that our recommendations will assist in achieving those goals.

The proposed rule has provided an option by which Fannie Mae and Freddie Mac can satisfy the risk retention requirements they otherwise would have in their role as a sponsor as long as they are in conservatorship or receivership and fully guarantee timely payment of principal and interest on mortgage-backed securities they issue. Similarly the rule (as directed by the statute) makes an exemption from risk retention for Federal Housing Administration (FHA) loans. We are sympathetic to the concerns that motivated the agencies to craft the rule in this fashion, and are not recommending that this aspect of the rule be changed at this time.

Nevertheless, it is essential to recognize that the Government Sponsored Enterprises (GSEs) and FHA will receive a competitive advantage by not having to retain risk on securitized loans. That advantage may lead to a further stifling of the recovery of a private mortgage securitization market and continue dependence on the GSEs and the FHA to support a secondary mortgage market. Our estimate, for example, is that the rule would increase the market share of FHA, and while it is hard to be precise, we believe the increase in the share would be significant as a direct result of promulgation of this rule. As the GSEs leave conservatorship, and as their scope is reduced, there is a danger that the market will become increasingly dependent on the FHA.

In that environment, we request the agencies to promptly create a plan that will reduce the amount of new originations in FHA. Every effort should be made to target FHA's portion of the loans to be no more than 10 or 15% of the total market. We would urge that the steps the agencies conclude must be taken, as well as the timing of when these steps will be taken, be published and comments requested from the public.

We believe it is important to analyze the impact that changes in underwriting standards have upon loan default rates and the quantity of loans that would fall within the QRM. We also believe that the agencies should focus on an additional metric. While movement in the volume of QRM loans based on movements in one or more factors is important, and while the ever 90 day delinquency rate realized by reviewing movement in different standards is also important, the key determinant should be the relative movement in volume as a function of the change in the ever 90 day delinquency rate, or said the other way, the relative movement in the default rate as a function of the movement in the size of the QRM loans available. The key to the decision as to what standards to adopt to create an appropriate size QRM pool, and what is the appropriate ever-90 delinquency rate for such loans must involve consideration of the relative movements of those two factors. While the FHFA review was thorough on what it covered, it does not appear to have provided the agencies with the further criterion to consider – namely, while a 1% default rate might be a relevant target, what is the change in the QRM volumes as changes are made in the different requirements in the rule. If moving the default rate to 1.1 instead of 1.0 increases the QRM pool by 5%, that relative movement is a reasonable basis upon which the agencies could base their decisions.

With respect to liquidity and the questions throughout the rule on that subject, we share the desire of the agencies to have liquidity both in the QRM pool and the non-QRM pool. We are not persuaded, however, that we can confidently say the two pools into which all mortgage loans are divided under the rule will lead to sufficient liquidity in either or both pools either now or over time. We cannot predict whether the pools will be large enough to produce a liquidity premium. Without liquidity, the securities produced by the pools will not be competitive. More important, if the pool is not large enough, securitizers will be unable to securitize quickly enough to create a mass large enough to issue securities, thereby adding to lenders' cost and in turn to consumers' cost. In addition, small pools result in odd lots of loans, and that in turn also adds to costs. We think that a better approach would be to try to make the liquidity of each of the pools, whatever size they might turn out to be, more effective by permitting comingling of QRM and non-QRM loans within a single securitization with QRM loans retaining their risk retention exemption. We believe that can be done without misaligning the interests of the investors, securitizers and originators. A more complete explanation of this concept appears in our more detailed recommendations.

We also would like to call to the attention of the regulators two inconsistencies between the risk retention proposal and that of the Qualified Mortgage proposal (Regulation Z; Docket No. R-1417, RIN No. 7100 AD 75), published by the Board of Governors of the Federal Reserve System and to be finalized by the Consumer Financial Protection Bureau. The definition of fees in the risk retention rule differs from that in the Qualified Mortgages rule. Ensuring that the definition will be identical in the two rules will reduce costs, avoid errors and create certainty in the standard, all to the benefit of the consumer. Similarly, the date at which the maximum interest rate is measured differs between the two rules, one being 5 years after consummation, and one being 5 years after the first periodic payment is due. Clarity and certainty will be promoted if those definitions are harmonized.

If this regulation is adopted as proposed, including the existence of the premium capture cash reserve account, some lenders will be prepared to make some non-QRM loans and hold them in portfolio, and some will make them and sell them to Real Estate Investment Trusts (REITs). It may be that these rules might lead to a major growth in REITs since they will be generally unaffected by the rule. One cannot predict at this time what the face of the market will look like either immediately upon the effective date of this rule or after the GSEs are phased out of their current dominant position.

HPC appreciates that the crash in the housing cycle was caused, in part, by declines in underwriting standards and by some excessive and unrestrained use of the securitization markets. We understand and support the goal of Congress and the regulators to take steps to strengthen underwriting standards and to strengthen accountability in the securitization process. Our comments are intended to ensure the proposed risk retention regulation and QRM definition helps achieve those goals, without hampering the overall mortgage lending market.

Section I—Specific Recommendations

1. Premium capture cash reserve account (See request for comments 12, 82-85)

The premium capture reserve account proposals would create severe impediments to securitizations and adverse consequences for borrowers. We believe that it would add substantially to the rates of non-QRM loans and in doing so would effectively eliminate private label securitization in that market and the economic and social benefits that follow from it.

The premium capture cash reserve account provisions proposed by the Agencies (§ ____.12) would require the securitizer to place in an account at issuance all "premium" received in the transfer of assets into a securitization. In addition to requiring securitization sponsors to place the proceeds in excess of par from the sale of any premium or interest only securities in a cash reserve account if the sponsor retains a senior I/O piece, rather than selling it, the sponsor must also account for the value of that piece in funding the reserve account. The account would be subordinated to all other interests in the securitization (including an eligible horizontal residual interest), could only be invested in a limited range of permitted investments and would have to remain in place for the entire term of the transaction except to the extent used to satisfy losses.

The Agencies, in proposing the premium capture reserve account, have attempted to address a concern that "a sponsor could effectively negate or reduce the economic exposure it is required to retain under the rule." In other words, the Agencies are concerned that the primary goals of the risk retention rule—to encourage improved underwriting standards and heightened due diligence in selection of securitized assets, to create greater alignment of interests between the transaction sponsor and investors, and to reestablish the market for private label securitizations by restoring investor confidence—may be undermined if sponsors are allowed to structure deals so that the risk retention is illusory. Although we appreciate these concerns, and in this letter suggest alternative ways of addressing them, we do not believe that the premium capture cash reserve account is appropriate as proposed. In attempting to eliminate a perceived source of potential evasion of risk retention requirements, the Agencies have proposed a mechanism that is vastly over-inclusive and will prevent transactions that would otherwise have had meaningful risk retention and alignment of interests under the Agencies' other proposals. It will create logistical challenges and inadvertent consequences for transactions it was not intended to include, and will increase the cost and decrease the utility of securitizations generally, consequences that will then be borne by consumers.

