



August 30, 2013

Credit Risk Retention – Revised Proposed Rule

(This Comment Call focuses only on the QRM aspect of the proposal.)

Executive Summary:

- The Office of the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve Board (Fed), Federal Deposit Insurance Corporation (FDIC), Securities & Exchange Commission (SEC), Federal Housing Finance Agency (FHFA), and the Department of Housing and Urban Development (HUD) are jointly proposing revisions to the original proposed rule which was published in the Federal Register on April 29, 2011, to implement the credit risk retention requirements of Section 15G of the Securities Exchange Act of 1934, as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).
- Section 15G requires the securitizer of asset-backed securities to retain not less than 5% of the credit risk of the assets collateralizing the asset-backed securities, but contains an exemption for asset-backed securities that are collateralized exclusively by residential mortgages that qualify as “qualified residential mortgages,” (QRM) as this term is defined by rule of the joint agencies.
- Few credit unions would likely be covered as securitizers. However, this proposal is important because the secondary market will likely conform to “qualified mortgage” (QM) and QRM standards. CUNA is also concerned that examiners will insist credit unions confine their mortgages to QMs/QRMs.
- As CUNA had urged, the proposal would revise the definition of “QRM.” Such a loan would have to meet any of the requirements for a QM,” as adopted by the CFPB.
- There would be no LTV, down payment, credit history, servicing or appraisal requirements to meet the definition of a QRM.
- Home Equity Lines of Credit, reverse mortgages, timeshares, and temporary “bridge” loans of 12 months or less would not be eligible for QRM status.

- QRMs would now include any closed-end loan secured by a dwelling (e.g., home purchase, refinances, closed-end home equity loans, and second or vacation homes) and not just principal dwellings secured by first-liens that are securitized.
- Subordinate liens would qualify as QRMs, as long as they met the definition of a “QM” and are securitized.
- Credit risk retention exemptions for QRMs would require certification and evaluation conditions by the depositor for the securitization.
- Subject to certain conditions, loans subsequently determined to be non-qualified after closing would be required to be repurchased.
- The agencies are seeking comment on a much more stringent “QM-Plus” alternative QRM definition.

CUNA will be working with the Leagues, the CUNA Lending Council, CUNA Consumer Protection Subcommittee, and the CUNA Housing Finance Reform Task Force on policy issues to develop our response, which we will share with leagues and others well in advance of the comment deadline. Click [here](#) for the joint proposed rule. Comments are due to the joint agencies by October 30, 2013, and can be filed at <http://www.regulations.gov>. **Please submit comments to CUNA by October 2.**

Commenters are encouraged to use the title “Credit Risk Retention” in their submission. Commenters should also identify the number of the specific request for comment, as designated by each agency. Please provide a copy of your letter to CUNA.

- **OCC:** Docket ID OCC-2013-0010; email to regs.comments@occ.treas.gov; 400 7th Street, SW, Suite 3E-218, Mail Stop (W-11, Washington, D.C. 20219;
- **FED:** Docket No. R-1411; email to regs.comments@federalreserve.gov or <http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm>; Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, D.C. 20551;
- **FDIC:** RIN 3064-AD74; email to Comments@fdic.gov or <http://www.fdic.gov/regulations/laws/federal/>; Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, D.C. 20429;
- **SEC:** <http://www.sec.gov/rules/proposed.shtml> or email to rule-comments@sec.gov. File Number S7-14-11; Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090;
- **FHFA:** RIN 2590-AA43; email to Alfred M. Pollard, General Counsel at RegComments@fhfa.gov; Federal Housing Finance Agency, Constitution Center, (OGC) Eighth Floor, 400 7th Street, SW, Washington, D.C. 20024;

- **HUD:** Regulations Division, Office of General Counsel, Department of Housing and Urban Development, 451 7th Street, SW, Room 10276, Washington, D.C. 20410-0500; RIN 2501-AD53).

For more information about this rulemaking, contact CUNA Deputy General Counsel Mary Dunn at Mdunn@cuna.coop or Associate General Counsel Jared Ihrig at jihrig@cuna.coop.

Detailed Summary:

Introduction

In April 2011, the agencies published a joint notice of proposed rulemaking that proposed to implement Section 15G of the Exchange Act, which was added by the Dodd-Frank Act. It requires joint agencies to prescribe regulations that (i) require a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer, through the issuance of an asset-backed security (ABS), transfers, sells, or conveys to a third party, and (ii) prohibit a securitizer from directly or indirectly heading or otherwise transferring the credit risk that the securitizer is required to retain under section 15G and the implementing rules.

