

COMMUNITY MORTGAGE BANKING PROJECT

Call to Action on Risk Retention

The Senate is now considering S. 3217, the Restoring American Financial Stability Act of 2010. The bill contains a risk retention provision that, unless amended, could cause mortgage interest rates to jump and create considerable turmoil for independent mortgage banking companies.

Status:

The Senate began consideration of S. 3217 late last week after the discussions between the Democrats and Republicans over attempts to craft a bill with bipartisan support concluded unsuccessfully. The Senate will begin debating and taking amendments to the bill beginning on Tuesday May 4th. The Democrat's objective is to send a final bill to the President by Memorial Day.

What the bill does:

- Requires regulators to issue rules requiring any securitizer to retain an economic interest in the credit risk for any financial asset included in a securitization equal to:
 - At least 5%, or
 - Less than 5% if the originator of the asset meets underwriting prescribed by the regulators.
- Establishes a joint rulemaking process between the FDIC, the OCC and the SEC for matters related to risk retention requirements on securitizations. None of these agencies have housing or mortgage market responsibilities.
- Requires these regulators to specify the permissible forms and the minimum duration of risk retention, and to allocate the required risk retention between the issuer and the originator "as the regulators deem appropriate."
- Regulators are permitted to exempt categories of assets and issuers under certain circumstances, which are not very well defined in the bill.

Key concerns with the bill:

- The Senate financial reform bill authorizes, but does not require regulators, to establish a class of low risk, well-underwritten mortgages that would be exempt from risk retention.
- This failure to exempt stable, affordable mortgages will create a period of prolonged uncertainty in the marketplace that will be detrimental to consumers, lenders and investors.
- The lack of clear direction to regulators on risk retention will exacerbate an already uncertain mortgage market.
- Under the bill, the OCC, the FDIC, and the SEC are required to prescribe the details of the risk retention requirements.
 - This places regulators with no oversight responsibilities or expertise in housing finance in charge of a market that finances 7 out of every 10 mortgages in the U.S.

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- The viability of GNMA and the GSEs' MBS programs would be in the hands of banking industry regulators.
- Similarly, the viability of the independent mortgage bankers' entire business model would be in the hands of the regulators for their largest competitors.

Suggestions for your letter:

- Opening: Tell your Senator you writing to express your serious concerns with the risk retention provisions in financial reform bill that will be coming to the Senate floor after the Easter recess.
- Describe your company:
 - How long in business
 - # of employees
 - Lending volume and # of branches/locations in the state
 - The type of lending - FHA/VA and traditional GSE business. Emphasize that your company stayed with this market and did not stray into subprime, Alt-A or other high risk lending.
- Explain how the Senate bill's risk retention requirements threaten to undermine the important role of securitization to the health of the housing market. An overreaching risk retention mandate would:
 - raise rates (by up to 300 bp according to JPM Securities estimate);
 - reduce liquidity for all mortgages, including fully documented, well-underwritten, fixed rate loans to creditworthy borrowers;
 - jeopardize recovery of housing market and the broader economy.
- Risk retention is not likely to even produce the intended results, and is not a substitute for strong underwriting standards. For example, many issuers in the last decade retained large risk positions in their securities and still failed. Risk retention did not curtail their risky lending.
- Risk retention could make our financial markets riskier, not safer:
 - banks would be holding more long term mortgages on balance sheet in the form of retained risk tranches funded by short term deposits (credit risk that can't be hedged);
 - more portfolio lending will mean more adjustable rate loans, not safer fixed rate loans that consumers prefer ;
 - explain how mortgage bankers have full risk retention today through repurchases and indemnifications for any loan that does meet the standards of FHA, VA or the GSEs;
 - excessive risk retention will drive locally based mortgage bankers and community banks out of the mortgage market, resulting in even greater consolidation. This means:
 - o reduced competition
 - o loss of local lenders with local knowledge of local markets
 - o lost jobs.

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- The Closing: To ensure ample liquidity for high quality mortgages, the bill should require regulators to establish clear standards for “Qualified Mortgages” that would be exempt from risk retention.
 - This will create strong incentives for the origination of lower risk loans with traditional, back-to-basics underwriting standards.
 - This will strengthen underwriting and sound lending behavior within the primary market, and help attract private capital back to the secondary and capital markets.
 - Risk retention requirements would then be focused on risky loans.
 - The bill should also ensure that FHFA and HUD participate in the risk retention rulemaking process, including establishing the standards for qualified mortgages and ensuring compliance.
 - Ask your senator to contact Chairman Dodd and Ranking Member Shelby to urge them to ensure that the bill requires the regulators to exclude high quality, low risk qualified mortgages from the risk retention requirements.

This is just a suggested approach. Personalize it -- the more you can demonstrate the adverse impact on your local/state housing market, and on your company, the better.