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The Office of the Comptroller of the Currency ("OCC"), Federal Reserve System ("the Fed"), Federal Deposit Insurance Corporation ("FDIC"), Securities Exchange Commission ("SEC"), Federal Housing Finance Agency (FHFA), and the Department of Housing and Urban Development (HUD) (collectively, "the Agencies") have solicited comments on re-proposed rules to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15 U.S.C. § 78o-11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Of particular interest to the National Housing Resource Center (NHRC) is the Agencies' re-proposed definition of the "qualified residential mortgage" ("QRM") exception to section 15G's credit risk retention requirements.[1] We appreciate the opportunity to comment on this proposal.

NHRC is a national advocacy organization serving the interests of the non-profit housing counseling community and, by extension, housing consumers, especially those who are low- and moderate-income and those from communities that have traditionally been underserved in the housing market, such as communities of color and rural communities. It is through this lens that we offer these comments in response to the Agencies' proposal.

NHRC is generally supportive of the Agencies' re-proposed definition of qualified residential mortgages. Given the risk-retention requirement for non-QRM loans, it is reasonable to expect that some lenders will not make non-QRM loans and that those that do will charge consumers more for them. Defining QRM in

[1] 15 U.S.C. § 78o-11(c)(1)(C)(iii).

a way that makes it inaccessible for many Americans, as the 20 percent down payment requirement in the original QRM proposal would have done and the QM-plus proposal would do, would further restrict access to credit in what is already a difficult environment for consumers seeking mortgage credit. The communities that would be most hurt by this further contraction of mortgage credit would be those communities that have historically had the most difficulty accessing mortgage credit, which were also among the communities hardest hit by the housing crisis.

In light of these concerns, NHRC is pleased that the Agencies have proposed a new QRM definition that would align the definition of QRM with the Consumer Financial Protection Bureau's (CFPB) definition of qualified mortgages (QM) that was released earlier this year. While NHRC is concerned that the QM definition will exclude borrowers with a reasonable ability to repay the loan who may have qualified using a more flexible underwriting approach, given Congress' restriction that QRM cannot be any broader than QM, NHRC believes that making QRM exactly as broad as QM is the right approach.[2]

The arguments in support of the Agencies' proposal to align QRM with QM are largely made in the proposal itself. After outlining the reasons for our support of the new proposed definition, we will then respond to some of the arguments that have been made against the new proposal. As these arguments are likely to turn up in the submitted comments, we believe they are worth responding to. We will conclude by addressing the Agencies' alternative QRM proposal, which would require, among other things, a 30 percent down payment for a loan to qualify as a QRM, and to which we are strongly opposed.

1. Aligning QRM with QM Appropriately Balances Ensuring that QRM Loans are High-Quality and Ensuring Adequate Access to Credit

a. QM's underwriting and product feature requirements are a reasonable stand-in for a borrower's likelihood not to default

Before making most residential mortgages, Dodd-Frank requires lenders to make a determination that the borrower has a "reasonable ability" to repay the loan (the "ability-to-repay rule"). The QM rule released by CFPB earlier this year provides that lenders will be presumed to have satisfied the ability-to-repay rule when making "qualified mortgage" loans, i.e. loans with certain product and underwriting features intended to ensure the borrower will have a reasonable ability to repay the loan. Specifically, for a loan to qualify as a QM, it must meet the following product features:

- Requires regular, periodic payments that are substantially equal (except for changes to payments that are the result of a permissible interest rate change) and do not result in an increase of the principal balance;[3]
- Generally prohibits loans that allow the consumer to defer repayment of interest (negative amortization loans) and loans that result in balloon payments, although there are circumstances under which each of these is permitted;[4]
- The loan term may not exceed 30 years;[5]

[2] 15 U.S.C. 78o-11(e)(4)(C).
[3] 12 C.F.R. 1026.43(e)(2)(i)(A).
[4] *See id.* at 1026.43(e)(2)(i)(B)-(C). The circumstances under which negative amortization loans and balloon payment loans may qualify as QM loans are provided 12 C.F.R. 1026.43(f).
[5] *Id.* at 1026.43(e)(2)(ii).