Section 15G specifically provides that a securitizer shall not be required to retain any part of the credit risk for an asset that is transferred, sold, or conveyed through the issuance of ABS by the securitizer, if all of the assets that collateralize the ABS are QRMs, as that term is jointly defined by the agencies.

Qualified Residential Mortgages (QRMs)

The original proposal would generally have prohibited QRMs from having features such as negative amortization, interest-only payments, or significant interest rate increases. The QRM definition in the original proposal also included underwriting standards, including a down payment requirement of 20 percent in the case of a purchase transaction, maximum loan-to-value (LTV) ratios of 75% on rate and term refinance loans and 70% for cash-out refinance loans, as well as credit history criteria and requirements. The QRM standard in the original proposal also included maximum front-end and back-end debt to income ratios of 28 and 36 percent, respectively.

Under the proposal, and as advocated by CUNA, the agencies are proposing to revise the QRM definition to be the same as the definition of Qualified Mortgage (QM) which has been adopted by the CFPB.

Additionally, the agencies are proposing to define “residential mortgage” by reference to the definition of “covered transaction” as contained in the CFPB’s Regulation Z. As such, a residential mortgage would mean a consumer credit transaction that is secured by a dwelling (including any real property attached to a dwelling) and any transaction that is exempt from the definition of “covered transaction” under Regulation Z. “Residential mortgage” would now include home equity lines of credit, reverse mortgages, mortgages secured by interests in timeshare plans, and temporary loans.

Importantly however, because the proposed QRM definition incorporates QM by reference, home equity lines of credit, reverse mortgages, timeshares, and temporary or “bridge” loans of 12 months or less would be excluded from QRM status. However, it would also expand the types of loans eligible as QRMs. Under the original proposal, a QRM was limited to closed-end first-lien mortgages used to purchase or refinance a one-to-four family property, at least one unit of which is the principal dwelling of the borrower. However, under the revised proposed rule, a QRM would be expanded to include any closed-end loan secured by any dwelling (e.g., home purchase, refinances, home equity loans, and second or vacation homes) and not just principal dwellings. Additionally, subordinate liens would be eligible to qualify as a QRM, as long as they meet the definition of QM, as well.

CUNA Questions
(1) Is the agencies’ approach to considering the QRM definition, as described above, appropriate? Why or why not?
(2) What other factors or circumstances should the agencies take into consideration in defining QRM?

Qualified Mortgages (QM)

The CFPB’s Ability-to-Repay regulation provides several definitions of a QM. Under the proposal, a QRM would be a loan that meets **any** of the QM definitions.

General QM Definition

To meet the general QM definition, a loan must have:

- Regular periodic payments that are substantially equal;
- No negative amortization, interest only, or balloon features;
- A maximum loan term of 30 years;
- Total points and fees that do not exceed 3% of the total loan amount, or the applicable amounts specified in the Final QM rule, for small loans up to \$100,000;

- Payments underwritten using the maximum interest rate that may apply during the first five years after the date on which the first regular periodic payment is due;
- Consideration and verification of the consumer's income and assets, including employment status if relied upon, and current debt obligations, mortgage-related obligations, alimony and child support; and
- Total debt-to-income ratio that does not exceed 43%.

QMs Eligible for Sale, Guarantee, or Insurance

Additionally, the proposal would provide that a QRM would also include a residential mortgage loan that meets the second, temporary QM definition as defined by the CFPB. This temporary second QM definition provides that a loan must have:

- Regular periodic payments that are substantially equal;
- No negative amortization, interest only, or balloon features;
- A maximum loan term of 30 years;
- Total points and fees that do not exceed 3% of the total loan amount, or the applicable amounts specified for small loans up to \$100,000; and
- Be eligible for purchase, guarantee, or insurance by Fannie Mae, Freddie Mac, HUD, VA, U.S. Department of Agriculture, or Rural Housing Service.

This temporary QM definition for loans eligible for purchase or guarantee by Fannie Mae or Freddie Mac expires once the entity exits conservatorship. Additionally, in the event that any of these other government agencies defines QM for their own loans under their own QM rules, the temporary QM definition will also expire.

Higher-Priced and Non-Higher-Priced QMs

Both non-higher priced QMs and higher-priced QMs will be eligible as QRMs, without distinction under the proposal, and could be pooled together in the same securitization.

