August 1, 2011

Office of the Comptroller of the Currency
250 E Street, SW.
Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0002
RIN 1557-AD40

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1411
RIN 7100-AD70

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
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Washington, DC 20429
RIN 3064-AD74

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U.S. Securities and Exchange Commission
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File No. S7-14-11
RIN 3235-AK96

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Regulations Division, Office of General Counsel
Department of Housing and Urban Development
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Washington, DC 20410-0500
FR-5504-P-01

Re: Credit Risk Retention

Dear Sir or Madam,

The Conference of State Bank Supervisors (CSBS) appreciates the opportunity to comment on the OCC, FRB, FDIC, SEC, FHFA, and HUD (the "agencies") request for comment regarding credit risk retention. We commend the agencies for the proposed rule's adherence to the policy goal underpinning Dodd-Frank's risk retention requirement: incentives should be aligned between securitizers and investors to promote prudent underwriting. The proposed rule also sets an appropriately high threshold for asset standards that are exempt from the risk retention requirement. To facilitate our comments on these areas, this letter is divided into a section on Retention of Risk and a section on Qualified Residential Mortgages, both of which outline specific policy goals and address pertinent topics related to each subject.

CONFERENCE OF STATE BANK SUPERVISORS
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RETENTION OF RISK

Policy Goal: Risk should be retained to the extent that it incentivizes securitizers to issue securities backed by prudently underwritten mortgages.

Amount of Risk to be Retained: Credit risk should be retained to the extent that it encourages prudent underwriting and securitization. Accordingly, the federal agencies should implement a dynamic rulemaking framework to monitor the performance of underlying loans in securities subject to credit risk retention, starting with a baseline of 5%. It is uncertain whether 5% is the appropriate amount of risk to be retained to align incentives; therefore, there should be a mechanism for adjusting the retention amount to reflect the status of underwriting performance. By starting at the statutory minimum, the agencies will be able to adjust the percentage upwards if there is a statistically significant higher level of defaults on the underlying mortgages compared with other similar pools of mortgages, thereby illustrating misaligned incentives in asset securitizations. A dynamic risk retention system would also allow the government to lead the rejuvenation of the secondary market, as investors can eventually determine their own comfort levels of shared risk based on the outcomes of government policies.

Form of Retention: CSBS believes that vertical risk retention is the most appropriate form of risk retention for the alignment of incentives. Vertical risk retention exposes securitizers to each tranche within a security and requires securitizers to have skin in the game throughout the economic life of a security. By having pro rata and prolonged exposure to a security's risk, securitizers will be economically interested in the performance of the entire security, which should put positive pressure on underwriting criteria. This ensures that incentives are aligned throughout the securitization process. However, we understand that a "full menu" of options is apposite given the current uncertainty over the future of securitizations, the diversity of assets that can be securitized, and the economic interests driving the different forms of securitization. Multiple options should be available to securitizers in the near term to ensure that the benefits of securitization are not nullified through regulatory restrictions that were not fully understood during the initial promulgation of a rule. The federal agencies should reassess the permissible forms of risk retention from time to time to ensure incentives are aligned.

When the agencies revisit the issue of risk retention form, CSBS believes that the agencies should take into account the economic and policy benefits of vertical risk retention.

Allocation to Originator: One of CSBS's primary concerns with the risk retention requirement was the potential negative effects risk retention could have on the community banking sector. Requiring community banks to retain a percentage of the risk of loans sold to a securitizer would prevent many community banks from engaging in residential mortgage lending. The proposed rule's requirement that a risk retaining originator originate at least 20% of the underlying loans in an asset-backed security should be adequate protection against the negative downstream effects on the community banking system. This threshold should also apply to securities backed by lower-credit risk loans subject to lessened risk retention requirements that the agencies have authority to promulgate.

Multiple Sponsors: Under the proposed rule, where two or more entities each meet the definition of sponsor for a single securitization transaction, only one sponsor is required to retain the credit risk of the underlying assets in accordance with the statutory and regulatory requirements. This presents a scenario where not all interests in a transaction are properly aligned. Accordingly, CSBS recommends that multiple sponsors of a security retain their pro rata share of credit risk. This would ensure that all parties to a securitization have an aligned interest in the success of the security.

Treatment of GSEs: CSBS agrees with the agencies' analysis of the application of risk retention to government sponsored enterprises. GSEs should be exempt from risk retention requirements because the federal government ultimately retains all credit risk associated with their actions. Further, requiring risk retention would be counter to policies designed to reduce the GSEs' portfolios. As noted in the proposed rule's analysis, the issue of risk retention by GSEs should be reexamined when a change in their structure occurs.

QUALIFIED RESIDENTIAL MORTGAGES

Policy Goal: The Qualified Residential Mortgage (QRM) should be the best category of mortgage available because securities backed by QRMs do not require securitizers to retain credit risk. Additionally, the standards for QRMs should be top-quality to ensure that a market for non-QRMs develops under a risk retention framework.

