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August 1, 2011

Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0002
Via email: regs.comments@occ.treas.gov

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1411
Via email: regs.comments@federalreserve.gov

Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429
RIN 3064-AD74
Via email: Comments@FDIC.gov

Securities and Exchange Commission
100 F Street, NE.
Washington, DC 20549-1090
File Number S7-14-11
Via email: rule-comments@sec.gov

Federal Housing Finance Agency
1700 G Street, NW., Fourth Floor
Washington, DC 20552.
RIN 2590-AA43
Via email: RegComments@fhfa.gov

Department of Housing and Urban Development
Regulations Division, Office of General Counsel,
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
Docket Number FR–5504–P–01
Via www.regulations.gov

**Re: Proposed Rules on Credit Risk Retention**

To Whom It May Concern:

Empire Justice Center is writing to comment on the interagency proposed rules regarding credit risk retention and the qualified residential mortgage (QRM) exemption as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. In general, we support the high standard set in the proposed definition of a qualified residential mortgage, which would exempt few mortgages from the risk retention requirements. However, to ensure alignment between the seemingly competing interests of good loan performance and access to affordable credit, we urge the agencies to base the final rules on the principles outlined below. While our comments differ from those of most other consumer advocates, we believe we have the same goal in mind—to provide fair access to responsible, affordable and sustainable mortgage credit.

**About Empire Justice Center**

Empire Justice is a non-profit legal services organization in New York with offices in Albany, Rochester, White Plains and on Long Island. Empire Justice provides support and training to legal services offices statewide, undertakes policy research and analysis, and engages in legislative and administrative advocacy. We also represent low-income individuals, as well as classes of New Yorkers, in a range of poverty law areas including consumer law.

Advocates in our Foreclosure Prevention Unit have seen first-hand the impact on homeowners who were given mortgage loans by lenders who cared little about the performance of the loan once the client walked out the door after closing. Before the foreclosure crisis, we saw the mortgage market morph into one where mortgage brokers and loan originators made their money up-front and were incentivized to put borrowers into abusive loans with little regard to the ability-to-repay and long-term loan performance. Other abuses we saw include lender fraud, a race to the bottom in underwriting standards, lack of documentation, high-pressure sales by brokers and other originators, deliberate reliance on inflated appraisals, and failures of regulators and credit rating agencies to police and identify weak or fraudulent lending.

We had been advocating for years comprehensive legislation and regulations to address these abuses, so we are pleased to see the risk retention and ability-to-repay requirements in Dodd-Frank, as well as other language to address abusive, predatory mortgage lending and servicing.

**Credit risk retention**

To address abuses in mortgage lending and to ensure safe, quality mortgages for consumers, the interests of consumers, originators, securitizers and investors must be better aligned than in the past. Requiring risk retention by securitizers is one of the ways Dodd-Frank increases this alignment and incents higher quality lending. The goal of the credit risk retention requirements in Dodd Frank is to facilitate sustainable credit origination--to incent securitizers to pay close attention to the quality and risks of mortgages by adding a layer of financial risk.

**The QRM exception to risk retention**

Dodd-Frank provides an exception to the credit risk retention requirement for those asset backed securities that are collateralized solely by qualified residential mortgages (QRMs). While Dodd-Frank does not define a QRM, it states that the definition of a QRM can be no broader than the definition of a qualified mortgage (QM) under its expanded ability-to-repay standard.

The proposed rules define a QRM as a first-lien 30 year mortgage on a 1-4 family property. Among other things, a QRM cannot have a loan-to-value ratio exceeding 80 percent on a purchase money mortgage, 75 percent on a refinance, or 70 percent on a cash-out refinance transaction; nor can the points and fees exceed 3 percent of the total loan amount. To qualify for a QRM, the borrower's housing debt-to-income ratio cannot exceed 28 percent and her total debt-to-income ratio cannot exceed 36 percent. In addition, the borrower cannot be 30 or more days past due on any debt obligation; within the past 24 months, cannot have been 60 or more days past due; and, within the past 36 months cannot have had declared bankruptcy, have had any personal property repossessed, or have owned any home that was subject to foreclosure, deed-in-lieu of foreclosure or short-sale. Finally, in a purchase transaction, the borrower must make a 20 percent down payment to qualify for a QRM.

**The timing of the credit risk retention proposal**

The proposed credit risk retention and qualified residential mortgage (QRM) rules have been promulgated in a time of major uncertainties around the economy, the mortgage markets and the housing finance system. In an environment with continued downward pressure on the housing market (and some prices touching 2000 levels), as well as high unemployment, there are, and will continue to be, many responsible borrowers with high debt-to-income (DTI) ratios, low equity and imperfect credit who find themselves shut out of the housing market.

