FDIC
Federal Deposit Insurance Corporation
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Legal Division

November 9, 2011

TO: Executive Secretary

FROM: Phillip E. Sloan, Counsel
Legal Division

SUBJECT: Meeting with Mortgage Bankers Association to Discuss the Notice of Proposed Rulemaking Related to Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Please include this memorandum in the public file on the Notice of Proposed Rulemaking relating to Credit Risk Retention (RIN 3064-AD74), 76 Fed. Reg. 24090 (the "NPR").

On November 8, 2011 FDIC staff (Michael H. Krimminger, Richard A. Brown, Kathleen M. Russo and Phillip E. Sloan) met with representatives of the Mortgage Bankers Association (David H. Stevens, Stephen A. O'Connor and Michael C. Fratantoni) to receive comments on the NPR.

The primary focus of the discussion was on the down payment requirement applicable to eligibility for "qualified residential mortgage" status under the proposed rules set forth in the NPR.

The document distributed at the meeting by the Mortgage Bankers Association is attached to this memorandum.

Impact of Risk Retention Rules on the Mortgage Market

PRESENTATION MATERIAL

UPDATED AS OF 11/8/2011

MORTGAGE BANKERS ASSOCIATION®
Investing in communities

Executive Summary

The housing crisis revealed deep flaws in the mortgage securitization process. Securitizers, lenders, investors and regulators all failed to recognize and address these problems before it was too late. A new system of accountability and transparency is needed to ensure that these mistakes are not repeated. A risk retention requirement is an important step in establishing a better regulatory plan to protect borrowers and ensure a safe and reliable mortgage system.

At the same time, it is essential that any risk retention requirements be done correctly so as not to constrain liquidity and to prevent a return to unsustainable lending practices. Securitization is a valuable liquidity channel for providing borrowers with affordable mortgage credit, particularly because portfolio lending does not have the capacity to meet market demands, and the future of the government sponsored enterprises is uncertain. Without a viable securitization process, the nation's housing finance needs cannot be met.

A workable risk retention requirement requires a delicate balance between creating accountability and allowing for an efficient securitization market. We believe Congress effectively threaded this needle by creating an exemption from risk retention requirements for well-underwritten, fully documented, sound and sustainable mortgages. The Qualified Residential Mortgage (QRM) exemption was intended to recognize that traditional mortgage loans — standard products, properly underwritten and with full documentation — were not the cause of this recent crisis, and securitization of these loans should remain unimpeded in order to return the MBS market to being among the most liquid in the world. By requiring a QRM exemption, the statute would keep consumer costs lower for these mortgages.

We strongly support the intention of the QRM exemption from the Risk Retention provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. That purpose is to establish an exemption from risk retention for well-underwritten and documented, sound and sustainable mortgage loans.

We believe, however, that the proposed rule implementing these provisions goes beyond what Congress intended and would drastically limit affordable mortgage financing options for moderate-income families, first-time borrowers, minorities and many others.

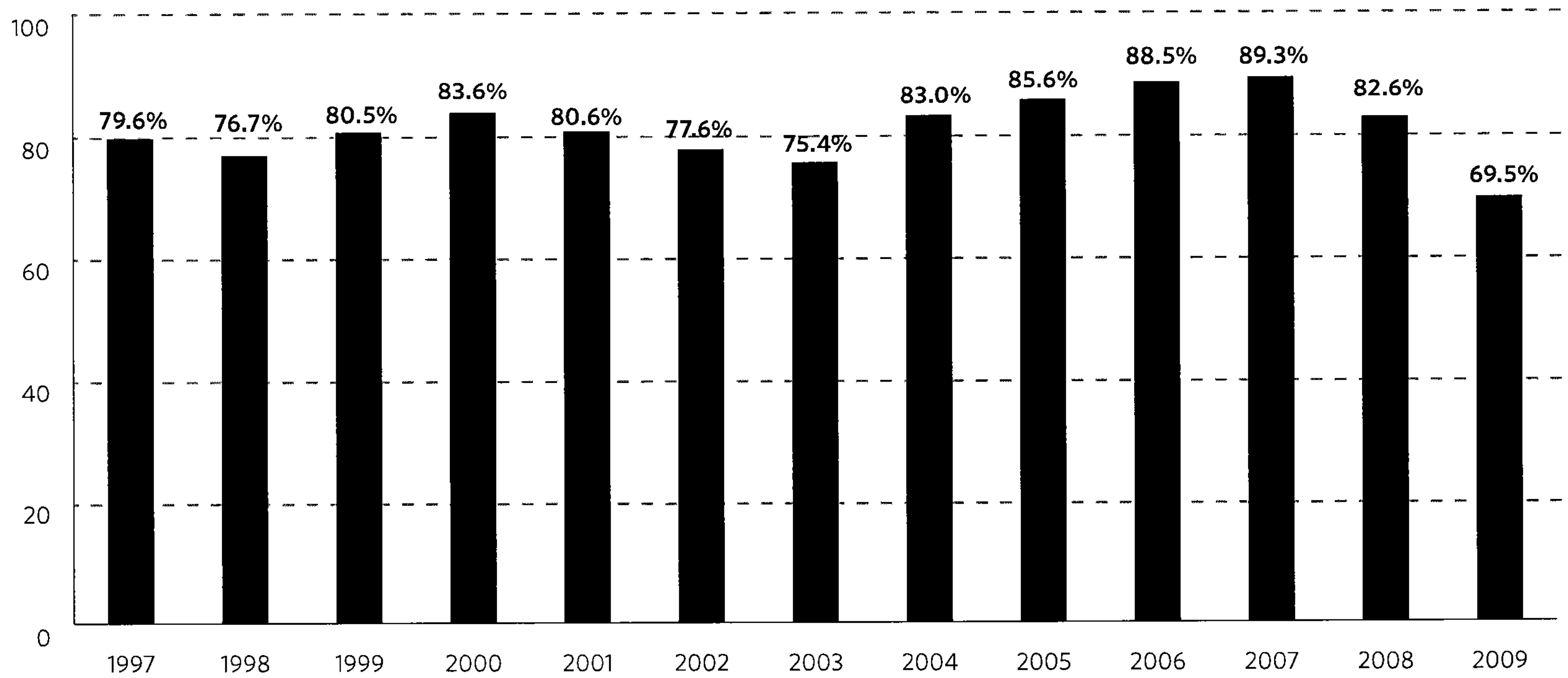
Our presentation highlights these concerns and the concerns of other organizations. The presentation uses independent and reliable data and information to make the following key points:

