The Proposed Risk Retention Regulations Reduce Credit Options for Qualified Borrowers

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Executive Summary

MBA strongly supports the intention of the Qualified Residential Mortgage (QRM) exemption from the Risk Retention provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. That purpose is to establish an exemption from risk retention for well-underwritten and documented, sound and sustainable mortgage loans.

We believe, however, that the proposed rule implementing these provisions goes beyond what Congress intended and would drastically limit affordable mortgage financing options for moderate-income families, first-time borrowers, minorities, and many others.

MBA's presentation highlights these concerns and the concerns of other organizations. The presentation uses independent and reliable data and information to make the following key points:

- The proposed regulation will hurt consumers by limiting access to credit for well-qualified borrowers.
- In particular, the proposed down payment, loan-to-value (LTV) and debt-to-income (DTI) requirements are unnecessary and not worth the societal cost of excluding far too many borrowers from the most affordable loans.
- By prescribing hard-wired down payment, LTV and DTI standards, the government will effectively take ownership of risk rather than require private lenders assume the risk and underwrite sustainable loans for consumers.
- The impact will be worse for minorities, first-time borrowers and homeowners with limited equity and threatens to disturb the balance between the rental and homeownership markets.
- Excluding risky products and requiring sound underwriting, full documentation and verification are the right steps to return private investment to the housing market and ensure sustainable and affordable housing credit for as many families as possible.
- The QRM provisions in Dodd-Frank share the same purpose of ensuring well underwritten mortgages as the Qualified Mortgage (QM) proposed under Dodd-Frank's separate ability to repay provisions, and the QRM should be aligned with the QM.
- Regardless of the deadline set by Dodd-Frank, it is important that this rule not be rushed. While a rule along the lines proposed, as well as the alternative proposal, will likely have a limited near-term impact on today's mortgage market, it creates significant long-term challenges to the return of private capital and a normal, healthy mortgage market.
- The mortgage market is functioning today because of heavy government support — a position that is neither sustainable nor desirable long-term. With Fannie Mae and Freddie Mac securitizing, and government agencies including FHA, VA and the Department of Agriculture insuring or financing most of the nation's mortgages, private investment capital remains largely on the sidelines. The rule, as proposed, could make it even harder for that to change. In fact, if finalized as proposed, the rule is likely to increase both the GSEs' and agencies' roles at a time when the future of the GSEs' and the government's role in housing has yet to be determined.
- Numerous other concerns must be addressed before this rule is finalized.

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Action Needed

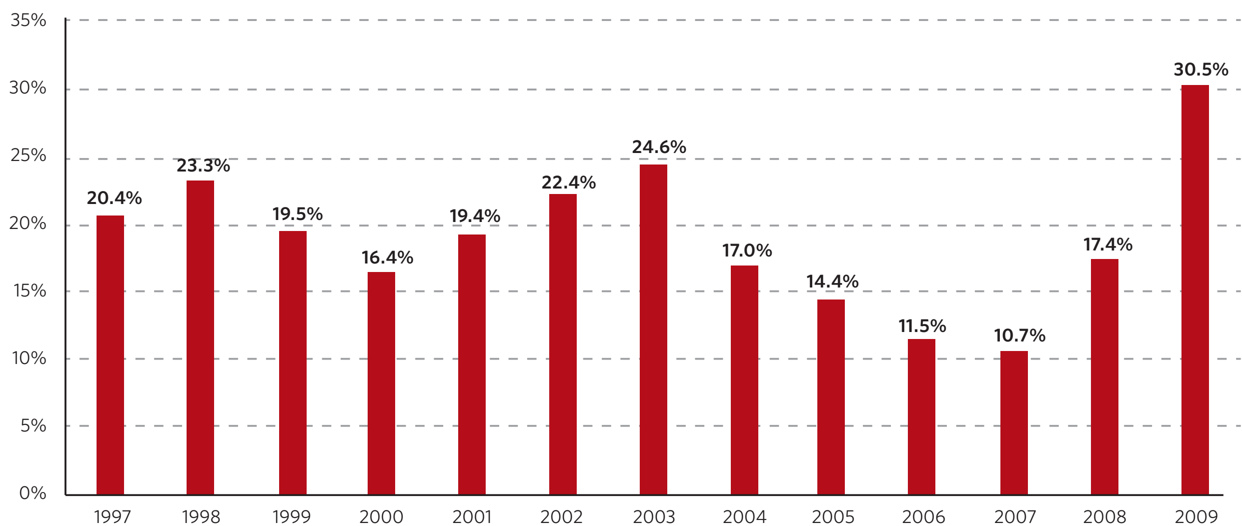
This is an extremely important rule that will have an enormous impact on families, markets and the housing recovery for years to come. Congress should take immediate action to synchronize the risk retention / QRM and ability to repay / QM rulemakings. The comment period should be extended, and the rule should be delayed and reconsidered until the QM and other concerns can be resolved. Given the range of issues and what is at stake for consumers, getting this right is far more important than getting it done quickly.

