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Dodd Frank QRM -Proposed Rules for Credit Risk Retention

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Amid the frenzy surrounding implementation of new Loan Officer Compensation rules, on March 29, 2011 the mortgage industry received the first of two major regulatory proposals issued in accordance with the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd Frank). The proposed rule is a first look at details of the hotly debated "skin-in-the-game" requirements included in Dodd Frank. Pursuant to these requirements "sponsors" of asset-backed securities must retain 5% of the credit risk associated with a security's collateral. In addition, Dodd Frank exempts certain types of securitization transactions from these risk retention requirements - among them, securities collateralized exclusively by "qualified residential mortgages." The proposal also sets forth definitions for such key terms as "qualified residential mortgage" with which the mortgage lending industry is particularly interested.

Importantly, the proposed risk-retention rules permit "securitizers" to allocate a portion of the credit risk which must be retained to the

originators of the securitized assets. Because this definition of "originator" refers to the person that creates a loan, only the original creditor of a loan (not a subsequent purchaser) is an originator for the purpose of this rule. As a result of the potential allocation of risk to original creditors, the mortgage lending industry has a vested interest in the final rules governing risk-retention requirements and should take the opportunity to review the proposal in its entirety and submit comments. Below are key points regarding the proposed definition of "Qualified Residential Mortgage" which, since no risk will be allocated to the originator of such assets, is of particular concern to creditors seeking to avoid risk-retention altogether.

Qualified Residential Mortgage (QRM)

- Dodd Frank requires the definition of QRM to be "no broader than" the definition of "qualified mortgage" set forth, ironically, in the later proposal issued on April 19, 2011, which will be the subject of a series of additional All Regs' articles.
- Since sponsors of asset-backed securities collateralized exclusively by QRMs will be exempt from risk-retention requirements entirely, the proposed definition is intended to ensure that such mortgages are of very high credit quality.

- Whether a residential mortgage is a QRM will be determined at or prior to origination of the mortgage loan. The proposal allows for modification of an individual QRM loan after securitization without jeopardizing the QRM status of the loan in order to promote appropriate loan modification.

- QRM eligible loans must be a closed-end first lien mortgage or refinance of a one-to-four family property (at least one unit must be the borrower's principal dwelling).

- A mortgage loan may qualify as a QRM only if the originator verifies and documents within 90 days prior to closing that the borrower satisfies the following credit history requirements: not currently 30 or more days past due on any debt obligation; not 60 or more days past due on any debt obligation within the preceding 24 months; and not a debtor in a bankruptcy proceeding, not subjected to property repossession or foreclosure, not engaged in a short sale or deed-in-lieu of foreclosure, and not subject to a federal or state judgment for collection of unpaid debts within the preceding 36 months.

- QRM eligible loans may not contain any of the following payment terms: terms allowing interest-only payments or negative amortization; any balloon payment; terms allowing the annual rate of interest to increase in excess of 2% (200 basis points) in any twelve month period and 6% (600 basis points) over the life of the mortgage transaction; and any prepayment penalty.

- QRM eligible loans' LTVs may not exceed a proposed ratio cap of 75% on rate and term refinances and 70% for cash-out refinances. For purchase transactions, the proposal requires borrowers to provide a cash down payment in an amount equal to at least the sum of: closing costs payable by borrower; 20% of the lesser of

estimated market value determined by appraisal or the purchase price; and if the estimated market value determined by appraisal is less than the purchase price, the difference between those amounts.

- A mortgage loan may qualify as a QRM only if the transaction is supported by a written appraisal that conforms to generally accepted appraisal standards, as evidenced by the USPAP, the appraisal guidelines of the federal banking agencies, and applicable laws.

- QRM eligible loans' front-end ratios may not exceed 28% and back-end ratios may not exceed 36%. Originators must verify and document a borrower's monthly gross income, monthly housing debt, and monthly total debt in accordance with the verification and documentation standards of the HUD Handbook.

- QRM eligible loans' total points and fees payable by the borrower in connection with the mortgage transaction may not exceed 3% of the total loan amount.

- QRM eligible loans may not be assumable by any person who was not a borrower under the original mortgage transaction.

- QRM eligible loans' documents must contain a provision obliging the creditor to have servicing policies and procedures to promptly initiate activities to mitigate risk of default on the mortgage loan and to take loss mitigation actions.

This proposed rule contains extensive additional provisions governing permissible methods for retaining required risk, treatment of government-sponsored entities, and additional proposed exemptions for other

types of securitization including an exemption for federally-insured or guaranteed residential, multifamily, and health care mortgage loan assets. Comments regarding this proposed rule must be received by June 10, 2011.

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