- The proposed regulation will hurt consumers by limiting access to credit for well-qualified borrowers.
- In particular, the proposed down payment, loan-to-value (LTV) and debt-to-income (DTI) requirements are unnecessary and not worth the societal cost of excluding far too many borrowers from the most affordable loans.
- By prescribing hard-wired down payment, LTV and DTI standards, the government will effectively take ownership of risk rather than require private lenders to assume the risk and underwrite sustainable loans for consumers.

- The impact will be worse for minorities, first-time borrowers and homeowners with limited equity and threatens to disturb the balance between the rental and homeownership markets.
- The proposed credit standard will not act as intended. Borrowers with very high FICO scores may not satisfy this credit standard, while those with very low credit scores may. Operationally, it will also be much more difficult for lenders to handle voluminous credit report data as opposed to summary scores.
- Excluding risky products and requiring sound underwriting, full documentation and verification are the right steps to return private investment to the housing market and ensure sustainable and affordable housing credit for as many families as possible.
- Most new households over the past couple of years have opted to rent. Rental vacancy rates have been declining. Imposing additional hurdles to homeownership through the imposition of an overly narrow QRM could keep more households as renters, potentially leading to upward pressure on rents.

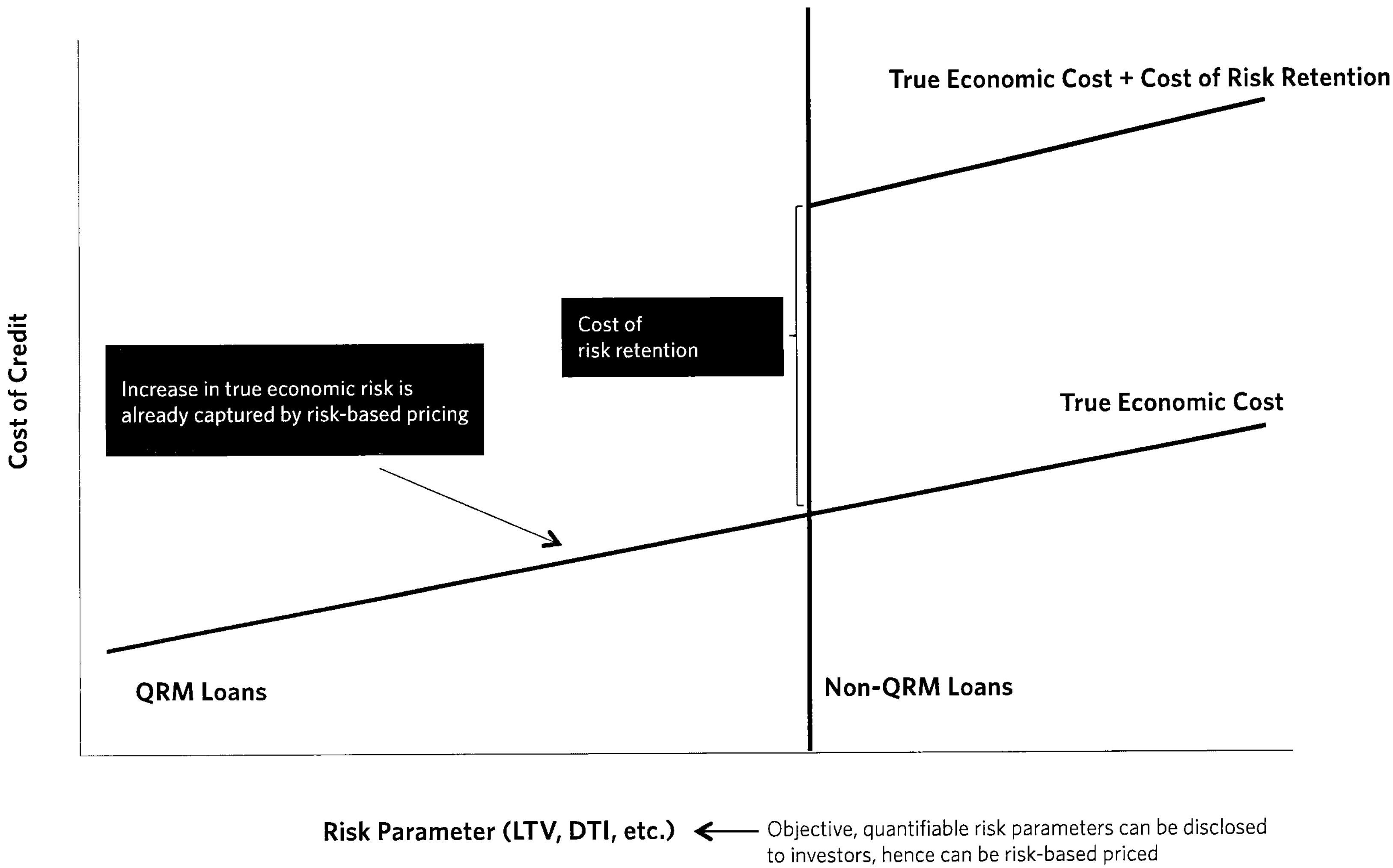
More Than 80 Percent of GSE Business from 1997-2009 Would Not Have Been QRM

