August 1, 2011

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Re: OCC-2011-0002, RIN 1557-AD40
VIA E-MAIL TO regs.comments@occ.treas.gov

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Re: Docket No. R-1411, RIN 7100-AD-70
VIA E-MAIL TO regs.comments@federalreserve.gov

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments – RIN 3064-AD74
VIA E-MAIL TO comments@FDIC.gov

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549 -1090
Re: File Number S7-14-11, RIN 3235-AK96
VIA E-MAIL TO rule-comments@sec.gov

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA43
Federal Housing Finance Agency
Fourth Floor, 1700 G Street, NW
Washington, DC 20552
Reg-Comments@fhfa.gov

Regulations Division
Office of General Counsel
Department of Housing and Urban Development
451 7th Street, SW
Room 10276
Washington, DC 20410-0500
RE: FR-5504-P-01, RIN 2501-AD53
SUBMITTED ELECTRONICALLY TO www.regulations.gov

Regarding: Proposed rule on Credit Risk Retention

Dear Sir or Madam:

The Community Bankers Association of Illinois (CBAI), which proudly represents 410 Illinois community banks, appreciates the opportunity to provide our observations and recommendations on portions of the proposed rule, Credit Risk Retention. The agencies are proposing this rule to implement the requirements of section 941 (b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act) which is codified as the new section 15G of the Securities Exchange Act of 1934.

Community banks were not the cause of the mortgage meltdown or the ensuing financial crisis. Yet community banks, their customers and communities continue to suffer from the effects of the resulting recession. We are seeking reasonable solutions to the current economic problems and a return to sustained growth and employment. A recovery in the housing market in an integral part of the economic recovery and credit risk retention will impact its recovery.

CBAI urges the agencies to focus on addressing the root causes of the mortgage meltdown and financial crisis and to promulgate rules consistent with Dodd Frank Act. By staying within these

boundaries any unintended consequences that will negatively impact community banks and the housing recovery should be minimized.

An overriding priority of the CBAI and Illinois community banks with any legislation, rules or regulations regarding the housing market and housing finance is that community banks retain a variety of ways to independently access secondary markets. Community banks should not have to access these markets through large banks and financial companies, and not be placed at a competitive disadvantage in serving the needs of their customers.

Exemption for Risk Retention Requirements

The CBAI strongly supports the exemption from risk retention requirements that the proposed rule contains for loans sold to Fannie Mae and Freddie Mac. This provision is critical to the recovery of the residential mortgage market. If this exemption was not provided, community banks would have serious difficulty allocating the capital needed to support the risk retention requirement. If community banks were forced to curtail or exit the residential mortgage market, credit availability would be limited. This would leave the marketplace to the largest lenders in the country and the shadow financial industry. These are the very entities which created the mortgage meltdown in the first place through lax underwriting standards and predatory practices. It should not be an unintended consequence of the rulemaking to further concentrate mortgage originations in the hands of those that created this disaster while community banks are forced out.

Definition and Characteristics of Qualified Residential Mortgage (QRM)

The Act directs the agencies to define the term QRM no broader then the definition of "Qualified Mortgage" (QM) as the term is defined under section 129C(c)(2) of the Truth in Lending Act as amended by the Act and implementing regulations. For clarity and ease of compliance, we believe that the definition of QRM and QM should be consistent and be as similar as reasonably possible. This will ensure clarity and facilitate compliance.

Community banks are proud to serve their <u>entire</u> communities including low and moderate income borrowers, first time home buyers, non-traditional or non-conforming loan borrowers, and small business borrowers who fund and support their businesses with their personal assets. Many of these individuals are borrowers that do not conveniently fit into rigidly structured borrowing formulas. Therefore, the CBAI also encourages the agencies to be flexible in determining the characteristics of a QRM.

Down Payment Requirement

CBAI believes that it should be up to the originator to set the down payment requirement based on the loan program used, the property and credit profile, ability-to-repay standards and the situation of the particular borrower. This is the essence of proper underwriting which many originators lost sight leading up to the mortgage meltdown. Community banks have always embraced and implemented sound underwriting standards, and the entire industry needs to again adhere to these important principals.

When Congress wrote the provisions of the Act it considered and rejected a statutory minimum down payment requirement because mortgages have been shown to perform well when accompanied by strong underwriting and safe, stable product features. The three sponsors of the QRM provisions have written the regulators saying that they intentionally did not include down payment requirements in the QRM. Hundreds of members of Congress have separately sent letters raising concerns about the proposal.

Clearly, the opposition to the proposed down payment requirements is strong and we urge the agencies not to include a specific down payment requirement in the final rule. Rather, the final rule should stress the important of a down payment requirement that is *adequate and appropriate* to the specific transaction and its risk profile.

Private Mortgage Insurance (PMI)

The proposed rule would not permit the use of private mortgage insurance (PMI) to offset down payment requirements as currently permitted for loans sold to Fannie Mae and Freddie Mac. PMI has long been used by lenders to insure mortgages with greater than an 80% loan-to-value ratio. PMI has enabled lenders to help many borrowers that do not have the economic means to meet high down payment requirements, particularly lower and moderate income borrowers and first time homebuyers. Community banks have significant experience with PMI and its role in helping their customers buy a new home. This has been a beneficial tool in mitigating risk and community banks want to continue to use it to help borrowers with less cash for down payments. We have concerns that if the use of PMI is not permitted to offset down payment requirements the housing recovery will be impeded as potential borrowers find it more difficult to obtain a new mortgage or refinance their existing mortgage.