QMs Originated by Small Creditors

If a creditor meets the definition of a "small creditor" under the CFPB's QM rule (total assets cannot exceed \$2 billion, and the creditor originates 500 or fewer first-lien covered transactions in the prior calendar year, including all affiliates, and holds the QMs in portfolio for at least 3 years, with certain exceptions, such as transfers of a loan to another qualifying small creditor, supervisory sales, and mergers and acquisitions), the general 43% debt-to-income ratio requirement under the QM rule does not apply. These loans would be eligible for QRM status. However, the loans will be ineligible for QRM status until the 3-year portfolio requirement is met, as the loans cannot be sold during this period.

Balloon QMs Originated by Small Creditors

Loans under this category would also be eligible for QRM status under the proposal, after the 3-year portfolio requirement is met. Under the Final QM rule, small creditors can originate balloon loans that are held in portfolio and meet certain criteria for a two-year transition period, which expires January 10, 2016.

Balloon QMs Originated by Creditors in Rural and Underserved Areas

Under the proposal, loans made by small creditors that operate predominantly in rural or underserved areas would also qualify as QRM loans, after the 3-year portfolio requirement is met.

No Credit History, Appraisal, Servicing or LTV Ratio Requirements

Unlike the original proposal, the new proposed rule does not contain either an LTV ratio requirement or standards relating to a borrower's credit history into the definition of QRM. There is also no written appraisal requirement contained in the proposed QRM definition, nor are there any servicing standards incorporated in the definition. However, as discussed below, the agencies are seeking comments on an alternate QRM approach, "QM-PLUS."

Credit Risk Retention Requirements

Consistent with the original proposal, the proposed rule would apply a minimum 5 percent base risk retention requirement to all securitization transactions that are within the scope of section 15G, regardless of whether the sponsor is an insured depository institution, a bank holding company or subsidiary thereof, a registered broker-dealer, or other type of entity, and regardless of whether the sponsor is a supervised entity.¹ The agencies note that the base risk retention requirement under the proposed rule would be a regulatory minimum. The sponsor, originator, or other party to a securitization may retain additional exposure to the credit risk of assets that the sponsor, originator, or other party helps securitize beyond that required by the proposed rule, either on its own initiative or in response to the demands or requirements of private market participants.

Section 15G directs the agencies to define QRM jointly, taking into consideration underwriting and product features that historical loan performance data indicate result in

¹ The proposed rule, in some instances, permit a sponsor to allow another person to retain the required amount of credit risk (e.g., originators, third-party purchasers in commercial mortgage-backed securities transactions, and originator-sellers in asset-backed commercial paper conduit securitizations). However, in such circumstances, the proposal includes limitations and conditions to ensure that the purposes of section 15G continue to be fulfilled. Further, even when the sponsor would be permitted to allow another person to retain risk, the sponsor would still remain responsible under the rule for compliance with the risk retention requirements.

a lower risk of default. In addition, section 15G requires that the definition of a QRM be “no broader than” the definition of a QM.”

CUNA Questions
The agencies invite comment on all aspects of the proposal to equate QRM with QM. In particular:
(3) Does the proposal reasonably balance the goals of helping ensure high quality underwriting and appropriate risk management, on the one hand, and the public interest in continuing access to credit by creditworthy borrowers, on the other?
(4) Will the proposal, if adopted, likely have a significant effect on the availability of credit? Please provide data supporting the proffered view.
(5) Is the proposed scope of the definition of QRM, which would include loans secured by subordinate liens, appropriate? Why or why not?
(6) To what extent do concerns about the availability and cost of credit affect your answer?
(7) Should the definition of QRM be limited to loans that qualify for certain QM standards in the final QM Rule? For example, should the agencies limit QRMs to those QMs that could qualify for a safe harbor under 12 CFR 1026.43(e)(1)?

Credit Risk Retention Exemption for QRMs

In order for a QRM to be exempted from the risk retention requirement, the proposal includes evaluation and certification conditions related to QRM status. For a securitization transaction to qualify for the QRM exemption, each QRM collateralizing the ABS would be required to be currently performing (i.e., the borrower is not 30 days or more past due, in whole or in part, on the mortgage) at the closing of the securitization transaction. Also, the depositor for the securitization would be required to certify that it evaluated the effectiveness of its internal supervisory controls to ensure that all of the assets that collateralize the securities issued out of the transaction are QRMs, and that it has determined that its internal supervisory controls are effective. This evaluation would be performed as of a date within 60 days prior to the cut-off date (or similar date) for establishing the composition of the collateral pool. The sponsor also would be required to provide, or cause to be provided, a copy of this certification to potential investors a reasonable period of time prior to the sale of the securities, and upon request, to the SEC and its appropriate Federal banking agency, if any.

