TEXAS MORTGAGE BANKERS ASSOCIATION

823 CONGRESS AVE, STE 220, AUSTIN, TEXAS 78701 | 512/480-8622 P | 512/480-8621 F | WWW.TEXASMBA.ORG | WWW.TEXASMORTGAGELICENSING.ORG

July 29, 2011

RE: Credit Risk Retention Proposed Rule
Office of Comptroller of Currency Docket No. OCC-2011-0002
Federal Reserve System Docket No. 2011-1411
Federal Deposit Insurance Corporation RIN 3064-AD74
Federal Housing Finance agency RIN 2590-AA43
Department of Housing and Urban Development RIN 2501 AD53

To Whom It May Concern:

On behalf of the Texas Mortgage Bankers Association, the oldest and largest state mortgage industry trade group, we appreciate the opportunity to comment on the proposed Credit Risk Retention rule. Our comments are primarily directed to the portion of the proposed rule defining a Qualified Residential Mortgage (Subpart D ___.15(c) and (d). Like many in our industry, we have serious concerns regarding the unintended consequences that would be the byproduct of the proposed definition. Furthermore, we feel this definition goes far beyond what was intended by the original sponsors of the Dodd Frank Act. Given the precarious health of the country's economy and housing market, it is essential that we take the time to understand the impact that this definition will have on both.

The TMBA recognizes the need to define the Qualified Residential Mortgage, and agrees that certain exotic loan programs (i.e. negative amortizing pay option ARMs) and certain income documentation types (i.e. stated income) should not be considered as a Qualified Residential Mortgage. The misuse of these non traditional documentation products, when combined with exotic loan programs, clearly contributed to the distress in the mortgage, housing market and overall economy.

Minimum Down Payment and LTV Requirement

While our members are troubled by several of the proposed criteria, we particularly are concerned about the Loan to Value ratio requirements contained in proposed ___.15 (d)(9) We do not feel the definition should include this component for three reasons: 1) default statistics do not support the notion that down payment is strongly correlated to frequency of default on traditionally underwritten loans; 2) a minimum down payment requirement would create a disparate impact on minority groups and first-time homebuyers; and 3) the ultimate borrowing costs to these impacted borrowers and the next tier of borrowers trying to sell their homes to these borrowers. This would have a detrimental impact on the weak housing market and further slow the economy as a result.

Statistics for 30 million loans show that while default rates on loans with a 5% down are higher than loans with a 10% down payment, the difference is statistically negligible and the performance of both groups is acceptable. By requiring a 20% minimum down payment, many good, performing loans would be excluded, or would be forced to pay a higher interest rate. The far more significant correlation with defaults is with reduced documentation of income and other underwriting standards. Loans with stated income defaulted at a rate 3 to 4 times that of traditionally underwritten, full income documentation loans (see default comparison by doc type). We believe that requiring the originating lender to verify employment, income, cash reserves, credit history, and prior mortgage or rental history is a more appropriate measure of determining the borrower's ability to repay the loan. The majority of the loans that defaulted over the past few years were lacking one or more of these under-writing criteria.

In addition to excluding many performing loans, the down payment requirement will have a significant and disparate impact on first-time homebuyers and minority borrowers. Studies have shown that even for the median income family, it would take 14 years to save the money needed for a 20% down payment (from the Center of Responsible Lending). Furthermore, the minority borrower, particularly Hispanic, is expected to comprise the largest population growth over the next 20 years. By excluding many of these borrowers from the ability to purchase a home, the housing market will be significantly and negatively impacted for many years to come. The disparate impact will create fair-lending issues within the banking system. The result of requiring a 20% down payment will be that affluent borrowers will be extended credit disproportionately and at a lower cost as compared to low and moderate income borrowers. This disparity will be felt disproportionately among minority and first-time borrowers.

While we believe that eliminating a down payment requirement or establishing maximum loan to value ratios is to be preferred in the final rule for the reasons cited, TMBA would strongly urge that loans in excess of any required LTV but covered by appropriate private mortgage insurance be considered as a QRM. Traditionally, lenders making mortgages with loan to value ratios greater than 80% have required private mortgage insurance, to mitigate the marginally greater risk of the higher LTV loans. While mortgage insurance does not reduce default frequency, it does reduce loss severity in the event of default. Loss severity is the primary concern for the security holder, and the American taxpayer on those loans with an implied government guaranty. For this reason, we believe a higher loan to value ratio should be permitted where mortgage insurance in appropriate amounts is required by the lender. This insurance ultimately passes much of the risk from the investor or government entity to the privately held mortgage insurance companies.

