7/29/2011

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Re: Proposal to Establish Credit Risk Retention Requirements per Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.
76 Federal Register 24090, April 29, 2011

OCC: 12 CFR Part 43; Docket No. OCC-2011-0002; RIN 1557-AD40
FRB: 12 CFR Part 244; Docket No. 2011-1411; RIN 7100-AD-70
FDIC: 12 CFR Part 373; RIN 3064-AD74
FHFA: 12 CFR Part 1234; RIN 2590-AA43
SEC: 17 CFR Part 246; Release No. 34-64148; File No. S7-14-11
HUD: 24 CFR Part 267; RIN 2501-AD53

Ladies and Gentlemen:

SpiritBank sincerely appreciates this opportunity to respond to the request for Comment by the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, the Federal Housing Finance Agency and the Department of Housing and Urban Development (known hereafter collectively as the "Agencies") on their joint proposal for rulemaking to implement the requirements of Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (hereafter, "Dodd-Frank Act," "Dodd-Frank," "DFA" or "the Act").

Section 941 specifically requires the Agencies to craft rules that require a sponsor (i.e. "securitizer") of asset-backed securities (hereafter ABS) to retain an economic interest in a portion of the credit risk of the securitization. This provision has become popularly known as ***"skin in the game."*** We will use that phrase interchangeably throughout our comment letter to imply risk retention.

While the debate may be over as to whether or not Risk Retention will be codified law under Dodd-Frank, the debate over ***sound implementation*** of Risk Retention as public policy is not. The proposed rule is confirmation of that fact given the sheer size of the proposed rule and the 174 individual requests for commentary, which is almost unprecedented in the construction of a rule such as this.

Congress has expressed continuing interest in this matter by the holding of several hearings these past several months in both the House and Senate on the matter of Risk Retention and the nation's housing finance markets. These hearings have focused on the impacts that will be felt by housing finance across the country if the rule should proceed as proposed.

The Risk Retention Rule and the *Qualified Residential Mortgage* (hereafter "QRM") exemption will have the most profound impact on residential finance and credit markets out of any regulation promulgated under Dodd-Frank hereto. The proposed rule itself is complex and intricately detailed. This fact is evidenced by the gracious gesture made by the Agencies to extend the deadline for comments from the original expiration date of 10 June to that of 1 August in order to facilitate greater feedback and commentary from industry stakeholders, members of Congress and the American People. Certainly, the sheer volume of responses one finds by doing a simple Google search on the term "Risk Retention" is further proof of the importance of this policymaking process.

SpiritBank believes that our history and market presence as a community bank engaged in residential mortgage lending sold into the secondary market can best give the Agencies a thoughtful, unique and relevant perspective into the impacts the proposed rule in current form will have if certain changes and alterations are not made.

<u>It is with the strongest of conviction that we believe the Rule as Proposed if unaltered will:</u>

1. ***Create long-term and irreparable damage to the system of securitization and housing finance in the United States;***

2. ***Create compelling economic DISINCENTIVES for lenders to extend housing and other forms of securitized credit to even the safest of borrowers on the most sensible of loan scenarios;***

3. ***Create a "bifurcated market" vis a vis pricing of QRM Loans versus Non-QRM Loans;***

4. ***Force a "flight to quality" of mortgage loans into the relative "safe harbors" of Statutory Exempt Programs (FHA/VA/USDA/HUD), further increasing the size of the federal government's footprint which is expressly against the wishes of the Obama Administration and the majority will of Congress;***

5. ***Fail to focus on fixing the actual problems of the Mortgage Crisis—poor underwriting and product structure coupled with little to no documentation of a borrower's capacity to repay the mortgage obligation which are summed up as "Non-Traditional Mortgages" (hereafter "NTMs").***

6. ***Further complicate and frustrate goodwill efforts by policymakers to resolve the reform of the GSEs (Fannie/Freddie);***

7. ***Constrict credit to Low and Moderate Income Borrowers seeking housing credit;***

8. ***Destroy any incentive for private capital to flow back into housing finance and credit markets;***

9. ***Further impede growth in the national economy which remains sluggish and lethargic;***

10. ***Create an environment of consolidation and concentration of market share into the hands of the largest Banks and Institutions nationally in residential mortgage lending.***

    Such an effect will only serve as a perpetuation, not diminution, of the doctrine of "Too Big to Fail"; a doctrine that is inherently and intrinsically anti-thetical and counterintuitive to the main arguments that gird the Dodd-Frank Act and the stated intent of its authors as reflected in the Main Title to the Act.

With this backdrop in mind, we will lay out the reasoning behind our arguments within this comment letter with replies to the requests for comment the Agencies have posted.

We believe the sheer number of requests for commentary is indicative of a sincere and willing openness on the part of the Agencies to solicit honest, relevant and productive feedback from industry stakeholders—Primary Originating Lenders, Securitizers, Investors, Home Builders, Realtors and most importantly- the US Taxpayer. For this, we wish to thank the Agencies for their engagement of stakeholders and the American People.

We further recognize and appreciate the Congressional imposed burden the Agencies found themselves laboring under to craft these extremely complex and detailed rules within such a shortened timeframe per the Act. It goes without saying that we appreciate the length to which the Agencies worked in crafting the proposed rule and the immense investment of time, resources and productivity that all the Agencies had to devote in order to coordinate a very complex and unified process of joint rulemaking. Not least among our several appreciations are the Agencies' willingness to craft a rule recognizing several manners by which a securitizer may fulfill the requirements of the rule (i.e. various forms or "risk retention") and the extension of time the Agencies approved on June 10 to extend the deadline for comments to August 1.

Our commentary is to be limited largely to the realm of questions related to the QRM and other provisions of the proposed rule as it relates to Risk Retention for Residential Mortgage Backed Securities (hereafter RMBS). With that in mind, we wish to present a brief outline as to the structure and contents of our comment letter:

I. Summary of Remarks & Background of Proposed Rule
II. Brief History and Background of SpiritBank and its role as a Community Bank
III. Background to the Mortgage Meltdown and Credit Crisis that peaked from 2007-2008.
IV. Our Philosophy and Guiding Principles of Risk Retention
V. Recommendations for Re-Crafting of the Proposed Rule
VI. Concluding Remarks

The views and arguments we express in this comment letter, while perhaps somewhat blunt at times, are intended to be constructive, relevant and honest intellectual arguments backed with empirical data and other references. We do not view this rule as an attack on the industry and likewise our comments are not intended as a verbal assault on the Agencies but rather part of the "conversation" that must be held if a functional, feasible and overall "safe" rule is to be implemented in final format.

As an industry stakeholder ***we see it as part of our duty to assist in providing the Agencies with the relevant information that supports what we believe is the most accurate and honest assessment of the damage that will be created by the proposed rule in its current form.*** We believe that both the gesture of the extension of the deadline and the way in which Agencies' staff have engaged and met with industry stakeholders is indicative of the Agencies' genuine and sincere belief that this is a collaborative process rather than confrontational.

Again, we appreciate the opportunity to deliver our candid and specific comments to the Agencies. There is near universal consensus that the form of the final rule will no doubt have an important and unmistakable impact on the future of Housing Finance in our nation for years to come. We cannot stress more emphatically the burden of "getting it right" on the final rule. We hope that our views and supporting documentation may assist so as to make that burden of decision somewhat easier for the Agencies. We would be happy as well to answer any questions or if we may be of further help in providing insight and viewpoints to Agencies to encourage any request to us at the contact information below.

I remain—

Cordially,

Bruce W. Schultz
Vice-President, Mortgage
SpiritBank

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Summary of Remarks and Background of Proposed Rule

Section 941 of the Dodd-Frank Act amends Section 3(a) of the Securities and Exchange Act of 1934 (15 U.S.C. 78c(a)) by adding news sections defining "asset-back security" and Section 15G. "Credit Risk Retention"[1] The Act authorizes the collective agencies (FDIC, FRB, OCC, SEC, FHFA and HUD) to issue rulemaking in tandem for the issuance of rules to govern the Congress' intent expressed in Section 941. Furthermore, the Act mandates the Agencies to issue rules within 270 days of the enactment of bill into law.

On March 29, 2011 the FDIC and other Agencies released the Notice of Proposed Rulemaking to the public and it was published one month later in the Federal Register on April 29, 2011 (Vol. 76 No. 83 Pages 24090 through 24186) with an initial comment deadline of June 10, 2011. On June 7, 2011 the Agencies, in a joint press release, announced an extension of the deadline to August 1, 201 due to the complexity surrounding the risk retention issue.[2]

There can be little doubt that the task of framing a workable and transparent framework of risk retention is one that will involve complex and detailed theory and implementation. Implementing Section 941 represents, perhaps, the most overarching and fundamental alteration to the nation's system of housing finance in our country's history. Securitization has served as the primary distribution system of housing credit from the capital markets to borrowers across the United States for the past 40 years since the Government National Mortgage Association (GNMA), "Ginnie Mae," issued and guaranteed its first pass-through securities whose cash flow streams were backed by payments on FHA and VA loans in 1970[3].

Since then securitization has grown to a multi-trillion dollar industry as cash flow receivables from home mortgages to commercial mortgages to business loans and auto loans and credit cards have all found themselves included in securitization transactions. The Government Sponsored Entities (hereafter GSEs or "Enterprises"- Fannie Mae, Freddie Mac and the Federal Home Loan Bank System—FHLB) have also found uses for securitization of their mortgage assets so as to replenish the funding necessary at primary level lenders who lend direct to the borrower.

Securitization has enabled for the greater reach of credit to borrowers and enabled smaller and individual investors to obtain greater access to a broader and larger set of asset classes once unattainable. Securitization has in essence, enabled economic growth to occur in this nation and the world.

The system of securitization itself is not to blame per se for the Financial Crisis of 2007-2008.

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[1] H.R. 4173- Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; Subtitle D "Improvements to the Asset-Backed Securitization Process" Section 941 "Regulation of Credit Risk Retention"—referred to throughout the letter as "Section 941". http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173enr/pdf/BILLS-111hr4173enr.pdf . The statutory language is found from Pages 515-523 of the Act at the aforementioned link.

[2] See Press Release at http://www.federalreserve.gov/newsevents/press/bcreg/20110607a.htm and Federal Register Vol. 76, No. 112/Friday June 10, 2011 found at http://www.gpo.gov/fdsys/pkg/FR-2011-06-10/pdf/2011-14444.pdf

[3] American Securitization Forum testimony before the House Subcommittees on Housing and Community Opportunity & Financial Institutions and Consumer Credit on November 5, 2003 http://financialservices.house.gov/media/pdf/110503cc.pdf

Some supporters of the *skin in the game* concept of Risk Retention are quick to point out that securitization, in their opinion, "failed" because there is not a proper "alignment of incentives" between originating lenders, securitization sponsors and investors/bondholders.[4] This hasty rush to judgment is myopic, misinformed and misguided at best. At worst, this view of securitization and *skin in the game*, taken to its logical conclusion has the potential to destroy the infrastructure of housing finance in this nation as we know it.

Understanding and recognizing that the Agencies are working within the immensely compacted timeframe in which they were given this rulemaking mandate by Section 941 of the Act, we also would argue that prudence ought to override the formulation of concrete opinions that have been expressed by numerous regulators and staff in their arguments for the proposed rule. We believe that the Agencies are genuinely sincere, again as evidenced by their numerous requests for commentary, and do not take this rulemaking responsibility lightly and understand the consequences it holds.

However, given the illogical reasoning in support of the proposed rule made by former FDIC Chairman Sheila Bair in the public domain since March 29, it is difficult to gauge the exact logic from which the Agencies, ***might be*** operating now that they are *sans* the former FDIC Chair. Specifically we'd cite the recent public interview and Q&A Session the former Chair had at the Council on Foreign Relations on June 9.

In response to a question on risk retention the former FDIC Chair said that non-QRM loans would have a "`10 to 15 basis points" higher rate from the non-QRM without giving any rationale. She further went on to state "***If we just get rid of it (the QRM exemption) it'd be fine with me, just making sure everybody keeps 5 percent, I would love that; this statue has this direction."***[5]

Such a perspective of risk retention we believe is inconsistent with the intent of Congress as is evidenced is the multitude of comment letters opposing the QRM as proposed. Furthermore, it conveys a misunderstanding of the intended role that risk retention must play within the system of securitization.

To illustrate we offer the following example:

Assume that a group of terrorists have managed to infiltrate and poison the water distribution system of a large populated American city. The toxic water flows into the homes and businesses across the city leaving carnage and destruction in its wake as numerous persons are made ill or killed by the contamination. The incident leaves the city numbed with panic and disbelief. As a result, water distribution systems across the nation go on an immediate lockdown and safe water can only be attained through purchases of the more expensive bottled variety.

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[4] Former FDIC Chairman Sheila Bair http://www.fdic.gov/news/news/press/2011/statement03292011.html

[5] "A Conversation with Sheila C. Bair" Andrew Ross Sorkin of the New York Times Interview at the Council on Foreign Relations on June 9, 2011. http://www.cfr.org/financial-crises/conversation-sheila-c-bair/p25253

Now fast forward three to four years. Would an appropriate government response in the debate to prevent a future catastrophe like the above be to implement policies that would raise the costs so high that a user would have no choice but to ignore obtaining their water through the traditional system of distribution and rather have to obtain their water through fewer and more expensive options? Of course such a response would be time consuming, expensive and ultimately ineffective given other options. ***It would be far advisable to create a better framework of security so as to prevent any terrorist from ever again having access the water systems of the nation's towns and cities.***

We understand and appreciate that the Agencies believe that this is what they are doing through their proposed rule on risk retention. However, what will occur if the rule is unaltered in final form, especially vis' a vis the Premium Capture Cash Reserve Account (hereafter PCCRA), the role of the GSEs and the definition of the QRM, will be an economic carnage as already battered housing markets find themselves with fewer buyers and the economic engine of the nation once again begins to fail.

We also want to clarify for the Agencies that we do not hold the opinion the nation's securitization system cannot be improved or modernized. Like a highway system that is aged and in need of repair and maintenance, so too is the infrastructure of securitization in need of upkeep and maintenance. However, instead of trying replacing the US Highway System with say High Speed Rail overnight, we would focus our efforts on improving what is already a fairly efficient system of credit distribution.

We believe that the best approach for the Agencies at this point would be to suspend the rulemaking process in order to re-construct the rule taking into account the large number of comments of concern the proposed rule has already received. There are in that plethora of commentary many comments from members of Congress including Congressman Barney Frank of Massachusetts, one of the principal authors of the Dodd-Frank Act itself whom has recently weighed in on the public record with concerns about the QRM itself[6]. We also strongly advocate to the Agencies that a further delay in the Commentary Deadline for this rulemaking is necessary and proper until such time as the Consumer Financial Protection Bureau (hereafter CFPB) finalizes the rulemaking on the "Ability To Repay" and "Qualified Mortgage" (hereafter "ATR" and "QM" respectively) proposed by the FRB and mandated by Title XIV of the Act. Section 941 provides for a limitation on QRM by establishing the QM as the "outer boundary" if you will, by which QRM may be judged[7].

