DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 43
Docket No. OCC-2013-0010
RIN 1557-AD40

FEDERAL RESERVE SYSTEM
12 CFR Part 244
Docket No. R-1411
RIN 7100 AD 70

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 373
RIN 3064-AD74

FEDERAL HOUSING FINANCE AGENCY
12 CFR Part 1234
RIN 2590-AA43

U.S. SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 246
Release No. 34-70277
RIN 3235-AK96

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
24 CFR Part 267
RIN 2501-AD53

Credit Risk Retention[1]

October 30, 2013

Comments of the
National Consumer Law Center
on behalf of its low income clients
and the
National Association of Consumer Advocates

The National Consumer Law Center[2] ("NCLC") respectfully submits the following comments on behalf of its low-income clients, as well as for the National Association of Consumer

[1] On the website of the Federal Reserve System at http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20130828a1.pdf.

[2] The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Truth In Lending* (8th ed. 2012), *Mortgage Lending* (1st ed. 2012), and *Foreclosures* (4rd ed. 2012), as well as regular newsletters on a range of topics related to consumer credit issues and low-income consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law

Advocates,[3] on the proposed credit retention rule relating to home mortgages and its exceptions: the QRM.

We are concerned about the availability and affordability of credit to the many borrowers who are unable to obtain loans that fit within the QRM. In our previous comments,[4] we encouraged the Agencies to tighten the qualifications for QRM loans, to encourage a robust and competitive market for non-QRM mortgages. We are certain that regardless of the exact parameters of the QRM definition, many of our low-income clients will continue to fail to qualify for QRM. The larger the non-QRM market, the more competition will be at play to ensure fair and affordable pricing for all homeowners. This approach to QRM is consistent with congressional intent: Congress indicated that the QRM was intended to be the exception to risk retention rule – not the bulk of the mortgage market. Risk retention alone is unlikely to realign incentives sufficiently to protect our low-income clients from unsustainable loans; we think competition will do more to promote access to affordable and sustainable credit for the most vulnerable borrowers, as Congress intended.

We understand and sympathize with the advocacy of many of our friends in other consumer, community, and housing organizations who have advocated for an expansion of the QRM exception because they fear the limitation of affordable credit for people who do not qualify for a QRM loan. We agree with this concern. QRM loans are likely to be cheaper for homeowners because investors are likely to regard QRM loans as having the government's gold seal of safety and soundness, regardless of actual risk retention. Conventional definitions of credit worthiness are often linked to impermissible factors such as race or gender, and a narrow QRM thus runs the risk of wrongly excluding credit-worthy borrowers from the least expensive credit. While industry almost certainly is exaggerating the gap, [5] it seems likely that there will be a gap, and that borrowers excluded from the QRM market will have to pay more for credit. However, we remain convinced that the best way to ensure that the non-QRM market is viable and competitive, with fair pricing, is to make the non-QRM loans a large percentage of the mortgage market.

We initially planned to respond with some detail to the questions posed regarding the QM Plus proposal (Requests for Comment #s 96 through 107). We intended to advocate strongly for

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affecting low-income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to address predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of the all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. These comments were written by NCLC attorneys Margot Saunders and Diane Thompson.

[3] The **National Association of Consumer Advocates** (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students, whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers.

[4] *See,* Comments of the National Consumer Law Center and NACA regarding Risk Retention, August 1, 2011. Available at http://www.nclc.org/images/pdf/car_sales/qrm_comments.pdf.

[5] The mortgage industry's promises of huge differentiations between the QRM and the non-QRM are so extreme as to make them patently unbelieveable. *See, e.g. "Proposed QRM Harms Creditworthy Borrowers and Housing Recovery," (www.mbaa.org/files/ResourceCenter/MIRA/QRMWhitePaper.pdf),* citing a 2009 report by JP Morgan Securities that estimates the potential impact on mortgage rates of a "combination of [accounting standards] SFAS 166/167, risk retention, and Basel II" that could result in issuers of securities having to keep 100% of the mortgages backing an MBS on their books under certain (easily avoidable) circumstances. Available at: www.zigasassociates.com/Text/JPMorgan_analysis.pdf, pp. 3-22.

the QM Plus – with some significant amendments to the terms of the QM Plus (such as replacing LTV requirements, which have a particularly pernicious disparate racial impact, with stricter standards for credit). However, we are not sure that having a broader risk retention marketplace (more securitizations required to include risk retention) that includes some QM loans, would really provide a more robust competitive market for the credit-challenged borrowers who remain on the outside of that growing group. We are not sure how fertile the soil would be for QM loans which do not qualify for the QRM exception. More to the point, for the borrowers about whom we are concerned, we are very unsure that broadening that group of QM borrowers who do not qualify for QRM would provide any benefits for the borrowers who qualify for neither QM nor QRM. We think the issue was – unfortunately – most likely resolved when the CFPB issued the standards for the QM.

