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April 30, 2012

Richard Cordray
Director
Bureau of Consumer Financial Protection
1700 G St. NW
Washington, DC 20552

Re: Qualified Mortgage; Regulation Z; Truth in Lending; Docket No. R-1417; RIN No. 7100-AD75

Director Cordray,

The Securities Industry and Financial Markets Association sends this letter on behalf of its members to reiterate and highlight key considerations and concerns with the promulgation of a proposed definition of a "Qualified Mortgage" ("QM"). We also request a meeting with you to discuss these concerns. This letter is a follow up to our prior submission to the Board of Governors of the Federal Reserve System on July 22, 2011[1]. As with our prior letter, these comments on the proposal were developed by our diverse membership, which includes financial institutions that act as residential mortgage originators, securitization sponsors, broker-dealers that act as underwriters, placement agents, market makers and asset managers that include some of the largest, most experienced investors in residential mortgage-backed securities ("RMBS") and other structured finance products. SIFMA's primary focus in consideration of this topic relates to the ability of secondary market participants to provide funding for mortgage credit; this is critical, as at this moment over 90% of mortgage credit is funded through these markets. The comments reflect SIFMA's goal of maintaining capital flow to the residential mortgage markets and maintaining the availability of affordable credit to qualified American consumers.

SIFMA is concerned that the QM regulations may be constructed in a narrow manner with parameters that will not allow for the certainty of compliance at origination. Our members believe such an outcome would restrict the availability of credit, through increased cost and restrictive underwriting, and would be detrimental to consumers. We will address three key points in this letter: (1) the parameters of the qualified mortgage definition must be scaled broadly, as opposed to narrowly, as QM loans will be predominant source of widely available mortgage credit; (2) due to the risk of liability inherent in non-QM lending, the parameters of the definition must provide clear, bright lines, and a safe harbor for compliance; and (3) the need for further, more detailed discussion of these issues with secondary market participants.

1. *Broad vs. Narrow: Mainstream Institutions Will Operate Only Within the Bounds of the QM*

SIFMA and its members strongly support the concept that underlies the relevant sections of the Dodd-Frank law – lenders should determine that borrowers have an ability to repay their loans before they extend credit. Discussions with our members have made clear that the liability attendant to the

[1] See "SIFMA Submits Comments to the Federal Reserve on Proposed Changes to Regulation Z and the Definition of Qualified Mortgage" ("SIFMA 2011 Comments"), available here: http://www.sifma.org/issues/item.aspx?id=8589934840

failure to adequately determine such ability to repay will result in the parameters of the qualified mortgage definition, when finalized, broadly determining the availability of affordable mortgage credit. We expect that any limited lending outside of the confines of the QM definition will be performed at far greater cost to the consumer, and due to a variety of reasons, be more likely to be provided by less regulated, less well-capitalized, and possibly less reliable entities. Further, the mortgage credit products that may be offered outside of the QM parameters will likely have little appeal in secondary markets, suggesting lower consumer benefits (e.g., accessibility, transparency, affordability, and prudential terms). This makes clear the need for the creation of a broader, as opposed to narrower, definition of a QM.

As a threshold matter, the ability to repay provisions of Title XIV of Dodd-Frank were not intended to outline the parameters of mortgage lending for the most creditworthy borrowers; that is the purpose of a provision of the risk retention statute which exempts Qualified Residential Mortgages (QRMs) from those requirements.[2] Indeed, the ability to repay provisions impose a requirement on lenders to determine an ability to repay on virtually every residential mortgage loan, and the QM definition is intended to define steps needed to show compliance with the ability to repay (ATR) requirement. Thus QM *should* broadly outline the parameters of responsible lending.

Defining QM to encompass the conventional mortgage market will not result in lenders ignoring a borrower's repayment ability when underwriting a loan. The ATR analysis required by the statute and a responsible underwriting analysis are related, but separate. The analyses are related because many of the statutory factors of the ATR test—consideration and verification of current and expected income, obligations and DTI ratios—are important parts of a responsible underwriting analysis that lenders employ for all loans. However, the analyses are separate because the ATR test is a compliance matter, while a complete underwriting analysis is done to ensure safety and soundness and to meet investor demands. It is entirely possible that a loan underwritten consistent with acceptable underwriting practices will be determined by courts to not meet the ATR requirements. Thus, defining QM broadly will create compliance guideposts for lenders that want to lend responsibly.