Personal Credit Histories

The proposed rule defines a set of “derogatory factors” about a borrower that would disqualify their mortgage as a QRM. These factors include: past due accounts, bankruptcies, repossessions, and judgements. To satisfy the requirements, the originator would need to verify and document within 90 days prior to closing that the borrower satisfies these credit history requirements. A safe harbor would be provided for the originator that, within this timeframe, obtains credit reports from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis.

In the proposed rule there are no provisions for borrowers to provide reasonable explanations of their financial position. A borrower that has minor delinquencies should be considered for a QRM. The rule should allow underwriters to consider mitigating factors for a borrower who does not fit neatly in the regulatory box. We are concerned that these requirements would cause a large number of otherwise “good” residential mortgage loans to not qualify as QRMs.

While the proposed rule does not offer credit scores as a factor, many community banks have found that credit scores are one of several important underwriting tools that should be considered in determining the creditworthiness of a borrower and in their analysis for being a QRM.

Debt Ratios

The rule proposes a front-end ratio limit of 28 percent and a back-end ratio limit of 36 percent to demonstrate ability to repay a loan. The agencies propose these limits because they are consistent with standards widely used in the early 1990s, with higher ratios only available to borrowers with relatively high down payments. The borrower’s monthly gross income and debt as defined in the HUD Handbook would be used to calculate the ratios. The borrower’s monthly household debt would be used in calculating the front-end ratio and the borrower’s total monthly debt would be used in calculating the back-end ratio. Here again, while these ratios are time-tested general standards, there are situations where there are offsetting factors which would allow for higher debt ratios while still being considered high quality loans. Therefore, we believe that these absolute requirements are too stringent and needed to be softened.

Mortgage Servicing Standards

While policy makers and consumers are rightly alarmed and disgusted by the sloppy and abusive mortgage servicing standards of large lenders, they must recognize that community banks have fundamentally different standards, practices and risks. With smaller servicing portfolios, better

control of mortgage documents, and close ties to their customers and communities, community banks have generally been able to identify repayment problems at the first signs of distress and work out mutually agreeable solutions with struggling borrowers.

Servicing requirements such as requiring significant oversight of third party providers and developing burdensome compliance programs, more extensive methods of communicating with borrowers and other new requirements that would be both burdensome and unnecessary for community banks have been discussed. Community banks do not have the staffing and financial resources to implement extensive new programs. If overly burdensome requirements are applied to all banks, regardless of size, it would cause many community banks to exit the mortgage servicing business and accelerate consolidation of the servicing industry with only the largest too-big-to-fail lenders surviving. Again, it should not be an unintended consequence of the rulemaking to further concentrate mortgage servicing in the hands of those that created this disaster while community banks are forced out.

In our view, the credit risk retention rule is not the appropriate place address servicing standards. The banking agencies have already begun to address servicing standards issues and any additional guidance should be proposed in a separate rule making process.

Federal Home Loan Banks

Many members of the CBAI are also members of the Federal Home Loan Banks (FHLBank(s)) and also active participants in the FHLB mortgage programs including the Mortgage Partnership Finance Program (established in 1997) and the Mortgage Purchase Program (established in 2000). These programs use a unique structure that allows a member of a participating FHLBank (Member) to retain a significant portion of the credit risk of the fixed-rate mortgages it originates when selling conventional loans to the FHLBanks. They demonstrate how credit risk retention can work to benefit mortgage lenders and consumers.

These programs are popular with smaller community banks because they provide an alternative to the traditional secondary market that may be difficult or prohibitively costly for many community banks to access. Nationwide, approximately 1,500 FHLBank member institutions, typically community banks, thrifts and credit unions, have used these programs to fund about $235 billion of mortgages that have helped homebuyers, including large numbers of low and moderate income buyers, purchase a new home or lower the cost of their existing home through refinancing.

These programs offer valuable insights and lessons about structuring credit risk retention for residential mortgages. Given their popularity and success, we urge these programs be allowed to

continue unaffected by this and any future proposed rules. Subjecting these programs to the current proposed rule would significantly reduce their ability to customize the fit between the credit risk of each loan and the credit enhancements required of the Member that originates the loans.

Conclusion

CBAI strongly supports a return to sensible underwriting practices for residential mortgages. These are practices that community banks never abandoned. We are deeply concerned that unless the issues raised in this comment letter are addressed the proposed rule will impede the recovery of the housing market and the economy by making it more difficult for borrowers, including low and moderate income and first time homebuyers, to obtain affordable mortgages.

CBAI appreciates the opportunity to comment on the proposed rule by providing our observations and recommendations on credit risk retention. If you have any questions or need additional information please do not hesitate to contact me at (847) 909-8341 or davids@cbai.com.

Sincerely,

/s/

David G. Schroeder
Vice President Federal Governmental Relations