Where the premium capture reserve account provisions apply, they would add a significant additional risk retention element for securitizations and fundamentally change the economics of these transactions. More likely, however, they would change the terms of the underlying loans, requiring borrowers to pay more in upfront fees and points because the capital markets tools and efficiencies utilized by securitization sponsors are effectively prohibited by this rule. In the context of Residential Mortgage Backed Securities (RMBS), contrary to other policy concerns, these provisions would discourage a movement away from reliance on entities such as Fannie Mae and Freddie as the key purchasers of loans.

Section 941 does not require, or even contemplate, the type of premium capture reserve account proposed by the Agencies. There is nothing in the statute or the legislative history that indicates that Congress intended to fundamentally change the economics of securitizations in ways other than through the retention of credit risk, nor that Congress believed a proposal such as the premium capture reserve account would be necessary to prevent evasion of the risk retention requirement. In attempting to ensure that sponsors hold a true 5%, the premium capture cash reserve account ensures that securitization sponsors will always hold well in excess of the congressionally mandated 5%. We urge the Agencies to reconsider this part of the proposed rule. At a minimum, we believe the total risk retained in any securitization issued in compliance with the rule should not exceed 5% of the credit risk in the securities, and any sort of premium capture reserve account should be narrowly tailored and structured as part of that 5%, rather than as an addition to it.

The rule mandates that a specific amount of risk is retained by the sponsor to ensure the originator underwrites loans prudently. Certain exemptions from risk retention are created for very low or no-risk loans, and through this process, the expectation is that the rule will align the interests of consumers, lenders and investors, while rejuvenating the private label securities market.

However the likely result should the premium capture account provision be retained as drafted, is that the private label securities market will be chilled rather than jump-started, that the GSEs and FHA will out-execute any private securitizer for whatever securitizations they choose to solicit, and origination of non-QRM non-agency loans will give way to portfolio lending or sales directly to unregulated REITs. While some would argue that would be prudent, none would deny that such a result would lead to a continued dearth of private label mortgage securitization. Removing the securitization tools meant to capitalize on natural market efficiencies will result in a continued scarcity of private label securitizations and less credit for that segment of the economy, higher prices for mortgages, and fewer mortgages.

<u>Identifying a "premium" in a securitization involves more than just comparing the net proceeds of the securitization to the face amount of the securitized loans, and the proposed formula therefore will lead to deeply flawed results that will harm the securitization markets, lenders and borrowers.</u>

The economics of loan origination, loan transfer, and securitization are complex. When a lender originates a mortgage loan, for instance, a number of different factors are reflected in the pricing of the loan beyond the credit risk of the borrower and the value of the collateral. These factors include whether the borrower has elected to obtain an interest rate lock; whether the borrower paid closing costs and fees at origination; whether the borrower has chosen to roll those costs and fees into the principal balance of the mortgage loan, or has elected to pay those costs and fees over time through a higher interest rate on the loan; necessary lender overhead allocations; and whether the borrower has bought down the interest rate on the loan by paying points to the lender.

Here is an example. Assume that a borrower is buying a house for $100,000 and paying a 20% down payment, or $20,000, leaving a loan of $80,000. Assume also that the closing costs and fees are $3,000 and that there are necessary originator overhead and originator profits. Assuming AAA private label mortgage backed securities with a 5%

interest rate trade at "par" and both rating agencies and investors assume literally no credit risk associated with this loan, and the borrower pays all closing costs, originator overhead, and originator profit in cash at closing and their loan is securitized that day. The borrower can take out an $80,000 mortgage with an interest rate of 5%.

Because of macroeconomic events and unavoidable life events such as death and illness, literally no loan can be converted into a 100% AAA security that would trade at "par." In the current market, conventional 30 year fixed rate loans with FICO scores close to 800, with 30% down payments, and a debt-to-income (DTI) in line with QRM requirements result in securities where close to 10% of the securities are less than AAA and trade well below par. By way of example, assume the same borrower's loan would result in two securities, one AAA security representing 90% of the loan (or in this case $72,000 = $80,000 x 90%) and one non-AAA security representing 10% of the loan or $8,000 ($80,000 x 10%) in this case. If the AAA will sell for "par" or 100 cents on the dollar and the non-AAA security will sell for 70 cents on the dollar, an originator securitizing this loan will only yield $77,600 ($72,000 x 100% + $8,000 x 70%). Obviously, securitization cannot support this loan as is. Therefore, the borrower needs to pay the originator $2,400 (the cost of the borrowed credit in the capital markets) in addition to the closing costs, originator overhead and profit noted above to support this loan.

The efficiencies of the capital markets and securitization historically have afforded borrowers another option. Because interest only securities sell for multiples of their coupon rate (anywhere between three to five times their interest rate), the cost of credit noted above, as well as any closing costs, originator overhead and profit could be easily financed via a modest increase in rate. Continuing on the example above, the $2,400 cost of credit plus $1,000 in originator overhead and $1,000 in originator profit equals $4,400 or 5.5% in points and fees. Assuming that interest only securities currently sell for four times their interest rate then this borrower needs to only pay an additional 1 and 3/8% (1.375%) annual percentage rate (APR) to finance these costs, so if base rate is 5%, pay 6.375% which would result in an increase in monthly payments for the borrower from $429.4 per month to $499.10 per month (a 16% increase in monthly payment). In sum, the borrower can pay an additional $4,400 at closing in addition to their $20,000 down payment and closing costs or pay an extra $69.64 per month while the loan is outstanding.

From the perspective of the borrower, the trade off is in the cost of up front points and fees versus the cost of the increased rate. The borrower receives the option of paying over time rather than immediately. Most importantly, points and fees paid at closing act as a prepayment penalty and a disincentive for borrowers to refinance into a lower, more affordable rate or loan product. In our example, because the $4,400 would be non-refundable but the $69.64 in additional monthly payments would only be owed when the loan was outstanding, paying the cost at closing would act as an artificial prepayment penalty for more than 5 years ($4,400/69.64=63 months)

Alternatively, assume the lender provides a rate lock to the borrower at the time its application is approved and enters into a concurrent hedge against its own exposure to rate movements. If the value of the loan goes down, the value of the hedge will go up; but conversely, if the value of the loan goes up, the value of the hedge will go down. If the increase in the value of the loan is treated as a "premium," notwithstanding the concurrent loss on the hedge, and is required to be captured in a reserve account, the lender will not receive the return it needs from the sale to offset the loss on the hedge. Restructuring the securitization to avoid monetizing this amount at closing does not resolve this issue, because the loss on the hedge will be immediate and the offsetting gain on the loan will have been transformed into an at-risk, long-term investment in the securitization. In other words, the premium capture provisions will have not only have negated the benefits of the hedge, but will have arguably made it completely uneconomical. In sum, the premium capture cash reserve account provision will make it cost prohibitive to rate lock borrowers.