We are aware of the contention that a narrower definition of QM will not be disruptive because lenders and secondary markets will be comfortable operating outside of the protections afforded by the QM, possibly with a reasonable pricing premium for those loans. Such predictions contradict feedback from our member firms, and we believe the CFPB would be ill-advised to implement QM rules in accordance with these views. History has shown that loans that carry with them significant or uncertain liability are simply not made, or are made with a significant pricing premium, which restricts the availability and affordability of those loans. Accordingly, we believe that lenders will respond to the liability risk through very restrictive underwriting guidelines, or significant pricing premiums, or both. These actions will result in less available credit to borrowers who would have otherwise received it had the boundaries of QM been drawn more broadly. Likewise, secondary market participants will take steps to avoid or price the risk of assignee liability; this will also make loans more expensive and less available.

[2] The QRM provisions of Dodd-Frank were intended to provide a specific, preferential treatment for higher credit quality loans. QRM was intended to create a smaller group of loans which represent higher credit quality to lenders, and for which risk would not need to be retained in securitizations. The ATR provision, on the other hand, was intended to outline a path for lenders to determine a borrower's repayment ability. The QM provision was intended to be an incentive for lenders to avoid the most risky loans and products after determining a borrower's repayment ability.

It is clear that the risk of liability will increase costs to consumers of non-QM loans – but SIFMA does not see a compensating benefit in a narrow QM definition. While a non-QM borrower may have more opportunity to challenge the origination of the loan, the loan may have riskier terms than permitted on a QM, will be significantly more expensive, and harder to obtain. Secondary market investors would likely demand risk-adjusted yield above what would likely be affordable for many borrowers. At the same time, non-QM borrowers would not receive significantly greater protections in the underwriting process than QM borrowers because the requirement to determine ability to repay applies to all loans. If reputable lenders are reluctant to bear the risk of liability for these loans, and secondary markets are reluctant to purchase them, there will be few avenues for their responsible production. For these reasons, we believe that the CFPB should implement broad, but sensibly structured parameters for the determination of a QM.

2. ***Bright Lines Will Promote Responsible Lending; Uncertainty of Compliance will Constrain Responsible Lending***

Given the impact of assignee liability discussed above, SIFMA believes it is critical that the final rules provide for certainty of compliance with ability to repay requirements. This would be optimally implemented through a safe harbor. The proposed rebuttable presumption approach could inhibit such certainty and effectively call the compliance of many loans into question. Because of this lack of certainty, a rebuttable presumption may cause lenders and secondary market investors to implement standards conservatively, as an overlay comfortably within the bounds of the QM definition. Such an overlay on QM guidelines would be similar in nature to the overlay some lenders place on Federal Housing Administration or Government Sponsored Enterprise minimum standards due to repurchase risk. Borrowers with credit profiles within but close to the edges of QM would be impacted, as credit availability under such a regime will be narrower than what was intended or envisioned by the CFPB.

Regardless of whether or not a safe harbor is provided, clear QM standards are paramount. Lenders and investors must be able to know at the time of origination whether the loan meets the QM standards. The standards that define QM compliance must be clear, objective, and verifiable. The secondary market for mortgage loans and the securitization markets will *require* verification of the QM status before a pool of loans is purchased or securitized. Not only must lenders represent and warrant that their lending practices comply with their underwriting guidelines, but also that their lending complies with all applicable laws and regulations, including the ability to repay rules. Subjective compliance standards will require increasingly costly due diligence efforts, will increase repurchase risk, and will reduce the value of loans in the secondary markets. Vague standards for QM could lead to secondary market investors imposing their own more objective requirements well within the bounds of QM to assure compliance with the standards. In other words, if bright lines are not implemented in the final rule, borrowers will pay more for their loans and have a harder time obtaining them. Objective standards will promote the legal certainty that is essential for lenders and their assignees to effectively price the mortgage loans in a manner that creates affordable outcomes for borrowers. [3]

[3] While SIFMA is still considering this issue more fully, we express further concern about the compliance and examination process to be employed by CFPB in the context of our discussion of bright-line standards. It is imperative that the ability to repay and QM rules be based on clear and objective standards, so that judgments of compliance or non-compliance may be based on similarly objective tests. If the CFPB's regulatory examination process is other than fully objective, the subjective guidance to field examiners will result in differential application of the regulations, resulting in a functional morphing of the regulations that could negate the critically necessary assurance of compliance we discuss above.

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3. <u>Request for Further Discussion of these Issues</u>

We hope this letter is helpful in focusing attention on what we view as two of the most critical aspects of the QM rulemaking from the perspective of the ability of the secondary markets to fund mortgage lending. Because QM will essentially define the scope of mortgage lending, it must be drawn in a responsible but broadly inclusive manner. It also must be drawn with objective, verifiable criteria, so that secondary market purchasers can avoid unexpected liability for loans they purchase in whole loan or securitized form.

We would like to discuss in more detail these issues and perspectives of secondary market participants, and request a meeting at your convenience. We appreciate your consideration of our views, and please do not hesitate to contact us with any questions.

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About SIFMA

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.