August 1, 2011

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, SW, Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0002, RIN 1557-AD40

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attn.: Elizabeth M. Murphy, Secretary
RIN 3235-AK96
Release No. 34-64148; File No. S7-14-11

Board of Governors of the Federal
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20th Street and Constitution Avenue, NW
Washington, DC 20551
Attn: Jennifer J. Johnson, Secretary
Docket No. 2011-1411, RIN 7100-AD-70

Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attn.: Alfred M. Pollard, General Counsel
RIN 2590-AA43

Federal Deposit Insurance Corporation
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Attn.: Comments, Robert E. Feldman,
Executive Secretary
RIN 3064-AD74

Department of Housing and Urban
Development
Regulations Division
Office of General Counsel
451 7th Street, SW, Room 10276
Washington, DC 20410-0500
RIN 2501-AD53

RE: Proposed Rule to Establish Credit Risk Retention Requirements: OCC Docket No. OCC-2011-0002; FRB Docket No. R-1411; FDIC RIN 3064-AD74; SEC File No. S7-14-11; FHFA RIN 2590-AA43; and HUD Docket No. FR-5504-P-01.

Dear Interested Parties:

On behalf of the National Council of La Raza (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States, dedicated to improving opportunities for Hispanic Americans—and the National Association for the Advancement of Colored People (NAACP)—the Nation's oldest, largest, and best known civil rights organization—we submit the following comments concerning the proposed definition for a Qualified Residential Mortgage (QRM). Together the NCLR and NAACP have, for decades, promoted policies, programs, and practices that support sustainable homeownership among racial and ethnic minorities.

The NAACP and NCLR conduct research and analysis on relevant public policy issues supporting strong fair housing and fair lending laws, and expanding access to affordable credit for all Americans, with a special emphasis on the particular challenges facing communities of color. In addition, NCLR is the largest Hispanic-focused housing counseling intermediary certified by the U.S. Department of Housing and Urban Development (HUD). The NCLR Homeownership Network (NHN), a network of 52 community-based counseling providers, works with more than 65,000 families annually and has produced more than 25,000 first-time homebuyers in its first decade. Through these efforts, NCLR and NAACP are working toward the advancement of Latino and African American families, strengthening America by promoting affordable homeownership opportunities, and ensuring that families facing foreclosure receive assistance.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is a landmark law that is ushering in a new era of transparency and accountability in financial markets. Like most new laws, much of its success depends heavily on the final rules and regulations that will guide its implementation. One such regulation is the required definition of a QRM which carves out a set of home mortgages to be exempt from the requirement that originators reserve 5% capital for loans sold into secondary market securities. The law was intended to realign incentives so that the entity that makes the loan maintains interest in its success even after it has been sold.

The NAACP and NCLR support the concepts of risk retention and realigning the incentives on which loans are marketed and sold. We are, however, concerned that the proposed definition will further cement unfair borrower segmentation by requiring a 20% downpayment to avoid risk retention. In the comments below, we provide a brief background concerning the lack of access to favorable credit options for people of color despite their creditworthiness, and we discuss QRM and how its definition will affect borrowers of all backgrounds. In the end, we recommend keeping the definition narrow but refocusing the definition on exotic products and poor underwriting while also rewarding the use of credit enhancements.

Background

Homeownership has long been the primary asset for most Americans. Steadily building modest wealth can leverage education, entrepreneurship, or retirement opportunities. When nurtured over a lifecycle, home equity can be shared with the next generation and further their financial security. Communities of color do not own homes at rates comparable to their White peers, which contributes heavily to the racial wealth gap. In fact, recent research by the Pew Research Center shows that wealth in White households exceeds that of Hispanic households by a staggering18-to-one ratio and by 20-to-one for African American households.[1]

Civil rights institutions have fought for decades for policies that ensure that qualified borrowers of color are able to access the same homeownership opportunities enjoyed by the rest of the market. Unfortunately, policies to this end have been undermined by lax oversight of financial institutions, faulty implementation, and predatory lending. An abundance of research has shown that African American and Hispanic borrowers were disproportionately sold subprime loans, even when their income and credit profiles warranted standard prime loans.[2] Equal access to mainstream financial services and affordable rental and owner-occupied housing is a critical step toward providing all families with access to wealth-building opportunities, good jobs, schools,

[1] Paul Taylor et al., *Twenty to One: Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics* (Washington, DC: Pew Research Center Social and Demographic Trends, 2011).