Percent of all mortgages that would NOT have met all requirements under the proposed QRM standard, by year of origination



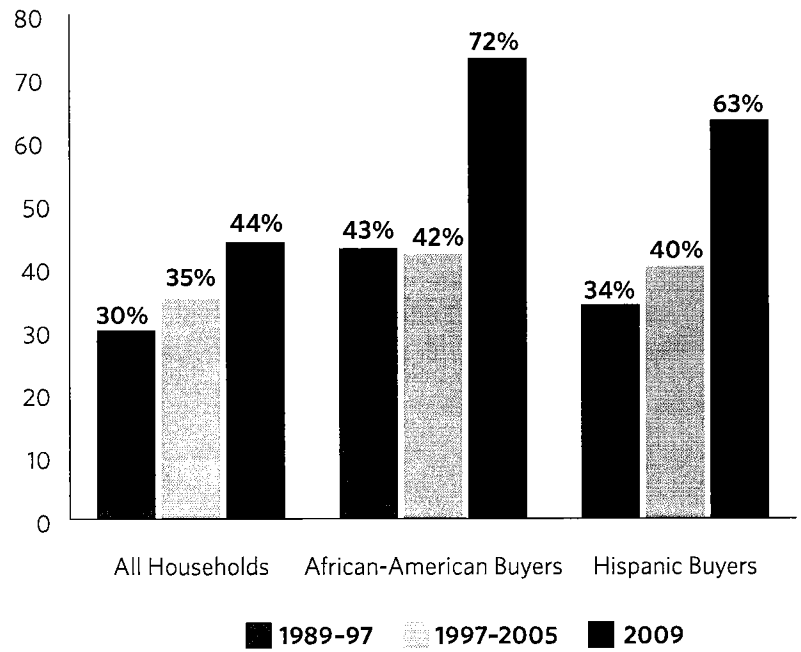
Source: FHFA.

Cost to Borrower Increases Beyond True Economic Cost When Risk Retention Requirements Are Triggered