Second Homes and Investment Properties

It is our position that second homes and investment properties not be excluded from inclusion in the definition of a Qualified Mortgage Loan as proposed in ___.15(c). These loans, if underwritten and documented properly, perform adequately.

Impact on the Housing Market and Overall Economy

Clearly, the disparate treatment of low-moderate income borrowers will be the most negative impact of this legislation.

While banks currently have excess capital and might fill the private securitization void (for non QRM loans held in portfolio), this is not a viable long-term option. Whether because of other higher-yielding products, or because of reserve requirements against their loan held, banks will eventually get their fill of mortgages, particularly those that don't meet the proposed QRM definition. These will require a securitization exit for these loans and lead to the issues cited above less liquidity and higher cost of credit. Due to the required return on the 5% risk retention capital, the interest rate charged to the borrower will be significantly higher – as much as 150 bps or 1.5%. We feel certain securities should be subject to risk retention by the issuer. These would include securities with lower documentation requirements, exotic loan types, and sub prime loans. At present there is no private securitization for these loans due to many factors – among those uncertainty regarding risk retention requirements. In order for this market to return, the risk retention requirements must be clarified.

In the near term, our fragile economy will be negatively impacted as well. Without credit availability for low-moderate income and first-time homebuyers, the surplus inventory of distressed (short sale and REO) properties will remain high for many years to come. Only investors would be suitable buyers for the properties in many cases.

In addition to the distressed market, home builders will be negatively impacted. With our nation's largest growing demographic unable to buy homes, the economy will experience a prolonged and sustained setback. This economic setback will not only impact the housing industry; its effects will bleed over into the retail sector and employment market.

Possible Solutions

We believe the unintended consequences of the current proposed definition are avoidable. The key to avoiding these consequences is eliminating the minimum down payment and focusing instead on documentation and loan type. By focusing on reduced documentation and exotic loan types in the QRM definition, the loans that most heavily contributed to the nation's real estate and economic crisis will be subject to risk retention by the security issuer. While this will subject these loans to higher interest rates, this is commensurate with the risk on these loans.

Reduced documentation loans include those where income is not verified by the loan originator. Whether the income is stated by the borrower or not, these loans did not require verification of the borrowers' income through tax returns, W-2's and pay stubs. The attached delinquency statistics show these loans defaulted at a rate significantly higher than low down payment loans with full income documentation (tax returns, W-2 and pay stubs verified).

The other significant contributor to loan defaults was exotic loans types, specifically short-term (i.e. less than 3 years) fixed terms, some of which include a negative amortization (i.e. Deferred interest) features. As the payments increased on these loans following the fixed-term period, the borrowers defaulted at alarmingly high rates compared to fixed rate loans. The inclusion of these exotic Adjustable-rate loan types will require risk retention by the issuer of the security. Once again, this would result in higher rates commiserate with the risk on these loans.

There will be additional unintended consequences as well. The TBA security market, used by banks and mortgage banks to hedge interest rate risk, will likely be negatively impacted. This additional risk will exacerbate the cost of credit and higher interest rates to non-QRM borrowers.

The current proposed legislation on covered bonds will address the risk retention issue. In this structure, the loans held in portfolio will be collateralized against the debt issue. We would support a covered bond exemption in the final definition. This will create additional market liquidity by providing banks with an alternative to securitization.

We believe the objective can be accomplished by revising the GSE eligibility requirements. If both Fannie Mae and Freddie Mac abstain from buying loans with low and/or alternative documentation, and any exotic or short-term ARM products, private securitization or bank portfolio lending will be the resulting and only option. If the final definition requires risk retention on these securities, the objectives of the sponsors will be achieved. The original purpose of the GSEs was to provide liquidity on standard, well-documented loans. GSE, or agency-eligible loans, previously carried a market significance. Reinstating the GSEs original purpose, combined with a revised QRM definition, will serve to achieve the objectives of the risk retention sponsors.

Lastly, we urge you to act deliberately and with caution in crafting the final rule. Our economy and real estate market are both in a fragile condition. The QRM definition as proposed will have a devastating impact on both. This impact can and should be avoided by revising the QRM definition as detailed herein.

We appreciate your careful consideration on these issues.

Sincerely,

Tim Fisher
President
First Continental Mortgage, Ltd.
tfisher@fcmchou.com

President-elect Texas Mortgage Bankers Association 2012