[2] Robert B. Avery, Kenneth P. Brevoort, and Glen Canner, "The 2007 HMDA Data," *Federal Reserve Bulletin* 94 (December 23, 2008); and Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on Price of Subprime Mortgages* (Durham, NC: Center for Responsible Lending, 2006).

transportation, health care, and other factors that determine positive life outcomes. Providing this access has been, and must remain, an important public policy goal.

The dual-market phenomenon—where borrowers have restricted access to the most favorable credit options for reasons unrelated to their personal creditworthiness—is hardly new. Its deep roots can be traced back as far as the Homestead Act of 1862 and have had a lasting effect on borrowers of color. An estimated 46 million White Americans trace their wealth to this legislation[3] which provided freehold title to "unoccupied" lands west of the Mississippi River. The policy, designed to populate the then recent expansion of the nation, facilitated the generation of wealth for White families, but was unavailable to minority individuals. This institutionalized separation of markets continued decades later with the redlining practices of the Federal Housing Administration (FHA) and the Veterans Administration.[4] Later, policies put in place by Fannie Mae and Freddie Mac reinforced market segmentation. The persistence of a dual market has created systemic market barriers, limited the wealth accumulation among communities of color, and led to disinvestment in minority neighborhoods.[5]

With an eye toward the conventional mortgage market of today, Latinos, African American, elderly and immigrant communities continue to go underserved. Disproportionately high denial rates among Hispanic and African American prime mortgage applicants also suggest that the market is not meeting the needs of racial and ethnic minority families. Often with unique borrower profiles, Hispanic borrowers are more likely to live in households that have multiple wage earners, additional co-borrowers, rely on cash income, and have a thin credit history or lack one entirely.[6] The tools used by lenders to assess the creditworthiness and mortgage price fail to capture the complete picture of minority households.

Furthermore, since the introduction of automated underwriting, mainstream and prime lenders have had little incentive to work with "hard-to-serve borrowers," such as Latinos, immigrants, African Americans and other traditionally underserved populations that are creditworthy but may require manual underwriting. In some cases, lenders referred borrowers to their subprime affiliates where loans could be processed quickly and profitably with little or no documentation, as was demonstrated by a case recently settled by the Federal Reserve against Wells Fargo.[7] Others simply neglect such borrowers, leaving a vacuum that other subprime and predatory lenders were quick to fill. As a result, many borrowers of color were steered into subprime, risky, and expensive mortgages, even when they had prime-qualifying credit. In fact, Latino and

[3] Trina Williams, "The Homestead Act: A Major Asset-Building Policy in American History," in *Inclusion in the American Dream: Assets, Poverty and Public Policy*, ed. Michael Sherraden (New York: Oxford University Press, 2005), 20–41.

[4] William J. Collins and Robert A. Margo, "Race and Home Ownership: A Century-Long View," *Explorations in Economic History* 38, (2001): 68–92.

[5] The wealth gap is particularly relevant to the housing finance system. Since most borrowers of color do not have the benefit of inherited wealth to supplement their downpayment, they are often priced out of homeownership or buy much later in life. Low homeownership rates, therefore, become a self-perpetuated cycle that prevents minority families and neighborhoods from accumulating intergenerational assets.

[6] Michael Stegman et al., "Automated Underwriting: Getting to Yes for More Low-Income Applicants" (presentation, 2001 Research Institute for Housing America Center for Community Capitalism Conference on Housing Opportunity, Chapel Hill, NC, April 2001).

[7] Board of Governors of the Federal Reserve, 2011 Enforcement Actions, press release, July 20, 2011.