CUNA Questions
(8) Are the proposed certification requirements appropriate? Why or why not?

Repurchase of Loans Subsequently Determined To Be Non-Qualified After Closing

Under the original proposal, if it was discovered after the closing of a QRM securitization transaction that a mortgage did not meet all of the criteria to be a QRM due to inadvertent error, the sponsor would have to repurchase the mortgage. Under the new proposal, there is a buyback requirement for these situations, as well, provided that the conditions set forth in section .12 of the proposed rules are met. These conditions are intended to provide a sponsor with the opportunity to correct inadvertent errors by promptly repurchasing any non-qualifying mortgage loans from the pool. Subsequent performance of the loan, absent any failure to meet the QRM requirements at the closing of the securitization transaction, however, would not trigger the proposed buyback requirement.

CUNA Questions
(9) What difficulties may occur with the proposed repurchase requirement under the QRM exemption?
(10) Are there alternative approaches that would be more effective?

Request for Comment on Alternative QRM Approach

Although the agencies believe that the proposed approach of aligning QRM with QM is soundly based, they are seeking public input on its merits. Additionally, the agencies are seeking input on an alternative approach to QRM that was considered by the agencies, but ultimately not selected as the preferred approach. The alternative 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. Under this approach, significantly fewer loans likely would qualify as a QRM, and would not be exempt from risk retention.

QM-Plus

The alternative approach is referred to as “QM-Plus” under the proposal. QM-Plus would begin with the QM criteria adopted by the CFPB, and add 4 additional factors. Under QM-Plus:

- A QRM would be required to meet the CFPB’s core criteria for QM, including the requirements for product type, loan term, points and fees, underwriting, income and debt verification, and DTI. There would be no distinction between those loans that fall within the CFPB’s “safe harbor” versus those that fall within the “rebuttable presumption of compliance” for higher-priced loans – either loan would meet this test for QM-Plus purposes. However, loans that are QM

because they meet the CFPB's provisions for GSE-eligible covered transactions, small creditor exceptions, or balloon loan provisions would not be considered QRMs under QM-Plus;

- QRM treatment would only be available for loans secured by one-to-four family real properties that constitute the principal dwelling of the borrower. Other types of loans eligible for QM status such as loans secured by boats used as a residence, or loans secured by a consumer's vacation home would not be eligible QRMs;
- All QRMs would be required to be first-lien mortgages. For purchase QRMs, this would exclude "piggyback" loans, and no other recorded or perfected liens on the property could exist at closing to the knowledge of the originator. For refinance QRMs, junior liens would not be prohibited, but would be included in the LTV calculations described below;
- The originator would be required to determine that the borrower was not currently 30 or more days past due on any debt obligation, and the borrower had not been 60 or more days past due on any debt obligations within the preceding 24 months. Further, the borrower must not have, within the preceding 36 months, been a debtor in a bankruptcy proceeding or been subject to a judgment for collection of an unpaid debt, had personal property repossessed, had any one-to-four family property foreclosed upon, or engaged in a short sale or deed in lieu of foreclosure;
- The LTV at closing could not exceed 70% (A down payment of 30% would be required). Junior liens would be permitted only for non-purchase QRMs, and must be included in the LTV calculation if known to the originator at the time of closing, and if the lien secures a home equity line of credit or similar credit plan, it must be included as if fully drawn. Property value would be determined by an appraisal, but for purchase QRMs, if the contract price at closing for the property was lower than the appraised value, the contract price would be used as the value.²

Securitizers would be required to retain risk for QMs that do not meet the factors listed above.

² The appraisal would be required to be a written estimate of the property's market value, and be performed not more than 90 days prior to the closing of the mortgage transaction by an appropriately state-certified or licensed appraiser that conforms to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board of the Appraisal Foundation, the appraisal requirements of the Federal banking agencies, and applicable laws.