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- For loans over $100,000, the points and fees may not exceed 3 percent (for smaller loans there are higher caps on points and fees).[6]

Additionally, to qualify as a QM the loan must also include the following underwriting criteria:

- The loan must be underwritten taking into account the monthly payment for all mortgage-related obligations using the maximum interest rate that may apply during the first five years of the loan;
- The loan must be underwritten taking into account the monthly payment for all mortgage-related obligations using periodic payments of principal and interest that will repay either the loan amount over the loan term or the outstanding balance over the remaining term of the loan as of the date the interest rate adjusts to the maximum rate that may apply during the first five years of the loan;[7]
- Lender must consider and verify the borrower's current or reasonably expected income or assets and current debt obligations, alimony, and child support;[8] and
- Consumer's total monthly debt-to-income (DTI) may not exceed 43 percent.[9]

There is also a "special rule" under which loans that are eligible to be purchased by Fannie Mae or Freddie Mac (or their successors), insured by HUD or the Rural Housing Service, or guaranteed by the Department of Veterans Affairs or the Department of Agriculture qualify as QMs.[10]

Importantly, CFPB's definition of QM excludes the subprime loans that were at the heart of the housing crisis. Specifically, negative amortization, interest-only, balloon payment, teaser-rate, and low- and no-documentation loans are all prohibited, save for some narrow exceptions. Excluding subprime loans from QM will greatly reduce the number of QM loans that default. Of course, some number of prime loans will still default, but the default rate will be a small fraction of what it was during the crisis when it was largely driven by defaulting subprime loans and loss of income. For example, a 2010 study of default rates of prime and subprime loans by the Chicago Fed found that prime loans made in 2007 defaulted within 12 months at a rate of 4.8% while subprime loans made in 2007 defaulted within 12 months at a rate of 21.9%.[11] Furthermore, even the 4.8% default rate for prime loans is much higher than it has been historically. In 2002, for example, the default rate among prime loans was 1.4%.[12]. Furthermore, the strong underwriting requirements will further reduce the likelihood of default among QM loans. Nonetheless, lenders will still have to underwrite loans responsibly.

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[6] *See id.* at 1026.43(e)(3).
[7] *See id.* at 1026.43(e)(2)(iv).
[8] *See id.* at 1026.43(e)(2)(v).
[9] *See id.* at 1026.43(e)(2)(vi).
[10] *See id.* at 1026.43(e)(4)(i)-(ii). Loans qualifying under this special rule are also subject to the prohibitions on negative amortization, interest-only, and balloon payment loans, must not have a term that exceeds 30 years, and must satisfy the QM points and fees requirements. *Id.* at 1026.43(e)(4)(i)(A). The "special rule" for loans eligible to be purchased by Fannie or Freddie is only applicable while each is under the conservatorship or receivership of FHFA. *Id.* at 1026.43(e)(4)(ii)(A)(1). The other "special rules" will sunset on the effective date of a rule defining "qualified mortgage" issued by the relevant agency or by January, 2021. *Id.* at § 78o(e)(4)(iii).
[11] Gene Amromin and Anna L. Paulson, Federal Reserve Bank of Chicago, Consumer and Community Affairs Division, *Default Rates on Prime and Subprime Mortgages: Differences and Similarities*, p.1.
[12] *Id.*

b. Because QRM cannot go further than QM to ensure access to credit, QRM should go exactly as far to ensure access to credit

While it would be possible to craft a definition of QM that would reduce the default rate to practically zero, doing so would not be desirable because it would make QM inaccessible for a large percentage of Americans, leaving more expensive non-QM loans as their only option for mortgage credit. Accordingly, the goal in defining QM should not be to reduce the default rate among QM loans to zero. Rather, the goal should be to adopt criteria that are a reasonable stand-in for a borrower's likelihood not to default while at the same time preserving access to affordable mortgage credit to borrowers with a low likelihood of default.