Qualified Residential Mortgage Criteria: CSBS generally agrees with the proposed rule's underwriting criteria for a Qualified Residential Mortgage. The proposed QRM standards include:

- 28% Front-End Ratio, 36% Back-End Ratio
- Borrower must not:
    - Currently be more than 30 days past due on a debt obligation
    - Have been 60 days or more past due on any debt obligation within the previous 24 months
    - Have been a debtor in a bankruptcy case, have a property repossessed, or be the subject of a foreclosure/deed-lieu of foreclosure/short sale within the previous 36 months
- ARMs with 2% annual and 6% life of loan interest rate adjustment caps

During the policy development process, CSBS's inclination was to advocate for an 80% loan-to-value ratio for mortgages that back securities exempt from risk retention. However, CSBS recognizes that there are divergent views on the appropriate LTV for a QRM at origination and their unknown impact on the mortgage market. Housing finance plays a significant role in our economy and affects all Americans. CSBS strongly recommends the agencies hold hearings to fully understand the effect any QRM down payment requirement will have on the broader mortgage market. These hearings should emphasize predictors, not fears, as to what the QRM will mean within the confines of mortgage origination and the secondary market.

Additionally, CSBS is concerned that the servicing requirements included in QRM standards are premature. While the QRM servicing standards are not necessarily mutually exclusive of basic servicing requirements, the requirements may be untimely considering the scale and scope of national servicing standards in discussion. Industry-wide servicing standards must be developed, and CSBS is prepared to work with the agencies to develop servicing standards that are uniform across state and federal lines. The States have a wealth of experience in the servicing arena, which should be leveraged with the agencies' recent efforts to address this problem.

Private Mortgage Insurance through a Lower Credit Risk Mortgage: The proposed rule outlines a lower-quality alternative for the QRM with higher risk retention standards for non-QRMs. Presumably, this alternative is in response to the high costs associated with some housing markets. As previously emphasized, a 20% down payment is a sizeable amount for any borrower considering the average price of a home was $246,800 in March 2011.[1] An average home buyer would need almost $50,000 available for a down payment to achieve the theoretical cost advantages associated with a QRM. Complicating this matter, the most populated areas of the country have significantly higher housing prices. The northeast corridor and pacific coast metropolitan areas have significantly higher housing prices, which make down payments challenging for borrowers that are otherwise qualified for a QRM.

While QRM standards should remain high to ensure only the best mortgages are exempt from risk retention requirements, private mortgage insurance should be considered as a tool to lower the cost burden for borrowers who meet QRM standards except for the down payment amount. The statute requires the agencies to consider how private mortgage insurance lowers the risk of default when determining whether it can be used as a product feature in QRMs. Much like the agencies described in the proposed rule analysis, CSBS could not point to specific evidence that illustrates private mortgage insurance lowering the risk of default. However, the statute permits the agencies to "establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages . . . ." 15 U.S.C.A. 78O-11(c)(2)(A). For each of these asset classes, the agencies must "specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan." 15 U.S.C.A. 78O-11(c)(2)(B). Finally, the agencies are permitted to allow the securitizers of these loans to retain "less than 5 percent of the credit risk . . . if the originator of the asset meets the underwriting standards prescribed [in the terms, conditions, and characteristics designated to indicate low credit risk]." 15 U.S.C.A. 78O-11(c)(1)(B)(ii). Under this framework, private mortgage insurance can be used as a product feature for a lower credit risk mortgage because the required analysis is in regards to credit risk, not risk of default.

Accordingly, CSBS believes that a mortgage with a minimum down payment of 10% and mortgage insurance used to achieve the final LTV determination should be subject to a 2% risk retention requirement if the remaining loan characteristics mirror that of the QRM. A 2% risk retention requirement should incentivize securitizers to ensure that the private mortgage insurance framework adequately lowers the credit risk of a mortgage. This would alleviate the cost burden on well qualified buyers that otherwise would represent the highest quality mortgage. Buyers with the QRM credit profile would then be incentivized to build equity in their home to be released from the insurance requirements.

[1] U.S. Census Bureau. *Available at* http://www.census.gov/const/uspricemon.pdf.

It should be noted that although private mortgage insurance is a useful tool to lower credit risk for investors and down payments for borrowers, the private mortgage insurance industry has been subject to considerable economic stress. Accordingly, the private mortgage insurance provider should have a strong A.M. Best or similar rating. Further, while implementing a framework for the lower credit risk mortgages and monitoring the progress of this framework in the future, the financial health of private mortgage insurance companies should be weighed when determining the reduced risk in mortgages with insurance. It may be the case that the risks in the private mortgage insurance industry become too high for the lower credit risk mortgage standards, in which case mortgages with private mortgage insurance may not be appropriate for a 2% risk retention requirement.

CONCLUSION

The proposed rule appropriately represents the purpose of requiring securitizers to retain credit risk for the securities they package and sell. Credit risk retention is an integral piece of a holistic approach to strengthening the financial system, which will require our continued attention as we address the regulatory shortcomings that led to the recent economic meltdown. As it relates to housing, risk retention is a policy that will address one of the fundamental problems that led to the housing bubble, and should not be an end around for housing affordability. In light of the current state of the housing finance market, CSBS believes that housing finance policy decisions must be deliberated in a thorough and holistic manner, and no single policy should be used as the catalyst to a safe and secure housing finance system. To that end, risk retention should be implemented to achieve the goals associated with an aligned-incentive system, and the agencies' proposed rule supports this policy goal.

Sincerely,

Neil Milner

Neil Milner
President & CEO