In part, there is a real question about whether the risk retention requirement, by itself, will make much difference to investors. Retaining five percent risk may not be sufficient to change behaviors.[6] It is well recognized that before the financial crisis, many involved in the securitization process held even more than 5% credit risk in their securitizations. Securitizers often desired to participate in the potential for the high returns promised in the riskiest tranches.[7] Given that history, a requirement for only a five percent credit risk retention seems unlikely to drive different behaviors. Moreover, investors burned by the recent crisis are likely to insist on some credit retention by originators, regardless of regulatory requirements.[8]

Comments on Questions 90 through 93

Avoiding a Magic Middle (Questions 90 and 91). Because of the complexities and market uncertainties with all of these new rules, we strongly urge all of the agencies to closely monitor the availability of fair and reasonably priced credit for borrowers whose loans do not qualify for either the QM or the QRM status. The problems in the mortgage marketplace over the past several decades began with the worst loans made to the least sophisticated borrowers who did not perceive they had choices in their credit, or did not know how to exercise those choices. It would indeed be a crime if, as the result of the huge congressional effort to address predatory mortgage lending, and insert some rigor and integrity back into the mortgage underwriting process, that this same group of credit-challenged borrowers were left with poor and expensive choices for their credit in the future.

Our recommendations are constrained by the limitations of both the pre-existing QM definitions and the congressional prohibition against the QRM exception being broader than the QM exception. We are mostly concerned with the borrowers on the fringes of both groups:

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[6] *See, e.g. Felix Salmon*, *"The anti-risk-retention lobby's bizarre logic,"* Reuters, June 1, 2011, pointing out that the extra cost of risk retention on a 30 year mortgage for $225,000 at 4.9% would cost $1 a month. Available at http://blogs.reuters.com/felix-salmon/2011/06/02/the-anti-risk-retention-lobbys-bizarre-logic/.

[7] *See, e.g.* Zandi, "The Skinny in the Game," Moody's Analytics, March 11, 2011.

[8] *See, e.g. "Felix Salmon*, *"The anti-risk-retention lobby's bizarre logic,"* Reuters, JUN 1, 2011, pointing out that "investors, burned during the financial crisis by the originate-to-distribute business model, are going to require a risk premium on any securitized paper where the underwriting bank doesn't retain at least 5%. For that reason, too, it seems reasonable to believe that QRM loans would if anything be more expensive than other loans, rather than cheaper. Available at http://blogs.reuters.com/felix-salmon/2011/06/02/the-anti-risk-retention-lobbys-bizarre-logic/

- borrowers who have fewer credit choices (because of low wealth, low income, compromised credit);
- borrowers who perceive they have fewer choices (because of misunderstandings about what is available in the marketplace); and
- borrowers who do not understand how to exercise their market choices by searching for the best loans with the best terms (either because they lack the financial sophistication to conduct this shopping, or who are misled by a market participant to their disadvantage).

We remain convinced that the best way to protect these borrowers on the edges is to make the market that supplies their credit as large as possible. To do that, the QRM universe should be as small as possible. If the QRM universe is too large, borrowers in the non-QRM space will be stigmatized and will have reduced access to affordable and fair credit.