MBA's Primary Concerns

The proposed regulations hurt consumers by limiting access to credit for well-qualified borrowers. For example:

- **High quality loans would not meet the proposed QRM requirements.** Even though 2009 was a year of highly conservative underwriting standards, only 30 percent of loans purchased by Fannie Mae and Freddie Mac would have met the proposed requirements. In effect, the QRM tightens an already-limited lending environment.

Percent of all Mortgages that Would Have Met all Requirements under the Proposed QRM Standard, by Year of Origination



Source: FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

More than 80 Percent of GSE Business 1997–2009 Would Not Have Been QRM

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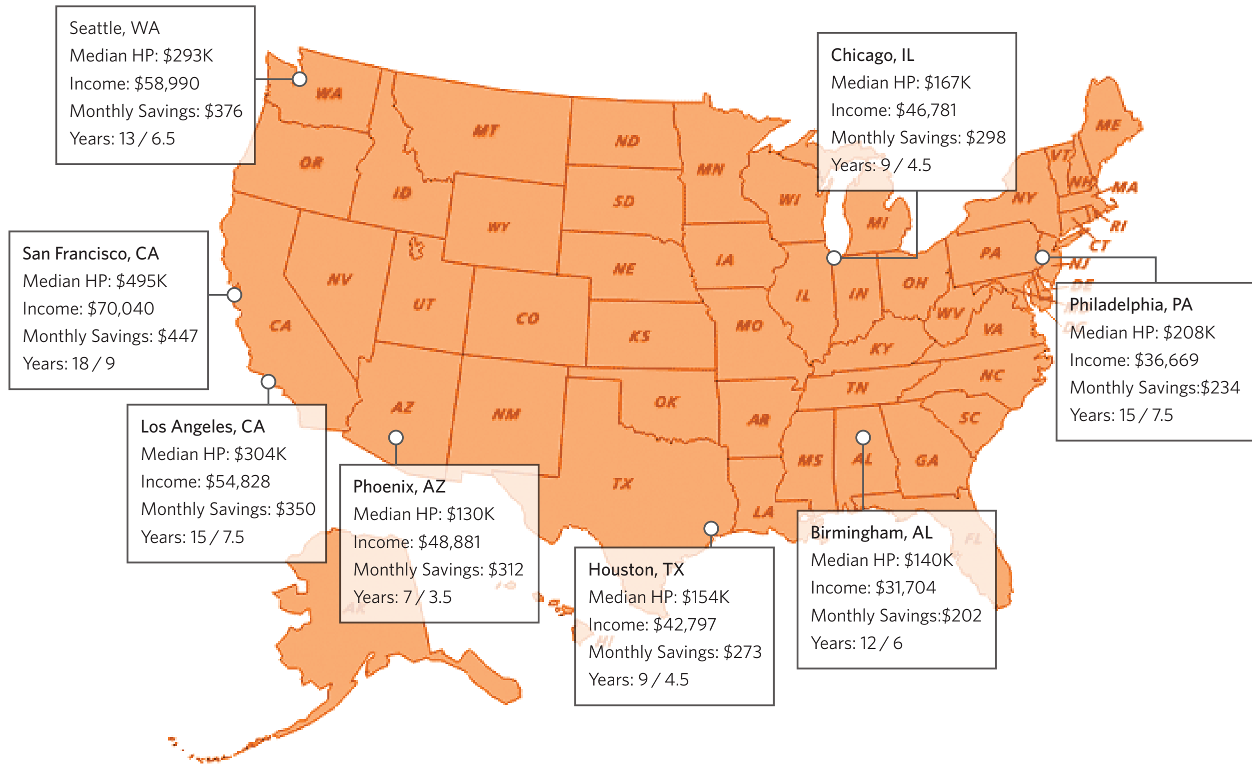
- **The QRM's proposed 20 percent down payment requirement puts homeownership out of reach for moderate-income borrowers.** It could take moderate-income borrowers, depending on where they live, up to 18 years to save for a 20 percent down payment on a moderately priced home. The proposed "alternative" of a 10 percent down payment is not much better. Renters will take much longer to save. Borrowers also must pay closing costs, which typically add another $5,000 to the amount a borrower must save.



