Statement for the Record

Mortgage Bankers Association

U.S. House of Representatives
Committee on Financial Services
Subcommittee on Capital Markets and Government Sponsored Enterprises

Hearing on "The Impact of Dodd-Frank on Customers, Credit, and Job Creators"

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1717 Rhode Island, NW | Washington, DC 20036 | www.mortgagebankers.org | (202) 557-2700

INTRODUCTION

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to submit this statement for the hearing of the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises entitled "The Impact of Dodd-Frank on Customers, Credit, and Job Creators."

We commend Chairman Garrett and Ranking Member Waters for holding this important hearing that addresses the impacts of the Dodd-Frank Wall Street Reform and Consumer Protection Act[2] (Dodd-Frank Act) on a variety of constituencies. While the Dodd-Frank Act is broad in its scope, we will primarily focus our comments to the area of the law that most significantly impacts commercial, multifamily and single family real estate lenders: credit risk retention.[3]

CREDIT RISK RETENTION AND IMPORTANCE OF SECURITIZATION

On April 29, 2011, the federal regulatory agencies[4] (Agencies) issued for comment a proposed rule that seeks to implement the Dodd-Frank Act's risk retention requirements. MBA notes that a well-designed and robust regulatory framework can be fully compatible with a vibrant securitization market for commercial, multifamily and residential real estate debt. MBA is committed to facilitating the establishment of a fully-functioning, transparent, liquid and responsible securitization market for these debt categories.

MBA appreciates a number of aspects of the proposed rule on risk retention. We strongly support the optional menu approach for risk retention structures in the proposal, because it provides flexibility for a broad range of market participants. A one-size-fits-all approach for the form of risk retention would not adequately address the range of issues that arise for RMBS and

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] Public Law 111-203, 124 Stat.1276-2223 (July 21, 2010).

[3] The credit risk retention requirement is set forth in section 941 of the Dodd-Frank Act.

[4] Office of the Comptroller of the Currency, Treasury ("OCC"), Board of Governors of the Federal Reserve System ("Federal Reserve Board"), Federal Deposit Insurance Corporation ("FDIC"), U.S. Securities and Exchange Commission ("Commission"), Federal Housing Finance Agency ("FHFA"), and Department of Housing and Urban Development ("HUD").

CMBS. Therefore, MBA supports the flexibility provided in the proposed rule and seeks additional, optional risk retention structures that meet the statutory risk retention requirement.

Unfortunately, as proposed, other elements of the proposed rule have the potential to severely curtail or shut down new issuance for the commercial mortgage-backed securities (CMBS) market and the private label residential mortgage-backed securities (RMBS) market.

For commercial real estate, the reduction or elimination of this important source of capital would have dire consequences. The lack of CMBS capital would likely increase borrowing costs and in some instances could prevent borrowers from refinancing their commercial or multifamily projects. For residential real estate, private label RMBS issuance could be stalled, which would memorialize the existing reliance on government guarantees for residential mortgages. Consequently, addressing the challenges in the proposed rule is important not just to the commercial, multifamily, and residential mortgage markets, but to the national economy.

Premium Capture Cash Reserve Account Proposal

A proposal that would be highly problematic for both the CMBS and RMBS markets is the Premium Capture Cash Reserve Account (PCCRA). We urge its elimination. The PCCRA calls for securitization profits to be placed into a separate account that would be placed in a first-loss position in the securitization structure. As proposed, we believe the PCCRA would be exceedingly disruptive to the CMBS market and effectively would remove the financial incentive to issue CMBS, potentially eliminating CMBS as a source of permanent mortgage capital for commercial and multifamily real estate borrowers. For RMBS, the PCCRA would effectively stall the return of the private label RMBS market.

Recommendations Specific to Commercial and Multifamily Real Estate

A vibrant and sound commercial and multifamily real estate ("CRE") market is integral to our nation's economy. The securitization market represents an important source of capital for CRE. At $575 billion[5], CMBS is the second largest source of outstanding commercial and multifamily real estate finance debt and represents 24 percent of total commercial and multifamily debt. Due to the tumultuous capital markets, CMBS issuance plummeted from $230 billion in 2007 to a total of $28 billion from 2008 through 2010.[6] With $30 billion of issuance in 2011, the CMBS market has started to strengthen. This fragile recovery of the CMBS market could be imperiled if the proposed rule is not properly implemented.