Unfortunately, we believe the QM-Plus proposal on the table does not go far enough, and thus runs the real risk of creating invidious distinctions that perpetuate racial inequities in access to credit, without producing any significant benefits for competition in the non-QRM space. The QM-Plus proposal would include almost all good-credit borrowers. Instead of relying on stellar credit credentials to separate a limited class of QRM loans from a much larger QM pool, the QM-Plus proposal relies on LTV-ratios. LTV ratios have almost nothing to do with the creditworthiness of the borrower, reflecting, instead, relative wealth positions. A high LTV may well mean a reduced risk for a lender when it comes time to foreclose, but that position is the essence of asset-based lending, a per se predatory practice.[9] Restricting access to credit solely on the basis of LTV ratios ignores ability-to-repay, encourages asset-based lending, and necessarily results in restricting access to credit to communities of color, who historically have had less inherited wealth with which to make a large downpayment, and whose homes have historically appreciated at slower rates, leaving them with less equity to leverage.

Alternative, tighter proposals, based, for example, on very high FICO scores, or the absence of any late payments for the last two years, are difficult to formulate in the absence of hard data about how the QM and QRM definitions will play out, and are themselves potentially linked to invidious treatment. Without more data, there is a real risk that any credit-based distinctions between QRM and QM will enshrine impermissible grounds as legitimate reasons for denying credit. Therefore, we reluctantly urge the Agencies to adopt a QRM proposal co-extensive with QM, while continuing to collect data and study market interactions.

Having reached that conclusion, we also advocate for the rejection of the specific distinctions contemplated by the Agencies, as discussed below.

Inclusion of Subordinate Lien Loans in QRM (Question 92). Many of the problem predatory loans during the past two decades would have been avoided if the originators had not encouraged borrowers to refinance their first mortgages in order to access the equity in their homes. Each refinancing of the first lien loan required loan expenses incurred on the entire loan, rather than just the new money lent and an extension of the entire loan term, triggering significant extra incursions in the available home equity. Had the new money lent been provided only through a

[9] *See, e.g.,* Office of the Comptroller of Currency, Advisory Letter No. AL-2000-7, Abusive Lending Practices 1 (July 25, 2007).

subordinate lien loan, homeowners would have saved significant dollars, and many homeowners would have avoided foreclosure. Housing-credit policy should always encourage subordinate lien lending rather than refinancing first liens. For this reason, subordinate lien loans that otherwise qualify for QM status must be included in QRM.

Inclusion of Loans Subject to Rebuttable Presumption Standard in QRM (Question 93). Loans subject to the rebuttable presumption standard are higher priced loans by definition.[10] The Agencies as well as much of the industry already believe that excluding loans from the QRM exception will drive up costs for those loans. It makes no sense to drive up their price further by excluding them from the QRM exception if they meet all of the other criteria. Such a decision would simply make it more difficult for borrowers of these loans to qualify for affordable credit (as the loans would be more expensive, the amount of credit that would be affordable would be less). There is simply no justification for such a distinction to be made.

Indeed, the existence of the rebuttable presumption will probably result in greater market scrutiny of these loans, and perhaps an insistence on risk-retention by originators, if the market believes that such risk-retention is the best method for reducing the slightly increased litigation risk associated with these loans. This market scrutiny and skin-in-the-game is precisely what Congress was aiming for with the risk-retention requirements. Because of the CFPB's definition of this category, which provides strong incentives for originators and securitizers to monitor risk, there is no need to subject these loans to formal risk-retention requirements.

That said, as we have discussed elsewhere,[11] there is no real difference in litigation risk between loans subject to the rebuttable presumption standard and those subject to the rebuttable presumption standard. There is little litigation risk for either group of loans, and the largest litigation risk will be posed when lenders fail to comply with the rules. Lenders who follow the rules and make QM-compliant loans, will have little litigation risk, and borrowers who wish to challenge the lender's determination will face an uphill battle under either the safe harbor r rebuttable presumption standard.

Conclusion

We appreciate the review of these comments and would be happy to provide more information on any of these issues.

[10] *See* 12 CFR § 1026.43(b)(4): "Higher-priced covered transaction means a covered transaction with an annual percentage rate that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction, other than a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; by 3.5 or more percentage points for a first-lien covered transaction that is a qualified mortgage under paragraph (e)(5), (e)(6), or (f) of this section; or by 3.5 or more percentage points for a subordinate-lien covered transaction."

[11] Comments to the Consumer Financial Protection Bureau and the Federal Reserve Board, Regulation Z: Docket No. R- 1417, by National Consumer Law Center, and others (May 11, 2011). Available at http://www.nclc.org/images/pdf/foreclosure_mortgage/predatory_mortgage_lending/comment-ability-to-pay-qm.pdf.