**Principles to ensure alignment between good loan performance and access to credit**

Empire Justice Center believes that the credit risk retention requirements and the exemptions of qualified residential mortgages from those requirements in Dodd-Frank and the proposed rules are balancing two needs: (1) to have originators and securitizers retain a vested interest in loan performance, and (2) to ensure that consumers, in particular low and moderate income borrowers and people of color, have access to affordable sustainable mortgages.

A significant proportion of borrowers Empire Justice Center cares about are unlikely to qualify for QRM loans, **EVEN if the debt-to-income, credit and down payment requirements in the proposed rule ARE LOOSENED.** So, how do we ensure that low-moderate income borrowers have access to affordable, responsible loans while still making sure that financial institutions maintain a vested interest in the performance of those loans? We believe that by adhering to the following principles these two interests can be aligned.

1. **Do no harm.** The first principle should be that the risk retention rules do not result in any harm to any class of borrowers, particularly low and moderate income borrowers and people of color.

2. **Focus on factors proven to be related to poor performance.** Risk retention rules – and likewise the exception to those rules, the QRM – should focus on the factors which research has shown are the most important drivers of poor credit performance – poor underwriting standards, lack of documentation, high up-front fees, escalating payments, prepayment penalties that lock consumers into unaffordable loans, and incentives to originators to burden consumers with extra costs.

3. **Ensure a robust, liquid non-QRM market.** The final risk retention rules and the QRM exemption should provide for a robust, liquid non-QRM market with enough prudently underwritten loans to ensure an active asset-backed securities (ABS) market. This will allow credit unions and mid and small sized community banks to originate non-QRM loans at a price that is commensurate with true risk.

   We know that lenders have done portfolio lending for a very long time. Many of these portfolio loans have been made to traditionally underserved communities and have for the most part have been performing loans. It is worth exploring if the standards used in portfolio lending could be applied to the non-QRM market.

Therefore, only the most safe and fair loans should be considered QRMs and thus exempt from risk retention. Expanding the QRM market by lowering the qualifications may well allow more low and moderate income borrowers access to this market. However, it could have the unintended consequence of such a weak non-QRM market that it is unsustainable or, at the very least, making the non-QRM market the exception rather than the rule, and thus jeopardizing the risk retention side of the equation and reducing the economic incentive for prudent underwriting.

**The proposed down payment requirement violates the principles**

The proposed rule's inclusion of a 20 percent down payment for consumers violates the principle to do no harm to any class of borrowers, as well as the principle to focus first on proven drivers of poor credit performance. This hurdle is likely to force many borrowers into a more expensive loan merely because of their lack of family and inherited wealth. Requiring a 20 percent down payment to avoid risk retention is likely to signal to the market that loans with smaller down payments are not safe and sound, when experience and data included in the proposed rule document that down payment is a strikingly less useful indicator of likely default than other conditions included in the proposed rule.

Congress specifically did not include down payment levels in the risk retention section of Dodd-Frank, despite two efforts to do so. The inclusion of down payment levels in the rule threatens to reduce widespread financing for low wealth borrowers without congressional direction. This will be especially true for communities and people of color, which historically have lower levels of wealth.

<u>There are two possible solutions.</u>

- The final rule could remove the loan-to-value and down payment requirements from the definition of QRMs. However, this may well take too many mortgages out of the non-QRM market, weakening it substantially.

- Alternatively, the loan-to-value and down payment requirements could be raised and be used solely as a means of restricting the size, rather than the composition, of the market exempt from risk retention. As presently proposed, the 20 percent down payment requirement, or the suggested alternative of 10 percent, are too likely to translate into an insurmountable barrier for low wealth borrowers. A much stricter loan-to-value measure of 40 or even 50 percent will not be mistaken by other market participants as a measure of credit worthiness, but as a means of restricting the size of the QRM mortgage market, and providing for a more robust non-QRM market.

  The other credit factors specifically enumerated by Congress, along with the robust Alternative 2 qualified mortgage (QM) requirements in the Federal Reserve's proposed ability-to-repay rule, can provide a means to meet congressional direction to base the QRM exemption on valid indicators of loan success that do not negatively affect an entire class of borrowers, eg., those with low wealth and savings.

**Conclusion**

The risk retention requirements in Dodd-Frank is only one of the several ways the legislation provides a long-awaited and much-needed framework to protect borrowers and communities from abusive lending practices. We urge the agencies to keep this in mind while implementing the final rule. We believe the above principles will help.

Finally, Empire Justice Center supports the recommendations of the National Consumer Law Center and the National Association of Consumer Advocates in their comments dated August 1, 2011.

Sincerely.

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