The underwriting standards in the CFPB definition do not strike the appropriate balance between ensuring that borrowers will be able to repay their loans and ensuring access to affordable mortgage credit for borrowers with a reasonable ability to repay their loans. In particular, the requirement that borrowers not have a debt-to-income ratio (DTI) above 43% will force some borrowers with a reasonable ability to repay their loans into higher-priced non-QM loans. The most obvious example of this is where the borrower is already comfortably making rental or mortgage payments that are higher than their mortgage payment would be at a 43% DTI. Housing counselors work with clients that are capable of carrying a DTI greater than 43%. Furthermore, the 43% DTI cap will disproportionately impact African American and Hispanic borrowers, two of the groups that were disproportionately impacted by the foreclosure crisis and have been historically underserved in the primary mortgage market. A recent analysis by the Federal Reserve, for example, found that roughly one-third of Black and Hispanic borrowers would not qualify for QMs based on the DTI limit alone.[13]

Unfortunately, Congress has not allowed the Agencies the discretion to relax QM underwriting requirements. Specifically, 15 U.S.C. 78o-11(e)(4)(C) instructs the Agencies that in defining QRM, the Agencies "shall define that term to be no broader than the definition 'qualified mortgage' …." In other words, the Agencies are not permitted to craft a definition of QRM that would encompass a greater number of mortgages than does CFPB's QM definition. In light of this, the Agencies' best option was to make the definition of QRM exactly as broad as QM, which is what the Agencies have done in this proposal.

2. Much of the Criticism of the Revised QRM Proposal Is Rooted in Misunderstandings or Misrepresentations of the QRM and QM Rules

a. It is appropriate for QRM to be aligned with QM because Congress intended both rules to reduce defaults

Much of the criticism of the revised QRM proposal has centered around the perception that the rules are meant to serve different purposes and, therefore, should not be defined in the same way.[14] More

[13] *See* Rachel Witkowski, *Blacks and Hispanics Likely to Be Hurt by 'Qualified Mortgage' Rule*, AMERICAN BANKER, Oct. 22, 2013 (available online at http://www.americanbanker.com/issues/178_204/blacks-and-hispanics-likely-to-be-hurt-by-qualified-mortgage-rule-1063055-1.html).

[14] See, e.g., http://www.americanbanker.com/bankthink/regulators-made-questionable-call-on-qrm-rule-1061715-1.html ("The QM definition does not serve the same purpose as QRM was supposed to and thus is inapt.").

specifically, critics have argued that QRM is meant as a rule to protect investors in residential mortgage backed securities (RMBS) while QM is meant as a rule to protect borrowers, and that this fundamental difference calls for different definitions for the two.[15] While it may be the case that the two rules were intended to serve superficially different purposes, i.e. protecting investors vs. protecting consumers, the means by which each seeks to accomplish its goal is more or less identical: establishing classes of mortgage loans that would have relatively low default rates. Put another way, what is good for borrowers is good for investors, and vice versa.

The QRM rule is an exception to a Dodd-Frank requirement that securitizers retain a portion of the credit risk for assets they securitize.[16] The idea underlying this credit risk retention rule is that by requiring securitizers to have "skin in the game," i.e. to retain a percentage of the credit risk for the assets they securitize and, therefore, to share in any potential losses resulting from defaults of the underlying loans, the underlying loan products will be less likely to default. The QRM exception recognizes an alternative means of lowering the risk of default: requiring certain underwriting and product features that historical loan performance data indicate result in a lower expected risk of default.