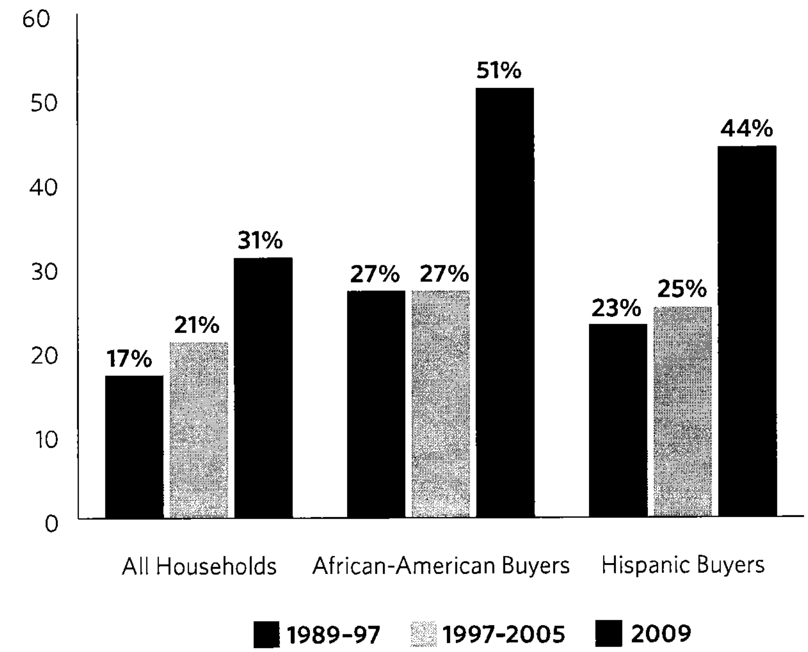


High LTV Lending Is Not a Recent Innovation — Heavily Used by Minorities

Percent of Homebuyers with LTVs of 90% or Higher

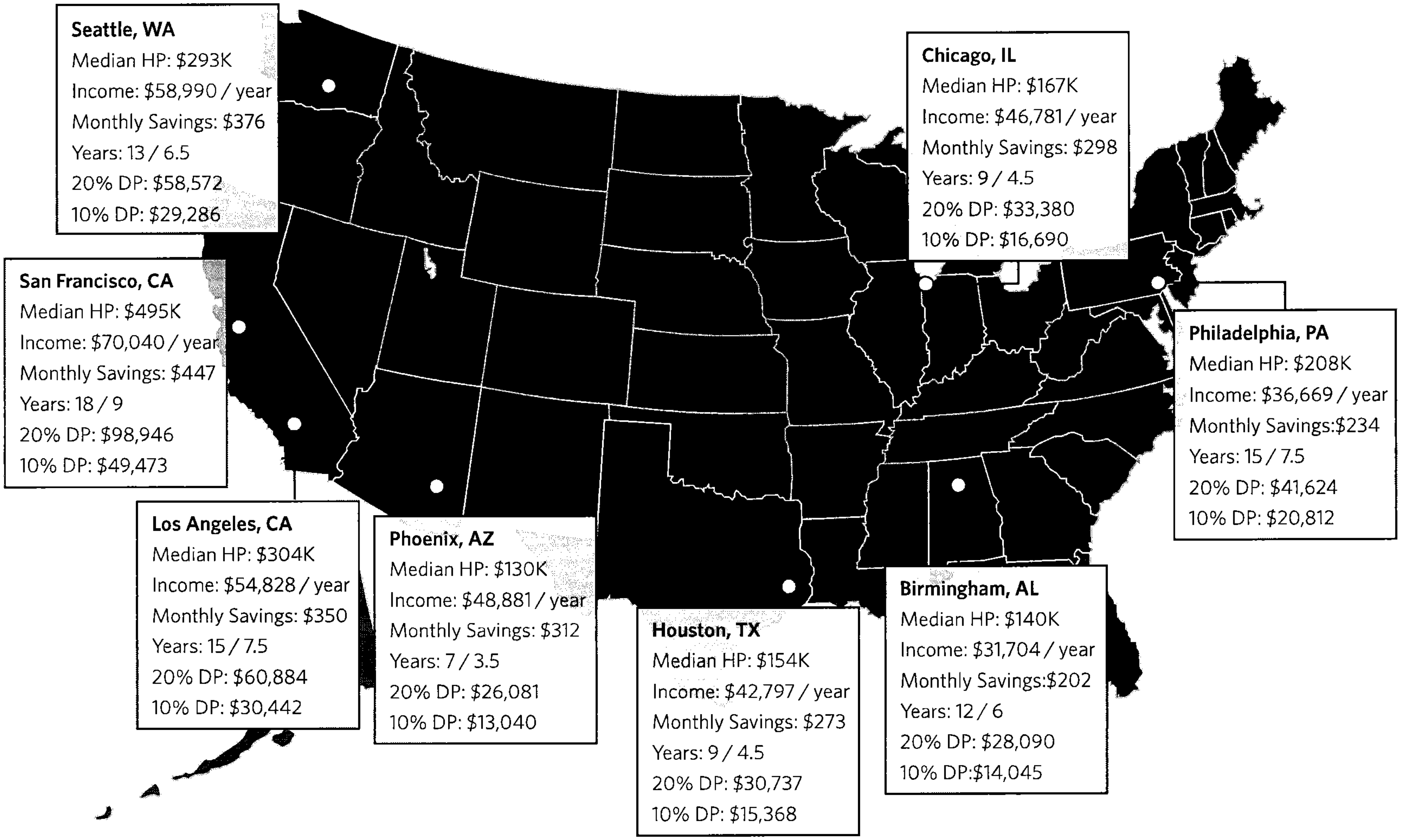


Percent of Homebuyers with LTVs of 95% or Higher



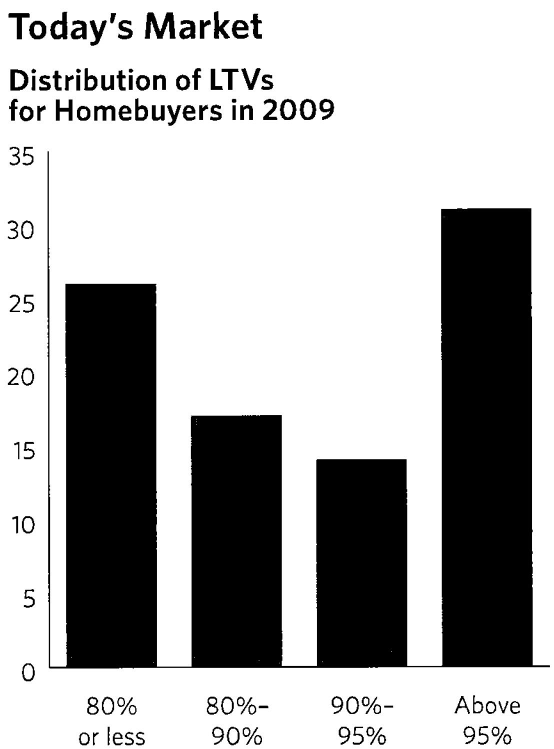
Source: MBA Analysis of Census Bureau American Housing Survey Data.