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[6] "Rep. Frank: Risk Retention Exemption Should Cover More Loans" by Alan Zibel; ***Dow Jones Newswires 7-11-2011*** **http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=201107111210dowjonesdjonline000239&title=update-rep-frank-risk-retention-exemption-should-cover-more-loans**

[7] DFA- Section 941 (b), (e) "Exemptions, Exceptions and Adjustments", (4) "Exemption for Qualified Residential Mortgages", (C) "Limitation on Definition" where it reads that the Agencies shall define the term (QRM) to ***"be no broader than the definition 'qualified mortgage' as the term is defined under section 129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder."***

It begs the question as to why the Agencies should continue with the Rulemaking while there remains an unsettled question which is that of the QM. It would not be a prudent exercise of rulemaking authority to proceed with the definition of QRM and Risk Retention until such time as the QM is finalized. The plain meaning and language of the statute is that Congress has not intended for the QRM to be finalized as it envisioned QM being finalized first, the mandates on Risk Retention rulemaking (i.e. 270 days after enactment) notwithstanding. Granted, we appreciate the unique burden the Agencies found themselves in with the statue mandating the large amount of rulemaking and we realize it is essentially the structure of the statutory language that has created this conundrum. Yet, a feasible and workable QRM cannot be built until QM is finalized. We would illustrate this point with the following example of a new home being built.

As one would not begin the construction of a new home until they knew the legal boundaries of real property itself, so too should the Agencies delay any final rulemaking on the QRM until such time as the QM is finalized and only then after adequate time is given for a re-opening of commentary on a new proposed rule post-QM. As the rulemaking on QM is akin to a "land survey" that establishes the boundaries of our hypothetical property; QRM then is the house itself. With that in mind as one would not break ground to construct the house (QRM) until they knew exactly "where" on the property they may legally build in terms of boundaries (QM) so too then should the Agencies wait to know the boundaries before they "build" the QRM.

Our remarks will also seek to establish a set of guiding principles by which we believe a sensible and feasible system of skin in the game, aligned with the intent of Congress in Section 941 of Dodd-Frank, may be attained. We specifically believe the following must be incorporated so as to create such a feasible and sensible system of Risk Retention that will, in the end, work for the betterment of the securitization system:

1. That the overriding criterion by which the rule should be constructed is that Risk Retention is a ***"means to an end and not the end goal itself."*** That "end" is, of course, better quality underwriting and thus better quality loans and loan performance as evidenced in lower default rates. Please pardon the pun but this goal is "better aligned" with the intent of Congress and Section 941.

2. Risk Retention policy must be transparent and easy to understand so that there is little doubt as to what risk is retained on non-exempt assets. In that same line of rationale, any system of skin in the game must be most heavily weighted against the riskiest of products such as those that lie at the root of the Financial Crisis of 2007-2008.

3. There must be multiple paths into the QRM and other "safe harbors" of exemptions so as to prevent the impediment of credit flow from capital markets to creditworthy borrowers.

4. Any system of Credit Risk Retention must not be used to pick winners and losers in the marketplace who are originating identical product (i.e. Residential mortgages) that are of similar credit and underwriting quality.

As a lender that primarily is impacted by Risk Retention through the effects it will have on Residential Mortgage products and pricing, we believe that the proper approach in crafting the final rule is very similar to that of a doctor diagnosing a patient who is sick and proscribing the appropriate medical treatment to address the illness. We will refer back to this illustration throughout our commentary.

We would find it odd that a physician might apply a radical and unnecessary treatment regimen in the hopes of preventing a return by a patient to an illness that has already lapsed. By this we mean that the cause of the Financial Crises of 2007-2008, which we explore in more detail in a following section, had at its core a variety of failures the most destructive of which was that assets backed by poor credit and poor underwriting criteria were allowed to seep into the securitization system.

Just as a patient with a fever who has seen the fever break, so too has our national housing finance system seen a swing to more pristine credit and sound underwriting standards. The market itself has successfully banned the types of loan programs and products that caused the "illness' in the first place—Non-Traditional Mortgages (hereafter NTMs meaning Alt-A and Subprime mortgage loans).

A prudent and wise physician would be seeking to help the patient prevent having a "relapse" into the sickness again. We believe the Agencies are sincere in their motivations to do the same in respect to the "patient" of the national housing finance system. However, we would encourage the Agencies to use the same prudence and wisdom in preventing such a relapse and not rely on a radical and unnecessary "treatment regimen" which is exactly what the proposed rule on Risk Retention provides.

There are far better "treatments" and solutions available to the Agencies that achieve the stated goals and aims of the Congress and Section 941. Instead of a broad and sweeping rule that encompasses risk retention on the overwhelming majority of loans, the Agencies ought to create a system of risk retention ***that incentivizes the overwhelming majority of mortgages made to be considered QRMs*** thus improving the overall credit quality of the market. That is achieved by a broader, more flexible and more realistic QRM and thus a more precise and focused view on what is ***not considered a QRM***.

It is with that illustration and premise in mind that we respectfully offer our comments to the Agencies in the hopes that our positions will persuade a re-working of the proposed rule.

History & Background of SpiritBank

SpiritBank is a state chartered Commercial Bank headquartered in Bristow, OK that has been in business since 1916. In the 95 years since her inception SpiritBank has grown to a size of $1.25 Billion in Assets putting her in the top 10% of banks in Oklahoma. Nonetheless, SpiritBank remains a Community Bank at her core and in her heart and through her daily mission.

Employing 485 Oklahomans in 13 branches located in 9 communities throughout the state, SpiritBank knows her roots and stresses daily the responsibilities we have to the depositors and borrowers in those communities where we operate and do business. After all, the first rule of good business, be it in banking or any other industry, is to take care of your customer by working to help them achieve their needs as well as their dreams and aspirations. This is the very essence of what it means to be a "community bank." Furthermore, by taking care of your customers your customers will take care of your business. Community banks do not seek to set their customers out to fail. That violates the first rule and principle of sound business practice.

SpiritBank, like most community banks, has had a large presence in the market of home mortgage finance from her very beginning. Whether it is the extension of a development loan to a builder, a home purchase loan for that first time buyer, a construction loan to build the dream house that a retiree has saved to build; in all of these cases SpiritBank plays an integral and fundamental role.

Some may think that a community bank is relatively unaffected by the events in capital markets regarding securitization and they would be sorely mistaken. SpiritBank has a relatively small yet robust retail residential mortgage lending department that lends primarily throughout Oklahoma and has averaged $180-$200 Million in loan volume (approximately 1100-1200 loans per year) for the past 3 years. The past few years has seen a large amount of that volume in purchase transactions.

SpiritBank's reach in residential mortgage finance stretches further than her direct to consumer retail lending channel. SpiritBank is the parent company and 100% owner of American Southwest Mortgage Company (ASMC), a secondary market platform that originates residential mortgages through third party origination from other smaller community banks, independent mortgage companies and mortgage brokers. In the 24 month period of 2009 and 2010, ASMC funded over 23,000 loans in 34 states (2/3 of the nation) for a dollar volume of over $3.373 BILLION.

The combined dollar volume alone of ASMC and the Retail Mortgage makes SpiritBank one of the largest if not the largest residential home mortgage lender in the state of Oklahoma. We believe this gives us a unique perspective and credibility on the issues facing our nation's housing finance system.

Both ASMC and the Retail Department are what are known as "Correspondent Lenders" meaning that they process, underwrite and close/fund in their own name all the mortgages they originate. Correspondents then typically present the closed loan product to a Secondary Market

Investor ("investor") who purchases the loan and then delivers on to one of the Agencies or other securitization channels in the secondary market itself. ASMC and Retail collect service release premiums for the sales of the mortgage along with any fees they collect from the borrower to cover overhead costs of origination and processing.

By being a Correspondent Lender, ASMC and Retail can execute "Delegated Underwriting Authority," meaning that each are essentially already sharing in the "risk" of the loan's performance under the Origination Agreements with the various Secondary Market Securitizing Sponsors who purchase the closed loans. The securitizing sponsors essentially "delegate" to ASMC and Retail the authority to underwrite the loans based on the Bank's financial strength, past underwriting history/performance, market presence, quality control and skill/talent levels of respective staff. In return both channels are able to offer more competitive rates, terms and lower cost options to borrowers.

A Correspondent Lender, who is acting in good faith (in other words one who is not a "bad actor"), has every incentive to process and underwrite quality loans in today's world, and even more so since the Financial Crisis of 2007-2008; all of this absent any consideration given to Section 941 of DFA and the general concept of Risk Retention as proposed by the rule. We explore and explain this point in more depth in a following section of our comment letter.

As before the financial crisis, the overwhelming majority of originated loans from both channels, ASMC and Retail remain standard, traditional products and programs that are both conventional (Fannie/Freddie "Agency" loans) and government (FHA/VA/USDA and HUD 184 Native American loans) in scope.

With that in mind one may be tempted to ask why we would be commenting on this letter given that the overwhelming majority of our current volume is either explicitly made exempt by the statutory language of Section 941 (i.e. "government loans" such as FHA/VA, etc) or considered by the proposed rule to be in compliance with risk retention requirements as they are loans sold to the GSEs/Enterprises.

Our concern is about the future of housing finance and knowing that the GSEs will eventually be unwound; something all political sides are proclaiming, we have grave concerns about the future of the "infrastructure" of housing finance for our nation. Securitization ***is*** that housing finance infrastructure and the Rule as proposed will drastically and most likely adversely impact its ability to continue serving in that capacity.

Measured Impacts to SpiritBank

Both our Retail and ASMC platforms would find themselves impacted in terms of the conventional loans made should the rule as proposed be finalized unaltered from its current form.

Retail Lending Department Impacts

A review of conventional loans closed in our Retail Department from October 1, 2011 to June 30 of 2011 (previous 9 months) found that out of 395 Conventional Loans closed for approximately $69.5 Million dollar volume, approximately 252 loans for $47.3 Million or about 63.80% of the units total and 68.10% of the total dollar volume would fail to meet the strict construct of the

QRM as proposed in at least one of the standard fields established by the Agencies related to Loan to Value (LTV) or the two Debt to Income Ratios (DTI%).

Conventional loans made up approximately 49.07% of the total units closed by the Retail Department during this timeframe (805 Loan Units Closed) with the remainder all being Government Loans (FHA, VA, USDA and HUD Native American Section 184). Conventional loans made up approximately 55.45% of the total dollar volume closed however during the same period ($125,396,365 Closed Volume) with the Government loans making up the remainder.

Thus roughly 31.30% of our TOTAL loan units closed (252 out of 805) and 37.76% of our TOTAL dollar volume closed during this timeframe falls outside the QRM for failing to meet at least one single standard in the area of LTV or Debt to Income Ratio (both Housing/Front and Total/Back Ratios were included in the review.

Measured Impacts to ASMC

ASMC is also not immune to the impacts of the QRM proposed by the Agencies. A cursory review of their year to date volume for 2011 shows 1230 loan units for almost $204 Million have been made on conventional loan programs. Of those 635 Units for almost $116 Million have had LTV's over 80%, requiring mortgage insurance and thus again are outside the QRM as proposed. This equates into 51.63% of the Units and 55.50% of the total loan volume year to date being once again Non-QRM loans.

Also by our calculations, some 1200 loans through ASMC were made in 2010 that were conventional first lien loans with less than 20% down. By the strict construct of the Agencies proposed rule, each one of these loans by virtue of the LTV alone would be outside the QRM.

These 1200 loans represent (on an average loan size of $172,000) over $209 MILLION in dollar volume or 1200 homeowners- families and single persons alike—who would be facing either higher rates due to the pricing structures that the proposed *QRM* will create, government loan options only or the potential for no loan program at all due to the potential capital restrictions that Risk Retention must create.

For if there is not to be any capital requirements implemented for the realization of that risk, then ***skin in the game*** must be a truly "toothless" measure as it has no enforcement mechanism. We do not believe that Congress or the Agencies intend for an unenforceable rule. We believe there will be imposition of some credible and tangible capital requirements which will have the ultimate effect and impact of constricting housing credit.

We will make a more in depth examination at certain specific loans in our Retail Review that failed to meet each strictly constructed benchmark that the Agencies proposed. In many cases

any reasonable person would find it utterly ridiculous that some of these loans would require a retained credit risk interest in the first place. It is evidence of why the Agencies structure of a rigid and static "underwriting matrix" as embodied in the proposed QRM is problematic in the first place.

SpiritBank's Role in Home Lending—Yesterday, Today and Tomorrow

Through her presence as a retail brick and mortar location and through ASMC, SpiritBank is helping to bring much needed housing liquidity to many markets throughout Oklahoma and across the nation. We are providing a secondary and tertiary channel for smaller community bank lenders who may not have the economies of scale to run a full time mortgage origination platform to serve the long term housing finance needs of their customers.

As we move forward into the brave new regulatory world post Dodd-Frank, we see the very vital role we play as a community bank in our cities and towns. We know the role that many other community banks, our competitors yet also our compatriots, also play in keeping local economies on track which in turn helps to promote the growth of state, regional and the national economy at large.

As we write these comments today the US Economy is caught in a quagmire of slow job creation and anemic growth. In the past few weeks our nation has had a literal slew of economic data released that portends that the US Economy, especially housing, is not recovering from the battering it took in the Financial Crisis of 2007-2008. On May 25 the FHFA released the House Price Index figures (HPI) for the First Quarter of 2011. It shows housing prices ***fell*** 2.5% in Q1 of '11. That is the largest quarterly decline since Q4 of 2008[8].

The S&P/Case-Shiller Home Price Indices only confirmed those fears six days later when their press release said of the data through March 31, 2011 that, ***"the U.S. National Home Price Index declined by 4.2% in the first quarter of 2011, after having fallen 3.6% in the fourth quarter of 2010."***[9] The press release went on to utter the words most feared by economists and policymakers when it said, ***"This month's report is marked by confirmation of a double-dip in home prices across much of the nation."***

The next day on June 1, Stephen Foley of the ***Independent.co.uk*** wrote of the Case-Shiller data that the fall in housing prices has now surpassed the 31% peak decline registered during the Great Depression of the 1930's.[10]

We have also had recent data confirming manufacturing is in a slowdown and that inflation on the producer and consumer levels may be moving up. In short, it as if the infamous "malaise" of the late 1970's has returned to visit our nation like Dickens' Ghost of Christmas Past.

[8] Federal Housing Finance Agency News Release on May 25, 2011; ***"House Price Index Falls 2.5 Percent in First Quarter 2011"***

[9] S&P Indices Press Release on May 31, 2011; ***"National Home Prices Hit New Low in 2011 Q1"***

[10] Stephen Foley, *Independent.co.uk,* ***"US House Price Fall Beats Great Depression Slide"*** June 1, 2011

With this backdrop then there can be no mistaking that ***skin in the game*** will have an impact in a market that is searching for recovery. The concept and doctrine of risk retention ***in theoria*** versus ***in usum*** are two completely different things. What may truly seem as "best" in theory is not often the best in actual practice.

While perhaps well intentioned, we know that any regulation has its costs versus its benefits and as the rule is presented and defined today, the costs are far too heavy to impose onto a housing market that is struggling to find its footing. After all, we're all aware of the old cliché' about just where "good intentions" can sometimes lead; and THAT is a destination our housing market and broader economy cannot afford to visit again.

Background to the Financial Crisis of 2007-2008

By now we know that the Great Financial Crisis that began in 2007 and culminated in the 3rd Quarter of 2008 with the fall of financial behemoths the likes of Lehman Brothers, AIG, Fannie Mae and Freddie Mac, all have in common the same root cause—Subprime Mortgage Lending.

The entire argument advanced by the advocates of Risk Retention is based around the concept that the "originate to distribute" model that existed prior to the crisis and to this day is fatally flawed in that there is a "misalignment of incentives" between the originators, securitization sponsors and investors/bondholders. The "theory" of *"skin in the game"* is that by having a defined economic "stake" in the securitization, a sponsor and/or originator will be more likely to underwrite quality loan products and avoid the excesses of the 2004-2007 period that lead to the rise of Subprime and ALT-A credit that have been largely to blame for the crisis.