CUNA Questions

- (11) As documented in the initial proposal, academic research and the agencies' own analyses show that credit history and loan-to-value ratio are key determinants of mortgage default, along with the product type factors that are included in the QM definition. If QRM criteria do not address credit history and loan-to-value, would securitizers packaging QRM-eligible mortgages into RMBS have any financial incentive to be concerned with these factors in selecting mortgages for inclusion in the RMBS pool?
- (12) Is the incentive that would be provided by risk retention unnecessary in light of the securitizer incentives and investor disclosures under an approach that aligns QRM with QM as described in the previous section of this Supplementary Information?
- (13) Does the QM-plus approach have benefits that exceed the benefits of the approach discussed above that aligns QRM with QM? For example, would the QM-plus approach favorably alter the balance of incentives for extending credit that may not be met by the QM definition approach or the QRM approach previously proposed?
- (14) Would the QM-plus approach have benefits for financial stability?
- (15) Would the QM-plus approach have greater costs, for example in decreased access to mortgage credit, higher priced credit, or increased regulatory burden?
- (16) Other than the different incentives described above, what other benefits might be obtained under the QM-plus approach?
- (17) The agencies request comment whether the QM-plus approach should also include mortgages that fall within QM status only in reliance on the CFPB's provisions for GSE-eligible covered transactions, small creditors, or balloon loans. For all but the GSE-eligible covered transactions, the CFPB's rules make the mortgages ineligible for QM status if the originator sells them into the secondary market within three years of origination. For GSE-eligible loans, it appears sale to the GSEs may remain the best execution alternative for small originators (although the agencies are seeking comment on this point). The agencies request commenters advocating inclusion of these non-core QMs under the QM-plus approach to address specifically how inclusion would improve market liquidity for such loans.
- (18) The agencies request comment whether, notwithstanding the agencies' concern about this additional risk of default, the agencies should remove the outright prohibition on piggyback loans from the QM-plus approach.
- (19) Commenters, including one group representing RMBS investors, expressed concern that excluding loans to a borrower that is 30 days past due on any obligation at the time of closing from the definition of QRM would be too conservative. The QM-plus approach is based on the view that these 30-day credit derogatories are typically errors, or oversights by borrowers, that are identified to borrowers and eliminated during the underwriting process. Thus, a 30-day derogatory that cannot be resolved before closing is an indication of a borrower who, as he or she approaches closing, is not meeting his or her obligations in a timely way. The agencies request comments from originators as to this premise.

(20) The agencies also request comment on whether the QM-plus approach should permit a borrower to have a single 60-day plus past due at the time of closing, but not two.
(21) The agencies further request comment on whether this approach should be included if the borrower's single 60-day past due is on a mortgage obligation.

Mortgage Availability & Cost

Many commenters, including CUNA, opposed the original QRM proposal, recommending that almost all loans without such features as negative amortization, balloon payments, or teaser rates should qualify for an exemption from risk retention. The basis for this opposition was that the original proposal would have resulted in a decrease in the availability of non-QRM mortgages and an increase in their cost, in addition to the concern with the original proposal's 20% down payment requirement.

The agencies note that the effect of aligning QRM with QM could ultimately decrease credit availability as lenders, and consequently securitizers, would be very reluctant to transact in non-QM loans. Since the QM criteria have been issued (and even before), many lenders have indicated they would not make any non-QM mortgages, expressing concern that they are uncertain of their potential liability under the Truth in Lending Act's ability-to-repay requirements.

CUNA Questions
(22) Would setting the QRM criteria to be the same as QM criteria give originators additional reasons to have reservations about lending outside the QM criteria?
(23) Would the QM-plus approach, which confers a distinction on a much smaller share of the market than the approach that aligns QRM with QM, have a different effect?

Lenders may charge significantly higher interest rates on non-QRM loans, with estimates ranging from 75 to 300 basis points. The agencies note that a significant portion of these costs were typically ascribed to provisions of the risk retention requirements that have been eliminated in the re-proposed rule. If the non-QRM market is small relative to the QRM market, investors might demand a liquidity premium for holding securities collateralized by non-QRMs. Investors might also demand a risk premium for holding these securities if non-QRMs are perceived to be lower-quality mortgages. If the scope of the non-QRM market is sufficiently broad to avoid these types of premiums, the factors impacting cost will be the amount of additional risk retention that would be required under the rule, above current market practice, and the cost to the securitizer of funding and carrying that additional risk retention asset, reduced by the expected yield on that asset.

CUNA Questions

(24) In light of these factors, the agencies seek comment on whether the QM-plus approach would encourage a broader non-QRM market and thus mitigate concerns about the types of costs associated with a narrow QRM approach described above. Considering the number of institutions in the market with securitization capacity and expertise that already hold RMBS interests presenting the same types of risks as the RMBS interests the proposed rule now establishes as permissible forms of risk retention, would the requirement to retain risk in a greater number of securitizations under the QM-plus approach act as a restraint on the amount and cost of mortgage credit available in the market?

CUNA Questions

(25) Any other comments or questions.