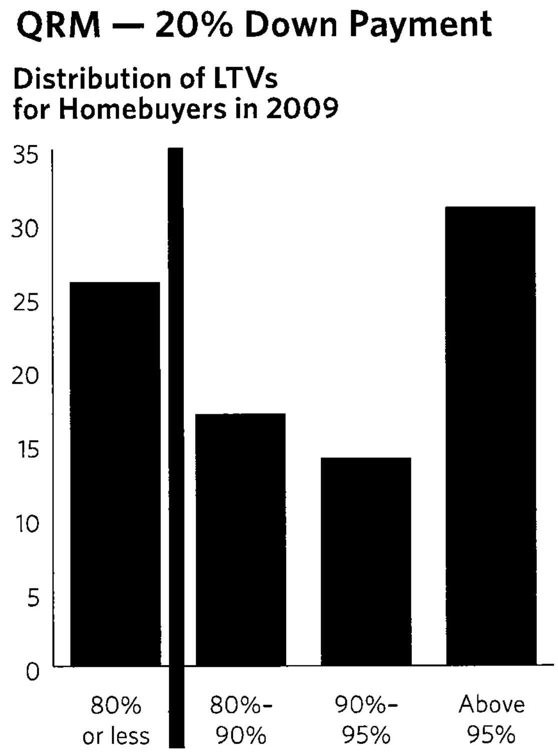
- High LTV loans have been an important component of the home purchase market for decades.
- Minority homebuyers have made much greater use of these loans.
- All homebuyers have made more use following the loss of wealth in the recession.

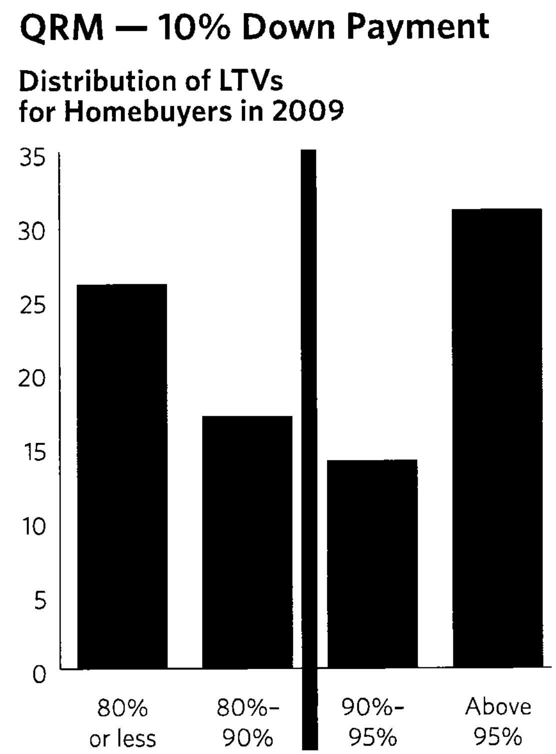


Notes: "DP": Down Payment. "Median HP": Median Home Price. "Income":Median household income, "Years": Years to Save for a 20% Down Payment / 10% Down Payment on a Median-priced Home.

Sources: National Association of Realtors, Census Bureau (American Community Survey, American Housing Survey), Federal Reserve, Bureau of Labor Statistics (Consumer Expenditure Survey)







Source: MBA Analysis of Census Bureau American Housing Survey Data.

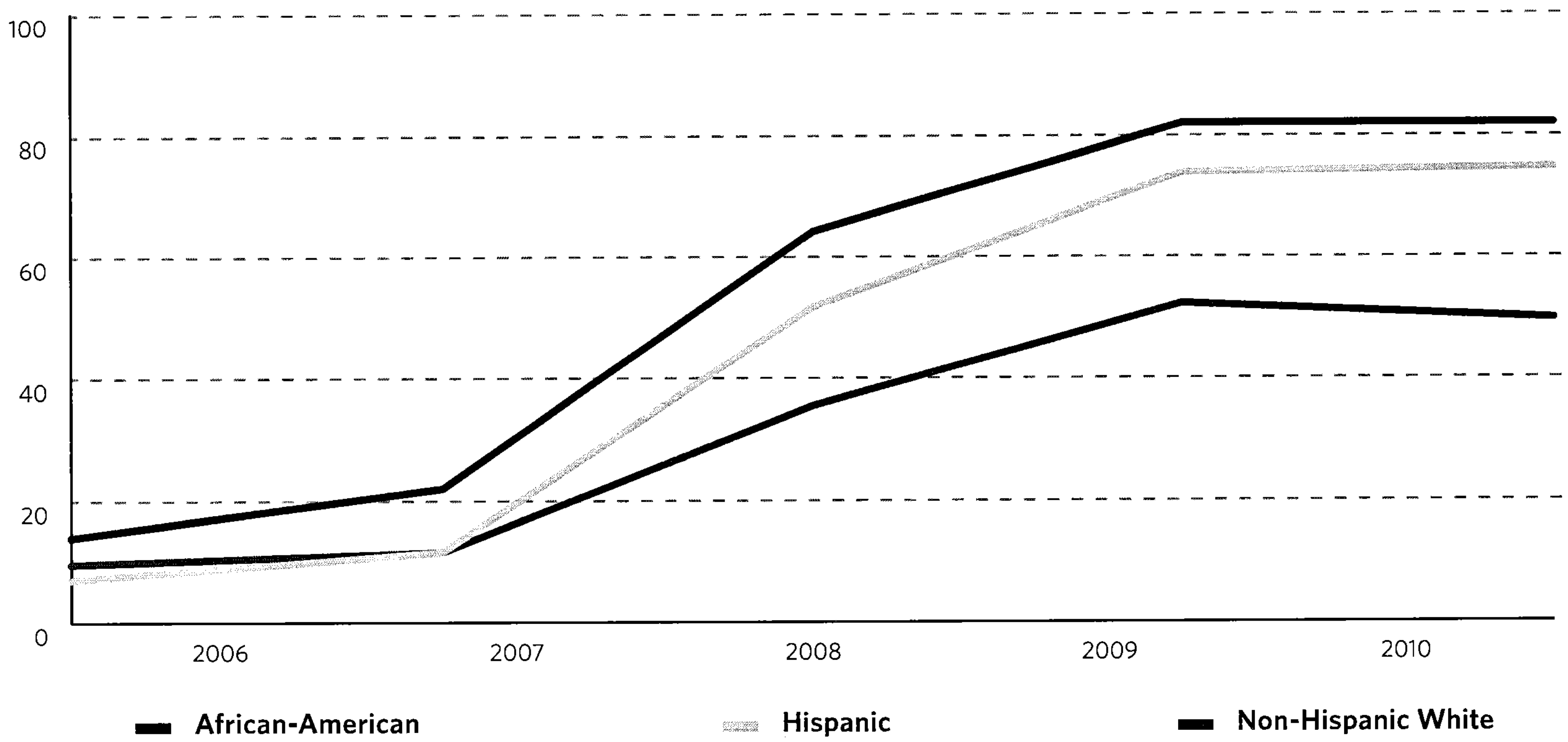
- Borrowers with conforming loan balances across the LTV spectrum have access to the liquidity of the TBA market, which provides the lowest rates.
- Borrowers with jumbo balances pay 30–40 basis points more for fixed-rate loans.
- In October 2011, 43 percent of purchase loans went to one of the government loan programs (FHA, VA or USDA).

