



October 30, 2013

Securities and Exchange Commission  
Office of Comptroller of the Currency  
Federal Reserve Board of Governors  
Federal Deposit Insurance Corporation  
Department of Housing & Urban Development  
Federal Housing Finance Agency

Re: Credit Risk Retention (Re-proposed Rule)

The American Society of Appraisers (ASA) and the National Association of Independent Fee Appraisers (NAIFA) appreciate the opportunity to comment on the above-referenced “Credit Risk Retention” proposed rule which implements section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 941 generally requires issuers of asset-backed securities (ABS) to retain not less than 5 percent of the credit risk of the assets collateralizing the ABS; but permits exemptions from or reductions in the retention requirements based on certain facts and circumstances, as determined by the Agencies. Our comments are limited to those aspects of the credit risk retention rule which relate to the valuation of the assets collateralizing the securities offered for sale to investors.

ASA and NAIFA are professional appraisal organizations representing thousands of professional appraisers across the U.S. Both organizations teach, test and credential highly qualified individuals for professional appraisal practice, including appraisal review, in the area of commercial and residential real property valuation. Additionally, ASA is a multi-disciplinary professional organization that teaches, tests and credentials individuals in business valuation and in the valuation of tangible and intangible personal property assets (e.g., machinery and equipment, fine art, antiques, collectibles, gems and jewelry and the contents of offices and homes). ASA is widely recognized as the nation’s preeminent credentialing organization for business valuation and the appraisal of tangible and intangible personal property. As a consequence of its multi-disciplinary character, ASA possesses the interest and expertise to comment on the feasibility and importance of valuing interests in personal property and business enterprises which sometimes collateralize certain categories of asset-backed securities.

## **ASA & NAIFA Comments On The Re-Proposed Risk-Retention Rule**

### **OVERVIEW**

While the re-proposed rule includes a number of features our organizations enthusiastically support (e.g., the provisions involving Qualifying Commercial Real Estate Loans), we strongly object to the proposal as it relates to risk retention exemptions for residential mortgage-backed securities (RMBS) and for commercial loans. The provisions of the re-proposed rule relating to

RMBS are especially troubling since they represent a dramatic reversal of the underwriting requirements established by the Agencies in the original risk retention proposal.

The changes to the Agencies' original risk retention proposal regarding the issuance of RMBS are far-reaching and, we believe, imprudent.<sup>1</sup> These proposed changes greatly expand the ability of RMBS issuers to be completely exempted from the 5 percent risk retention requirement. It does so by eliminating a number of important underwriting safeguards that the Agencies required in their original proposal in order for a mortgage loan to meet the definition of a "Qualified Residential Mortgage (QRM)."<sup>2</sup> One of the critical mortgage loan underwriting features omitted from the Agencies' re-proposed definition of a Qualified Residential Mortgage is the requirement for a professional appraisal of the market value of the residential properties collateralizing mortgages in the pool of mortgage-backed securities offered for sale to investors. The re-proposal also omits from its underwriting requirements for a residential mortgage loan to be regarded as "Qualified", a borrower's credit history and a loan-to-value standard.

These changes are completely contrary to the Agencies previously articulated framework for a Qualified Residential Mortgage – specifically, that they should be "of very high credit quality" and reflect "underwriting features that historical loan performance data indicate result in a lower risk of default." We fail to understand how a mortgage loan underwritten by a lender without reliance on a borrower's creditworthiness and without knowledge of the market value of the collateral property in the event of default, could be found by the Agencies to meet those QRM tests. We also fail to understand the public policy rationale for the Agencies' conclusion that residential mortgage-backed securities composed of loans with greatly stripped-down underwriting requirements can and should be exempted from Dodd-Frank's risk retention requirements without undermining the essential purpose of these requirements and without jeopardizing the financial interests of RMBS investors.

Our concerns over and opposition to the provisions of the re-proposed rule governing collateralized commercial loans, similarly relate to the absence of any requirement for appraisals of the market value of the tangible and intangible properties which collateral many such loans, as well as for appraisals of the "going concern" value of commercial borrowers, which is often an important factor in evaluating a firm's ability to repay a loan.

The views of our organizations on the requirements proposed for various asset classes are set forth below in some detail:

- **QUALIFIED RESIDENTIAL MORTGAGE LOANS – AGENCIES' REVERSAL OF CRITICAL QRM UNDERWRITING REQUIREMENTS INCLUDED IN ORIGINAL CREDIT RISK**

---

<sup>1</sup> The re-proposed rule was published in the *Federal Register* of September 20, 2013. The original risk retention rule was published in the *Federal Register* of April 29, 2011. By letter dated June 16, 2011, ASA and NAIFA submitted written comments to the Agencies on the original risk retention proposal.