African American borrowers were more than twice as likely to receive the kinds of mortgages most at risk of default. Even after controlling for income, credit score, loan-to-value (LTV) ratio, and presence of a co-borrower, borrowers of color were disproportionately represented in the subprime market compared to their White peers.[8] In addition, research shows that Latinos were 30% more likely than Whites to receive a high-cost loan when purchasing their home and that Latinos and African Americans were more likely to receive loans with interest-only or negative amortization features, prepayment penalties, and high yield spread premiums. [9] The pattern is repeating itself in today's market where 60% of Hispanic and Black borrowers are relying on FHA mortgages rather than receiving conventional mortgages, which are often cheaper and quicker to close.[10]

The dual credit market has had severe consequences on communities of color. As a result of the barriers that restrict quality loan products and steer families into risky subprime loans, racial and ethnic minority Americans are losing their homes at a record pace. The loss of homes through foreclosure and the decline in home values has resulted in a 66% decline in wealth levels among Hispanic households and a 53% decline among African American households compared with just 16% among White households. From 2005 to 2009, the median level of home equity held by Hispanic homeowners declined by half—from $99,983 to $49,145. For African Americans, they saw a decline from $76,910 to $59,000.[11] The increasing number of homes for sale further demonstrates the depth of the crisis. As of August 2009, there were 3.62 million existing units for sale, which would likely take eight and a half months to exhaust at the current sales pace.[12] In some markets, distressed transactions—meaning the sale was rushed and usually at a discount—represent up to 30% of home sales.[13] Such sales tend to be concentrated in the ten highest foreclosure markets, all of which have large Latino populations. Making matters worse, tight credit standards and the reliance on FHA leave many minority borrowers without the ability to compete with cash-laden investors eager to scoop up bargain properties.

Ultimately, regulators must take great care to ensure that the final Qualified Residential Mortgage definition does not facilitate another dual credit market. This can be accomplished by creating liquidity for safe non-QRM mortgages which continue to meet the definition of a Qualified Mortgage and eliminating borrower-specific attributes such as wealth that will unnecessarily fragment the market.

Considerations for Defining a Qualified Residential Mortgage

The housing bubble was driven by unregulated lenders that operated an originate-to-distribute business model in which customers were steered toward loans that generated the highest upfront profits regardless of their actual credit risk or the availability of more responsible products. Therefore the NAACP and NCLR strongly support the concept of risk retention, which would

[8] *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages.*

[9] Ibid.

[10] Shaun Donovan for the U.S. Department of Housing and Urban Development, *FHA and the Future of the Housing Market,* 112th Cong., 1st sess., 2011.

[11] *Twenty to One: Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanic.*

[12] Mortgage Banking, "Existing Home Sales Slip in August, Prices Also Fall," *Mortgage Banking,* November 1, 2009.

[13] Lucia Mutikani, "Home Sales at 2-1/2 Year High," *Reuters*, November 23, 2009, http://www.reuters.com/article/ idUSTRE5AM34G20091123 (accessed January 4, 2010).

require securitizers to keep a capital reserve for all but the least risky loans sold to the secondary market. Risk retention will be an effective tool to better align the incentives of originators, lenders, and investors. We also agree that to achieve this goal, QRM should be narrowly defined. However, we are concerned that the proposed definition may perpetuate a dual credit market where certain borrower segments are unable to access responsibly underwritten mortgages.