Former FDIC Chariman Sheila Bair, in echoing her support for the NPR on Risk Retention at the March 29, 2011 said the following in her Press Release:

"Almost 90% of Subprime and Alt-A originations in the peak years of 2005 and 2006 were privately securitized. During that period, the separation of originating and securitizing loans from the risk of loss in the event of default fed a massive amount of lax and unaffordable lending which fueled the housing bubble. Since neither lenders nor securitizers appeared to hold any real risk in the transaction, the "originate to distribute" model of mortgage finance misaligned incentives to reward the volume of loans originated, not their quality." [11]

To summarize Chairman Bair's viewpoint it is fair to say that she and other supporters of the proposed rule see that the "system" of securitization as represented in the "originate to distribute" model as being responsible for the rise of subprime and Alt-A programs/products.

We would agree with Chairman Bair's statement about the securitization aspects of the market as most loans were securitized during that period. From 2001 to 2006 the ratio of Securitized Product to Origination in subprime went from 46% to 75%; Alt-A increased from 19% to 91%;

Jumbo increases, including Jumbo Prime, were more muted at 33% to 46% and there was an increase of 76% to 87% in Agency loans[12]

But after greater reflection we see that rather than the model of securitization being to blame for creating "misaligned incentives" that lead to the credit crisis, that in an ironic way that argument itself that is truly "misaligned" from logic, the historic record of facts and a basic understanding of economics. In fact it is quite divorced from reason. We would respectfully disagree with the

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[11] Former FDIC Chairman Sheila Bair http://www.fdic.gov/news/news/press/2011/statement03292011.html

[12] ***Inside Mortgage Finance 2007*** as referenced on Page 7 of Staff Report No. 318 of The Federal Reserve Bank of New York; ***"Understanding the Securitization of Subprime Mortgage Credit"*** by Adam Ashcraft & Til Schuermann; March 2008. Note that Agency is inclusive of Conforming (Fannie/Freddie) along with FHA/VA loans- GNMA, FHLMC and FNMA. http://www.ny.frb.org/research/conference/2007/liquidity/Ashcraft-Schuermann_subprime_04Dec2007.pdf

Former Chairman's assessment, if indeed it is her position from the above statement, that the "originate to distribute" model is to blame for the Financial Crisis.

It is easy to point the finger at the "system" itself when it is not the "system" of securitization that failed but rather a failure on a multitude of other fronts that created the meltdown. This "chicken or the egg" debate about whether securitization caused the meltdown is speculative at best. Furthermore to summarily dismiss the historic record and simply put the fault squarely at the feet of securitization itself makes about as much sense as Lewis Carroll's fantastical Queen of Hearts shouting ***"Sentence First and Verdict Afterwards!"***

To gain a true understanding we must look at **the multitude of factors** that all played a role in bringing the economic crisis about. It would be equally as irrational as those who blame securitization exclusively for the Financial Crisis for those of us in defense of it to say that a single cause lead to the meltdown. Rather, it was a series of connected factors and variables that in tandem, created the crisis. The singularly myopic viewpoint that is perhaps implied in Chairman Bair's statement is unfortunately typical of the view shared by many supporters of Risk Retention who see this rule as some kind of "silver bullet" to the prevention of another credit meltdown. But this is wishful thinking at best.

There is no difference in this rule as proposed. But this is not to be unexpected if the Agencies are writing the rule with the wrong perspective in mind as to the roots of the Financial Crisis itself. Let us hearken back to our "good doctor" who must proscribe a treatment regimen to prevent a relapse of sickness and therefore must examine and determine the causes of the illness in the first place.

Likewise, it is prudent for the Agencies to review the historic record for the different causes both in the long and short terms that lead to the Financial Crises. We believe that once the Agencies have a better and proper understanding and perspective they will see why our arguments regarding the proposed rule are valid.

We advance the following four examples as a sample of the interconnected causes of the housing and credit bubbles that allowed the toxicity to build within the system that eventually came to a head in 2007-2008. These are by far not the only exclusive causes but they each played a major

role and they shall assist in establishing the background for our good doctor to perform the necessary review in determining a diagnosis and prescription.

The Role Of Monetary Policy—Easy Money and Bubbles

It is a commonly held opinion in economic circles post crisis that central banks kept rates too low for too long in the earlier years of the decade thus creating a "debt subsidy."[13]

In a world awash and flush with "cheap money" brought about by an overly accommodative monetary policy, it should be no surprise that investors from around the globe would begin to "stretch for yield" and in turn compromise on the quality of their investments in order to

[13] ***"Surviving the Panic"*** *Wall Street Journal Op-Ed/Review& Outlook;* September 16, 2008

maximize their opportunity and potential for gain[14]. As interest is the "price" of money, itself a commodity, as the money supply grew in the 2001-2004 period and the price of money fell then the common laws of economics tell us that the quantity demanded increased. "Easy Money" allowed would-be borrowers to ratchet up home prices further fueling the asset bubble in housing.

Such an economic backdrop in place served as the perfect catalyst for the Subprime and Alt-A markets to flourish. For had there not been such a global demand for enhanced investment yield and performance, the "product innovation" that was found in Subprime and Alt-A lending would not have been so prevalent in the first place. Furthermore, the accelerated increase in housing prices brought on by such an accommodative monetary policy in the first place also created greater demand for product innovation on Wall Street for the creation and expansion of Subprime and Alt-A products to meet the demand of would-be borrowers competing to be home owners. In essence the process became self-sustaining and self-fulfilling.

Failure of Ratings Agencies—AAA Loses its Luster

Another major factor includes the failure of ratings agencies. The major ratings houses failed to perform proper due diligence on the mortgage pools backing the securities issued by Wall Street that were created from Subprime and Alt-A loans. Their own incentive to gain greater business served as an obstacle to objective judgment when it came time to attach their coveted AAA rating to various securities.[15]

Investors have long held the "AAA" standard in high esteem but now they question the entire premise upon which that standard is built. Many investors believe that the agencies failed as they did not verify the accuracy and integrity of the data upon which they based their ratings of different Mortgage Backed Securities.[16]

Ratings agencies failed to perform the necessary review and due diligence due to serious misalignment of incentives within their own structured system. In their heated competition to gain market share from the different Wall Street houses, credit agencies ignored problems that they were aware of ranging from the high risk nature of the loans backing the RMBS to outright fraud. The US Senate on Subcommittee on Investigations in their April 13, 2011 report said the result from the weakening of credit rating standards was "***a race to the bottom.***"[17]

The AAA rating is considered an *imprimatur* within the investment community as it delineates and separates the "sheep from the goats" as it were in terms of credit quality. According to the

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[14] Jeremy Siegel, Professor Economics at the Wharton School of the University of Pennsylvania as referenced in Knowledge@Wharton June 20,2008 Edition, ***"Subprime Crisis: Could New Rules Avert Another Credit Crisis? Perhaps, But Be Wary"*** **http://knowledge.wharton.upenn.edu/article.cfm?articleid=1985**

[15] US Senate Subcommittee on Permanent Investigations Report – "Wall Street and the Financial Crisis. Anatomy of a Financial Collapse" April 13, 2011 – Page 244
http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf

[16] Reuters "SIFMA Faults Raters, Calls for Global Advisory Board" July 31, 2008
http://www.reuters.com/article/2008/07/31/sifma-ratings-idUSN3135269720080731

[17] See Footnote 15 for source- same source Page 244

Senate Subcommittee report, ***"Traditionally, investments holding AAA ratings have had a less than 1% probability of incurring defaults."*** They went on to say of the impact of massive losses on AAA rated subprime RMBS that ***"Inaccurate AAA credit ratings introduced systemic risk into the U.S. financial system and <u>constituted a key cause of the financial crisis."</u>*** (emphasis added)[18].

The Financial Crisis Inquiry Commission (referred to as FCIC) which issued its Final Report in January of 2011 described the Ratings Agencies as ***"key enablers of the financial meltdown"***[19]. The Commission goes on to describe the way in which the AAA ratings stamped on poor quality RMBS backed by Subprime and Alt-A credit borrowers was relied upon by investors and in some cases required by regulatory mandates for financial institutions in determining acceptable investments for their portfolios. Even the Dissenting Statements of other Commission members assess that one of the causes of the Financial Crisis lies with the erroneous ratings given to RMBS by the Ratings Agencies[20]

So complex had the different forms of Private-Label (those offered that are not backed by HUD/FHA, Fannie or Freddie) RMBS and the disclosures that accompanied them become over the past few years that investors basically surrendered and ceded their obligation to perform their own due diligence and simply took the AAA rating as "gospel truth". In essence they ignored that first good rule of any investing is *caveat emptor*, "let the buyer beware". They too failed in their role to perform the necessary vetting of the securities they purchased. Instead they relied too heavily on the "seal of approval" that the "AAA" rating implied, not appreciating the fact the Agencies

New York Times columnist Joe Nocera, co-author of ***"All the Devils Are Here"*** in an interview in New York Magazine said the following in response to a question as to whom he would pick as the "absolute villain" of the crisis, ***"Institutionally, the biggest villains by far were the ratings agencies."***[21]

But what exactly was it that the Ratings Agencies failed to miss in their review of Private Label RMBS? Without a doubt it was the poor credit quality of loans backing the securities in the first place.

<u>At the Root of the Problem—"Product Innovations"—Subprime and Alt-A Loans</u>

Any truly free market system has within it the capacity for innovation and development of new processes, ideas and structures. The same is true in the markets for housing finance. Although

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[18] See Footnote 15 for source- same source Pages 243 & 244

[19] FCIC Final Report- Conclusions of the Commision- Page *xxv* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

[20] FCIC Final Report- Dissenting Statement of Commissioners Keith Hennessey and Douglas Holtz-Eakin and Vice-Chairman Bill Thomas—Page 426 http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf

[21] New York Magazine 11/16/2010 "Joe Nocera Likes to Be Angry" http://nymag.com/daily/intel/2010/11/joe_nocera_and_bethany_mclean.html

there is a small caveat to this in the sense that US Housing Finance has always had some component of government support or backstop. Certainly the role played for many years by FHA and HUD to promote affordable housing has been just such a backstop.

The role played by the GSEs in their support of providing a secondary market of liquidity for traditionally underwritten mortgages is also today a more explicit form of government intervention whereas prior to the Financial Crisis there was the "quasi" or "implied" government relationship between housing finance markets and the US Government via those same GSEs.

As we stated earlier, the low interest rate environment helped to create a "debt subsidy" and as global investment dollars poured into the US capital markets, Wall Street's innovators in the Private-Label RMBS markets began to churn away at new programs and products to bring more home lending to more borrowers. These complex products were not properly vetted by ratings agencies as well as by institutional and individual investors. But the product innovation is key to the entire crisis because it sowed the seeds of the economic disaster that would come to fruition in the Financial Crisis. The product innovation is the bridge that created the housing bubble into a credit bubble and kept it self-sustaining for so long.

The two main product features to spring up in the earlier part of the decade were those of "Subprime" and "Alt-A" loans. Rajdeep Sengupta, economist at the St. Louis Fed gives us the most basic definitions of these two terms. Subprime loans typically are those to borrowers with a history of poor credit performance whereas Alt-A loans typically are made to those borrowers with a history of good credit performance but are in need of more "aggressive underwriting" than traditional Prime Conforming and Prime Jumbo (Jumbo defines those over the GSEs Conforming Loan Limits; $417,000 for a Single Family Residence as of this letter)[22].

Let us examine each one in a little more detail beginning with Subprime.

A Short History and Background to Subprime Lending

Subprime loans did not make their first appearance or "debut" in credit markets in the early part of the decade as many may think. Rather in the days prior to the housing and credit boom most subprime lending had been done by traditional "hard money" lenders and consumer finance companies that made the loan and collected it themselves. However there were also other companies who did access the capital markets and securitized the loans. In 1997 the top 10 lenders held roughly 38% of the market collectively[23].

Such loans traditionally carried much higher interest rates and were essentially capped at much lower loan to value ratios. Traditionally the loans were serviced by the lender who made the loan at the finance company[24]. Such terms were done to keep the level of risk relatively low with the return to the lender relatively high.

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[22] Rajdeep Sengupta "Alt-A: The Forgotten Segment of the Mortgage Market" FRB of St. Louis *Review* January/February 2010, 92 (1) , pp. 55-71 http://research.stlouisfed.org/publications/review/10/01/Sengupta.pdf

[23] Brenda B. White, ***"A Short History of Subprime"*** *Mortgage Banking Magazine March 2006* http://findarticles.com/p/articles/mi_hb5246/is_6_66/ai_n29277523/

[24] The New York Times, ***"The Deal That Fueled Subprime"*** March 6,2009

In the autumn of 1998 a financial crisis was sparked when Russia devalued its currency, the ruble. The failure of the hedge fund, Long Term Capital Management sparked an incredible flight to quality among investors who sought the safety of US Treasuries. The result was that the market for liquidity for subprime securitizations evaporated and companies such as Southern Pacific Funding, ContiMortgage, AMRESCO and FIRSTPLUS all filed for bankruptcy[25]. Subprime was gone, for a while anyway.

From the late 1990's on there was a consolidation of firms as many traditional consumer finance companies were acquired by larger "money center" and "investment banks." Citigroup acquired Associates, JP Chase acquired Advanta and HSBC acquired Household International. It would not be until later in the middle of the decade that Subprime began its return.

Alt-A an "Alternative" to "Agency" Lending

Sengupta elaborates in his paper that Alt-A loans were typically made to borrowers with good credit histories but who were in need of more "aggressive underwriting" such as little to no documentation of income or allowance of higher debt to income ratios[26].

Originally Alt-A loans were created to meet the needs of borrowers with good credit who could not meet traditional underwriting standards when it came to particular parameters such as the verification of Income, Assets or Employment. In other words, it provided for lenders to allow flexibility in the underwriting to provide credit to borrowers who were otherwise unwilling or unable to provide the necessary documentation to support the qualifying information on the application.

Self-employed borrowers or borrowers who perhaps couldn't verify the source of their assets for down payment according to traditional means were able to find "flexibility" in the underwriting of their loan. Originally most Alt-A loans would be done to allow a borrower to exempt a single parameter of required underwriting information such as verification of income or of assets.

By 2003 the Alt-A market of programs had grown with different lenders offering their own "tailored suite" of products with Alt-A features. Examples of some of the "acronym soup" to describe the suite of products include[27]:

- SISA—Stated Income Stated Asset
- SIVA—Stated Income Verified Assets
- No Ratio- No Debt Ratio Calculated
- NINA—No Income No Asset, *aka "No Doc"*

"No Doc" loans were by far the riskiest of loans in the Alt-A product lines because of their inherent lack of information and data to verify the borrower even had the capacity to make the loan payment. In essence a "No Doc" loan was driven by credit score and down payment only[28].

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[25] See foot note 23 above- same source, White
[26] See footnote 22 above-same source, Sengupta
[27] "A Journey to the Al-A Zone; A Brief Primer on Alt-A Mortgage Loans" from Nomura Fixed Income Research, June 3, 2003 http://www.securitization.net/pdf/nomura_journey_060303.pdf

Perhaps the best way to describe Alt-A loans comes from Edward Pinto from the American Enterprise Institute who writes in a June 2008 Paper:

"Alt-A Loan: These loans either had low or no documentation requirements or had some feature that was "alternative to agency" (hence, "Alt-A")—i.e., did not meet the traditional underwriting guidelines of the GSEs in such characteristics as Original LTV, Combined LTV, debt ratio, rules for loans on investment properties, rules on cash-out refinances, condominium guidelines, special income definitions, low start rates, or negative amortization ARMs."[29]

"Alt-B" Lending—Better Known As "Hope and Faith Based Lending"

But perhaps the worst of the program "innovation" that lead to the credit crisis came from the marriage between Subprime and Alt-A that began to occur in 2005-2006.