Similarly, if a sponsor of a securitization wishes to include in the securitization loans that it did not originate that are trading at a premium, it will not be able to do so, because the premium it pays to acquire the loans will be trapped in the reserve account or in the transaction as an at-risk, long-term investment. For instance, if the securitization sponsor buys the borrower's loan from the originator in the first example for $84,400, thus allowing the originator to recover the fees and costs it included in the rate, the sponsor cannot monetize the extra $4,400 from the higher rate—even though it is out of pocket for those funds. That sponsor ends up holding more than 5% risk retention, notwithstanding that the 5% risk retention it would otherwise hold is in no way diminished by monetizing that $4,400. These types of issues make the proposal fundamentally unworkable.

<u>The premium capture reserve account may lead to additional up-front points and fees for borrowers that would otherwise have been included in the loan rate and may increase the barriers to home ownership and reduce the availability of mortgage loans.</u>

The economics described in the previous section will change the options available to a borrower if the lender wishes to securitize the loan or to sell it to another party that may securitize it. For example, a lender may decide not to make rate locks available if it cannot then hedge its own interest rate risk in an economically feasible way. A lender may also require the payment of fees and costs at origination rather than allowing the markets to provide the borrower with the option of paying via a modest increase in rate. Overall loan pricing will increase to reflect the increased costs of retaining significant exposures within securitization, or as a result of reduced availability of the securitization markets as a source of capital and liquidity for mortgage loan origination.

The financial position of many consumers, as well as the definitions in the Qualified Mortgage proposed regulations will limit the amount of fees or points they are able to pay. Obtaining required down payments has always been a hurdle for borrowers, and may well be a greater hurdle in the mortgage financings of the future, in which QRMs will require 10-20% down payments, FHA likely will increase the size of down payments it will require and more conservative lending standards may extend these changes to the broader market. If lenders increase upfront fees and costs, or reduce the availability of options to incorporate those fees and costs into the terms of the loan, that will further add to consumers' burden. In addition, other provisions in the Dodd-Frank Act limit the points and fees that can be charged without causing a loan to be defined as a high cost mortgage, the kind of mortgage that most lenders avoid financing. The combination of these considerations may prevent some consumers from obtaining mortgage loans for which they otherwise would have qualified.

If securitization sponsors can only obtain reasonable profits by requiring additional points up front, not only will some borrowers be unable to assemble the cash needed at closing, some that will be able to do so will be disadvantaged when they refinance or move. In addition, consumers may lose the option of using certain channels. Small lenders may find it takes a lengthy period of time to assemble sufficient loans in these conditions to go to market, and during that time must carry the risk of the entire book of loans on their balance sheet. That may prove too much of a cost to many smaller lenders, and the result to the consumer will be the reduction in choices available to them.

In addition, the capital market tools used to afford the financing options shown in the above example whereby a borrower is able to affordably finance various costs via a premium rate are effectively abolished by the premium capture cash reserve account. Senior interest only mortgage bonds trade for multiples of their interest rate because of their seniority. Subordinating this cash flow to the lowest possible position within the securitization (the only option offered by the provision) causes it to trade at pennies on the dollar thereby eliminating this capital market efficiency. Further, allowing the originator to sell or retain a senior interest-only mortgage bond, but then forcing the securitizer to fund a low yielding (US Treasury instruments) high risk reserve account with all of the proceeds or estimated proceeds from the sale or retention, eliminates this tool as well. This rule, combined with the current 3% cap on points and fees in the QM definition will result in many borrowers being unable to obtain financing at all, because neither increased rate, nor points and fees will be an alternative for funding their cost of credit, closing costs, originator overhead and other expenses typically captured in premium rate or in cash at the time of closing. This is especially true for low to moderate income borrowers as fixed closing costs are a greater percentage of their smaller loan balances.

<u>The costs of holding the interest in the premium capture spread account would make such a position unworkable.</u>

The present value of an investment is reduced when the investor bears additional risks or the expected repayment date is extended. For mortgage loan securitizers, the premium capture reserve accounts would both increase the risk of return on the securitized loans and extend the period before returns would be achieved, thus significantly reducing the anticipated yield on their investment. Lenders will need to compensate for this reduction by charging the consumer additional fees or by charging an even higher rate to the consumer to justify the risk and time value associated with the delayed return of all premium on the loan. Originators include both overhead costs and borrower specific costs in the consumer rate. Not allowing securitization to release these costs that have been reflected in the loan rate will eliminate this consumer friendly tool outlined above. Fixed lending costs borne by the borrower over time through the rate increase are more cost effective for consumers, and allow the borrower to bear these costs only during the life of their loan, rather than paying all of them regardless of the actual life of such loan. Certain regulators have in the past discouraged the front-loading of fees, and new provisions of the Truth in Lending Act, as modified by the Dodd-Frank Act, specifically preserve "a consumer's ability to finance, at the option of the consumer, including through principal or rate, any origination fees or costs permitted under this subsection." The premium capture account seems in direct conflict with these goals.

These concerns also carry through to the securitization itself. In a securitization structure with different tranches of risk, the yield to the investors in each tranche reflects the risk of that tranche. In other words, senior tranches bear low interest rates while deeply subordinated tranches earn significant yields to compensate them for the greater risk. The proposal for the premium capture account reverses that paradigm. In addition to trapping funds in the transaction, it requires those funds to be invested in low-yielding investments and restricts the ability to reduce the interest in the account over time. The value of the account, in these circumstances, would be far lower than the value of the funds that were placed into it, meaning that it would constitute an uncompensated transfer of value to the securitization investors in a way that may not consistent with safety and soundness of the sponsor. Alternatively, the cost will again be passed through to the consumer. Neither outcome is desirable.

<u>The increased amount of risk retained in excess of that required under the other risk retention provisions of the rule may require the securitizer to consolidate the transaction on its balance sheet.</u>

Retention of the risk of loss in an asset transfer is a critical element in determining whether the transfer of financial assets meets the conditions for sale accounting treatment and determining whether the transferor must consolidate the variable interest entity to which it has transferred its assets as the "primary beneficiary" of that entity. Recent changes in the financial accounting standards for transfer of financial assets and consolidation of variable interest entities have made it increasingly difficult for transferors to deconsolidate transferred assets. Retaining such assets on balance sheet, however, can have significant implications for regulatory capital purposes, financial covenant compliance and other aspects of financial accounting that would further alter the economics of securitization and reduce the availability and increase the cost of credit.

Furthermore, the requirement to retain a first-loss position, coupled with the 5% additional risk retention that would be required through other provisions, will at least put significant pressure on the true sale analysis for the transfers and may preclude opinion-level certainty as to whether a legal true sale has occurred. A legal true sale is essential to "delink" the rating of the securitization from the rating of the sponsor. If a legal true sale cannot be achieved, it will be impossible for all but the highest-rated sponsors to obtain ratings high enough to justify the cost of securitization, effectively eliminating residential mortgage securitization as a funding tool for nearly all market participants. We do not believe that is the intention of the provision, but the possibility that the provision leads to this conclusion is a real one and should not be ignored by the agencies as they consider whether or not to include the provision in a final rule.