That the QRM rule is, at its core, about reducing the incidence of default among QRMs is clear on its face. The legislation instructs the relevant regulators when defining the term "qualified residential mortgage" to take into consideration "underwriting and product features that historical loan performance data indicate result in a lower risk of default …." The legislation also provides a list of examples of such underwriting and product features that illustrate the goal is to reduce defaults:

- Documentation and verification of financial resources that are relied upon to qualify the mortgagor;
- Residual income of mortgagor after all monthly obligations;
- Ratio of mortgagors' housing payments to income;
- Ratio of mortgagors' total monthly installment payments to income;
- Mitigating the potential for payment shock on adjustable rate mortgages;
- Mortgage guarantee or other insurance or credit enhancements obtained at origination to the extent such insurance or credit enhancement reduces the risk of default; and
- Prohibiting or restricting the use of product features that have been demonstrated to exhibit a higher risk of borrower default, such as balloon payments, negative amortization, prepayment penalties, and interest-only payments.[17]

The QM rule, on the other hand, is a substitute for the requirement that lenders of residential mortgage loans make a "good faith determination based on verified and documented information that … the consumer has a reasonable ability to repay the loan …." Lenders making loans that qualify as QMs are legally presumed to have complied with the ability-to-repay determination requirement. Put another way,

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[15] See, e.g., http://www.americanbanker.com/issues/178_170/how-the-latest-qrm-proposal-undermines-dodd-frank-1061762-1.html (attributing to Kevin Jacques, finance professor at Baldwin Wallace University, the argument that it was an error to align QRM with QM because "[t]he QM regulation was designed to protect consumers, while QRM was designed to protect investors.").
[16] 15 U.S.C. § 78*o*-11(b).
[17] *Id.* at § 78*o*-11(e)(4).

Congress designed the QM rule to act as a stand-in for lenders making the determination that the borrower is reasonably likely not to default. While the two rules may have different constituencies, investors for QRM and borrowers for QM, their goals are essentially the same: minimizing defaults.

b. A relatively broad definition of the QRM exception does not necessarily "swallow the rule"

The other major criticism of the decision to align QRM with QM is that because a relatively large percentage of mortgages that are now being originated would qualify as QRMs, the entire credit risk retention rule would become essentially meaningless. Typical of such criticism is an article that poses the question, "If regulators create a risk retention requirement that applies to relatively few loans, does it exist at all?" and goes on to quote University of North Carolina Charlotte professor D. Anthony Plath's description of the re-proposal as having "'… essentially diluted the link between credit quality and bank risk taking …. We're back-sliding into the way things were in 2006 when banks could originate loans without regard for how risky they were.'"[18]

First, while it is technically true that banks will be able to originate loans without regard to how risky they are, this would be true under any definition of QRM (or QM). QRM and QM do not establish absolute minimum underwriting standards; rather, they establish classes of relatively safe loans that receive greater protections than their non-qualifying, supposedly riskier counterparts. So, while Professor Plath is correct that banks will be able to originate loans without regard to how risky they are, banks that do so will be subject to borrower lawsuits to block foreclosure proceedings (if the bank did not determine the borrower had a reasonable ability to repay the loan) and the bank would be on the hook for losses resulting from default (because the loan would be subject to Dodd-Frank's credit risk retention requirement).

Critics who charge that the re-proposed QRM definition guts Dodd-Frank's risk retention rule overstate the eligibility for QRM under the re-proposed definition and mistake the mortgage credit climate that existed during the run-up to the housing and foreclosure crises for that which exists today. It is simply not the case, as critics seem to believe, that all mortgages would qualify for the benefits of QRM under the re-proposed definition. In fact, the risky loans that were at the heart of the housing crisis, such as negative amortization loans, interest-payment-only loans, loans with balloon payments, and low- and no-documentation loans, will not qualify as either QRMs or QMs.

The reality is that most loans being originated today would qualify as QRM under the re-proposed definition (and QM) because most loans being originated today are high quality loans that are reasonably likely not to default. In other words, most of the loans being made today are exactly the types of loans that Congress intended to qualify for both QRM and QM.

