United States Senate

COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510-6350

November 8, 2010

The Honorable Shaun Donovan
Secretary of Housing and Urban Development
Department of Housing and Urban Development
451 7th Street S.W.
Washington, DC 20410

The Honorable Sheila Bair
Chairman, Federal Deposit Insurance U.S. Corporation
550 17th St., NW
Washington, DC 20429

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
2001 C Street, NW
Washington, DC 20001

The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
4th Floor
Washington, DC 20552

The Honorable John Walsh
Acting Comptroller
Office of the Comptroller of the Currency
1775 Duke Street
Alexandria, Virginia 22314

Dear Secretary Donovan, Chairman Bair, Chairman Bernanke, Chairman Schapiro, and Messrs. DeMarco and Walsh,

As cosponsors of Senate Amendment #3956, which added the exemption for "qualified residential mortgage" to the risk retention provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), we are writing to express our continued interest in this issue and in the implementation of the statutory provisions. We believe that properly crafted regulations will provide access to safe, stable and affordable home loans for creditworthy borrowers while granting investors confidence that the mortgage assets backing the securities they purchase will meet or exceed their performance expectations. We look forward to working with you to ensure that, consistent with the language of Section 941 of the Dodd-Frank Act, the regulatory definition of "qualified residential mortgage" incorporates mortgage terms and features that result in lower risk of default.

While risk retention can serve as a strong deterrent to the excessive risk taking that contributed to the crisis, it also imposes significant costs and reduces liquidity in the mortgage market. Applied across the board, risk retention could raise the cost of mortgage credit even on well-underwritten loans to highly qualified borrowers. This would be both an unfair, and avoidable result. Therefore we determined to fashion an amendment that would address the primary causes of the problem directly and provide an incentive for lenders to originate safe, stable and affordable mortgages to borrowers with the demonstrated capability to make the monthly payments required. With our amendment the deterrent value of risk retention is focused where it should be, on lax underwriting standards and risky product features rather than on all residential mortgages.

As ultimately enacted in Section 941(b) of the Dodd-Frank Act, this provision requires the Securities and Exchange Commission, the Secretary of Housing and Urban Development, the Director of the Federal Housing Finance Agency, and the Federal banking agencies jointly to issue regulations exempting "qualified residential mortgages" from the risk retention provisions of Subtitle D. These agencies must jointly define the term "qualified residential mortgage," taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default, such as documentation and verification of a borrower's financial resources; standards regarding residual income and debt to income ratios; factors that mitigate the potential for payment shock; mortgage guarantee or other insurance or credit enhancement obtained at the time of origination; and prohibitions on balloon payments, negative amortization, prepayment penalties, interest only payments and other features that increase the risk of borrower default.

It was our clear legislative intent that, underwriting and product features that data indicate a lower risk of default must be considered. Prior to sponsoring the Amendment, we were provided with analyses of loan level data that demonstrated that loans that satisfy the elements set out in our Amendment default less frequently and cure more often than riskier loans. We understand that each of your agencies has been provided with this analysis, updated to reflect loan performance in 2010. In particular this analysis demonstrates that historically tested standards, including full documentation of borrower income and assets, reasonable total debt-to-income ratios and restrictions on risk loan features, such as negative amortization and balloon payments, significantly reduce the risk of default. In addition, for loans with lower down payments that have combined loan-to-value ratios greater than 80 percent, the protections provided by mortgage insurance result in lower losses for lenders and investors and fewer foreclosures for borrowers than similar loans that lack insurance. The mortgage insurance provision ensures that the qualified residential mortgage exemption can serve those consumers that cannot afford a 20 percent down payment while putting substantial private capital at risk to drive underwriting discipline.

As discussed above, the definition of "qualified residential mortgage" should delineate a category of mortgages that pose less risk to borrowers, lenders and investors based on criteria and attributes that have been demonstrated to result in a lower risk of borrower default and avoidance of features that have been demonstrated to result in a higher risk of borrower default. It is important that this definition be drawn broadly enough to support the recovery of the housing market, while remaining rooted in empirically sound underwriting and product standards that will incent lenders to originate prudently underwritten loans and avoid increased costs to homebuyers associated with the risk retention requirements. As you undertake the implementation of Section 941(b), we look forward to discussing with you the process you will use to review historical loan performance data and the conclusions that you draw from that data.

Sincerely,

Senator Mary L. Landrieu

Senator Kay R. Hagan

Senator Johnny Isakson

cc: The Honorable Timothy Geithner
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220