It is possible that the basic 5% risk retention requirement, if properly structured, could be met in a way that would not be inconsistent with sale accounting treatment or require consolidation of the transferee entity. The proposed premium capture reserve account, however, would change that analysis by significantly increasing the transferor's interest in the transferred assets and eliminating the ability of the transferor to avoid holding the first-loss position. To the extent that this approach would require recognition of assets that would otherwise be derecognized, the costs of the securitization would increase even beyond the cost of the additional risk retention.

We urge that the agencies reconsider this part of the rule and that at a minimum they ensure that the total risk retained in any issue under the entire rule combined does not exceed the amount proposed in Subpart B, section___3(a), namely 5% of the credit risk in the securities. We think that can be done in a variety of ways. We would recommend either of two ways.

Recommendation: Use market value rather than par value and eliminate the requirement of a premium capture account.

The rule uses par as the value for determining the appropriate risk retention. Par value, however, may not equate with the price at which the securities are sold - that is market value. Appropriate risk retention should be measured by market value of the credit risk portion of the bonds.

Such risk should not include the costs associated with securitizing the loans or with the fees that borrowers have paid in the form of increased rate. On the other hand, if a loan is a subprime loan, then the additional interest rate above par is at least in substantial part associated with the increased credit risk that is in the loan.

The appropriate way to address risk retention, therefore, would be to charge the 5% risk retention on all parts of the transaction that are associated with risk, but not to charge them for interest rate that is associated with recoupment of costs. The premium capture account, if utilized at all, should be utilized to retain risk against the appropriate credit in the rate increment above par at sale.

The easiest method for doing that would be to simply mandate 5% retention of the total proceeds of the sale of the bonds and delete the provisions relating to the premium capture cash reserve account. It is not totally accurate because there will be some risk retained against amounts that recoup costs, but that is an error on the side of retaining more risk than required. It has the additional merit of being easily administered and easily audited.

The key difference between this and the proposed rule is that the additional risk retained against the difference between par and market value is 5%, not 100%. That is consistent with the purpose of the rule so is a useful correction that assists in aligning interests and ensuring prudent underwriting. Under this model, it will not be possible for securitizers to manipulate tranches to avoid risk retention.

Finally, the rule has also imposed additional disclosures on sponsors, including a requirement that the sponsor disclose in writing the material assumptions and methodology used in determining the aggregate dollar amount of asset backed security (ABS) interests issued by the issuing entity in the securitization. Such disclosures will assist in valuing amounts retained in excess of the required risk retention should that occur.

Recommendation: Permit use of vertical slice or representative sample option without requiring a premium capture account.

As an alternative to the elimination of the premium capture account we urge the regulators to exempt from the requirement of the use of the premium capture account those instances in which the vertical option or the representative sample option for retaining risk are used.

The concern expressed by the regulators is that the securitizers can manipulate the process so that they effectively dilute the effect of the other risk retention rules in the proposal. That cannot be done if the securitizer holds the risk in a vertical slice. The securitizer holds 5% of each slice, pari passu with the entire deal, so there is no way to manipulate the holdings to dilute the retention. Similarly, the process by which the random sample is selected and held protects against any manipulation, so that option does not permit securitizers to reduce the effective risk retention. Absent the possibility of manipulation, there is no overriding reason for using the premium capture account.

Therefore, we would urge that the regulators modify the premium capture cash reserve account provisions to remove the requirement of retaining such an account if the securitizer uses the vertical slice or random sample option for retaining risk.

2. Underwriting standards (See requests for comment numbers 12, 120, 123, 143-49)

The Housing Policy Council has reviewed the definition of QRM in the proposed rule and the scope and coverage of the standards that are mandated to permit a loan to qualify for the QRM risk retention exemption. Based on its review, and the separate reviews of many of its members companies of their own data, HPC cannot conclude that the size of the QRM pool resulting from application of the proposed rule would be sufficiently large to ensure efficient securitization of QRM loans. We recommend, therefore, that the agencies not adopt the standards in the proposed rule and instead adopt the Alternative proposal to move the percentage of loans that are QRM and those that are non-QRM toward the goal of creating a balanced market of roughly 50% each for QRM and non-QRM loans.

We do not come to this conclusion lightly. The final regulation establishing the QRM standard will have a significant impact on the mortgage market. We also recognize that certain standards effect the definition more than others, and that some segments of the society will be adversely affected more than others under different scenarios. There are differing views on the appropriate criteria for QRM from many stakeholders in the mortgage market and among our own members. For example in trying to determine the appropriate underwriting standards to ensure that loans that qualify for the QRM meet high standards that minimize the risk of default, there are differing views on what underwriting criteria are most reliable and determinative There is the view held by some of our members that a loan-to value (LTV) should not be considered as a standard, but others firmly believe that consideration of LTV is not only consistent with good underwriting but that an 80% LTV is an appropriate one for QRM loans based on the purposes of the rule.

After consideration of all aspects of the proposal and its effect on the housing market, the Housing Policy Council has arrived at its recommendation believing that it best balances legitimate objectives and makes the QRM rule as effective as possible. To this end, the Housing Policy Council believes the regulators should adopt the Alternative proposal, including of course the requirement for the use of mortgage insurance or other credit enhancement to move the LTV from 80% to 90%.

We have reviewed individual loan files in the CoreLogic servicing dataset of about 49 million loans originated from the years 2001-2010. We did not include loans that would fail the Qualified Mortgage test such as interest only loans, balloon loans, negative amortization loans, loans with maturities longer than 30 years, and loans that did not have full income verification. We felt theses were loans that would not be widely originated in the future since they fail to meet the standards of Qualified Mortgages and hence risk creating substantial liability for originators and securitizers. We used a FICO score of 690 as a proxy for the credit standards in the rule, as the Federal Housing Finance Agency did in their analysis.

Based on that data base and those assumptions, we ran programs covering individual years over the period 2001 - 2010 designed to determine the size of the pool of Qualified Residential Mortgages under different conditions and the default rate for those loans. We then ran programs designed to discover the size of the pool and default rate of Qualified Residential Mortgages if the Alternative underwriting standards were adopted.

Based on those runs, we discovered that the size of the QRM pool under the proposal for the entire 10 year period would be 25.1% of the total loans in our sample, and the expected default rate would be 0.81% utilizing the period of review as 2001-2008. For 2010, an unusual year but the most recent for which we have data, the QRM market share under the proposal would be 39.4%, but the loans originated in that year have not matured sufficiently to ascribe a meaningful default rate to them.

Under the Alternative underwriting standards, the size of the QRM pool over the 10 year period would be 33.3% of the total loans with an expected default rate for the period

2001 - 2008 of 1.02%. For 2010, the QRM market share under the Alternative would be 53.5%.