<u>Risk Retention Hold Period</u>**.** The CMBS market provides extensive and robust transparency with regard to the performance of underlying loans, which allows investors the opportunity to

[5] This number also includes collateralized debt obligations (CDOs) and other asset-backed securities (ABS) issuance.
[6] MBA Commercial Real Estate/Multifamily Finance, *Quarterly Data Book*, First Quarter 2012, p. 52.

determine loan performance and identify loans or securitizations that are not performing as expected. Accordingly, the required risk retention hold period should be three years for all risk retention holders, including issuers, originators, and first-loss B-piece buyers.

Third-Party Risk Retention. The Dodd-Frank Act specifically takes into account the critical role served by third-party purchasers of the first-loss, B-piece CMBS position. We support the role of the B-piece buyer serving the risk retention function and emphasize the importance of the economic viability of this structure, consistent with the statutory language. For example, MBA is concerned that if B-piece buyers must hold the risk retention portion of the securitization for the duration of the security, they would be reluctant to serve the risk retention role. This could result in only those CMBS issuers who have balance sheet risk retention holding capacity being able to issue CMBS.

Operating Advisor. The proposed rule calls for the appointment of an "Operating Advisor" with broad unilateral powers beginning at the inception of the securitization. In lieu of this proposal, MBA recommends a framework that would more effectively and efficiently serve the investor-protection objectives of the proposal. Specifically, a special servicer (affiliated with the third-party B-piece buyer fulfilling a risk retention role) would be required to provide enhanced disclosure of relevant information in one consolidated place that is maintained by an independent third-party source. In addition, governing documents would set forth a dispute resolution mechanism available for investors. Finally, the Operating Advisor's role should only begin when a "change in control event" occurs through the application of appraisal reductions and realized losses to a level specified by the CMBS loan documents.

Financing of Risk Retention Interests. MBA recommends allowing sponsors and third-party purchasers to use some financing to fund its risk retention position, including first-loss, horizontal "B-piece" interests. Prohibiting all such financing would limit the incentive to engage in securitizations and, in particular, reduce the number of third-party purchasers willing to assume the risk retention role and increase the cost of securitization (and ultimately, the cost to borrowers).

Underwriting Standards for Zero Risk Retention. As proposed, the underwriting standards for CMBS are so restrictive that a negligible percent (less than 1 percent) of existing CMBS loans would qualify for zero risk retention. Accordingly, MBA has provided regulators with recommended revised metrics for a low-risk loan and changes to the proposed rule that would make the standards consistent with long-held CRE lending practices, ultimately providing a more meaningful exemption under the low-risk loan statutory directive.

Recommendations Specific to Residential Real Estate and QRM

MBA supports efforts to enhance the accountability of all housing finance transaction participants including borrowers, lenders, securities issuers and investors. A risk retention requirement is an important step in establishing a better regulatory plan to protect borrowers and investors, and ensure a safe and reliable mortgage system. At the same time, it is essential that any risk retention requirements be done without unnecessarily constraining liquidity. Without a viable securitization market, the nation's housing finance needs cannot be met.

MBA believes that Congress' intent in crafting the Dodd-Frank Act's risk retention requirements was to address errant securitizer and originator behavior inherent in the originate-to-sell model by aligning the interests of borrowers, lenders and investors in the long-term performance of loans. This "skin in the game" requirement, however, is not a cost-free policy option. Recognizing these costs, the Dodd-Frank Act establishes an exemption from risk retention requirements for qualified residential mortgages (QRMs). By requiring a QRM exemption, the statute would keep consumer costs lower for QRMs, with higher costs for non-QRM loans. Congress has repeatedly expressed in statements and letters to regulators its belief that the QRM should be broadly defined.[7]

Below are recommendations for specific elements of the proposed rule that MBA has provided to the Agencies:

<u>Align QRM with QM.</u> The risk retention regulations should operate in concert with proposed regulations implementing the "Qualified Mortgage" (QM) definition under Dodd-Frank's "Ability to Repay" requirements. This section of the Dodd-Frank Act requires lenders to verify a consumer's ability to repay a mortgage.