A story entitled *"Subprime and Nonprime Are Blurring in the Indistinct World of Alt-B Lending"* from ***Secondary Marketing Executive*** perhaps best sums up what occurred:

"Prime Alt-A lenders adding Alt-B or Alt-A minus (which is between Alt-B and prime Alt-A) loans to their pools are diluting the quality of those securitizations."[30]

In essence the high demand for loans created in part by the "debt subsidy" of a low interest rate environment lead to the dangerous mixing of Subprime (known as "B&C Lending") and Alt-A. Now with Alt-B loans were being made to borrowers with impaired credit histories with little to no documentation.

The article goes on to say:

"Alt-B can be characterized as loans to prime borrowers with nonprime loan characteristics, explains Frank Sillman, CEO of the Mortgage Professionals Group of IndyMac Bank in Pasadena, Calif. In the past, prime borrowers were forced into subprime loans because of

those features. They were either prime or subprime, and there was nothing in between.

For instance, a 700-score, full-doc borrower with no assets used to need a no income/no asset loan for a full point in pricing. But an Alt-B loan now allows a full doc, no asset loan for an extra half point to five-eighths point of additional pricing.

"We've eliminated the cliffs on pricing," Sillman says. "The old 620 Mason-Dixon Line doesn't exist anymore. It's more of a continuum."

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[28] See Footnote 27 above- Same Source; Nomura Fixed Income Research

[29] Edward Pinto "Sizing Total Exposure to Subprime and Alt-A Loans in US First Mortgage Market as of 6.30.08" http://www.aei.org/docLib/Pinto-Sizing-Total-Exposure.pdf

[30] Secondary Marketing Executive August 2005 http://www.mortgageorb.com/e107_plugins/content/content.php?content.388

As new products emerged across that continuum, Wall Street players coined the Alt-B term, he says."[31]

The August 2005 piece from ***Secondary Marketing Executive*** exposes for us the beginning of the move to higher risk features in mortgage products. The products were heavily marketed and to no surprise were successfully sold to an entire new class of sub-par credit. The relative ease of less documentation and the ability to ignore certain negative aspects of a borrower's credit profile made these products all the more easier to market. For many borrowers the ability to own a home or remove equity was a dream come true. However if their credit didn't allow them the ability to borrow at traditional prime loan rates then no problem, "Alt-B" was there to meet their needs.

As Professor Mark Zandi, Chief Economist for Moody's Analytics writes on page 40 of his book ***Financial Shock***:

"By 2006, well over half of subprime loans were so-called 'stated income' loans; the borrower simply stated the income and the lender accepted that number. Some borrowers lied outright and many more stretched the truth to stretch into a mortgage."[32]

Subprime Arms, Option ARM's and Negative Amortization

As if the combination of poor credit and very little, if any, documentation of a borrower's ability to make a mortgage payment were not enough to bring elevated levels of risk into the housing finance system, the next addition would prove to be the pinnacle of poor product structure.

Wall Street's Wizards created and peddled Subprime loans using a risky product structure known as a "2/28" or "3/27" ARM. This basically meant the loan was fixed for the first 2 or 3 years and then went to a one year or 6 month adjustable rate note for the remainder of the life of the loan. Demyanjk and Gopalan write that ***"more than 45%"*** of the 3 million plus subprime loans originated and sold in the secondary market from 2004 to 2006 were ARMs based on information from LoanPerformance Corp[33].

The performance of these ARM loans has been abysmal to say the least. According to the latest figures available from the FRB of New York (for November 2010) approximately 56.9% of all outstanding Subprime Loans nationally are ARM loans. Further, approximately only 50.50% of all Subprime Loans nationally are even current. Roughly 13.5% are in Foreclosure and another almost 18% are 90 days or more past due on their mortgage payment.[34]

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[31] See Footnote 30 above- Same Source "Secondary Marketing Executive" August 200

[32] Mark Zandi, ***"Financial Shock—A 360• Look at the Subprime Mortgage Implosion and How to Avoid the Next Crisis"***, 2009 by Pearson Education, Inc. publishing as FT Press; Upper Saddle River, New Jersey

[33] Yuliya Demyanyk & Yadav K. Gopalan, "Subprime ARMs: Popular Loans, Poor Performance" in the Spring 2007 edition of ***Bridges*** published by the St. Louis FRB http://www.stlouisfed.org/publications/br/articles/?id=542

[34] Federal Reserve Bank of New York http://www.newyorkfed.org/creditconditions/

But not only did borrowers make use of 2/28 and 3/27 ARM loans. Perhaps the most dangerous of all loan structures was the "Option ARM." Option ARM loans, euphemistically referred to as "Pick-a Pay" or "Payment Option" or "Cash-Flow" ARMs became all the rage in the mid-point

of the decade. This was especially the case in overheated housing markets like California, Florida, Nevada and Arizona where home price appreciation put the ability of owning a home out of reach for many would-be homeowners[35].

An Option ARM is a loan with the potential for Negative Amortization to occur. Whether or not Negative Amortization occurs depends on whether or not the borrower "opts" to choose one of several payment choices. Traditionally those choices were: A 30 year Fixed Rate Amortized Payment; a 15 Year Fixed Rate Amortized Payment; Interest Only or the "minimum payment". The minimum payment would be based on a start rate or "teaser" rate and would actually be a payment below the actual market rates upon which the contractual obligation of the borrower under the note is amortizing. The result would be "negative amortization" evidenced by an increasing loan balance each month should the borrower choose to make only the minimum payment[36].

What Do You Get When You Mix Bad Credit, Lax Underwriting and Risky Product Features?

The results, as we know by now, were disastrous. The toxic mix of poorly underwritten loan products with high risk factors contributed to an essential "layering of risk" in which various program features and products indicative of higher credit and default risk were essentially "layered" one on top of the other. The traditional "4 C's" of lending*[37]- Capacity, Capital, Credit and Collateral had basically been stripped away to a single criterion—that of Collateral only. The premise was that as long as home prices continued to rise, borrowers would be able to refinance out before the ARM loan they had adjusted to a higher rate.

Professor Zandi explains on Page 38 of ***Financial Shock***:

"With so many borrowers with sketchy credit getting increasingly complex ARMs, a growing number faced difficulty staying current on their loans. Yet for millions to actually begin losing their homes, something else had to be at work. Credit risk managers call that

something else "risk layering". This was the combination of subprime borrowers and their unmanageable ARMs with little or no down payment, unverified and thus unreliable incomes, and already burdensome debt loads."[38]

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[35] CNNMoney.com "Option ARMs" Housing Recovery Killer?" 11/26/2009 http://money.cnn.com/2009/11/24/real_estate/option_ARM_defaults/index.htm?postversion=2009112607

[36] HSH & Associates "Option ARMs: A Negative 'Option' Explained (Pay Option ARMs)" http://library.hsh.com/articles/more-tools-resources-and-info/mortgage-basics/option-arms-a-negative-option-explained-pay-option-arms

[37] Author's Footnote: Some lists contain a 5th "C"; that of "Character"- the basis of which is that at the end of the day the borrower must be trustworthy to repay the loan. Some lists see "Credit" as indicative of that attribute.

[38] Mark Zandi- ***Financial Shock*** See Footnote 32 above- same source

Like a house of cards built on a foundation of beach sand, with the tide rolling in and the sea breeze blowing, it would only be a matter of time before these loans began to default. The combination of so many different high risk features diluted the probability of performance while raising significantly the likelihood of default.

Once again we turn to Professor Zandi who states in his special report ***"The Future of the Mortgage Finance System":***

"The loans backing securities in the private-label RMBS market grew increasingly risky. At the market's apex in early 2007, almost 40% of such loans went to subprime borrowers with low credit scores and carried elevated loan to value ratios. So-called alternative-A loans, made to homeowners whose credit files contained some irregularity, accounted for another 27% of the market."[39]

The stage was set for a spectacular collapse of epic proportions.

Borrower Incentives to Performance--The Role of Occupancy in the Financial Crisis

We believe it is prudent to pause and take stock of the exact role played by occupancy in the Financial Crisis as it relates to mortgage delinquencies and foreclosures. We believe that one cannot gain a proper perspective and more complete understanding of the crisis without taking into consideration the impact of foreclosures and defaults that occurred on loans for "Non-Owner-Occupied" (hereafter N-O-O) properties.

As if all the aforementioned layering of risk was not enough these toxic products were available for mortgage transactions on not just owner occupied homes but on N-O-O homes as well. An N-O-O could be for either a Second or "Vacation" home that is occupied part of the year by the borrower for seasonal/recreational use or an N-O-O may be an Investment Property. By that term we mean that the borrower may plan to hold the home as a rental for the cash flow created by a renter or the borrower may intend to hold the property for some time and sell it; what we would consider speculation.[40]

As Robinson and Todd go on to state, ***"Non-Occupant owners are likely to have different motives, characteristics, and behaviors than owner-occupants."***[41] The psychology of a default is much less punitive to the non-owner occupant as opposed to that of an owner-occupant where the borrower loses their actual domicile when one considers emotional impacts involved in

losing the home one occupies. Non-occupant borrowers have less incentive to perform should they be unable to simply for no other fact than one of lack of emotional ties to the home itself.

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[39] Mark Zandi & Cris deRitis Special Report "The Future of the Mortgage Finance System" Moody's Analytics February 7, 2011 http://www.economy.com/mark-zandi/documents/Mortgage-Finance-Reform-020711.pdf

[40] See Breck L. Robinson and Richard M. Todd *"The Role of Non-Owner-Occupied Homes in the Current Housing and Foreclosure Cycle"* Working Paper No. 10-11 May 2010 Federal Reserve Bank of Richmond Pages 2-3 http://www.richmondfed.org/publications/research/working_papers/2010/pdf/wp10-11.pdf

[41]

With less incentive to perform an N-O-O borrower is by their very nature of a more heightened risk. Combine this risk level with the ease of access to credit afforded by Alt-A and non-prime loans with little to no documentation of a borrower's ability to repay and you have a recipe for disaster. The "risk layering" was being ramped up as Professor Zandi explains further:

"Alt-A and jumbo borrowers weren't quite as layered up, but they weren't far behind. In 2006 for example, nearly 15% of Alt-A borrowers were investors; they bought a house not to live in, but to sell quickly at a profit. These buyers were much more likely to walk away from a bad mortgage deal."[42]

The Federal Reserve Bank of New York further fleshes out the details in their State by State Level Loan Characteristics on Alt-A loans available on data through November 2010. Using data from FirstAmerican CoreLogic, FRB-NY shows that 27.8% of outstanding Alt-A loans in the US as of November 2010 was secured by Non-Owner Occupied homes. But certain states where property values have crashed since peaking in 2004-2005 have higher concentrations. For example, 36.4% of Alt-A loans in Arizona was secured by N-O-O; 37.6% in Florida and 35.7% in Nevada.[43]

There is a direct correlation between the easy credit terms afforded investors through Alt-A and Subprime loans and the marked and rapid increase in the percentage of sales of homes that were N-O-O from 2004-2007, the peak years of the real estate and credit bubbles.[44] The ability to finance an N-O-O with this type of reduced and relaxed documentation, if it can even be called "documentation" with a straight face, helped to fuel the speculation that drove both the housing bubble and housing credit bubble in overheated markets such as Las Vegas, Miami and Phoenix. Speculative buying and selling by investors continued to drive up home prices in roughly 20 major metropolitan markets.[45]

Such ease of access and rapid price appreciation for speculation in N-O-O essentially fed the increase in real estate transactions perhaps accounting for as much as 61-70% of the increase in home sales from 2004 through 2005.[46] Such rapid appreciation continued until the point the speculation stopped as real estate prices began to crash. From there we see the fallout created by the extension of no and low documentation loans and subprime loans on ARM structures to borrowers purchasing an N-O-O property.

What were the results? It was a housing "ARMageddon" *(pun FULLY intended)*. Professor Douglas G. Duncan, the MBA's Chief Economist in his commentary on the MBA's National

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[42] Zandi, ***Financial Shock*** Page 40; See Footnote 32 Above- Same Source
[43] Federal Reserve Bank of New York http://www.newyorkfed.org/creditconditions/ and http://www.newyorkfed.org/regional/States_AltA.xls
[44] Keith Jurow "Investors Played a Key Role in Creating Housing Bubble" World Property Channel 3/5/2010 http://www.worldpropertychannel.com/us-markets/residential-real-estate-1/real-estate-news-real-estate-investors-real-estate-speculators-home-foreclosure-crisis-realtytrac-national-association-of-realtors-home-foreclosure-rates-in-2010-2136.php
[45] Keith Jurow—See Footnote 44 above- Same Source
[46] Robinson and Todd—See Footnote 40 above-Same Source Page 7

Delinquency Survey for the First Quarter of 2007 helped put into perspective the impact of ARM loans on N-O-O properties:

"Information provided to the MBA from a variety of sources indicates that the foreclosures in Florida, Nevada, California and Arizona are heavily influenced by speculators who are walking away from properties now that home prices have started to fall in areas of those states and they face resets in the adjustable rate mortgages they took out for these homes."[47] *(emphasis added)*

Les Christie of CNNMoney.com goes on to reference Duncan in a piece less than 90 days later on August 30, 3007 where he quotes Duncan as saying ***"Defaults are on the rise in most parts of the country, but…it is not always the case of a homeowner losing his or her home but [it's] often the case of an investor gambling on a continued increase in home values and losing that gamble."***[48]

Christie goes further and references the percentage of defaults in Nevada, Arizona, Florida and California for both Prime and Subprime loans on N-O-O properties. Nevada sat with 32% of all prime mortgages in default and 24% of all subprime defaults being on N-O-O. Arizona was at 26% Prime and 18% Subprime and California at 21% Prime and 15% Subprime. Florida stood out at 25% of prime defaults being N-O-O and 14% of Subprime defaults being N-O-O. This occurs while the national average of Prime Defaults that were N-O-O was 13% and 11% on Subprime.[49]

In markets like the San Francisco Bay area by the end of 2007 roughly 20% of all properties that had fallen into foreclosure the first nine months of the year were owned by investors. Erin McCormick and Carolyn Said write in the December 16, 2007 *San Francisco Chronicle* that:

"Easy money through no-questions asked subprime mortgages allowed almost anyone to become a real estate speculator." They go on to say further in the article that, ***"The vast majority of these properties were bought with little or no money down, according to an analysis of DataQuick's loan information. Some 80 percent of the investor-owned Bay Area foreclosures were purchased at the height of the real estate market in 2005 and 2006, public records show."***[50]

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[47] Douglas G. Duncan, Mortgage Bankers Association "Delinquencies Decrease in Latest MBA National Delinquency Survey" June 14, 2007 http://www.mortgagebankers.org/NewsandMedia/PressCenter/55132.htm
[48] Les Christie "Flippers Fuel Foreclosures" CNNMoney.Com 8/30/2007 http://money.cnn.com/2007/08/30/real_estate/flippers_fuel_foreclosures/
[49] Les Christie- See Footnote 48 Above- Same Source
[50] Erin McCormick and Carolyn Said, "Investors Own About One-Fifth of Bay Area Homes in Foreclosure" 12/16/2007 *San Francisco Chronicle* http://articles.sfgate.com/2007-12-16/news/17272865_1_foreclosures-real-estate

The layering of risk combining little to no down payment for Non-Owner Occupied/Investment properties being purchased as speculations. The authors of the *SF Chronicle* piece further investigate the heightened instances of fraud that may be in play in the instances of speculating borrowers facing multiple foreclosures. Fraud is the more ***"sinister side of flipping"*** as they say in the article.[51]

We believe it is essential for the Agencies to understand in the final crafting of any Risk Retention Rule that the Financial Crisis must be looked at in an accurate, honest and historic context. The application of "blanket risk retention" across the board as the Agencies propose

would serve to crowd out reasonable lending to those borrowers who need it versus those who are using questionable products with poor structure, underwriting and features to engage in reckless speculation which ultimately feeds a housing and credit bubble and amplifies the damage and fallout from the bursting of the same. It is absolutely critical that the Agencies understand the roles of Occupancy and Speculation that were present in the Financial Crisis.