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Default Rates

	QRM	Alternative Approach
2001	0.48%	0.66%
2002	0.36%	0.48%
2003	0.39%	0.50%
2004	0.72%	0.88%
2005	1.49%	1.73%
2006	2.11%	2.47%
2007	1.94%	2.52%
2008	0.64%	1.00%

Total	**0.81%**	**1.02%**

QRM Market Share Adjusted for QM

	QRM	Alternative Approach
2001	21.2%	29.1%
2002	27.7%	36.3%
2003	28.8%	37.6%
2004	18.6%	23.9%
2005	17.2%	22.0%
2006	17.7%	22.7%
2007	18.8%	25.3%
2008	25.4%	37.5%
2009	39.8%	55.2%
2010	39.4%	53.5%
Total	**25.1%**	**33.3%**

Other companies ran proprietary programs to test whether on the basis of their individual confidential company data the results would be the same, and a number of companies that ran the data confirmed that their results were consistent with these results

The data can be viewed in a number of different ways. In considering what standards to mandate, the agencies should consider the size of the pool of QRM loans and the size of the pool of non-QRM loans that a particular set of standards would create. Successful securitization depends upon a pool of securities large enough to obtain a liquidity premium, and absent that, they will price themselves out of the market and deny consumers the benefits of the efficiencies of securitization. Exactly how large that pool needs to be is very difficult to quantify, but to the extent that the standards create too small a pool in either the QRM or non-QRM sectors, securitization as a whole will suffer. The result of that will be expansion in portfolio lending with its strengths and limitations.

The Alternative proposal does not increase the default rate beyond what would be a very low rate. While no data is available for the very newest loans, lending during the past two years has been based on conservative underwriting standards, and therefore low default rates can be expected. Even assuming the longer period 2001 - 2008, the default rate of the Alternative proposal was only 1.02%.

As stated above, HPC believes that the preferable goal for initiating the QRM risk retention standards should be in the area of 50-50, recognizing that over time and with changing market conditions, those percentages will change. What is 50-50 now might become 40-60 or 60-40 in a few years. At a split of approximately 50-50, those inevitable changes can better be accommodated than beginning with a split of 30-70, heavily tilted to QRM or non-QRM.

The Housing Policy Council has considered these results and individual company results have run their own data to attempt to discover the impact of the rule and possible changes in the rule.

As a result, HPC has concluded that the risk of creating illiquid markets using the proposal as the standard is substantial. A percentage share in the 30% range is sufficiently low and the market may not be able to provide the liquidity premium to issues in that range.

We believe that a range that is closer to 50-50 will be the safer route to take. That range we believe can be approached by utilizing the Alternative proposal as the standard for QRM exemption going forward. We appreciate that this percentage will change as time passes and as the economy and the markets themselves change, but it is a better place to begin than at a more unbalanced level.

Most important, and as a subject for further consideration by the agencies, we believe that the current economy and conditions in the housing industry, as well as the positioning of both the GSEs and the FHA create an untenable situation.

As we said earlier in this letter, we believe it is crucial that the agencies recognize that this rule will expand the role played by the government, with all the attendant consequences that brings. We also said that we do not recommend that the exemption provided to the GSEs be changed at this time. But it is crucial that the agencies make a statement that this expanded role is not the expected role the government will play going forward.

For example, we urge the agencies to promptly publish a schedule of changes that are anticipated and the time table for such changes designed to reduce the market penetration of the FHA. Taking the first steps to moving the FHA market share to the more normal 10-15% is very important.

The agencies could change FHA loan limits, pricing, underwriting and quality control standards. They also could, for example, recommend that the FHA reinsure some of its insurance obligations with the private sector. The private mortgage insurance industry has the capacity and the skill set to immediately engage on such an activity, and the FHA has both the authority and the need to do so.

There are other steps that could be taken, and calling for a full discussion of the issue and establishing schedules and time lines is eminently reasonable at this point, and in particular doing so closely in conjunction with the promulgation of this rule which moves in the opposite public policy direction would be desirable.

Recommendation: Adopt all aspects of the Alternative underwriting standards.

3. Servicing standards in the mortgage documents (See request for comments 125, 130, 133, 139, 140)

You have asked a series of questions about the addition of mandatory servicing standards in the regulation. As a general response to those questions, HPC feels strongly that servicing standards are inappropriate as part of the QRM definition, and especially misplaced as part of the mortgage documents. Instead, HPC believes the appropriate federal regulators should develop strong and uniform servicing standards applicable to all servicers and all residential mortgages independent of this rule, and avoid adoption of a document-based, fragmented approach to servicing.

Together with investors and counseling agencies, our members have created guidelines and model forms and processes for many features of the servicing process, and in particular the servicing of non-performing loans. They have created HOPE NOW, an alliance that is designed to assist homeowners in distress, and to create joint efforts with other entities, including the Federal government, of standardization on forms and processes. Our track record is clear that we support uniform standards for servicing non-performing loans.

We do not believe that Congress intended the agencies to use the risk retention rule as the vehicle for creating uniform standards of mortgage servicing. Section 941(B) of Dodd-Frank directs the regulatory agencies to define the term "qualified residential mortgage . . . taking into consideration underwriting and product features that . . . result in a lower risk of default." Servicing standards simply are not underwriting or product features; the only way they could be considered product features is by forced inclusion as terms in the mortgage documents. Moreover, there is no indication in the statute or the legislative history that Congress intended the regulators to create new product features, but rather we think it is quite clear and unambiguous that they authorized the regulators to examine existing product features "that historical loan performance data indicate result in a lower risk of default." Further, Section 941 (B) subsections (i) – (v) set forth specific items that should be addressed in the definition of QRM, none of which involve servicing standards and all of which clearly reveal themselves to be "underwriting and product features" that fall under the general rubric of one of three categories: (i) borrower characteristics; (ii) payment structures; or (iii) mortgage insurance.

Including the specific servicing standards selected creates major problems. The standards are made a part of the mortgage documents, and that introduces new obligations that are inconsistent with the generally accepted understanding of the purposes of mortgage documents. A note and security documents reflect a transaction in which the lender agrees to do a specific thing -- i.e., lend the borrower money -- and the borrower agrees to repay the money and preserve the value of the lender's collateral during the life of the loan. If the borrower does not repay, then the documents explain the consequences of that. The mortgage documents do not provide a right of action for the borrower since the lender has already done everything it was supposed to do -- lend the money. Inserting additional requirements beyond lending the money to the borrower changes the character of the note and mortgage.

In addition, adding servicing standards to the responsibilities of the lender in the note and mortgage will add layers of complications and reduce the uniformity and predictability of national servicing standards. The questions surrounding the mortgage and the note will be subject to state law interpretation, and notwithstanding that there will probably be a federal rule to determine if the words used to implement this rule meet the Sec. 15G standards, the question of state law will be appropriate as the words are viewed with respect to the note and mortgage. Mandating that these standards be in the note and mortgage could very well lead to a variety of different interpretations of their meaning.

It also will complicate future modifications the regulators might wish to make in the servicing responsibilities of lenders. Once the provisions as now drafted are in the mortgage documents, they are part of the contractual agreement between the parties, and the regulators do not have the authority to change those rights, notwithstanding that in the future they conclude that a contrary position on one or more parts of the rule might be better for consumers and lenders.