- The small share of homebuyers who can make 20 percent or larger down payments get access to the lowest mortgage rates and have the broadest access to credit.
- All other homebuyers either get loans through a government program, or pay a higher rate than those who qualify as QRM.

- If regulators opt for the alternative proposal, it could make the situation even worse. As shown, the purchase market would be cut in half.
- Stronger credit borrowers with less than a 10 percent down payment would likely opt for a government loan, leaving minimal liquidity, and even higher costs for those in the non-QRM space.

Minority Borrowers Use Government Lending to a Greater Extent

Government[a] Share of Home Purchase Loans by Borrower Characteristic



a. FHA, VA, USDA

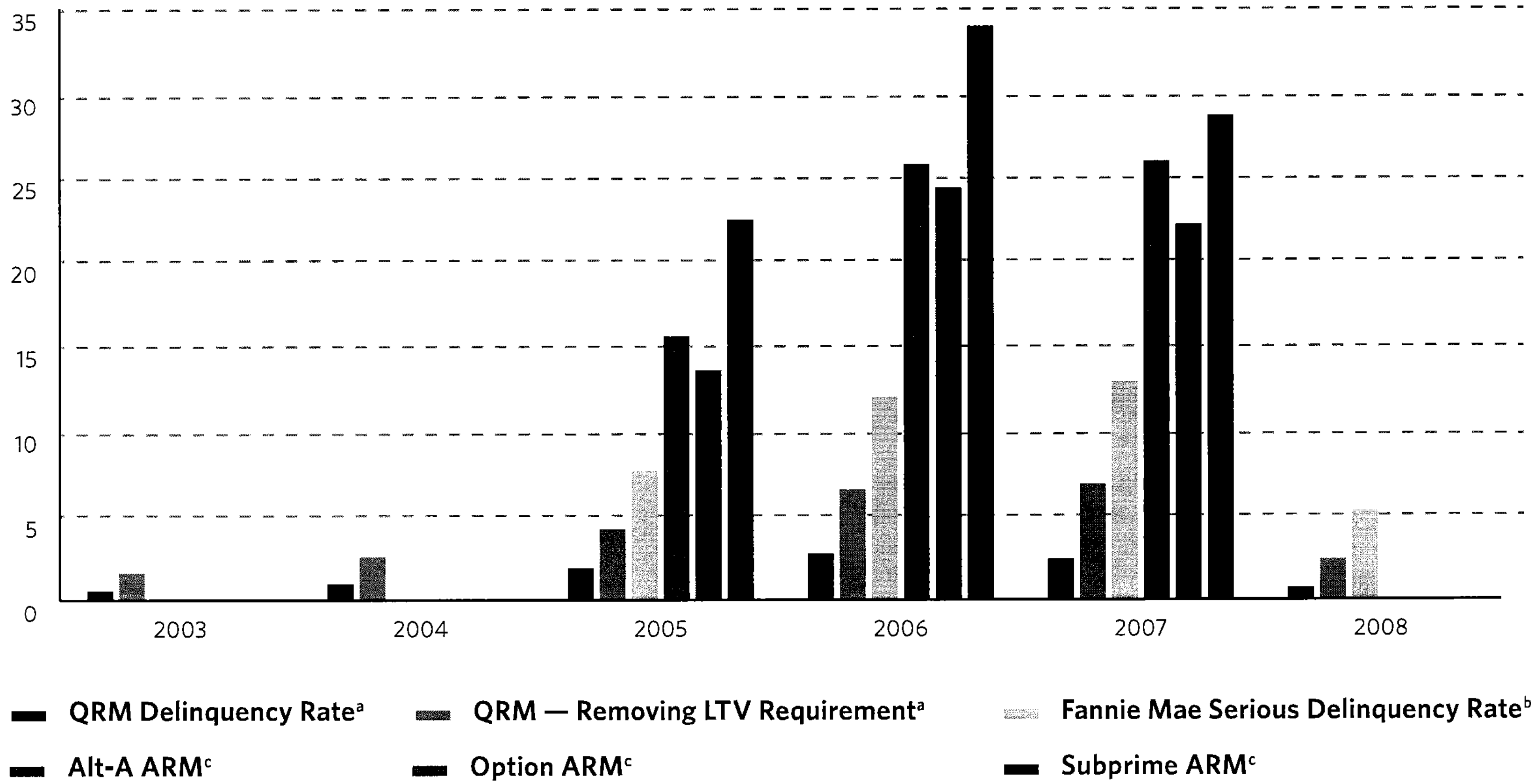
Source: Federal Reserve Analysis of HMDA data.