The combination of these multiple risk layers would lead to the complete collapse of real estate markets around the nation as thousands upon thousands of foreclosures can trace their roots back to the fact they were speculations or "bets" on the direction of housing prices. Furthermore they many were structured on the risky 2/28 ARM structure with little to no documentation thus effectively making them an "Alt-B" loan as referenced above.

It leaves little room for surprise then that so many would fail. The words of Layne Sapp, the CEO of MILA, Inc a former subprime wholesaler quoted in the ***Secondary Market Executive*** piece from August 2005 would ring eerily prophetic. He warns about the potential for home prices to deteriorate (the one thing that "nobody" in the Subprime laboratories of Wall Street saw happening) and thus spike delinquencies. The article says:

"With home values appreciating, lenders can afford to have looser underwriting criteria, but if that appreciation slows, underwriting will tighten up, Sapp predicts. (Quoting Sapp) 'Everybody is pushing the underwriting envelope. Everybody is buying deeper into the credit spectrum. If lenders aren't careful, there could be a train wreck' he warns."[52]

A "train wreck" was a nice way to describe the juggernaut that was hurtling itself towards the American economy due to the risk created by these programs.

<u>Analysis and Diagnosis</u>

We've come to the end of our review of the background to the Financial Crisis in terms of the root causes that lead to the rapidly deteriorating credit conditions and rapid rise in foreclosures and mortgage delinquencies.

At this point our good doctor would render their diagnosis and prescription of a proper, safe and relevant treatment regimen.

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[51] McCormick and Said- See Footnote 50 Above-Same Source
[52] See Footnotes 30 and 31 Above- Same Source

The Diagnosis: Credit markets became inflated into a bubble as were housing markets in the earlier part of the decade due to relaxed monetary policy, inflows of global capital, a lowered interest rate environment and other economic forces in play. This created essentially a "debt subsidy" that in turn spurred innovation in programs and products to expand credit availability.

Poorly structured products with little to no documentation of a borrower's ability to repay the obligation were created and made readily available to mass segments of the population. These products contained inherently risky features that posed a greater potential for default (2 Year ARM loans, Interest Only and Negative Amortization for example) due to payment shock that would occur. Furthermore these products eventually whittled away at the traditionally accepted

underwriting standards of Credit, Capacity and Capital and left Collateral only as the main underwriting feature by which the loans would be based. To illustrate consider the following data points all from a study by the GAO given in a PowerPoint presentation in October 2007:[53]

- The study shows Subprime and Alt-A loans accounting for 65.4% of the increase in defaults; 70.7% of the increase in foreclosure starts and 68.9% of the increase in foreclosure inventory from Q2 of 2005 through Q2 of 2007.

- The study further indicates on Page 15 of the presentation a steady easing of underwriting standards and wider use of certain features by showing an increase in the number of Subprime ARM loans and specifically 2/28 ARMs in Subprime and Alt-A products. From 2003 the percentage of Subprime ARM loans from about 60% to a little under 80% by 2006. Alt-A was a more rapid increase from roughly 30% of all Alt-A loans being ARMs in 2003 to roughly 65% ARM share of Alt-As in 2006.

- The study further shows the percentage of Alt-A and Subprime loans with low or no documentation rising steadily over the 2003 to 2006 timeline from roughly 60% to 80% of all Alt-A loans having no or low doc with Subprime moving from the upper 20%'s to over 40% no or low doc in the same time period.

- The study also indicates that the percentage of loans with Interest Only and Negative Amortization features saw differing trends in the same 2003-2006 timeframe in both Subprime and Alt-A categories with Interest Only (I.O.) be leveling out and actually declining from 2005 to 2006 in Subprime to about 20% of the Subprime Loans done from around 30% peak in 2005. Alt-A stayed between the 40% to 50% range in that timeframe. Negative Amortization loans skyrocketed on Alt-A from about 5% of all Alt-A loans having "Neg Am" features to over 40% by mid 2006. Subprime moved from basically 0% in 2003, peaked in 2004 at around 20% of all Subprime originations having "Neg Am" features before declining again to almost 0% by mid 2006.

[53] US Government Accountability Office presentation by Steve Westley to the Hudson Institute October 24, 2007 http://www.google.com/url?sa=t&source=web&cd=1&ved=0CBkQFjAA&url=http%3A%2F%2Fwww.hudson.org%2Ffiles%2Fdocuments%2FWestley.ppt&rct=j&q=%22GAO%22%20%22Overview%20of%20the%20Subprime%22&ei=cakvTrnGD4izsALNwMF6&usg=AFQjCNHqD0ymw2JpipbxBohxzFv0RF5L-g

Based on this data is it logical that the diagnosis would take into account that product structure played a key role in the failure of NTMs (Subprime and Alt-A; "Non-Traditional Mortgages") to perform as agreed? With roughly 80% of all Subprime loans made in 2005 being ARMs and 3 out of 4 of each ARM being a 2/28, the payment shock resulting would tend to be too much and that would normally force a subprime borrower into refinancing.[54] However, with property values declining, borrowers who had maxed out on previous refinancing taking cash out, etc found it impossible to refinance a higher balance onto a lower value home. Many borrowers opted to walk from the home.

Our diagnosis would further conclude that the "layering of risk" played a key and integral role in the ramping up of toxic product into the housing finance system as it increased the overall total risk by the combination of various characteristics that may cause higher instances of default. A study by MGIC as referenced in Professor Zandi's report *"The Skinny on Skin in the Game"* takes an in-depth look at the increased potential of foreclosure that each attribute adds to the average mortgage loan including both product features and reduced underwriting standards:

Incremental Foreclosures Risk By Loan Attribute

Negatively Amortizing ARM	3-4 times
Reduced documentation	3 times
Subprime Credit	2-3 times
Non-owner occupied	2-3 times
Amortizing ARM	1.5-2 times
Over 45% total debt-to-income ratio	1.5 times
Cash-Out Refinance	1.5 times

Incremental risk relative to the performance of the base loan shown in Table 1 that is similar in all respects except for the risk factor being analyzed.

Source: MGIC[55]

Treatment Regimen

Now that we know our diagnosis we turn to the treatment recommendations.

Of course, it's obvious what caused the Mortgage and Financial Crisis—poor credit quality coupled with poor structure in terms of loan programs and products. The fact that the loans were securitized is secondary and only incidental to the fact that the loans themselves were inherently toxic by virtue of being poorly underwritten and based on the most ridiculous of "standards". The problem was not "securitization" but rather "lending standards". The goal should be to improve the screening of loans for access to the system of securitization not by charging the "hidden tax" of Risk Retention universally on each loan as the former FDIC Chair wishes nor on all loans except a very small subset (which we believe runs counter to the stated, clear and explicit intent of Congress regarding the QRM). Rather the goal must be to balance the dual

[54] Faten Sabry and Thomas Schopflocher "The Subprime Meltdown: A Primer" June 21, 2007 NERA Economic Consulting http://www.nera.com/extImage/PUB_SubPrimer_1108.pdf
[55] Mark Zandi & Christian deRitis Moody's Analytics, "The Skinny on Skin in the Game" March 11, 2011 http://www.economy.com/mark-zandi/documents/QRM_030911.pdf

mandates of improving credit quality and avoiding a restriction of access to credit markets for soundly underwritten loans.

To illustrate take the example of a drunk driver who gets into his auto and has an accident killing other persons. What is the direct causation? Is the auto or the fact the operator of the automobile was intoxicated? While the car itself was used as an instrument of death and destruction does that make the automobile inherently dangerous? No. The fault and causation lies with the intoxicated driver. Would it make any economic sense (or common sense for that matter) to force automobile manufacturers to completely re-create the automobile structure, system, etc so as to make it so expensive and cumbersome they decide to exit the auto manufacturing business because government regulation has made it so expensive for the vast majority of consumers that he or she cannot purchase the auto?

The point here is that the problem to solve is keeping the drunk driver out of the driver's seat in the first place. Think of the system of securitization as the automobile. Think of the toxic loans as the drunk driver. The way to properly prevent this credit meltdown from occurring again is to address the issues of:

1. Verification of Ability to Repay (Addressed through the Recent FRB proposal on the Qualified Mortgage or QM) and the effective removal of No Doc and Low Doc loans from the system

2. Product Structure- tighter controls on ARM loans and risky features such as Interest Only and Negative Amortization

The good news is that the Agencies can look to other rulemaking and regulatory mandates promulgated in the past two years that are in effect today that achieve these ends. We will expand on that shortly.

With these two goals in mind for our "treatment regimen" let us now turn to our Philosophical Principles regarding Risk Retention and the Rulemaking therein.

Preamble and Principles of Risk Retention

The word "credit" is derived from the Latin "*credere*" which means basically, "to believe". Inherent to the concept of belief is trust, that basic principle common to human beings regardless of race, gender, nationality or culture; which says that one may place a level of faith essentially in the promises of another. The foundation of banking, especially community banking is about that very same concept- trust. It is about the trust that our customers put in us and we in them. The very notion of basic banking- depositing and lending alike- is about trust.

So it is no surprise that credit ought to be about basic trust; specifically that a borrower may trust the terms that a lender gives them in a loan transaction and for the lender that they may trust the borrower to repay according to those same terms.

What has been lost in the debacle of the Subprime and Alt-A Mortgage Meltdown is that most

basic trust between borrower and lender. So too has trust been lost at the investor level of those who purchased RMBS backed by toxic assets. While a healthy dose of skepticism is always advisable in the underwriting of any loan, borrowers must know that they have a certain amount of security in terms of their monthly mortgage payment. Likewise, lenders must know that they will see the return of their principal lent with the investment return paid in the interest.

It has been said that "Risk Retention is a solution in search of a problem." In light of the many reforms and regulatory changes that have taken place both pre and post Dodd-Frank, it can easily be argued that Risk Retention itself is a form of regulatory "overkill" to the most extreme of degrees ***IF*** the QRM remains narrow and Risk Retention is applied broadly to the overall market.

However if QRM and Risk Retention are applied specifically and directly into those areas of the marketplace where risky assets were originated then the impact on creditworthy borrowers access to credit will be minimized. The impact we will address is that of bifurcation of market pricing for QRM versus Non-QRM loans and that of the basic offering of non-QRM loans.

We believe that in the framing of any regulatory policy it is prudent to follow principles which serve to best implement the policy in accordance with Congressional intent that furthermore will not endanger economic recovery in these fragile times.

To that end we offer the following "Principles of Risk Retention" that we believe best expresses the role that this policy is intended to play and the one for which it is best suited. Our principles herein address the different sections of the proposed rule for which the Agencies have made request for comment.

The principles are:

I. ***Risk Retention rules must be constructed so as to meet the maxim of primum nil nocere, "First do no harm" taking into account the impact to be had by specific portions of the Rule in relation to definition of boundaries and parameters***

II. ***Risk Retention, as framed by the statue, is intended by Congress to be a MEANS to an End- not the End itself***

III. ***Risk Retention cannot be viewed in isolation from or as exclusive to other policy making related to reforming regulation of housing and mortgage finance nor may it be viewed in isolation from the QM defined by the FRB in ability to repay rulemaking***

IV. ***The Final Risk Retention rule must enable a "dynamic" as opposed to "rigid" QRM Exemption that is wide in scope and is better aligned with Congressional intent, allows for multiple paths into the QRM "Safe Harbor" and does not seek to be used as tool to pick "winners and losers" in Housing Finance and Credit Markets.***

The main argument at hand is this—Risk Retention seeks to influence the quality of assets being securitized by influencing the behavior of originators & sponsors through the process of incentives and disincentives applicable to the capital structure of those firms. In so doing, the theory is that it will prevent toxic assets from entering into the system as sponsors will be less likely to place risky assets into securitization pools on which there's a higher degree of default.

As we explain further in these principles we believe the end will not be attained without great cost to the structure of securitization markets, housing markets and ultimately the US Economy.

With that in mind we turn to our First Principle:

Principle # 1 "Primum non Nocere—First Do No Harm"

We believe that any prudent policymaking process which seeks to prevent the potential for past harms to be repeated is a process that incorporates as its first and overriding principle the doctrine of ***Primum non Nocere, "First Do No Harm"***.

While commonly used in medical parlance when describing the role of the physician in treating the patient, this doctrine is no less relevant and just as applicable in the debate over the creation of Risk Retention Policy. The Agencies are in effect taking on the role of "physician" in their creation of policy to implement the guidelines of Section 941 of DFA.

Just as a prudent physician would not want to recommend a treatment in an ill-informed manner so to must regulators resist the temptation to practice their own form of "defensive medicine" in the form of over-reaching rulemaking that goes beyond the scope of legislative intent. As a result of aggressive regulation, the actual harms that are sought to be addressed by the rule will only be amplified and made worse instead of being addressed adequately.

Therefore the most prudent and logical perspective from which the Agencies ought to approach this rulemaking process is best summed up in the following bullet points regarding the final rule that implements the Risk Retention goals outlined in Section 941:

- The final rule must not create nor encourage the potential to create credit constriction, higher interest rates and costs of housing credit and/or drain credit liquidity from housing finance markets;

- The final rule must not seek to "radically overhaul" or "radically alter" the current system of securitization in such a way as to upset the basic fundamentals of longstanding credit markets the effect of which (such an upset) would be to lead to the deleterious harms aforementioned above;

- The final rule must be reflective of a thoughtful and prudent cost-benefit approach analysis which juxtaposes the short and long term costs of the rule versus any short and long term benefit attained;

- The final rule must create an environment, consistent with Congressional intent, which will foster sound underwriting, higher quality mortgage product innovation and ***greater access to multiple sources of sound and affordable housing credit***.

The principle of ***"first do no harm"*** in relation to Risk Retention can best be summed up as the following; the Agencies must not create a final rule in their zeal to improve credit quality to unrealistic levels of default so as to foster the creation of a housing finance system which creates sharply distinct classes of borrowers and mortgages and thus raises significant the cost of credit and lessens the availability of credit to many potential borrowers.

We also believe that Congress has intended the same principle of ***primum nil nocere***. We would point out that part of that intent is found in the new Section 15G (d) Originators (2) (C) where it speaks to the potential impact of risk retention obligation on consumer and business access to credit on reasonable terms[56]. We believe this is indicative of Congress' intent, along with the mandating of the studies by the FRB in Section 941 and the study on the Macroeconomic effect of Risk Retention by the FSOC in Section 946 in making certain that the impacts of the rule as carried out will not endanger the access to credit for the vast majority of American consumers and businesses.[57]

As mentioned earlier in our letter, as of the current time (mid-year 2011) housing markets are continuing to slide as the nation experiences a "double dip". Job creation and economic growth are anemic and sluggish. The imposition of the massive regulatory "reworking" upon Banking and the Financial Sector in general both pre and post DFA are creating nothing more than further

[56] Dodd-Frank Act Section 941 (b) (d) (2) (C)
[57] Dodd Frank Act Section 941 (b) (i) "Effective Date of Regulations" (c) Study on Risk Retention (2 Report AND Section 946 in its entirety refer to the mandated study by the Federal Reserve Board and the Financial Services Oversight Council respectively

costs to the entire credit system itself which delivers the ability of the real estate sector of the nation's economy to function.