Just as important, including them in the mortgage documents provides plaintiff attorneys with a rich field of possible lawsuits to promote, either in defense of actions brought to enforce the note or as actions brought to expand the obligations undertaken by the lender. This creates another risk that must be considered by lenders in originating mortgage loans, or assignees in buying the mortgages, and the price of those litigation risks must be baked into the price of the loan. It will inevitably increase the price of loans.

That adds a further oddity to the process – a low-risk loan has in its price a charge to account for the cost of litigation risk, while the non-QRM, the loan which is, by definition, more likely to default, does not have that same risk. The effect of including servicing standards in the definition of QRM is that the safest, lowest risk loans have certain safeguards that the higher risk loans may not have.

There are a number of institutions that have recently entered into consent agreements with one or more federal agencies in which they agree to meet certain mortgage servicing standards. Reports are that as many as 50 additional companies also are being reviewed and may be asked to sign such an order. It is unclear how the more specific rules of the orders will align with the more general requirements of the rule. It is nearly inevitable that because they are not identical, they will at some point be in conflict, creating a confusing situation for regulators, the parties, or a court to unravel.

There is no need for that fragmented, confusing approach to regulation to be adopted. The Board of Governors, the OCC, the FDIC, FHFA, HUD, CFPB and Treasury are even now working on an interagency effort to develop a set of comprehensive nationally applicable mortgage servicing standards which take into account not only the issues in the standards proposed under the rule, but numerous servicing issues not addressed in the proposed rule. FHFA and HUD have an initiative underway to determine appropriate compensation arrangements for servicing both performing and non-performing loans. In these and comparable initiatives, the agencies can craft with the comments of interested third parties comprehensive rules applicable to all mortgages. We urge the agencies adopt that approach, since any other approach, including utilizing this risk retention rule as the base for servicing standards will lead to inconsistencies and confusion and gaps in coverage.

This rule is designed to ensure that risk is retained in securitization transactions, that certain mortgages are exempt from the risk retention provisions, and that all in the securitization process can through due diligence know that those standards have been met at origination. Exempt mortgages are determined by either exemptions clearly delineated in the statutes (e.g., mortgages guaranteed or insured by certain federal agencies) or by meeting the standards of underwriting in the definition of qualified residential mortgage.

Whether those standards have been met can be determined at the time of origination of the mortgage. Certainty exists at that point, although of course if the representation made about income or down payment turns out to be false, any protection of the exemption can be lost.

Compliance with the implementation of the representation that certain servicing standards have been established cannot be determined at origination. They can only be evaluated by reviewing the performance in the future should a loan become non-performing. There is no certainty of compliance with the servicing standards at time of origination. All parties dealing with the alleged QRM loan, therefore, would have to recognize that there is no certainty in that designation at time of origination or securitization since the test of qualification as a QRM can only be determined later when the loan becomes non-performing. Such uncertainty raises serious questions of the practical desirability of the exemption itself, and as described in more detail below, may raise questions of whether or not the loans can even be securitized.

This may be why there is no mention in the statute of how servicers in the future might deal with a loan that becomes delinquent. We suggest that there is no good public policy reason why the agencies should try to go beyond the clear directions of the statute to include an extraneous condition for any QRM loan - namely, how the servicer sometime in the future might deal with delinquencies on the mortgage - when there is a clear and better public policy tool to meet the same goals, namely the adoption by the agencies of a uniform national servicing standard.

In order for a private-label RMBS transaction to receive ratings higher than corporate debt ratings assigned to the seller of the mortgage loans into the transaction the sale of loans to the securitization trust must be viewed by the rating agencies as not being subject to legitimate challenge in a bankruptcy or insolvency of the seller. These determinations are made in reliance upon opinions from securitization counsel that a properly briefed court would respect the contractual provisions of the transaction documents characterizing the transaction as a sale of the mortgage loans to the securitization trust rather than as a financing secured by the mortgage loans. Such “true sale” opinions generally cannot be delivered if the transaction documents contain features providing for the repurchase of loans based upon contingencies other than breaches of representations and warranties relating to the characteristics of the loans at the time the related RMBS are issued. Transaction terms providing for the repurchase of loans upon the occurrence of credit events or other contingencies occurring after the date loans are sold to a securitization trust are particularly inconsistent with a "true sale" characterization of that transaction.

The inclusion of servicing standards in QRM loan documents would present a challenge to the "true sale" characterization of QRMs included in an RMBS transaction, not withstanding that the representation itself ostensibly can be verified at origination. As described in more detail herein, the failure to adhere to the servicing agreements or a court ruling interpreting ambiguities in the servicing agreements differently from the servicer's interpretation could call into question the QRM status of a loan at any time during its life as well as the validity of the representation. Because securitizers will be required to repurchase loans that are determined to no longer qualify as QRMs from securitization trusts that are exempt from risk retention, servicing events or court rulings regarding servicing practices could cause securitizers to be subject to repurchase obligations for entire pools. These contingent repurchase obligations may not allow law firms to conclude that a sale of mortgage loans has taken place or rating agencies to conclude that a transaction can be rated if it included QRMs, particularly because of the difficulty in interpreting some of the vague language in the servicing mandates of the rule. Even if law firms and rating agencies can conclude that a "true sale" has taken place for an RMBS transaction that included QRMs, securitizers may not be willing to issue RMBS transactions that are exempt from risk retention because of the repurchase risk created by the inclusion of servicing agreements in the QRM loan documents.

Investors and rating agencies also may be uncomfortable with the uncertain and untested impact that including servicing agreements in loan documents will have on borrower behavior and the enforcement of mortgage loans. To address this uncertainty, rating agencies may require that mortgage loans be repurchased upon the occurrence of certain adverse events relating to the inclusion of servicing agreements in loan documents, such as the filing of class action litigation or the filing of affirmative foreclosure defenses relating to the servicing agreements. Alternatively, they may require more credit enhancement for RMBS transactions that include QRMs. Investors may choose not to purchase, or demand higher yields for, RMBS transactions that include QRMs. These rating agency and investor reactions will offset some or all of the economic advantage a transaction that is exempt from risk retention will have over a transaction that is subject to the risk retention requirements and may cause transactions that include QRMs to be economically unviable.

There are serious ambiguities in the servicing standards. For example, left nearly open-ended is the requirement that servicing compensation arrangements be established and maintained that are consistent with the other servicing requirements. Viewed from the perspective of a lender, this language provides a difficult hurdle to clear in seeking a dismissal of a class action on summary judgment when there are no facts in dispute. The rule lacks any safe harbors for defendants in this situation and the terms in the rule have no fixed meaning. In this case, it may not be a stretch to say that nearly any arrangement can be challenged on some grounds.

There are other comparable ambiguities, such as "take into account other appropriate underwriting criteria," "addressing" the issue of subordinate liens, disclose to investors a "description of the procedures to be implemented," and referencing net present value but not defining it. The inevitable conclusion to which any lender would be drawn is that it must undertake substantial litigation and enforcement risk in making QRM loans that include the servicing mandates.