Notes: "DP": Down Payment. "Median HP": Median Home Price. "Income":Median household income, "Years": Years to save for a 20% downpayment / 10% downpayment on a median-priced home.

Sources: National Association of Realtors, Census Bureau (American Community Survey, American Housing Survey), Federal Reserve, Bureau of labor Statistics (Consumer Expenditure Survey)

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- **Minorities and first-time borrowers will fare even worse under the QRM's high LTV and low DTI requirements, as these families typically have much less savings.**

Family Net Worth By Selected Characteristics

	Median Net Worth	
Family Characteristic	2007	2009
All families	125.4	96.0
Percentile of income (2007)		
Less than 20	10.1	7.2
20–39.9	39.1	32.9
40–59.9	95.4	72.6
60–79.9	216.7	167.5
80–89.9	373.5	302.5
90–100	1,205.1	894.5
Race or ethnicity of respondent (2007)		
White non-Hispanic	178.8	149.9
Nonwhite or Hispanic	32.8	23.3
Housing status (2007)		
Owner	244.8	192.6
Renter or other	5.5	3.6

Source: Federal Reserve, 2009 Survey of Consumer Finances

- **Borrowers with little equity will find it difficult, if not impossible, to refinance into a loan with better terms.** Borrowers who have faithfully made their mortgage payments on time but live in areas of significant home price declines will not be able to refinance into a better QRM loan because of the proposal's 75 percent LTV requirement for refinancing.
- **Many who currently spend a considerable portion of their income on rent would not qualify for QRM mortgages because of the proposed rigid DTI ratio requirement, despite the fact that they are currently managing rising rents.** Underwriters should have the flexibility not currently offered by the proposal to consider factors compensating for a higher DTI, such as the assets of borrowers.
- **The QRM requirements could disturb the balance of rental and ownership markets.** While renter household growth is strong, the number of owner households continues to decline. However, rental vacancy rates are dropping. At some point, given the small number of new units being built, the hurdles to homeownership in the proposed rule could put upward pressure on rents. Rent increases will lessen savings and make it even more difficult for renters