<u>Loan-to-Value (LTV).</u> The rules should not hardwire a specific LTV amount, but instead permit offsetting factors in the context of prudent underwriting. Higher LTV loans may pose greater risks. However, these risks can be mitigated by compensating factors such as strong credit and appropriate documentation.

<u>Debt-to-Income (DTI).</u> In lieu of the QRM's hardwired proposed front-end and back-end DTI ratios, the final rule should instead require lenders to consider and verify a borrower's income, assets and obligations.

<u>Credit History.</u> The proposed rule's mandatory thresholds for individual negative credit events should be eliminated. This requirement may disproportionately penalize consumers for potentially minor offenses. Instead, lenders should be required to consider and verify credit history using widely accepted government or non-government standards.

<u>Risk Retention Duration.</u> The rule should provide for the sun-setting of risk retention requirements between two to three years from loan origination. Defaults due to improper

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[7] See for example Credit Risk Retention comment letter submitted by Senators Mary Landrieu, Kay Hagan, and Johnny Isakson (May 26, 2011) and comment letter submitted by Representative Tom Price (April 15, 2011).

underwriting or other defects typically occur during the first two years. Beyond that period, most defaults are caused by life events or other external economic circumstances.

Exempt Seasoned Loans. The rule should exempt seasoned loans from risk retention requirements. A loan seasoned for two to three years prior to securitization and current at all times during that period should be exempt from risk retention requirements.

Permit Commingled QRM and non-QRM Pools. The rule should permit blended pools of QRM and non-QRM loans that meet the QM definition. If a securitizer must wait until it has assembled a "critical mass" of QRM loans sufficient to support an MBS offering, the liquidity of these loans could be significantly impaired.

MBA believes that without substantial revisions, the proposed risk retention regulations will have a significant negative impact on credit availability and affordability for first-time, minority, low-to-moderate income homebuyers as well as others in the marketplace. While we endorse the promotion of safe and sound lending standards through the statutory QRM exemption, we urge that the proposed exemption be redrawn to more closely follow the parameters set by Congress.

OTHER ELEMENTS OF THE DODD-FRANK ACT

An element of the Dodd-Frank Act that is outside of risk retention but may require future legislative action is section 939A, which requires all federal agencies to remove reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness of a securitization. We understand that this provision was added to the Dodd-Frank Act because policymakers had concerns that structured security purchasers were overly reliant on ratings and did not perform adequate independent due diligence.

Unfortunately, the unintended consequences of section 939A have already been realized in the bank regulatory capital context. Specifically, the alternative to credit ratings that has been finalized for risk-based capital standards for market risk in the simplified supervisory formula approach (SSFA). This approach contains structural issues that can cause it to unfairly increase risk-based capital for structured securities, including CMBS.[8]

The SSFA is also part of the Basel III proposed rule that provides an updated regulatory capital framework for banks.[9] MBA would urge Congress to monitor the implementation of the SSFA and be prepared to take corrective action if the SSFA or other consequences of section 939A significantly harm the securitization market.

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[8] See MBA comment letter: Risk Based Capital Guidelines: Market Risk, Alternative to Credit Ratings for Debt and Securitization Positions, February 3, 2012.
[9] Basel III is comprised of three rules and can be accessed from the following website: http://www.federalreserve.gov/newsevents/press/bcreg/20120612a.htmut

In addition to the Dodd-Frank Act, there are far reaching proposed bank regulatory capital rules (such as Basel III), securitization rules (such as Regulation AB), as well as rapidly evolving financial accounting reporting rules that have combined to create regulatory uncertainty for financial institutions. The inability to quantify pending regulatory compliance costs and business operational changes has resulted in financial institutions retaining capital that could be more efficiently deployed in the private sector. Consequently, when implementing the Dodd-Frank Act, MBA would urge policy makers to be mindful of the aggregate compliance costs of new regulations, as well as the regulatory capital and financial accounting reporting regimes that financial institutions are and will be required to implement on a concurrent basis.

CONCLUSION

The proposed risk retention regulations are of the utmost importance to restoring a strong and stable housing market. MBA urges Congress to request the Agencies conduct a more substantive economic impact analysis and publish revised proposed regulations in order to give interested parties another opportunity to review and comment. MBA greatly appreciates the opportunity to provide the single family, commercial and multifamily perspectives on the impact of the Dodd-Frank Act.