Recommendation: Delete the servicing requirements and utilize other efforts now under way to establish uniform national standards

4. Commingling QRM and Non-QRM loans in the same pool (See request for comments 12, 106-08, 110)

The American mortgage market has benefitted over time from securitization, and its benefits have been widely discussed. While there are many features to such a market, a crucial one is that the pool of loans from which a seller selects loans to be delivered be sufficiently deep that the process providing for the best sales execution, and lowest corresponding rate that may be offered to borrowers, can work. Therefore, liquidity, and the resulting liquidity premium that flows from it, is crucial to the creation of the most efficient residential mortgage market.

Obviously, one crucial factor in liquidity is that there is a large pool of mortgages from which to draw. Exactly how large a pool is necessary for an efficiently functioning securitization market is not easily calculated, but generally speaking, the larger the better.

The proposed rule divides all loans into two groups, one group composed of QRM loans and the other of non-QRM loans. While the market would support combining the two types of loans in one securitization, the benefits of the exemption from risk retention that the QRM loans carry is lost if that occurs, and the securitization would be priced, from a risk retention perspective, as though it were a securitization of non-QRM loans. The pricing advantage of the QRM loans would be lost.

Therefore, viewed from the environment prior to implementation of the rule, one large pool of loans is now subdivided, thereby reducing the size of the total pool. The depth of the pool is reduced, and two smaller pools are created.

Because of pricing concerns associated with the pools, and especially of the non-QRM pools, as well as the uncertainty of the government competition in that sector, it is very difficult to conclude that either or both of the two pools will be sufficiently deep to permit a sufficiently liquid market to function. If it cannot, then the consumers will be subjected to less credit and credit at higher prices. How much less credit and how much higher the cost are both unknown. That there will be less and that price will be higher is not unknown - they will be. The higher price will be embedded throughout the industry, so it will necessarily be passed on to consumers. If certain pools are illiquid, securitizers can be stuck with batches of loans without critical mass to sell or securitize and will need to charge a liquidity premium to compensate for this possibility.

One way to address the problem of liquidity for both the QRM and non-QRM loans is to permit loans from either pool to be used in a single issue with each loan carrying whatever risk retention provisions required by other provisions in the rule. Currently the proposed rule only specifically provides for exemptions from risk retention for pools backed by all QRM loans. As noted below, the Dodd Frank Act would permit commingling with an adjusted risk retention requirement. The regulators simply would need to provide for the specific mechanics of how the related risk retention would work. Without such a provision pools made up of mixed loans will probably not be assembled frequently and if they are, QRM loans will bear the non QRM loans cost of credit, and borrowers will bear the increased cost.

However, if the agencies were to permit the exemption from risk retention to remain on a QRM loan that is in a mixed loan pool, then such issues would be mitigated. What that would mean is that the depth of the pool from which issues would be drawn would be as broad as before the adoption of the rule, and therefore the necessary liquidity would be available.

Section 941(b) of the Dodd Frank Act requires the agencies to implement rules requiring a securitizer to retain an economic interest in a portion of the credit risk for a residential mortgage that it securitizes, and provides exemptions and exceptions only in certain prescribed circumstances. The proposed regulations seek to implement the statutory standards in 15 U.S.C. 78o-11(c)(1)(B)(i)(II) and (C)(iii), in part by establishing standards that require all of the loans in an issue that is exempt from risk retention be QRM loans or the exemption from retention of risk will be lost. (Subpart D___.15(b)).

There does not appear to be any legislative history indicating whether or not Congress intended to require risk retention for QRMs if they are commingled with non-QRMs in a single securitization. Legislative history is silent on the point.

Nor does the Supplemental Information articulate the public purpose served by the statutory language and the standard, but the assumption must be that it advances the general purposes of risk retention - namely, as articulated by the Supplemental Information in the Introduction to the rule – it "facilitates the flow of credit to consumers…on economically viable terms and is consistent with the protection of investors."

It may be the purpose is to avoid masking non-QRM loans in a securitization with QRM loans. The transparency required by the disclosures in the rule, however, can address that issue more directly and reduce the need for all of the loans in a securitization to be QRM loans if the exemption from risk retention for those QRM loans is to be applicable. See, for example, Subpart B___4(b).

The Act establishes many exemptions from risk retention. Many government agencies are exempt in a variety of circumstances, and loans that meet the definition of

Qualified Residential Mortgage are also exempt. The pool of loans covered by these exemptions is very large, even if the QRM pool itself is small, leaving the pool of loans available to the private label market considerably smaller than it otherwise would be.

The Dodd Frank Act does not limit its exemptions to just government agencies. It grants broad authority to the agencies to make exceptions in other circumstances provided certain conditions are met. The Act says that exemptions to the rules can be adopted if they help ensure high quality underwriting and improve the access of consumers and businesses to credit on reasonable terms, or otherwise are in the public interest.

In that provision of the Act establishing standards, Congress has directed the regulators to consider the public interest in establishing standards:

> The regulations prescribed…shall provide for a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors. (15 U.S.C. 78o-11(c)(1)(G)(i)).

In addition to that direction, Congress also provided broad authority to the regulators to make exceptions, exemptions or adjustments when they were in the public interest:

> The Federal banking agencies and the Commission may jointly adopt or issue exemptions, exceptions or adjustments to the rules issued under this section…. Any exemption, exception, or adjustment adopted or issued by the Federal banking agencies and the Commission under this paragraph shall (A) help ensure high quality underwriting standards for the securitizers and originators of assets that are securitized or available for securitization; and (B) encourage appropriate risk management practices by the securitizers and originators of assets, 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. (15 U.S.C. 78o-11(e)(1)and (2)).

The prohibitions found in 15 U.S.C. 78o -11(c)(1)(B)(i)(II) and (C)(iii), therefore, are not without possible qualification. If it is in the public interest to do so, and doing so does not violate other provisions, the regulators may make exceptions to those prohibitions.

Ensuring liquidity in the securitization market is in the public interest and certainly will provide more credit for consumers and businesses at better terms than if it doesn't exist. Comingling QRM and non-QRM loans while retaining the exemption in the QRM loans will provide greater liquidity and provide loans at lower cost to consumers, clearly a development in the public interest.

There is nothing in commingling itself that will lead to imprudent underwriting, since the eligibility requirements for the loans in the pool to qualify as QRM loans will remain and the total amount of risk retained with respect to securitized non-QRM loans will be the same regardless of whether the loans are securitized in transactions that are commingled or consist solely of non-QRM loans. Audits will be straight forward, since the loan level audits will remain as they were before the commingling occurred. The content of the loans will be transparent to the investors, and if there is question about that, the disclosures can make specific reference to transparency when QRM and non-QRM loans are commingled.

The risk retention provisions of the Act must be considered in their totality, the standards must be considered in conjunction with the exemptions, whether they be permissible or mandatory, to address the broader issue of the provision -- facilitating the flow of credit to consumers on economically viable terms while being consistent with the protection of investors. Permitting commingling of QRM and non-QRM loans in one securitization, under the intense disclosure requirements of the rule, will best meet that legislative purpose.

We urge the agencies to ensure liquidity in the market by permitting such commingling, with risk retention percentages determined on a weighted average of the QRMs and non-QRM loans included in a transaction so risk retention is required only on those loans that are not QRMs.