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[18] Rob Blackwell & Joe Adler, *How the Latest QRM Proposal Undermines Dodd-Frank*, American Banker, September 3, 2013 (available online at http://www.americanbanker.com/issues/178_170/how-the-latest-qrm-proposal-undermines-dodd-frank-1061762-1.html?pg=2). See also, Robert C. Pozen, *How to Create Another Housing Crisis*, Wall Street Journal, September 11, 2013 (available online at http://online.wsj.com/article/SB10001424127887324094704579065292392851168.html) (arguing that the proposed changes to the QRM definition would gut the requirement that lenders bear some risk of loss and lead to more defaults).

3. The Benefits of the Agencies' Alternative QRM Proposal Would Not Outweigh the Cost of Reducing Access to Affordable Mortgage Credit

The Agencies have also proposed an alternative QRM definition, called "QM-plus," which would include the product and underwriting requirements of the CFPB's QM definition, but would add four additional requirements:

- QRM would only be available for one- to four family properties that constitute the principal dwelling of the borrower;
- QRM would only be available for first-lien mortgages;
- QRM would not be available if the borrower was currently 30 or more days past due on any debt obligation, or if the borrower had been 60 or more days past due on any debt obligation within the preceding 24 months, or if the borrower had been a party to a bankruptcy preceding, subject to a judgement for collection of an unpaid debt, had personal property repossessed, had had any one- to four- family property foreclosed upon, or engaged in a short sale or deed in lieu of foreclosure within the preceding 36 months; and
- QRM would only be available for a loans with a loan-to-value ratio (LTV) of 70% or less.

Adopting the alternative QM-plus standard for QRM would have several effects. Most significantly, many Americans, including many with a reasonable ability to repay their mortgage loan, would be shut out of the QRM market and forced into the more expensive non-QRM market, especially borrowers from communities that have traditionally been underserved in the primary mortgage market, including borrowers of color and low- and moderate-income borrowers. The additional underwriting requirements in QM-plus standard would also further reduce the default rate for QRM loans lower relative to the QM standard. QM-plus would also create a significantly larger non-QRM market, which could produce some benefits in terms of additional liquidity for non-QRM loans. However, the benefits of marginally decreasing default rates (beyond the already low rates that can be expected from the QM standard) and increasing liquidity in the secondary market for non-QRM loans would not offset the cost of decreasing access to QRM, and therefore driving up the cost of mortgage credit, for a substantial number of credit-worthy Americans. Accordingly, NHRC strongly opposes the Agencies adopting QM-plus as the QRM standard.

a. The benefits of marginally decreasing default rates would not offset the costs of greatly reducing access to QRM loans

It is clear that the credit history and LTV requirements in the QM-plus proposal would further reduce default rates as compared to the requirements of the QM-alone proposal. It is also the case that a substantially smaller number of loans would qualify for QRM status under the QM-plus approach than would do so under the QM-alone proposal. The important question is whether the benefits of reducing the default rate would outweigh the costs associated with greatly reducing access to the QRM market. NHRC strongly believes they will not.

The product and underwriting requirements included in CFPB's QM definition prohibit subprime mortgage products and should drastically reduce the default rate for QM loans from the unacceptably high rates that existed during the crisis. For example, for loans originated from 2005 to 2008, the rate of serious delinquencies (90 days or more past due) among loans that would have qualified as QMs was 23 percent while it was 44 percent for loans that would not have qualified as QMs. As the Agencies correctly suggest, a 23 percent rate of serious delinquencies among QM loans would be unacceptably high, but that high rate is an historical anomaly that is largely attributable to the surge in subprime and other traditional loans, as well as poor underwriting standards, that lead first to the inflation of housing prices and subsequently to the collapse of the housing market and huge surge in unemployment. A more accurate picture of the expected performance of QM loans is provided by the estimated 1.4 percent rate of serious delinquency or foreclosure by the end of 2012 among prime, fixed rate mortgages that comply with the QM definition originated from 2009 to 2010 (as compared to 16 percent for such loans originated from 2005 to 2008). In other words, QM alone can be reasonably expected to bring default rates to reasonably acceptable levels that much more closely resemble historical rates than what we saw during the crisis.