- HMDA data show that minority borrowers have already heavily been using government housing programs such as FHA in recent years.
- For example, 81.6 percent of African-American borrowers used a government program to finance the purchase of a home in 2010.
- An overly narrow QRM definition would further increase minority homebuyers' reliance on these government programs, as they would be the primary source of low-down payment lending.

Proposed QM and QRM Regulations Would Eliminate Riskier Loan Features

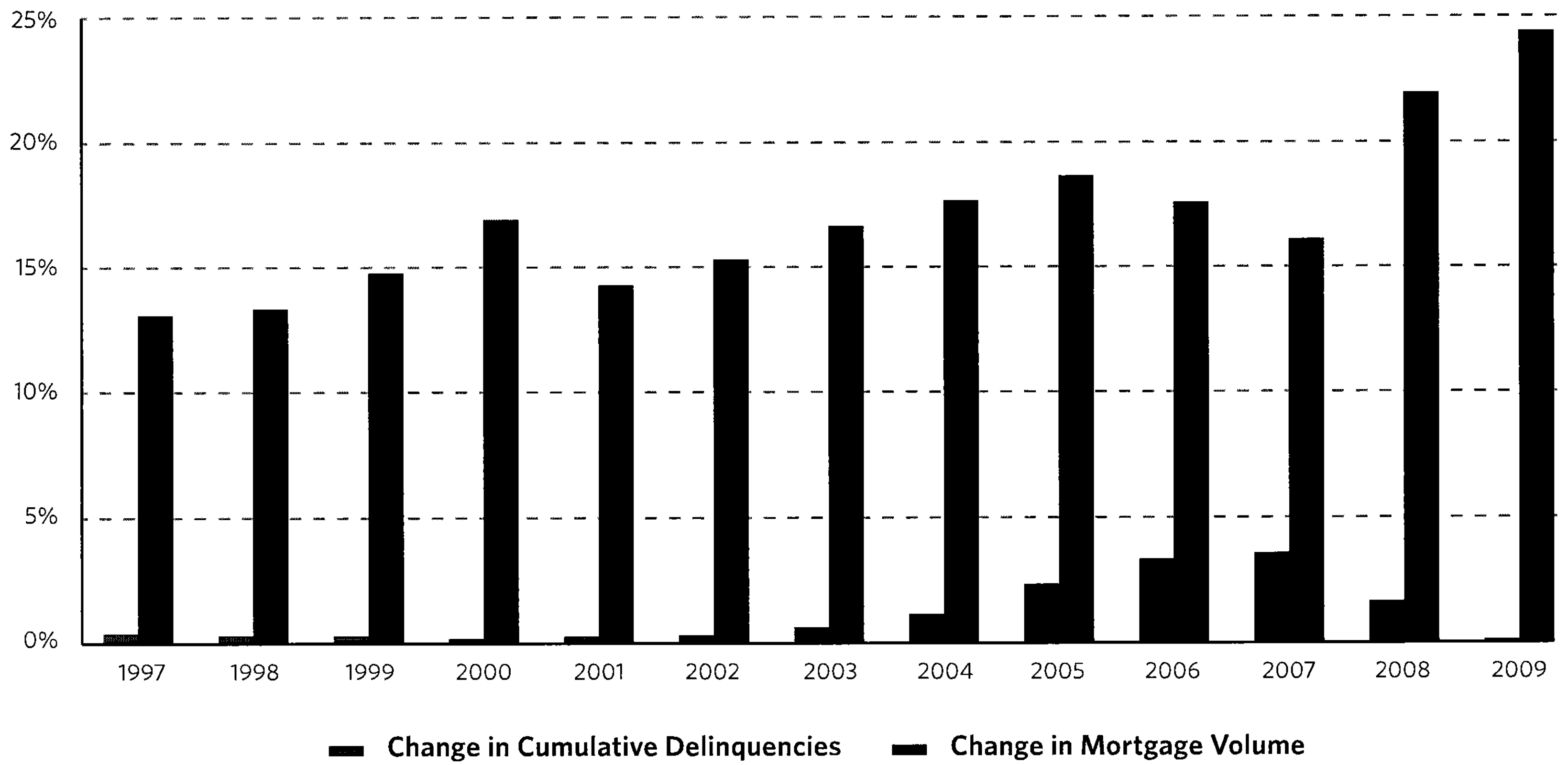
- Requires full documentation — eliminates no-doc lending
- Eliminates negative amortization (option ARM) products
- Sharply curtails ARM products with deep teaser rates
- Non-owner occupied loans would not qualify for QRM