<sup>2</sup> Loans which meet the Agencies' definition of a QRM are exempt from risk retention requirements, pursuant to a Dodd-Frank amendment to section 15G of the Securities and Exchange Act of 1934.

## **RETENTION PROPOSAL IS UNWISE AND HAS NO PUBLIC POLICY JUSTIFICATION:**

**Our organizations strongly object to the omission from the re-proposal’s definition of a Qualified Residential Mortgage, any requirements for an appraisal of the market value of residential properties collateralizing mortgages in pools of mortgage-backed securities. The absence of any valuation requirement denies critical information to potential investors in RMBS (a significant category of ABS) and ignores a central lesson of the recent collapse of the mortgage-backed securities markets and the damage it caused the U.S. economy.**

We fail to understand the public policy rationale for the Agencies’ dramatic decision to eliminate a series of common-sense and time-tested underwriting requirements they established in the April 29, 2011, original proposal, for determining whether a residential mortgage is a Qualified Mortgage. The original proposal established a clear set of underwriting criteria for loans to be included in pools of mortgage-backed securities exempt from risk retention requirements. These now-eliminated criteria included borrower credit history; payment terms; loan-to-value ratio; “qualifying appraisals”<sup>3</sup> and several other underwriting standards and product features for QRM that the Agencies’ stated (based on careful review of extensive mortgage performance data) were necessary to “help ensure that such residential mortgages are of very high credit quality”.

The commentary explaining the requirement for professional appraisals stated that “The Agencies’ believe these requirements will help ensure that the appraisal is prepared by an independent third party with the experience, competence and knowledge necessary to provide an accurate and objective valuation based on the property’s actual physical condition. These requirements are intended to ensure the integrity of the appraisal process and the accuracy of the estimate of the market value of the residential property” serving as collateral for the securitized mortgages.<sup>4</sup>

Importantly, perhaps, the re-proposal does include a discussion of an alternative QRM approach and a request by the Agencies for comment on it (even though they have apparently concluded it is not their “preferred approach”). As stated in the re-proposal: “The alternative approach (referred to as “QM-plus”) would take the QM criteria as a starting point for the QRM definition, and then incorporate additional standards that were selected to reduce the risk of default.” (Emphasis added). These additional standards include requirements for credit history; loan-to-value ratio (with the collateral property’s value determined by a professional appraisal); and, a first lien. In their request for comment on this alternative approach, the Agencies acknowledge that “academic research and the agencies’ own analyses show that credit history and loan-to-value ratio are key determinants of mortgage default...” (Emphasis added)

---

<sup>3</sup> A “Qualifying Appraisal” was defined as follows: “The creditor obtained a written appraisal of the property securing the mortgage that was performed not more than 90 days prior to the closing of the mortgage transaction by an appropriately state-certified or state-licensed appraiser that conforms to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP) promulgated by the Appraisal Standards Board of the Appraisal Foundation, the appraisal requirements of the Federal banking agencies, and applicable laws.” (*Federal Register* of April 29, 2011 at page 24167).

<sup>4</sup> Ibid, page 24125.

The Agencies ask for comment on whether securitizers packaging QRM-eligible mortgages into RMBS would have reason to be concerned if the QRM-eligible mortgages comprising the pool did not include credit history and loan-to-value. The obvious answer to us is that the securitizer would be concerned (or certainly should be concerned) based on the fact that absent information on mortgagors' credit histories and on loan-to-value ratios, prospective RMBS purchasers would have no meaningful basis for determining risk exposure. This would be a particularly acute dilemma for RMBS purchasers acting in a fiduciary capacity for investors. An additional point worth mentioning is that while underwriting in a way to prevent "mortgage default" is a critical consideration, so too is the related issue of the likelihood of lender or investor recovery in the event of default. While the credit history of a mortgagor is certainly central to measuring the possibility of default, the nature and extent of financial recovery on a defaulted mortgage is often dependent on the market value of the collateral property and the LTV ratio of the loan.

We are convinced that the alternative QM-plus approach discussed in the re-proposal is far superior in every meaningful way to the Agencies so-called "preferred" approach. We believe the underwriting criteria for qualifying RMBS established by the Agencies in the original credit risk retention proposal were the correct ones; and urge them to return to those criteria in the final rule. While some sensible modifications of the original underwriting criteria for qualifying mortgage loans may well be justified (e.g., a reasonable reduction in the down payment percentage), eliminating credit histories and LTV/appraisal requirements are inherently contrary to the high underwriting standards essential to ensure the safety and soundness of mortgage loans deemed to be qualified and, thereby, exempt from risk retention policies. Moreover, creditworthiness and LTV considerations have been integral and commonly-understood components of the mortgage underwriting process for many decades. Their inclusion in the final criteria for determining QRM loans should increase, rather than decrease, the number of mortgage loans eligible for exemption from risk retention requirements in an RMBS offering; and, their inclusion in the final rule will enhance their attractiveness to RMBS investors.