The proposed rule will only serve to further raise costs to institutions and therefore to consumers using the credit products provided by the banking and financial sector. We see that this first principle cannot be reconciled against two key components that the Agencies have proposed—

the Qualified Residential Mortgage (QRM) exemption to Risk Retention requirements and the Premium Cash Capture Reserve Account (hereafter PCCRA).

Qualified Residential Mortgage Exemption (QRM)

Some have argued that the QRM in being the *exception to the rule* should by its very nature be very narrowly focused. That argument would be true if the intent of Congress were to make Risk Retention applicable on all assets; something former Chairman Bair has alluded that she would like to see occur regardless. We address this point further in our second principle.

However it is interesting that the Congress would place the requirement for studies about the impact of Risk Retention in the first place if there was not the concern among legislators that a broadly imposed form of Risk Retention would not have adverse economic effects in the first place.

Let us examine the proposed QRM Exemption in the Rule itself:

- Applicable to only Owner Occupied Primary Residences
- Excessively low Loan to Values including 20% Down Payment for Purchases; 75% Loan to Value Maximum on Non-Cash Out Refinances and 70% LTV Maximum on Cash Out Refinances.
- Extremely low Debt to Income Ratios of 28% Front and 36% Back Ratio. The Front or Housing Payment Ratio is the ratio of the monthly housing payment to the gross monthly income. The Back or Total Ratio is the ratio of all monthly creditor payments including the new proposed mortgage to the gross monthly income.
- An inflexible credit standard as proposed in no 60 day late payments in the previous 24 months and no current 30 day late payments at time of application is excessively vague and fails to take into account the extensive modeling that has occurred with FICO and other credit score mechanisms over the past 25 years.

The main problem that the QRM's above parameters exhibits is that is a rigid and inflexible rule that fails to recognize that underwriting is part science and part "art" but is not 100% one or the other. Any good lender can attest to that. The failure of a loan to meet a single criterion above automatically subjects it to Risk Retention requirements. This "isolative" type of viewing each parameter independent of the other is the opposite extreme of the Alt-A and Subprime debacle

when too much emphasis was given to only the value of the collateral. But whereas the standards were too loose with those programs the QRM has the opposite impact of being too constricting.

In each instance we have examples from our own Retail Originations from October 1, 2010 through June 30, 2011 that would fail to meet at least one field of the QRM requirement that when examined. We would submit for the Agencies the following loans that would each be subject to Risk Retention but when viewed ***in its totality*** is seen to be at very low risk of default.

Each of these loans were underwritten using Automated Underwriting Systems and Full Documentation of Income, Employment and Assets. Yet each fails due to the strict construct of the QRM itself. The field which creates the FAILURE to meet is highlighted:[58]

Purpose	Term	LTV	Credit	Front Ratio	Total Ratio
No Cash Refi.	10 Year Fixed	37.800%	No Lates/752	31.172%	39.124%
Purchase	15 Year Fixed	94.997%	No Lates/700	15.149%	22.288%
Cash Out Refi.	15 Year Fixed	71.000%	No Lates/739	17.352%	26.189%
No Cash Refi.	15 Year Fixed	75.459%	No Lates/746	14.403%	19.128%
Purchase	30 Year Fixed	57.112%	No Lates/789	31.915%	36.349%
Purchase	30 Year Fixed	70.000%	No Lates/785	29.861%	39.346%
Purchase	30 Year Fixed	88.571%	No Lates/758	16.715%	26.546%
Purchase	30 Year Fixed	80.000%	No Lates/809	29.522%	30.409%

In short, the QRM as constructed is overly rigid and violates that first principle in that it would force Risk Retention on loans such as the above where even the slightest violation of one of the parameters would throw it outside any reasonable and sensible Safe Harbor. Even the concept of setting such rigid boundaries must also call into question a lender responsibility as well to the borrower.

For example- in the first example of the No Cash Out Refinance at 37.80% LTV with front ratio exceeding by more than 2% points the QRM limit and the back ratio by slightly over 3% points; had the loan been done on a 15, 20 or 30 Year Amortization it would have had a lower payment and most likely met all the parameters to be a QRM—however, the consumer would face a higher rate due to the longer term and have an longer period to pay the debt and thus pay more interest.

This specific example could lead to unscrupulous lenders attempting to "game" the system and offer the borrower longer terms to lower debt to income ratios in order to make them qualify for the loan or entice them to take the longer term but "pay more" towards the debt to pay it off early

[58] Taken from our own review of Retail Dept Closings from October 1, 2010 through June 30, 2011. "No Lates" means there is nothing in the past 24 month credit history of the borrower that according to the proposed rule would disqualify them from meeting the QRM. The number after the backslash is the mid or qualifying FICO credit score used. Our system was unable to examine each loan in our almost 400 screened conventional loan units to see if it meets the very unique credit standard therefore there are no examples above showing that the loan failed to meet the credit standard alone; however credit was reviewed on each example above before posting the data into the table.

when in reality if a borrower with as much equity and as excellent credit as the above asks for a 10 Year loan with those Debt to Income ratios then it is irresponsible to not make the loan as a 10 Year loan is by its very nature, "less risky" as it is a shorter term in which the debt is outstanding.

Regarding the LTV limits—the Senate authors of the QRM Exemption to Risk Retention have made it clear beyond the shadow of any doubt their intent regarding LTV's vis a vis the QRM itself. In their letter of 16 February 2011, Senators Hagan, Landrieu and Isakson addressed the

heads of the respective agencies and clearly stated the intent of the QRM as they envisioned it specifically stating that although they held discussion about a minimum down payment in the QRM they ***"intentionally omitted such a requirement"***[59]. The QRM authors go on to state further that they intended QRM to support the creation of a ***"robust underwriting framework that will attract private capital to support responsible lending and borrowing"*** and that those families in areas of the country hardest hit by the housing and credit collapse would find ***"a high down payment simply out of reach"***[60]***.*** The Agencies have a duty to respect the Congressional intent of the QRM's authors in re-proposing the rule.

We would also indicate that the Congress must have intended to broaden the Safe Harbor of QRM as the statute casts a wide net exempting loans insured through FHA, VA, HUD's Native American 184 Program as well as USDA loans for the Guaranteed Rural Housing Program (Section 502 Single Family Program). Certainly the underwriting and product features of these programs must play a role in their obtaining the exemption and not just the "full faith and credit guarantee" of the Federal government, a guarantee which as of this moment is being gravely tested in the halls of government as our leaders debate the issue of raising the nation's debt ceiling.

Looking at each individual component of the proposed QRM we see how it will fail our Primary Principle of "First, do no harm." We begin with the overly zealous Loan to Value Ratios (LTV).

Loan to Value

Higher down payments will impact lower to moderate income borrowers most and limit their options to most likely FHA loans only; which then may have requirements of its own that could subsequently disqualify otherwise creditworthy borrowers from purchasing a home. According to analysis using NAR (National Association of Realtors) provided data, the Coalition for Sensible Housing Policy shows it would take an average family 16 years to save the amount needed to put 20% down using current median home sales price, borrower income and average savings rate data[61].

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[59] February 16, 2011 Letter to Agency Heads from Senators Hagan (NC), Landrieu (LA) and Isakson (GA) http://www.federalreserve.gov/SECRS/2011/July/20110711/R-1411/R-1411_062411_81705_592214916466_1.pdf
[60] See Footnote 59 Above- Same Source
[61] Coalition for Sensible Housing Policy Comment Letter June 22, 2011 Page 4 http://www.federalreserve.gov/SECRS/2011/July/20110713/R-1411/R-1411_071111_81825_448305040394_1.pdf

The Coalition, made up of 45 associations from across the spectrum of stakeholders represents a rich diversity of the American public. From the NAACP to the National Urban League to the Consumer Federation of America to the Mortgage Bankers Association, American Bankers Association and Center for Responsible Lending; the Coalition has in union together a powerfully compelling 10 page comment letter that we strongly encourage the Agencies to take note of its analysis and recommendations in their final construction of the rule.

The Coalition paper goes on to cite data from a 2010 study done by Vertical Capital Solutions for Genworth Financial and the Community Mortgage Banking Project. In it the study examines the impact of larger down payments on mitigation of default versus the number of borrowers it

would disqualify from meeting the overly burdensome high bar of LTV. There is relatively minor improvement in performance rates with larger down payments versus the larger percentages of borrowers who are eliminated from being able to meet that standard. The result as the paper says ***"compromises the intent of the QRM provision in Dodd-Frank, which is to assure clear alignment of interests between consumers, creditors and investors without imposing unreasonable barriers to financing of sustainable mortgages."***[62]

Furthermore, as data from CoreLogic shows, 39% of homebuyers in 2010 would have been eliminated from meeting the 20% down requirement[63]. CoreLogic's data also shows that some of hardest hit states such as Nevada, Arizona, Georgia, Florida and Michigan would also be most impacted due the massive decline in real estate values in those states.[64]

Given that these states had many borrowers who were harmed by the subprime and Alt-A product features and the fact now that they lack the equity to obtain what will arguably be the best priced mortgages in the market, it is patently unfair and also a very unwise policy move to require such large equity positions for homeowners to refinance out of such products. Requiring 25% equity for a No Cash Out Refinance disqualifies 64% of homeowners in Michigan, 66% in Florida, 65% in Georgia, 72% in Arizona and a staggering 83% of homeowners in Nevada[65].

Phoenix, Arizona is considered at the very core of the housing crisis. In the metropolitan area of Phoenix 2 out of every 3 residential mortgages are considered "underwater"; meaning more is owed on them than they are worth. Roughly 200,000 of mortgages are roughly 50% larger than the value of the homes[66]. With so many homes "underwater" there is no chance that a QRM with such a strict LTV would do anything but perpetuate the crisis.

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[62] See Footnote 61- Same Source Page 5
[63] Jon Prior "QRM Would Have Cut out 39% of Homebuyers in 2010: CoreLogic" HousingWire 5/17/2011 http://www.housingwire.com/2011/05/17/qrm-would-have-cut-out-39-of-homebuyers-in-2010-corelogic
[64] Jon Prior "QRM Requirements Could Slash Refinancing in Hardest Hit States" HousingWire 6/22/2011 http://www.housingwire.com/2011/06/22/qrm-requirements-could-slash-refinancing-in-hardest-hit-states
[65] See Footnote 64—Same Source
[66] Barry Wood "Stuck in Phoenix, the Epicenter of Housing Crisis" for MarketWatch July 28, 2011 http://finance.yahoo.com/real-estate/article/113212/phoenix-epicenter-housing-crisis-marketwatch?mod=realestate-sell

What lender will want to offer anything but QRM loans in these markets due to the fact they would have to hold back risk and subsequently capital in order to cover potential losses in a market where losses would naturally be higher due to the decline of real estate values in the first place? Absent a common sense rule regarding LTV, there will be little to no tangible ability or options for those in the hardest hit states to bridge out of the defective products many of them may still be in and thus the real estate market will move along sluggish at best. Furthermore a lack of lending options to consumers with well structured products is likely to lead to a resurging in non-bank financials returning to the market imposing higher cost options to the consumer.

Debt to Income Ratios

The Rule's Debt to Income Ratio is also overly restrictive as proposed. Like LTV they are overly rigid and lack the ***dynamic flexibility*** that is required in any prudent underwriting that

takes into account the total credit profile of the borrower. Nor does the rule take into account the cumulative rise in the cost of housing over history, inclusive of recent declines in value, relative to the less spectacular rise in real incomes after other cost of living expenses the past 40 years. The rule does not take stock of the fact either that with both a housing ratio and total ratio one could have a borrower with only one debt- the home mortgage- that exceeds the front ratio of 28% but is below that of the total 36%. Certainly such a borrower should not pose an excessive risk to require retention therein.

The construct of the rule regarding ratios also does not take into account the increase of a housing payment due to the shorter term inherent in a 15 or 10 year note. From our own example above (10 Year Note) we'd submit that the rule is blind to the point that a longer term might lower the DTI to get the loan into the QRM but would essentially harm the borrower in terms of a higher rate and potential for more interest to be paid.

These are just several reasons the Agencies should re-work the rule on Ratios and we would advance a recommendation of a more dynamic and flexible rule that takes into account the cross section of different characteristics of the borrower's overall credit profile and terms of the proposed loan. Residual income should be a characteristic considered for higher DTI% borrowers as well. This runs in tandem with the spirit of the QM which we discuss further later in this letter.

Credit Performance Parameters

The requirement by the proposed rule regarding credit history is overly vague and lacks the clarity and transparency needed to give proper guidance to lenders. We appreciate the reluctance and caution the Agencies express in using particular credit scoring however we believe to do so is to also miss several valid points including:

1. The adoption of credit scores industry wide has lead to a greater reliability, objectivity and accuracy in the predictive values of a borrower's credit performance;

2. Inability to use credit scoring will impose new compliance costs on lenders as they screen for these other standards;

3. There is a blind spot created by how seemingly immaterial events such as a medical collection due to perhaps a dispute with an insurance company may disqualify an otherwise creditworthy borrower from qualifying for the QRM.

We would point out that the Federal Reserve has indicated already in August 2007 in the opening paragraph of their report to Congress regarding credit scores that ***"The large savings in cost and time that have accompanied the use of credit scoring are generally believed to have increased access to credit, promoted competition and improved market efficiency"***[67]

We would also point out the significance found in HUD's decision announced in January of 2010 to require a 580 or higher credit score for borrowers to qualify for the minimum 3.5% down payment. Borrowers with scores under 580 are subject to 10% down payments. FHA's announcement was in the context of "addressing risk" to strengthen the overall FHA insurance fund. Part of their statement read in regards to their FICO decision that:

"This allows the FHA to better balance its risk and continue to provide access for those borrowers who have historically performed well." *(emphasis added)* [68]

The Agencies should adopt a measure closer to that of the QM in which there is latitude given to lenders to use a variety of widely accepted government and non-government standards to verify credit history which is inclusive of credit bureaus and credit scoring. Allowing this latitude for lenders can allow the Agencies also to suffice to meet their concerns for relying exclusively on scoring alone as credit scores may be one of ***several means*** used to meet the credit performance standard of the QRM.

A Note On Occupancy

While we do point out in our commentary the role that Non-Owner Occupied properties played in the Financial Crisis with Subprime and Alt-A lending, we would encourage the Agencies to consider allowing both classes into a separate QRM in order to facilitate the movement of housing inventory in markets where it is most needed.

The market has already effectively moved to capping LTV's on these occupancies and it would be entirely prudent to apply a more stringent LTV and Debt to Income Ratio requirements given the higher nature of default risk. However if a borrower were to put a large amount down (20 or 30 percent) on a Second/Vacation Home or an investment property then there is more mitigation of risk given the ***occupancy and intended use*** of the property.

Our concern is however in markets where there is a high number of vacation and investment occupancies that it will limit the market of buyers as no lender will want to hold risk on their

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[67] FRB "Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit" as required pursuant to Section 215 of the Fair and Accurate Credit Transitions Act of 2003 (Page 5) http://www.federalreserve.gov/boarddocs/RptCongress/creditscore/creditscore.pdf

[68] HUD No. 0-016 "FHA Announces Policy Changes to Address Risk and Strengthen Finances" http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2010/HUDNo.10-016

balance sheet to securitize these occupancies. Limiting buyers vis a vis the QRM will only continue the stagnation of housing markets.