Impact of Removing LTV Requirement Relative to Performance of Non-Traditional Loans



a. Ever-90 Delinquency Rate
b. Serious Delinquency Rate as of Q2 2011
c. Cumulative Default Rate as of 6/3/11
Source: FHFA, Citi, Fannie Mae.

Difference in Volume and Performance when Removing the Debt-to-Income/ Payment-to-Income Requirements from the QRM Standards



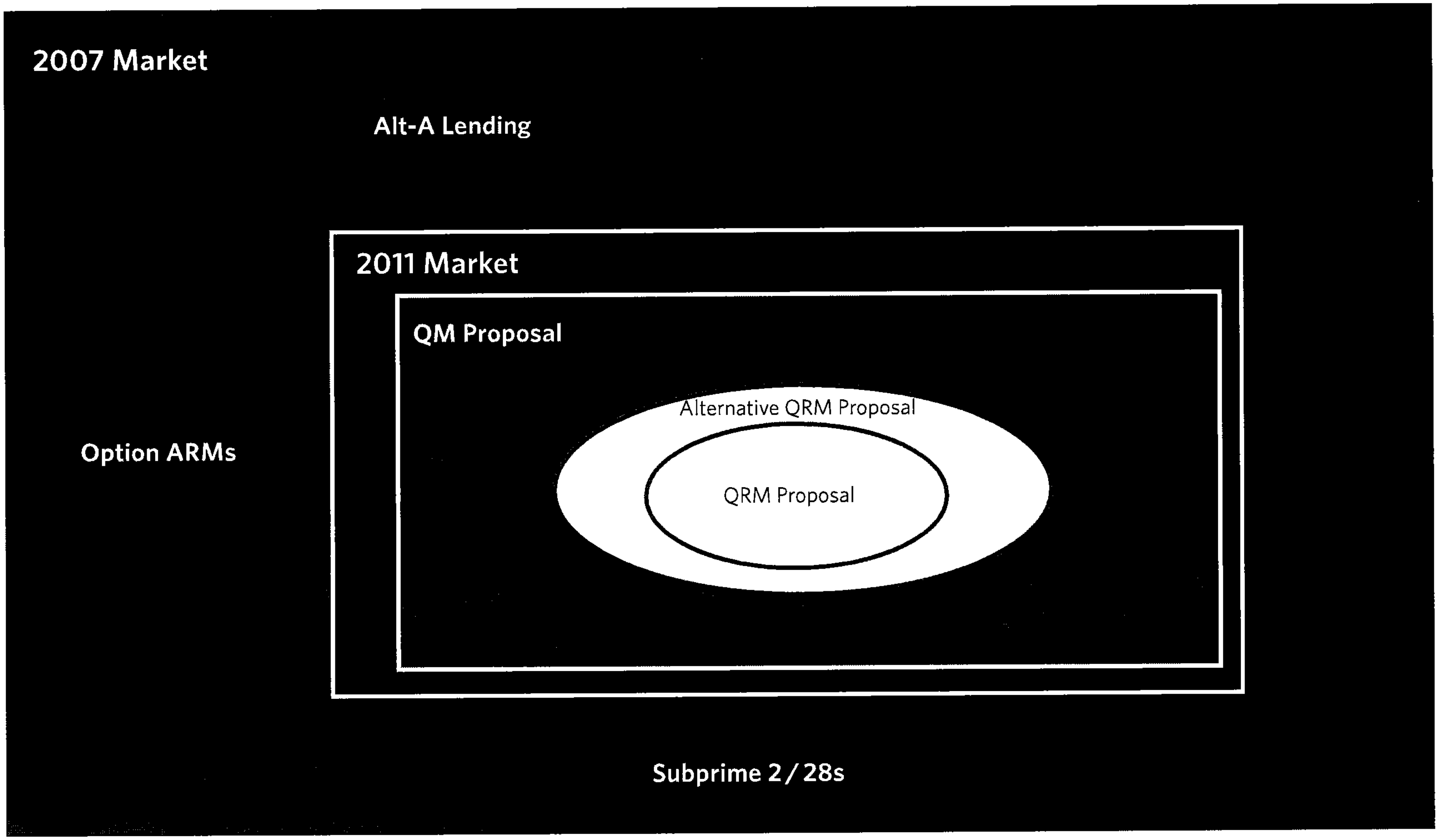
Source: FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

Debt-to-Income/Payment-to-Income Ratios

FHFA data and analysis show that removing the DTI requirement would result in a very large (up to 24%) increase in loans that would qualify, but a relatively small increase in cumulative delinquencies.

QRM Only Available to Narrow Slice

Market has already pulled back to safer products



Where would most minority and low-income homebuyers fall?

For More Information, Please Contact

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