- **QUALIFYING COMMERCIAL REAL ESTATE LOANS – AGENCIES' UNDERWRITING REQUIREMENTS FOR QUALIFYING CRE LOANS PROTECT THE INTEGRITY OF THE RISK RETENTION EXEMPTION PROCESS:**

**Our organizations strongly support the re-proposal's affirmation of the original proposal's collateral valuation underwriting provisions for Qualifying Commercial Real Estate (QCRE) loans, including the establishment of professional appraisal requirements (e.g., reliance on state certified or licensed appraisers, as appropriate, and adherence to the Uniform Standards of Professional Appraisal Practice) for valuing commercial real property collateralizing such loans included in pools of securities.**

Our organizations enthusiastically support the re-proposal's valuation requirements governing QCRE loans that would be exempt from credit risk retention requirements when they are securitized and included in a pool of such loans. The market value of properties collateralizing commercial real estate loans – even if repayment of those loans is not dependent on the sale of or

income from the properties – is essential for QCRE and their exemption from credit risk retention requirements.

- **QUALIFYING COMMERCIAL LOANS – AGENCIES’ UNDERWRITING REQUIREMENTS FALL FAR SHORT OF WHAT IS NECESSARY TO PROTECT INVESTORS AND THE EFFECTIVENESS OF THE RISK RETENTION EXEMPTION PROCESS:**

**Our organizations strongly object to the absence of any valuation requirements in the underwriting standards for a Qualifying Commercial Loan (QCL), even in situations where the loan proceeds finance the acquisition of tangible and intangible property or where collateral property is otherwise a significant factor in the borrower’s ability to repay the securitized loan.**

We are perplexed by the obvious disconnect between the absence of any valuation provisions in the QCL portions of the proposed rule, on the one hand, and the Agencies’ lien acquisition requirement, on the other. We question the efficacy of the lien acquisition obligation absent an accompanying requirement for an appraisal of the market value of the encumbered property. A concrete illustration of this disconnect can be found in the Agencies’ discussion of a proposed risk retention exemption for Utility Legislative Securitizations (ABS issued by state-regulated electric utilities).<sup>5</sup> As justification for this exemption, the Agencies state that these securities “would be required to be secured by the intangible property right to collect charges for the recovery of specified costs and such other assets of the issuing entity” and would be accompanied by a guaranty that neither the state nor any of its agencies has authority “in any way to reduce or impair the value of the intangible property right...” Nowhere, however, does the Agencies’ proposal include a requirement for a valuation of this important intangible right – a valuation that would give investors an asset-level knowledge of the intangible asset’s value.

We see a similar disconnect between the absence of a valuation requirement and the Agencies’ admonition that commercial lenders “should consider the appropriate value of the collateral to the extent it is a factor in the repayment of the obligations.” Whether the collateral value is sufficient, depends on an appraisal. Credentialed business appraisers are competent to value intangibles and credentialed personal property appraisers regularly value tangible personal property assets.

The Agencies’ assert that they intend the underwriting standards for qualifying commercial loans exempt from risk retention requirements (including those that are collateralized and those used to finance the acquisition of tangible and intangible property) “to be reflective of very high-quality loans.” Absent a valuation requirement as part of the underwriting process, we doubt that such commercial loans are capable of meeting such a high standard.

---

<sup>5</sup> Section IV (D)(1) of the re-proposal, *Federal Register* page 57974.

Finally, the re-proposed rule states that “the agencies are declining to propose a requirement of a qualifying appraisal so as not to increase the burden associated with underwriting a QCL.” We are surprised by, and respectfully disagree with, the Agencies’ characterization of a qualifying appraisal for qualifying commercial loans of the kind described above as an underwriting “burden”. We question the effectiveness of a final rule governing commercial loan securities that are exempt from risk retention requirements, absent any mechanism which would ensure that lenders, ABS investors and regulators have a reliable understanding of the value of the tangible and/or intangible properties collateralizing the loans. Without a valuation of the market value of underlying assets, ABS investors have a very limited ability to assess risk.

We hope the views of our organizations are helpful to the Agencies and the SEC. We would appreciate an opportunity to meet with the Agencies and the Commission to discuss our comments and concerns in greater detail. We will be in contact with you in an effort to arrange such a meeting. If there are any questions or if additional information is needed, please contact Peter Barash, Government Relations Consultant to ASA and NAIFA at 202-466-2221 or [peter@barashassociates.com](mailto:peter@barashassociates.com), or John D. Russell, Director of Government Relations for ASA at 703-733-2103 or [jrussell@appraisers.org](mailto:jrussell@appraisers.org).

Sincerely,  
ASA and NAIFA