Premium Capture Cash Reserve Account

The other main feature offered by the Agencies that fails our First Principle is that of the Premium Capture Cash Reserve Account or "PCCRA" for brevity sake.

The argument in favor says the PCCRA is needed in order to prevent securitization sponsors from somehow avoiding the spirit of the regulation by monetizing the spread on non-QRM loans by the issuance of premium or interest only tranches at the creation of the RMBS.

There are several glaring problems with the PCCRA beginning with the fact there is statutory authority absent for the Agencies in creating the structure.[69] However the problems extend further in that they create a "structural deficiency" if you will in the system of securitization by essentially confiscating profits and thus destroying any "profit motive" for lenders to create Non-QRM securitizations. The securitization of such loans would quite simply be unfeasible and uneconomical[70].

We would further point out that Mr. Berliner is almost prescient in their analysis of the potential issues that would arise from the PCCRA including:[71]

1. Seriously restricting the ability of sponsors to offer originators the ability to pass on savings to the borrower in the form of above par pricing credits to the borrower for the purposes of helping them offset closing cost expenses;

2. The potential to seriously disrupt and prevent any return of Non-Agency (i.e. Private Label or Non-GSE) RMBS to the marketplace;

3. Concentrate more risk into the Banking system instead of allowing it to be more evenly spread throughout capital markets to investors;

4. Create the potential for High-Cost loan violations due to the increase in rates necessary to make a securitization economically feasible.

Creating uncertainty could also have deleterious impacts on secondary market lenders such as SpiritBank and ASMC that offers "Best Efforts" lock options to our borrowers. By this we mean that we give borrowers the option to lock their interest rate in at application on a "best efforts" delivery to our secondary market investors. The opposite or "mandatory" locking imposes a fee on lenders for non-delivery whereas "best efforts" allows for a more flexible option for

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[69] Robert Barnett "Our Perspectives" June 2011 Newsletter entitled "Risk Retention Rule—Premium Capture, Commingling and Servicing" http://www.bsnlawfirm.com/newsletter/OP0611_2.pdf

[70] Bill Berliner "Premium Capture Accounts and Private Label MBS" ***Asset Securitization Report*** June 2011 Reprinted at http://www.berlinerconsulting.net

[71] See Footnote 71 Above-Same Source

borrowers to protect themselves from rate increases. This option of being able to lock 30-45 or 60 days prior to the delivery of the close loan would most likely be lost with the PCCRA in operation.

Professor Zandi is rather blunt in his analysis of the PCCRA where in *"Reworking Risk Retention"* from Moody's Analytics published June 20, 2011 he states of the PCCRA, ***"Unfortunately, the rule is less likely to accomplish its goal than it is to increase borrowing costs and restrict mortgage credit"*[72].**

Zandi further states regarding the impact of PCCRA on 30 year Fixed Rate mortgages that, ***"The premium capture rule may also create incentives not to originate as many 30-year fixed-rate mortgage loans."***[73]

This is perhaps the most potentially devastating impact that we would see from implementation of the PCCRA. As the Act promotes the idea and principle of sound lending on standard terms such as 30 year mortgages, this will work counter to making 30 year financing available. Richardson, Acharya, van Nieuwerburg and White point out the very important fact facing the Agencies in this rulemaking:

"Preserving the central role of the 30 Year fixed-rate mortgage requires a well-functioning securitization channel."[74]

Given the previously mentioned mandates that the statute puts to the Agencies to ensure there is access to credit on reasonable terms (see Footnote # 56), we would strongly encourage the Agencies to scrap this portion of the proposed rule. It violates the first principle of "Do No Harm" and it violates in spirit the mandates of Section 941's directive to the Agencies in taking care to not block access to credit through the rule.

In both these instances of the QRM and the PCCRA we set that each fails in its own way to meet our first Principle of Risk Retention which is that the first care and duty should be to "do no harm" to the system of securitization.

<u>Principle # 2—Risk Retention is a MEANS to an End, Not the END itself</u>

Perhaps the principle that most describes the difference in opinions and views of Risk Retention embodied under Section 941 of the Act is the argument that Risk Retention is intended to be on all loans and thus the QRM is very narrow. Again we'd refer back to the recent comments in Footnote # 5 by former FDIC Chairman Sheila Bair as indicative of that view.

We would strongly disagree with that premise. We can look to the letters filed already referenced by the QRM's Senate authors and to public statements on the record. For example,

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[72] Mark Zandi & Cristian deRitis Moodys Analytics Special Report "Reworking Risk Retention" June 20, 2011 http://www.economy.com/mark-zandi/documents/Reworking-Risk-Retention-062011.pdf?src=MZ

[73] See Footnote 72 Above- Same Source

[74] Matthew Richardson, Viral V. Acharya, Sgijn van Nieuwerburg and Lawrence J. White "Guaranteed to Fail: Fannie Mae, Freddie Mac and the Debacle of Mortgage Finance" Princeton University Press 3-21-2011

Senator Johnny Isakson, one of QRM's authors said the following in a floor statement on the one year anniversary of the passage of Dodd-Frank into law. We quote at length various portions of that statement and will let it speak for itself as to the intent of those who added the QRM to the Risk Retention standards:[75]

"The Dodd-Frank bill, as many in this room will remember, originally called for a total 5-percent risk retention on every residential mortgage made, which would have eliminated many people from making any residential mortgages at all."

"What happened in the mortgage collapse was not a failure of equity or skin in the game by the borrower; it was the collapse of underwriting. Mortgage lenders got into loosey-goosey underwriting--subprime credit. They made loans to people who were higher risk in order to price it at a higher rate, and they blurred qualifying requirements to where, all of a sudden, if you walked in and fogged up a mirror with your breath, you could probably get a mortgage loan and they could probably securitize it.

Dodd-Frank was designed to see to it that didn't happen again, and I commend them for it. But as government often does, sometimes it goes too far when the pendulum swings back the other way."

"For years in this country we have had 90 percent and 95 percent conventional financing or, in terms of FHA, 3.5 percent downpayment and VA none at all. There have been various varieties of downpayments that have been allowed based on the loan and its insurance. But with this rule of requiring risk retention on any loan with a downpayment of less than 20 percent, except for an FHA or VA loan, it is going to literally destroy what is left of the residential housing market because it will extract what is probably 40 to 45, maybe 50 percent, of the current market today."

Risk retention for the sake of risk retention alone is not a persuasive argument for prudent policymaking in regards to the rule. Again we believe Congress intended by the addition of the QRM Exemption and other language previously referred to already in this letter to make QRM broad. So too was the reasoning for the inclusion of so many prudently underwritten programs such as FHA, VA, etc. into a statutory exemption.

Furthermore, the intent of Risk Retention is to incentivize sound underwriting based on traditional methods of verification and traditional, safe product features that lessen the likelihood of default. This is clear from the statute's language in the definition of the QRM where it prohibits and restricts the use of risky product features such as Negative Amortization, interest only payments and balloons[76].

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[75] Senator Johnny Isakson Floor Statement US Senate July 18, 2011
http://isakson.senate.gov/floor/2011/070811doddfrankanniversary.htm

[76] Section 941 Dodd-Frank Act under "E" "Exemptions" (B) Qualified Residential Mortgage, (v)

It is clear from this that Congress intended to use the QRM as a means to an end—that end being dual in nature; better underwriting quality and better/safer product features.

<u>Principle # 3—Risk Retention Cannot Be Viewed in Isolation from Other Reform Measures</u>
ABA President and CEO and former Governor of Oklahoma Frank Keating said in his letter of 12 January, 2011 to the heads of the respective Agencies tasked with the duty of rulemaking for Risk Retention that:

"However, risk retention requirements cannot be considered in isolation from the many other mandates of Dodd/Frank intended to deter or eliminate these same practices. Even before enactment of Dodd/Frank, there have been ongoing dramatic changes to the regulations governing mortgages under the Real Estate Settlement Procedures Act (RESPA, the Truth in Lending Act (TILA) and the Secure and Fair Enforcement for Mortgage Licensing (SAFE)

Act. Moreover the federal bank agencies have just announced significant changes to appraisal standards. Failure to consider the joint impact of these new requirements, which are intended to work in concert with other legislative and regulatory changes, will defeat the

purpose of Dodd/Frank by imposing significant and unintended costs on borrowers and lenders far beyond what is contemplated by the legislation, thereby unnecessarily constraining credit markets"[77]

One cannot stress enough the point of Governor Keating's argument—Risk Retention as a "regulatory tool" to prevent the problem that caused the credit meltdown from occurring cannot be viewed as a single silver bullet. In fact we can see the impact of the other changes made in the past 18 to 24 months.

On January 1, 2010 a new Good Faith Estimate (GFE) form took effect for universal and mandatory use by all lenders nationally. Gone forever was the day of different lenders having different formats of GFEs. Furthermore embodied in the new GFE are new "tolerances" on expenses to incentivize lenders to be accurate and honest in their calculation of costs to a borrower. With this came new disclosure procedures for changes in the GFE and when such changes were allowed.

TILA changes have also taken place including new formats that seek to simply the information on the TILA in clearer and more precise language to the borrower. Furthermore, in 2009 the a new APR test under TILA came into being where the borrower's Final APR is tested against the previous APR quoted and if the Final APR is higher by more than 0.125% there is a new waiting period before closing with disclosures to the borrower.

In 2009 the new "HPML" (High Priced Mortgage Loan) test came into being where the borrower's final APR is tested against a new "Average Prime Offered Rate" (APOR). If that

[77] Governor Frank Keating, President and CEO of American Bankers Association Jan. 12, 2011 letter http://www.aba.com/aba/documents/press/CANON%207%20WEST7012_EXCHANGE_01122011-163835.pdf

final APR exceeds the APOR by 150 basis points or more (1.50% +) then there are restrictions including:

- No Prepayment Penalties
- Mandatory Escrow of Property Taxes/Hazard Insurance
- Verification of the Borrower's Ability to Repay

The final condition (verification of ability to repay) is key in removing any incentive or market for Subprime/Alt-A product to return to the market. Please follow our analysis—

Alt-A loans tended to carry higher rates due to the risk embodied in the fact there was less documentation (if any) of a borrower's capacity to repay the loan. Today, post market meltdown, there is no market for these types of loans as they were the primary cause of the meltdown in the first place. However supposing demand for such a product did arise, the rate on such loans would most likely exceed the 150 basis point brightline for HPML and thus require a full verification of the borrower's ability to repay the loan. So, given that the loan is Alt-A with limited documentation in the first place, that becomes impossible unless the lender and/or sponsor would wish to take the liability of violating the rule and making such a loan. In today's market environment and regulatory world that is very unlikely.

We also have the new QM mandated by Title XIV of the Act. The comment period to the FRB ended on 7/29 and the new CFPB will finalize that rule regarding a borrower's "ability to repay". We've already briefly touched on the importance of "ATR" and the QM as a boundary for the QRM subset. But what 's also important is that the "ATR/QM" rule is intended by the FRB to eliminate Alt-A loans as this rule is applicable across the spectrum to ALL mortgage loans regardless of whether or not they find themselves in an RMBS pool.

One only needs to turn to the quote from Maureen Yap, Senior Attorney with the Federal Reserve in the Division of Consumer and Community Affairs in the May 26, 2011 call held by the FRB of San Francisco on the ATR Rule. In regards to the provision under the General Ability to Repay standard the consideration and verification of "Income or Assets (other than the house)" Ms. Yap said:

"This provision essentially means that creditors can no longer originate No or Low documentation loans. The income or assets relied on to qualify the consumer must be verified and documented."[78]

It is clear then that the FRB and the Bureau will finalize a rule that effectively ends No and Low documentation programs that lead to the crisis. In that regard then it becomes apparent that Risk Retention is unnecessarily redundant. For what need is there to incentivize using a capital based restriction a lender to NOT make a loan type that is now effectively illegal?

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[78] Source Maureen Yap, Sr. Attorney at the FRB. Can be found at Outlook Live or at the following link http://www.visualwebcaster.com/FederalReserveBankSF/79706/event.html

We encourage the Agencies to take into account the rules that have been promulgated up to this point regarding these different issues and to evaluate the impact they will have in bringing sounder quality lending to the mortgage industry.

In a sense of irony, as of the date of this letter we are seeing the implementation of the SAFE Act which is effectively a national licensing registry. The idea here is that SAFE will help to weed out the "bad actors" who pushed questionable products and practices in the past. Removing these "bad actors" is akin to removing the hypothetical terrorist who poisoned the water system in our earlier illustration.

We strongly encourage the Agencies to pause and take stock of the issues addressed by these other regulatory reforms in their promulgation of the final rule.

Principle # 4—A Standard of Dynamic Flexibility & Multiple Paths into the QRM Exemption

As we've stated, we believe Congress did intend for a broad QRM and exemption from Risk Retention as a means to incentivize sound underwriting for the vast majority of mortgage loans

made. We've also shown how the QRM fails to meet any reasonable standard that it first "does no harm" to the system of securitization.

The problem with the QRM as proposed is ultimately its rigidity as we've discussed. We believe also that there should be the ability, especially on the LTV standard, to go above 80% LTV and still maintain a QRM exemption. This is achieved with Mortgage Insurance (hereafter MI). The rule is true to the statue in that it considers MI in the context of how it "prevents" default at the time the insurance is placed at origination[79]. A Promontory Financial Group Study of the MI Industry published in January of 2011 gives us guidance as to the benefits of MI. By making itself available as a first loss position, MI essentially increases the presence of total private capital available in the marketplace of credit and housing finance[80].

The study goes on to explain on page 6 the incentives to avoiding foreclosure that MI provides which would clearly and strongly meet the requirements of the Rule in answering the questions the Agencies have regarding MI. It says:

"• Incentives to avoid foreclosure. While not a form of institutional risk management per se, a financial institution's incentives to modify loans or take other measures to avoid foreclosure impact financial stability. Because PMIs do not generally incur claims obligations unless a borrower defaults, the interests of PMIs are closely aligned with those of borrowers in this area."[81] *(emphasis added).*

Being in first loss position gives the MI company a strong incentive to prudently underwrite and protect their interests from a loss arising from foreclosure. Thus there is an alignment of

[79] Dodd-Frank Act Section 941 (E) Exemptions (4) QRM (B) (iv)
[80] http://www.promontory.com/assets/0/78/110/286/974d1fb8-ac46-413e-a62a-4b5472f4df14.pdf
[81] See Footnote 80- Same Source

borrower-insurer-investor incentives and benefits that is gained from the presence of MI on loans over an 80% LTV.

The study further goes on to explain the other added benefit of MI which is that it provides a "second set of eyes" throughout the underwriting process[82]. This is true as the MI companies set standards that they too must review to make certain the loan is safe, sound and poses a lower risk of loss. In this way the MI industry helps to impose discipline onto lenders as oftentimes the requirements to gain MI on a loan over 80% LTV may be stricter and narrower than the guidelines posed by the GSEs themselves.

On July 26, MI Company Genworth Financial also released an analysis of 5.7 Million low down payment (high LTV) loans that they had commissioned Promontory to conduct. Some of the highlights include:[83]

- Higher LTV loans with "piggyback" (that is a second mortgage originated at the time of lending that is made to avoid the MI requirement) had a cumulative default rate 21% greater than loans with MI form 2003-2007
- Third party data from CoreLogic Servicing Database was used in the review
- FHA loans with Government backed MI were included in the study

Congress has also weighed in on the matter of MI. In a comment letter to the Agencies dated June 17 and signed by 286 members of the US House, the signors state that the Agencies ought to consider and include loans with MI and less than 20% down within the QRM exemption.[84]

Part of having a dynamic flexibility that allows multiple paths into the QRM is that underwriting must not be viewed as a sort of "black box" activity. It is much more in-depth and dynamic rather than "static". When underwriting becomes "static" which is what the QRM as proposed advocates, then there is greater chance for underwriting to become relaxed and less observant which can lead to the same default issues that caused the Financial Crisis.