Recommendation: Permit commingling of QRM and non-QRM loans in the same issue without the loss of the exemption from risk retention of the QRM loans in the pool

5. Sunset of risk retention (See request for comments 12, 13, 15, 16)

Under the proposal, the mandated risk must be maintained by the sponsor throughout the life of the securities issued. HPC questions whether that is necessary in order to achieve the benefits of the rule, and also suggests that requiring that lengthy a retention period will withhold funds from the credit market unnecessarily.

To ensure prudent underwriting and align the interests of the investors and the sponsors, the regulation proposes that the sponsors retain a share of the credit risk in the issue.

Our member companies believe that peak delinquency periods on residential mortgage loans emerge in 2 to 4 years following origination. It is during this period that delinquencies that could have been predicted through prudent underwriting generally occur. Delinquencies that occur after that initial period are generally not the result of weaknesses in the loan file that should have been identified by prudent underwriting standards and reviews, but are likely associated with life events such as death, sickness, divorce, unemployment, etc.

That being the case, there is no useful purpose in requiring that the risk be retained throughout the life of the issue. Nothing is to be gained from mandating that retention in years 5 through 30. Losses that have devalued the current value of retained interest will already have occurred, and therefore the negative impact on the sponsor of the imprudent underwriting will have had its impact. The capital will remain dormant against risks noted above that are outside the foreseeable scope of any originator.

On the other hand, requiring that the capital resides dormant with the sponsor will hold from the credit markets additional funds that otherwise would be available for extending mortgage credit. Permitting it to be withdrawn and used in the market place will be beneficial to all participants.

We would recommend, therefore, that the agencies terminate the requirement for retention 4 years after the date of the issuance of the securities.

Recommendation: The period for required risk retention terminate 48 months after the date of security issuance

Section II—Specific Recommendations

1. **Establishing adequate pool of loans if regulators conclude that appropriate prudential levels can be reached by utilizing the constraints of loan products and documentation or that the premium capture cash reserve account must be retained in the final rule.**

The Qualified Mortgage definition places serious constraints on the type of loan products that may be offered and imposes serious documentation mandates. Based on generally accepted conclusions about the source of the recent housing crisis, these constraints should address the most serious of the weaknesses that generated the plethora of bad loans.

The constraints of the Qualified Mortgage definition were established by Congress as a means to ensure that loans were prudently underwritten and that loans were not made unless there was a reasonable belief that the borrower had an ability to repay the loan at the time the loan was originated. The rule implements that objective by establishing either a legal safe harbor or a presumption of compliance, articulated in the rule by two separate proposals offered for comment by the Board of Governors. It seems reasonable to believe that if a loan was generated within those constraints, the loan would be a loan sufficiently prudently underwritten to be exempt from the need for risk retention since it would be a loan that the QM regulation concludes would be one the borrower could reasonably be expected to repay. The purpose of each section of the Act is to create prudently underwritten loans, with the risk retention definition having the further purpose of reviving the securitization market at the same time.

We assume that creation of liquidity in the pool or pools of mortgages is a major goal in the rule. In order to maximize the securitization possibilities, it is essential to build the largest pool of loans within the constraints of the QRM and QM limitations. That is best done by building both a large pool of QRM loans and one of non-QRM loans if the premium capture cash reserve account is eliminated. With that a private label market outside of the pool of QRM loans can develop quickly, increasing the amount of financing available for the market. The GSEs for the near term will continue to monopolize the loans in the QRM pool because of their pricing advantages outlined in the proposed rule.

With the premium capture cash reserve account in place, however, there will effectively be no private secondary market in non-QRM loans. That is because the increased interest rate necessary to produce those loans will create a significant differential between the QRM and non-QRM loans. While some of that might be absorbed in increased fees, the limitation on fees under the Qualified Mortgage proposed rules is very restrictive. As we have pointed out in the discussion of premium capture in Section I, that limitation makes it very difficult to successfully by pass the premium recapture account.

In order to build the largest pool of loans, therefore, non-QRM loans not being available for securitization, the pool of loans will have to come from QRM loans. To the extent that the limitations on QRM loans duplicate those in the QM restrictions, there will be more QRM loans; to the extent they are tightened and include restrictions not in the QM restrictions, there will be fewer.

At their extreme, QRM loans are finally constrained by the limitations of QM loans, in that the definition of QRM loans may be no broader than QM loans. To maximize the increase in the size of the pool of prudently underwritten loans, therefore, the regulation would have to move the definition of QRM loans as close as possible to that of QM loans. In fact, concluding that the QRM loan definition should be the same as the QM definition would be within the boundaries of the statute since at that point the definition would be the same as, not broader than the definition of QM..

If the agencies believe that the constraints on loan products and documentation of QM are adequate to ensure the production of prudently underwritten loans to produce the level of affordable housing determined by the agencies to be appropriate, then utilizing just the one definition - namely that of QM - for both rules would be optimal. That will increase certainty for both lenders and consumers, and provide greater transparency for investors.

To the extent that the agencies conclude that in some respects, the Qualified Mortgage definition does not provide sufficient assurances for investors under the QRM rule, then they of course should establish those standards in the QRM rule that are necessary to produce high quality underwriting for the securitizers and originators. To the extent that creation of a large pool of loans and thereby offering opportunities for promotion of a desirable securitization market remains a public policy of section 941, then the additional standards that the agencies require for qualification as a Qualified Residential Mortgage should be selected with a bias toward permitting the restrictions in the QM definition to be sufficient protection for prudent underwriting.

Recommendation: Define Qualified Residential Mortgage the same as Qualified Mortgage, or as close to it as possible.

2. **Retain recommendations from Section I relating to servicing and duration.**

While the parts in Section I relating to the premium capture cash reserve account and commingling are not relevant in this part of the comment letter, those parts relating to servicing and to duration are just as relevant in this Section as in Section I, and the Council would like to reiterate that they be considered should the agencies choose Section II as the best path to follow to achieve their objectives.

Recommendation: Delete the servicing requirements and utilize other efforts now under way to establish uniform national standards.

Recommendation: The period for required risk retention terminate 48 months after the date of security issuance.

Conclusion

We are prepared to support either the recommendations proposed in Section I or those proposed in Section II. We have tried to describe the consequences of adopting one or the other, and if there are any questions on that or any other part of the letter, we hope you will contact us.

We believe it is important to emphasize once again that the worst possible result would be one in which the agencies not only retained the premium capture cash reserve account but also at the same time defined the QRM in a narrow, prescriptive way. It is the judgment of our member companies that this result would inflict major harm immediately on the recovery of the housing market.

We appreciate the opportunity to submit the views of the Housing Policy Council on this important proposed regulation. While we are submitting this prior to the extended deadline, we will continue to review your proposal and reserve the right to submit supplemental information if we feel it will be useful to the accomplishment of your objectives. If you wish to discuss any aspect of this proposal further, please contact Paul Leonard at 202-589-1921.

With best wishes,

John H. Dalton

John H. Dalton
President
Housing Policy Council