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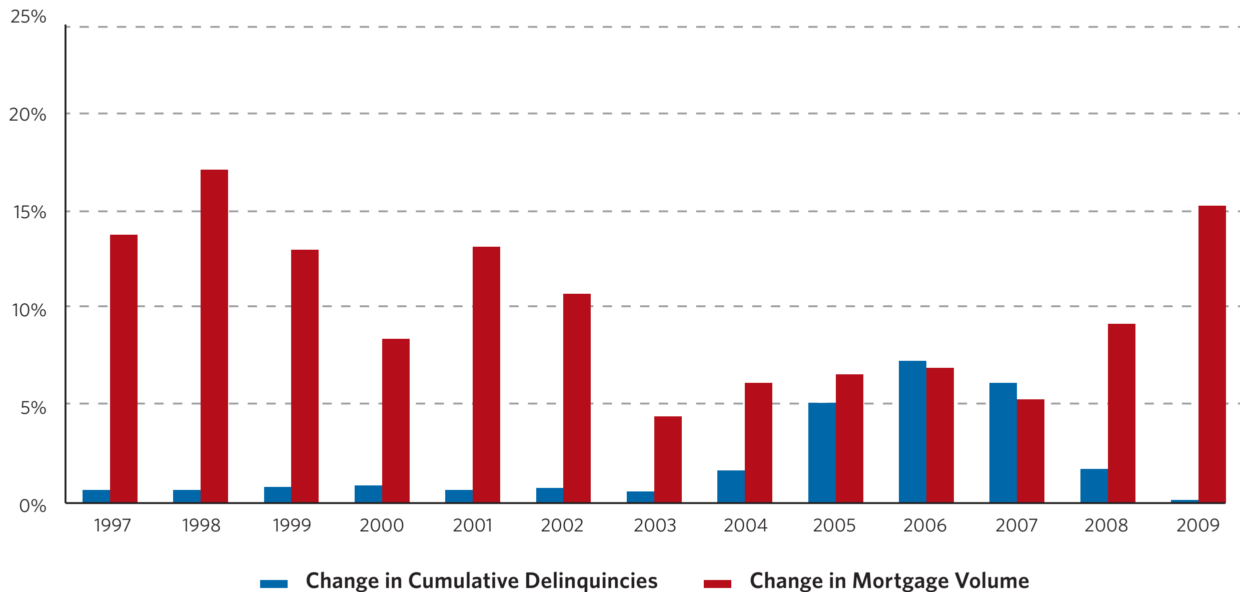
to become homeowners. The down payment is typically the highest hurdle for first-time homebuyers transitioning from rentals.

Specific down payment and DTI requirements are unnecessary and not worth the societal cost of excluding far too many borrowers from the most affordable mortgage loans to achieve homeownership. For example:

- Based on the LTV requirement alone, the proposed QRM rule would have disqualified approximately 50 percent of purchase loans made over the past four years. During this period, 35-40 percent of purchase money mortgages have had LTVs or cumulative LTVs of 95 percent or higher.

Difference in Volume and Performance when Removing the Loan-to-Value Requirements from the QRM Standards



Source: FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

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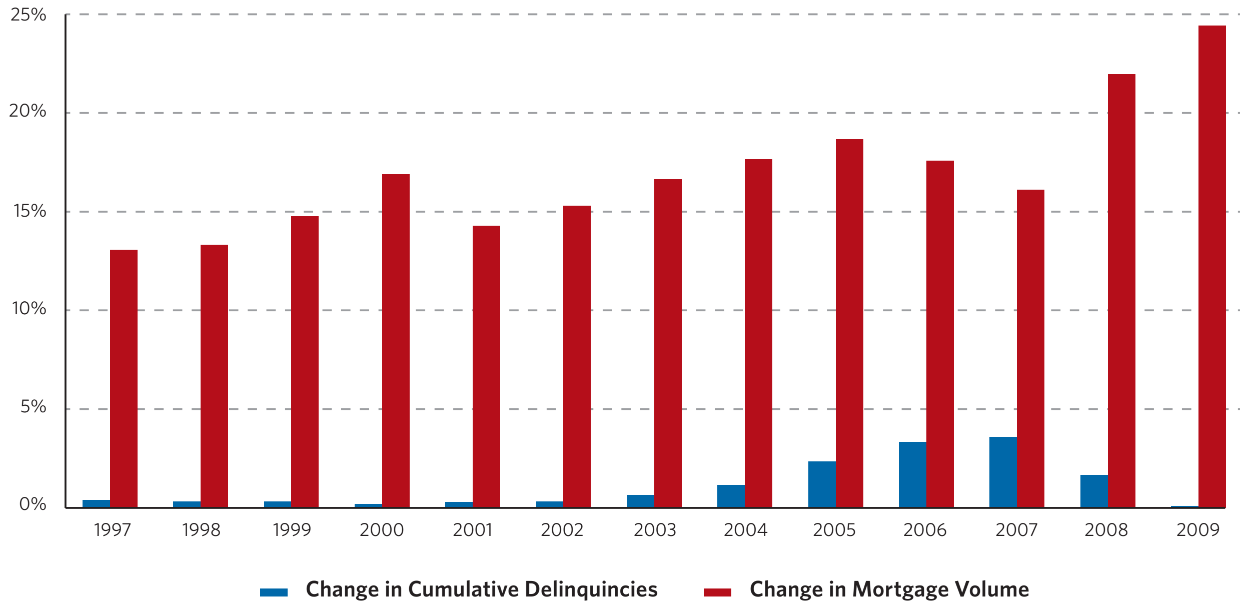
- According to the Federal Housing Finance Agency, a very large number of borrowers will be disqualified as a result of the proposed DTI and LTV standards. At the same time, the imposition of the proposed DTI and LTV standards will result in a very small decrease in delinquencies.