Racial and ethnic minority families and their children will contribute heavily to the next generation of homebuyers. Leaving them out of the market could have detrimental effects on a large swath of the population, as well as our national economy. The future of Latino and African American homeownership depends heavily on whether there is a robust and liquid mortgage market where a number of potential lenders compete for their business. While there are many factors that contribute to this, the introduction of the risk retention rule represents an opportunity to break down the old walls that supported a dual credit market for so many decades. To achieve this goal, we offer two points for the drafters' consideration:

Focus on aspects that introduce true systemic risk. Research has shown that product attributes with poor underwriting standards such as payment shock, lack of documentation, and prepayment penalties are key drivers of default. Borrower characteristics, such as loan-to-value ratio and credit standards are not critical indicators of systemic risk. As cited in the proposed rulemaking background section, experience and research have shown that loans with lower downpayments can perform well when properly underwritten. Research by the Center for Community Capital revealed that similarly situated low- and moderate-income borrowers perform dramatically different depending on the product characteristics.[14] Analysis of data from CoreLogic Inc. on loans originated between 2002 and 2008 shows that increasing downpayment in 5% increments has minimal impact on default rates.[15] While the risk of default rises at the lower downpayment levels, the increase is too slight to outweigh the substantial benefits of keeping loans available to those without the cash for high downpayments.

The small risk created by a lower LTV can be accounted for through other credit enhancements, such as prepurchase counseling, insurance, and price. For example, research has shown that objective advice from an independent, trained housing counselor prior to purchase effectively reduces the likelihood of default.[16] Similarly, recent research has shown that counseling during a delinquency improves cure rates and lowers rates of redefault.[17] Therefore we recommend that QRM be designed in a manner that limits exotic products and with deceptive features and rewards credit enhancements that reduce risk.

[14] Lei Ding et al., Risky Borrowers or Risky Mortgages: Disaggregating Effects Using Propensity Score Models, *Journal of Real Estate Research* 33, no. 2 (2011): 245-277.

[15] Source: Vertical Capital Solutions of New York, an independent valuation and advisory firm, conducted this analysis using loan performance data maintained by First American CoreLogic, Inc. on over 30 million mortgages originated between 2002 and 2008.

[16] Abdighani Hirad and Peter M. Zorn, A Little Knowledge Is a Good Thing: Empirical Evidence of the Effectiveness of Pre-Purchase Homeownership Counseling (symposium, Low-Income Homeownership Working Paper Series, 2001).

[17] Neil Mayer et al., National Foreclosure Mitigation Counseling Program Evaluation: Preliminary Analysis of Program Effects September 2010 Update (Washington, DC: The Urban Institute, 2010).

Allow for a robust and protected non-QRM market. NCLR and the NAACP agree that only a small number of loans should be exempt from the risk retention rule—we recommend that fewer than half of the mortgages fall into the QRM box at any given time. This will ensure there is a broad and liquid non-QRM market where many lenders will compete on the same terms for the business of qualified, low-wealth borrowers. While this appears to have been a goal of the current draft definition, we have serious concerns that it falls far short. The authors do not merely use LTV to shape the market, but go much farther by suggesting that a 20% downpayment is a reasonable standard for a safe loan. In this way the QRM definition will send a strong signal to the market that lending to a borrower with a lower downpayment is risky or unsafe. Despite the hope expressed by the authors that lending continues in the non-QRM market, the focus on borrower characteristics—wealth and credit in particular—will create a stigma that allows lenders to overlook or overprice this segment. Rather than risk unduly penalizing a segment of borrowers by eroding the market for their business, the authors should remove downpayment or LTV from the definition all together.

Conclusion

Regulators must view QRM as one piece of a large puzzle that will make up our future housing finance market. Beyond QRM, the definition of Qualified Mortgage and the next generation of government-sponsored enterprises will significantly impact the scope, price, and type of credit available, especially among traditionally underserved borrowers. The magnitude of the foreclosure crisis and the passage of Dodd-Frank have led to a unique opportunity to redefine the manner in which credit is priced and distributed. Our common goal should be to ensure that every qualified borrower has access to responsibly priced credit on an equitable basis no matter where they live. We look forward to working with you toward this goal.

Should you have any questions regarding the contents of this letter, please contact Janis Bowdler, Director of NCLR's Wealth-Building Policy Project, at jbowdler@nclr.org or (202) 776-1748 or Hilary Shelton, the Director of the NAACP Washington Bureau and the Senior Vice President for Advocacy and Policy at (202) 463-2940.

Sincerely,

Janet Murguía

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