Risk Retention- Winners and Losers

Part of this final principle is that the Risk Retention Policy should not be used to pick "winners" and "losers" in the housing finance system.

We have concerns that the provision allowing the GSEs to be considered as meeting the Risk Retention requirement as long as they remain in conservatorship by the Treasury is not a wise long term policy. GSE Reform is an issue that is eventually going to be taken up in either this session of Congress or the next after the 2012 elections. The rule is essentially creating a

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[82] See Footnotes 80 & 81- Same Source Page 11

[83] http://www.prnewswire.com/news-releases/promontory-study-shows-lower-default-rate-for-insured-mortgages-126166083.html

[84] http://www.federalreserve.gov/SECRS/2011/July/20110712/R-1411/R-1411_062411_81717_359995645753_1.pdf

"subsidy" or "quasi-subsidy" that makes Fannie and Freddie unlikely to unwind anytime soon and private capital to return to take their place which is a stated goal of all along the political spectrum.

Richardson, Acharya and others state further:

"When the mortgage securitization market dried up in late 2007, after the revelations of all the 'private-label' subprime related securities that had gone south, the federal government naturally pushed Fannie and Freddie and the FHA forward to fill the gap-- including a near doubling of the size of mortgages (in some parts of the United States) that would qualify for their support. Now that they are heavily entrenched in a much wider swath of the mortgage market, their government backing means they have lower costs and are thus subsidizing mortgages. This makes it difficult or perhaps impossible, for private-label securitization to be reestablished. Accordingly, the heavy presence of Fannie and Freddie and the FHA currently may be indicative not of the private sector's disinterest in reviving private-label securitization but simply of the private sector's inability to compete against the subsidies which crowd out the competition."[85]

The QRM itself picks winners and losers in that only the safest of the safe will make the exemption while other loans are left out despite their creditworthiness.

There has also been concern expressed by FHA Acting Director Bob Ryan who said in testimony in a House Financial Services Subcommittee on Capital Markets and GSEs hearing on Risk Retention in April the following of the QRM ,

"We are concerned by the 20%. It may be too high. We are seeking feedback on the performance benefits of lowering it."[86]

Finally we'd present this fact—the cost of Risk Retention itself will impact smaller banks and lenders much more than the larger institutions. While some have thrown out the "10 to 15 basis points" figure we believe that the true cost of Risk Retention will be much higher on non-QRM loans. Essentially a "bifurcation of price" will develop between QRM and non-QRM loans.

Professor Zandi estimates 75 to 100 basis points increase in rate for Non-QRM loans and further points out in a footnote to the statement that it is a ***"conservative estimate of the rate impact of the risk retention rules on non-QRM loans"***[87]

The conclusion is simple- the rule as proposed would fail each of the principles we advocate for in the promulgation of a better rule. We believe that pausing the rulemaking process and taking

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[85] "Guaranteed to Fail: Fannie Mae, Freddie Mac and the Debacle of Mortgage Finance" by Matthew Richardson, Viral V. Acharya, Sgijn van Nieuwerburgh and Lawrence J. White 3-21-2011 Princeton University Press

[86] http://www.housingwire.com/2011/04/14/lawmakers-to-consider-reducing-qrm-down-payment-to-10

[87] See Footnote 72 above- Same source http://www.economy.com/mark-zandi/documents/Reworking-Risk-Retention-062011.pdf?src=MZ

into account the recommendations that follow would better allow for the Agencies to gauge what may work better and meet the full intent of the Congress in the final rule.

Other Concerns-Considerations Regarding Risk Retention

We would address two other specific areas of concern with the Rule as proposed by the Agencies which we believe will, again, run counter to the Congressional mandate of Section 941 (e) (2) (B) where Congress states the necessity of improving access of consumers and business to reasonable credit terms.

Transfer of Risk Retention and Impact on Smaller Lenders/Originators

The Rule provides that the sponsor of the securitization is solely responsible for the holding of the portion of the credit risk but that they may however, within certain restricted parameters, transfer a portion of that obligation to the originator of the loans which make up the securitized pool of assets against which the RMBS are issued[88].

As a correspondent lender who originates and sells the whole mortgages on a servicing released basis to larger "mega-bank" securitization sponsors, our concerns are that while we cannot be mandated per se into sharing in the Risk Retention obligation we do believe that larger servicers may essentially force Risk Retention sharing through the mechanism of "price" in what will be offered to smaller lenders/originators in terms of interest rates and products.

Smaller lenders may find themselves essentially "shut out" of any secondary market outlets in the sense that they cannot afford to hold the risk retention in the first place but nor can they compete with the higher rates on both Non-QRM loans as well as QRM loans that most certainly will result as sponsors attempt to increase margins on both classes of mortgages in order to make up for the costs of the 5% retained risk.

Such an impact would be detrimental and devastating on the ability of community bank lenders such as ourselves to bring long term affordable credit options and access to affordable rates and products to the markets we serve. In rural and smaller metropolitan areas the lack of long term housing credit would have a deleterious effect on the housing markets and local economies.

Current Forms of Risk Retention in the Status Quo—"Reps & Warrants"

Our other concern lies in the fact that there seems to be little to no consideration of the current forms of risk retention that are embodied within the status quo that smaller lenders like SpiritBank currently has in place within the relationships we have with our own secondary market investors.

Currently there exists in secondary market transactions different avenues and mechanisms that act as *de facto* forms of risk retention for the originating bank or lender of the mortgage. These *de facto* versions of risk retention incent the originator to underwrite the loan honestly, accurately and we dare say even "conservatively".

[88] 76 Federal Register April 29, 2011 Page 24114

The main incentive lies in the representations and warranties, commonly referred to as *reps & warrants* that an originator like SpiritBank makes to a secondary market investor/servicer who in turn securitizes the loan. *Reps & Warrants* are the foundational bedrock of incentivizing good product quality and underwriting. They establish the legal framework for which the originator may have to ultimately repurchase, settle a claim or indemnify the secondary market investor for a loss incurred from an unworkable default of a loan underwritten and closed by the originator and sold to the secondary market investor.

The term *Reps & Warrants* means quite simply that the originator is making "representations and warranties" to the secondary market investor that they, the originator has abided by all terms and conditions of the sales agreement between both parties in the origination, underwriting and closing of the loan being sold. This includes for example making the *rep & warrant* that all local, state and federal laws and regulations regarding mortgage origination have been followed to the letter. The originator makes a *rep & warrant* that they have abided by the underwriting guidelines outlined by the secondary market investor in the exercise of their delegated authority to underwrite the loan. It also includes the *rep & warrant* that the originator has not failed to disclose material facts known about the loan that may adversely impact future performance nor are they aware of any fraud or other misrepresentation made by themselves or the borrower(s) and if it is later discovered that such fraud or misrepresentation may have occurred they originator will make the secondary market investor whole.

Reps & Warrants are enforceable and act as a powerful incentive to originating correspondent mortgage banks such as ours. The fact is that if we do not abide by the letter and spirit of the *Reps &* Warrants we are required to make we could find ourselves without access to the secondary market. Let us illustrate a true example of a recent claim on a loan made in mid 2007.

We were notified in mid February of this year (2011) by the secondary market investor who had purchased a loan that they were demanding either repurchase of the loan in whole or that we make settlement with them. When examining the grounds for the repurchase it was made on the basis that the borrower failed to disclose to us the lender that they had taken out additional loans not reflected on their application or credit bureau.

The result was that the borrower's debt to income ratio was well above what underwriting guidelines allow when those debts were added back in. In investigating the background of the loan we discovered that there was no disclosure by the borrower to us of the debts and at that time there was little in the way of technology to double check whether a borrower had opened new debts prior to closing the loan (since then with the rise of the QC initiatives by the GSEs in 2010 there is now the ability to screen prior to closing for new undisclosed debts and thus prevent a case such as this from occurring).

Regardless however, we opted to settle. The original loan was for the purchase of an Investment Property, a single family residence that the borrowers were planning to use as a rental investment. They had subsequently defaulted and the secondary market servicer had taken the home back in a foreclosure action. Our original loan was for $61,200. The indemnification

amount we paid was approximately $11,047. This represents roughly 18.05% of the balance of the original loan. **Now that is "skin in the game".**

The question may arise, "Why did you elect to pay the cost? Why didn't you refuse or fight the process?"

The answer is quite simple and it would be the same for countless other bank lenders such as ours. We elected to pay the cost because we made the representation and warranty that the loan met all underwriting guidelines. We made the rep & warrant that information in the loan was accurate and true to the best of our knowledge and it happened that in the end it was not albeit no fault of our own.

While we may never know if the borrower intentionally misled us and it is almost impossible to determine for sure as the Loan Officer is no longer with SpiritBank, we understand the basis of the investor's claim. Had we refused to honor the rep & warrant we made the most likely scenario would have played out:

1. The Secondary Market Investor would have immediately frozen all pending purchases of loans from SpiritBank. The result is an immediate impact to our liquidity and ability to sell loans in our pipeline. A reduction of liquidity is any lenders worst nightmare as now loans cannot be sold. It is akin to an automobile engine running out of motor oil and the engine subsequently "seizing" or "locking" up.

2. Further failure to resolve the issue would incur legal proceedings brought against SpiritBank for breach of contract in failing to honor the *Reps & Warrants* made on the specific loan in question.

3. The Secondary Market Investor would most likely file a complaint of fraud and/or misrepresentation with an industry resource such as the LexisNexis® MARI, Inc (Mortgage Asset Research Institute) which maintains MIDEX® (Mortgage Industry Data Exchange) database of SpiritBank's failure to honor its obligation and the potential case of fraud by the borrower and SpiritBank's subsequent refusal to settle based on their representation and warranty on the loan.(***http://www.lexisnexis.com/risk/midexreports/***)

4. Other Secondary Market Investors working with SpiritBank may find, in a routine consultation of MARI or MIDEX, such a complaint and most likely request an immediate explanation accompanied by a potential freezing of pending purchases by that investor from SpiritBank. This would further complicate and worsen the liquidity position of our Mortgage Lending department.

And the potential for loss due to enforcement of *Reps & Warrants* does not extend merely to Conventional or "Non-Government" loans. Rather, *Reps & Warrants* applies and extends to all loans made by a primary originating lender such as SpiritBank.

As you can see, there are incentives for an originating lender such as we to conduct due diligence and quality underwriting in order to maintain our ability to sell loans; basically to stay in business. Those incentives include:

1. Operational Incentives to maintain liquidity and thus continue operations
2. Financial Incentives to avoid legal claims and costs
3. Reputational Incentives to avoid being possibly "tagged" as an originating lender that does poor quality underwriting and fails to honor their contractual obligations

In short, most of the Risk Retention debate has revolved around the term "misaligned incentives". While that may have been very true of a large number of non-bank lenders and brokers (many of whom are no longer in business) there is no doubt that the current system of *Reps & Warrants* provides a strong incentive for Originators to perform honestly and prudently in their origination and underwriting function for loans to be sold into the Secondary Market. That main incentive is the desire of the Originator to remain in business and continue their lending activities.

The rise of technology such as MIDEX® allows larger secondary market investors to better screen primary market originators and as such determine whether or not there is a high correlation of fraud associated with loans originated by a particular primary lender.

We strongly encourage the Agencies take into account the system of *Reps & Warrants* that exist in the status quo as a form of embedded "risk retention" that provides the incentive alignment they seek to attain through promulgation of the rule. We further encourage the Agencies to add to the Final Rule provisions that Correspondent Mortgage Lenders who operate on a system of industry accepted and Agency Endorsed standard of *Reps & Warrants* will be considered in compliance with the provisions of the *QRM* requirements of the rule and all loans made under aforementioned system be considered *de facto QRMs*.

Risk Retention Recommendations

We believe that the rule as proposed for Risk Retention in the end will do more harm than good for the current housing finance system in the United States in the long run. To that end we would respectfully make the following recommendations to the Agencies:

- Postpone further rulemaking on Risk Retention and the QRM until such time as the QM Rule and Ability to Repay has been finalized by the CFPB.

- Remove the rigidity from the proposed QRM Rule by starting over and more closely aligning it with the QM which addresses the real root of the cause of the financial crisis—the failure to properly verify the borrower's ability to repay a mortgage.

- Strike in its entirety the PCCRA provisions from the rule completely so as to not create economic "disincentives" to lending by private capital.

- Strike all provisions related to the Servicing aspects of QRM as this is outside the scope of the statutory authority of the Agencies in rulemaking plus it creates a contradictory standard in that loans most needing the standards promoted will not receive them as the loans least likely to default are the ones getting the treatment as QRM. This should be addressed in separate rulemaking and only after Congressional authorization via statute.

- Provide within the QRM the ability for lenders to securitize loans with LTV's over 80% with the presence of Private Mortgage Insurance. Reduce the minimum down payments to the 3-5% range for all conventional loans.

- Create a final rule that applies Risk Retention not based on the end "guarantor" (such as the GSEs) but rather one that is based on the ***Origination and Underwriting Processs***—in other words, if a Jumbo loan of $800,000 is underwritten to the same standards as an FHA loan is today (i.e. "full documentation" of income and assets) then both should be exempt from Risk Retention based on the virtue of the underwriting process itself as a way of mitigating risk. Failure to do so will only further entrench FHA and the GSEs which runs counter to the stated and implied intent of the Obama Administration and Congress to lessen the "Footprint" of the Federal Government in housing finance markets.

- Allow for industry input for the creation of standardized representations and warranties that provide better transparency to the process of securitization and more clearly outline the obligations of originators and securitization sponsors. And in so doing allow such *reps & warrants* to serve as a *de facto* form of Risk Retention that would meet the spirit of Section 941 in the alignment of incentives throughout the production chain of a mortgage from originator to end investor in the RMBS backed by said mortgage.

- Take into Account the changes made over the past year by the GSEs to improve the quality control process of originations through Fannie Mae's Loan Quality Initiative and Freddie Mac's Responsible Lending-The Power of Quality.

- Take into Account the regulatory changes that have taken place and are taking place today regarding various other reforms such as RESPA, TILA and SAFE.

- Take into account the changes regarding Loan Originator Compensation that took effect under TILA on April 1 that banned the practice of compensation to originators based on terms and/or conditions—***this in and of itself creates some of the best incentives for proper and prudent behavior and action by originators.***

- Provide a time limit on when Risk Retention will expire- the rule provides a lifetime holding of the Risk Retention. ***Lenders and Sponsors should not be responsible for underwriting a loan in the "present" and bearing losses in the "future" that most likely will be completely and wholly unrelated to what the Originator knew at the time the loan was originated.*** Such duration should expire within a 12-18 month seasoning period after origination. Failure to implement a reasonable duration period will only add further risk premium to the rates on non-QRM loans that are offered- if they're offered at all.

Concluding Remarks

We would once again thank the Agencies for allowing us this opportunity to comment on this very fundamentally important and industry changing rule that will impact housing finance and credit markets for the foreseeable future. It is essential that the Agencies "get it right" as was echoed time and again at the March 29 FDIC Board meeting in which the NPR was announced.

We believe as we stated earlier, there is a sincere desire by the Agencies involved to engage the industry in a discussion on this issue. The entire securitization infrastructure as we know it and have known it for 40 years is on the line as is the future of GSE reform as the Final rule issued will impact both. We appreciate this opportunity to address our concerns and hopefully shed some light in our feedback.

Please feel free to contact us if we may be of further assistance.

I remain—

Cordially,

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