Difference in Volume and Performance when Removing the Debt-to-Income / Payment-to-Income Requirements from the QRM Standards



Source: FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

- High down payment and low DTI requirements for private market financing will drive borrowers to FHA or GSE loans just at a time when increased private financing and less government involvement is sought. In 2009 and 2010, many more borrowers chose FHA or other government loans, which allowed lower down payments. For most of this time, 50 percent of purchase loans on owner-occupied residences were insured by FHA.
- Congress specifically excluded LTV and down payment from the list of factors to be considered by regulators in formulating the QRM. The legislative history of the bill indicates that the exclusion was intentional.

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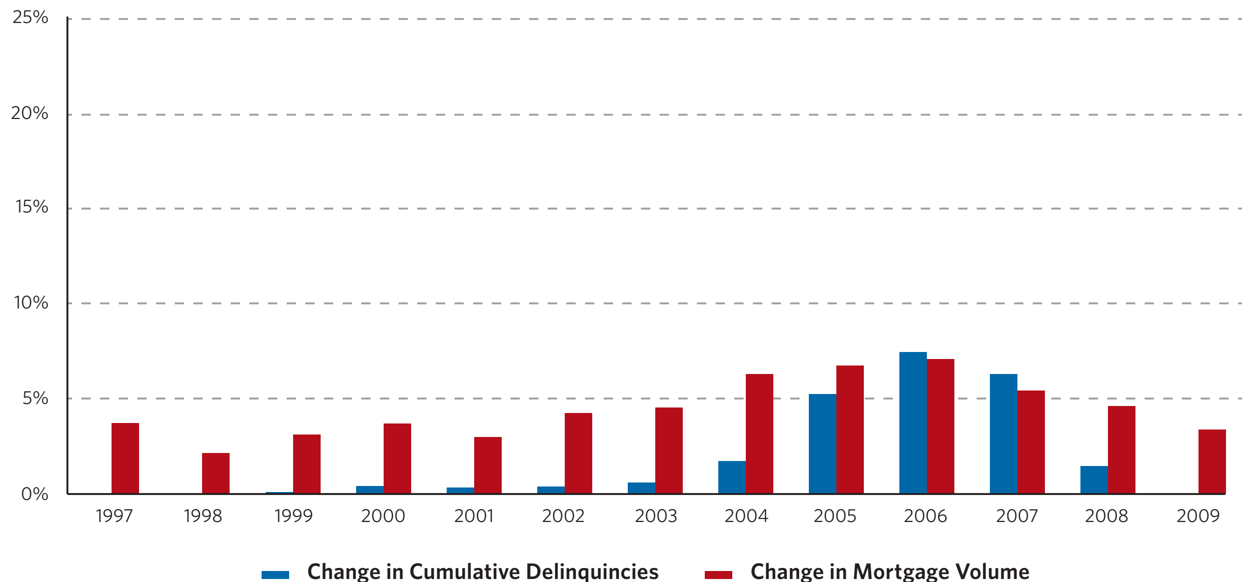
Excluding risky product features and requiring sound underwriting, documentation and verification are the right steps to return private investment to the housing market and ensure sustainable, well underwritten loans for as many families as possible. For example:

- Data shows that, by simply imposing the product-type requirements in the proposal, most of the problem loans, would not have met the proposed QRM standard.

Difference in Volume and Performance when Removing the Product-Type Requirements from the QRM Standards



Source: FHFA. "Mortgage Market Note 11-02: Qualified Residential Mortgages." April 11, 2011.

- The proposed QM definition will likely ensure that borrowers have an ability to repay without specifying particular DTI and LTV ratios. The proposal requires consideration, documentation and verification of the income or assets of borrowers, underwriting based on the maximum interest rate over the first five years, and use of a payment schedule that fully amortizes the loan and takes into account any mortgage-related obligations. It excludes loans with product features that increase default risk, including negative amortization, interest-only payments, or balloon payments, or have a loan term exceeding 30 years. The QM proposal does not and need not include rigid LTV or DTI requirements.

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Regardless of the deadline set by Dodd-Frank, it is important that this rule not be rushed. While a rule along the lines proposed and the alternative proposal will have a limited near-term impact on today's mortgage market, Dodd-Frank creates significant long-term challenges to the return of private capital and a normal, healthy market.

- The mortgage market is functioning today because of heavy government support — a position that is neither sustainable nor desirable long-term. With Fannie Mae and Freddie Mac securitizing, and government agencies including FHA, VA and the Department of Agriculture insuring or financing most of the nation's mortgages, private investment capital remains largely on the sidelines. The rule, as proposed, could make it even harder for that to change. In fact, if finalized as proposed, the rule is likely to actually increase both the GSEs' and agencies' roles during a time when the future of the GSEs' and the government's role in housing has yet to be determined.
- The GSEs are exempt from the proposal's risk retention requirements during conservatorship, and FHA and other agency loans are exempt under Dodd-Frank. While the GSE exemption is appropriate at this time, as long as GSE securitizations enjoy an exemption, private investors subject to risk retention would have great difficulty competing given their extra capital costs and applicable risk retention requirements. As the economy recovers, the GSEs' share of loans would continue to grow.
- If the rule maintains its high 10–20 percent down payment and low LTV and DTI requirements, demands for FHA, VA and other government financing will continue to grow, thus increasing the government's share of the market as well. Qualified borrowers with less money to put down who are successfully paying a greater share of their income for housing will have few non-governmental alternatives for affordable rates.
- An ill-considered rule will not only adversely affect the return of private capital to the market but also undermine the search for workable solutions regarding the future of the GSEs and the role of the government in housing finance itself.
- Since the QRM can be no broader than the QM, introducing QRM before QM is resolved makes little sense.

By prescribing hard-wired down payment, LTV and DTI standards, the government will effectively take ownership of risk rather than requiring private lenders to assume risks and underwrite sustainable loans for consumers.

- If the government establishes specific down payment, LTV and DTI requirements for non-government loans, it assumes a level of responsibility for outcomes that the private market should bear. Like the QM rule as proposed, the QRM could set standards including mandates for consideration of income and DTI, without specifying rigid numbers.
- Consumers are best served when lenders are able to offer sustainable private financing choices, applying sound underwriting as required and considering compensating factors as warranted.

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Numerous other issues concerning the risk retention proposal deserve careful attention before any final rule is issued. These include the premium capture cash reserve account provisions, and the lack of duration provisions and restrictions on securitizing QM and QRM loans.

The comment period should be extended, the rule should be delayed and reconsidered until the QM and other concerns are resolved.

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