While reducing default rates among QRM loans even further is of course a worthwhile goal, if QM alone will bring default rates to acceptably low levels, which we believe it will, additional criteria should only be adopted if they do not unnecessarily limit access to mortgage credit. The proposal to require a 30 percent downpayment for QRM loans does not meet this standard, as it would be extremely onerous for most families. For example, a family earning the national median income and saving 5 percent of its after-tax income would need to save for 13 years to be able to save enough for a 10 percent down payment and 5 percent in closing costs for a home with the national median sales price.[19] Obtaining a QRM would be practically impossible for these borrowers and they would be forced into more expensive non-QRM loans. Such an outcome does not justify the marginal benefit to be gained by further reducing the expected default rates for QRM loans below the acceptably low level that can reasonably be expected from QM alone.

b. The benefits of expanding the non-QRM market would not offset the cost of greatly decreasing access to more affordable QRM loans

The fact that QRM-loans would be practically out of reach for so many borrowers under the QM-plus proposal would lead to a much larger non-QM market than there would be under the QM-alone proposal. While there are some conceivable benefits of a relatively large non-QRM market, these potential benefits do not outweigh the costs associated with shutting a larger number of borrowers with a reasonable ability to repay their loans into higher-priced non-QRM loans.

There are two potential benefits of having a relatively large non-QRM market. First, by making QRM loans unavailable to a large number of borrowers with a reasonable ability to repay their mortgages, there would be a large number of high-quality non-QRM loans, which would make non-QRM loans as a whole less risky. It is likely, however, that lenders would simply price non-QRM loans according to their perceived risk, charging a lower risk premium for borrowers who met all of the QRM requirements

[19] Michelle Singletary, *Proposed 20% down payment rule could put owning a home out of reach for many*, WASHINGTON POST, June 18, 2011 (available online at http://articles.washingtonpost.com/2011-06-18/news/35235953_1_qrm-payment-rule-risky-features). (citing calculations by the Center for Responsible Lending).

except for the 30 percent down payment requirement. The additional compliance cost that will result from the risk-retention requirement for non-QRM loans will be passed on to all non-QRM borrowers, however, regardless of how safe the underlying mortgage is. As such, a rule that puts a large number of relatively safe loans into the non-QRM category, as the QM-plus proposal would do, would unnecessarily inflate the cost of even extremely safe non-QRM loans. It is unlikely that this additional cost would be offset by the potential discount that could result from non-QRM loans as a whole being seen as less risky.

A second benefit of a having a relatively large non-QRM market would be greater liquidity for non-QRM loans on the secondary market. This is a more difficult benefit to quantify, but, on balance, the additional benefit of having a more liquid secondary market for non-QRM loans does not seem to outweigh the additional cost of requiring risk retention for loans to borrowers with a reasonable ability to repay the loan.

The Agencies' re-proposed definition for QRM loans appropriately balances the competing goals of ensuring a reasonably low likelihood of default and affordable access to credit for borrowers who reasonably unlikely to default. In fact, the hard 43 percent DTI cap will force some borrowers who could manage a higher DTI into more expensive non-QRM loans, but the prohibition on QRM being defined more broadly than QM means the best possible solution is to make QRM exactly as broad as QM. The Agencies' alternative QM-plus proposal would force a large number of borrowers with a reasonable ability to repay their mortgages into higher-priced non QRM loans. Accordingly, the Agencies should adopt their proposal to link the definition of a QRM to CFPB's definition of a QM.