MORTGAGE BANKERS ASSOCIATION

October 14, 2014

Moody's Investors Service, Inc.
7 World Trade Center
at 250 Greenwich Street
New York, NY 10007
(Request for Comment Page on www.moodys.com)

Re: *Moody's Updated Approach to Rating US Prime RMBS*

To Whom It May Concern:

The Mortgage Bankers Association (MBA)[1] thanks Moody's Investors Service, Inc. (Moody's) for the opportunity to review and comment on *Moody's Updated Approach to Rating US Prime RMBS* (Proposed Approach). The following are MBA's overarching comments related to the representation and warranty framework and then some additional general comments on the Proposed Approach.

Representations and Warranties

Comments on R&W Section of Moody's Proposed Revisions

While not directly related to credit, representations and warranties (R&W) nevertheless serve to clarify the rights and responsibilities of each party to the RMBS transaction. This provides comfort to investors that the underlying deal structure will perform as promised. When calibrated correctly, R&W are a powerful foundation that reduces uncertainty and ensures all parties' incentives are aligned.

MBA has some concerns, however, with specific provisions in Moody's proposed R&W analysis. These concerns are reflected below.

Property Valuation

[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, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

Moody's treats as credit neutral a property valuation R&W that meets "customary Fannie Mae or Freddie Mac standards" as well as Uniform Standards of Professional Appraisal Practices (USPAP) standards. By implication, it appears that R&W which limit in any way the application of GSE standards will be viewed negatively. MBA believes this is a mistake because there is substantial uncertainty in how the GSEs enforce their appraisal practice standards. In fact, uncertainty around appraisal practices and enforcement has been a significant driving force behind MBA's efforts, along with FHFA and the GSEs, to reform the GSE R&W framework to provide greater clarity.

There is similar uncertainty surrounding the R&W that the selected appraiser "met Fannie Mae's and Freddie Mac's criteria for selecting an independent appraiser." Left unstated is how parties should account for the GSE exclusion list. The GSEs maintain an active record of vendors, including appraisers, with whom they will not work, regardless of whether the vendor meets the objective criteria. However, this document is not transparent and is largely inaccessible to third parties. Thus, if Moody's is going to include this as a credit neutral R&W, it should specify how the GSE exclusionary list is to be considered, if at all.

MBA is generally concerned by the deference given to GSE standard practices because those practices are subject to significant GSE discretion. MBA believes it would be better to rely on objective, transparent standards. If Moody's decides to rely on GSE standards, MBA recommends relying on the Guides alone and explicitly reject incorporating GSE practices into its R&W model.

Early Payment Default Provision

Moody's R&W framework would set as the credit neutral policy a provision that requires the sponsor to automatically repurchase a loan that becomes delinquent within the first three months following origination. MBA strongly recommends that this provision be altered due to the significant costs it would impose when viewed in light of Basel III. Basel III requires banking organizations to hold risk-based capital against credit-enhancing representations and warranties at a 100% risk-weight. This would require banks to hold capital against these exposures for the period in which a mortgage is subject to the early payment default provision, imposing significant costs on lenders and reducing the availability and affordability of housing finance.

Data

Under the data R&W provisions, Moody's framework would have sponsors identify whether or not a loan was QM, and for QM loans, identify the type of QM (general or GSE patch) and whether the loan was safe harbor or rebuttable presumption. MBA believes this segmentation of QM is unnecessary because investors will already have the information necessary to make the determination themselves. Under Reg AB, RMBS issuers will be required to disclose detailed, loan-level information to investors. While private offerings are not currently subject to the recent Reg AB amendments, it is likely they too will be accompanied by significant loan-level disclosures that investors can review and price.

It is unnecessary to require sponsors to separately identify the QM-status of a loan. Because there can be overlap among categories (for instance, many "temporary patch" QM loans would also be QM loans without the patch), requiring identification provides investors with little value that is not otherwise provided in the securities disclosures, but subjects the issuer to potential liability. MBA recommends that Moody's eliminate this Rep.

Mortgage Insurance

Item 8 in the R&W framework refers to primary mortgage insurers that are "acceptable" to the GSEs. MBA urges Moody's to clarify this provision because the term acceptable is ambiguous. If it is intended to mean "approved," Moody's should alter the language accordingly.

Using the term "acceptable" is confusing because there are no separate "acceptability" requirements for the GSEs beyond the general approval guidelines. In the event Moody's intends for this to incorporate some lesser portion of the GSE approval guidelines, MBA believes that should be made clear.

Moody's should also re-evaluate this item in light of the recently released private mortgage insurer eligibility requirements (PMIERs). PMIERs set strong capital requirements for MIs seeking to write business on loans owned or guaranteed by the GSEs. However, the PMIERs also have many provisions that will likely result in many MI firms focusing their business entirely in the GSE space. Thus, it is possible for an MI to be operating consistent with the PMIERs capital requirements but otherwise not be approved by the GSEs. In light of this ambiguity, MBA believes Moody's should clarify this provision.

Borrower

Item 11 sets as a credit neutral condition that the borrower is a natural person. MBA notes that many loans are made to *inter vivos* trusts organized for the benefit of a natural person, and that such loans are eligible for GSE purchase or guarantee. MBA believes the current rep, as drafted, is too narrow and should be expanded.

Other General Comments

Proposed Aaa Scenario Is Too Harsh

The Aaa Scenario is that portion of the Proposed Approach that determines the level of subordination required to support the Aaa tranches. In that scenario, Moody's assumes that national home prices will decline 30 percent over a 30 month period and then increase back to levels at the time of the analysis by month 180 (15 years). Depending on the geographic concentrations, they may assume a 30 to 60 percent decline. The Aaa scenario further assumes a 5 percent linear increase in unemployment levels over a 30 month period and then dropping back to the unemployment rate at the time of the analysis by month 180 (again – 15 years).

MBA believes the assumed duration of the real estate price shock is too severe. During the recent "Great Recession," real estate prices dropped by 22 percent[2], and six years later we are only 6 percent behind the peak values. It would make more sense to have a shorter duration recovery – like eight to ten years with significant recovery in years three through six.

MBA also believes that Moody's and the investor community may be better served by a more granular shock scenario with respect to real estate price shock. For example, the hardest hit areas during the Great Recession were in the "sandbelt states" where prior to the downturn, real estate price inflation far exceeded nationwide price inflation and far exceeded general price inflation. The second hardest hit areas were areas that were under broadspread economic stress like the "rustbelt" areas. MBA believes that the stress test should take into account real estate appreciation relative to overall price inflation as well as economic areas like the "rustbelt" where unemployment shocks may be more significant.

Cumulative Affect of Layering of Negative Assumptions

MBA notes that the Proposed Approach seems to layer risk upon risk without taking into account countercyclical forces. For example, on page 11 the Proposed Approach assumes that interest rates will remain flat in a recession when it is highly probable that the Fed will work to reduce interest rates. Lower interest rates would certainly allow for higher prepayments or for loan modifications to lower, more affordable rates – thus reducing the probability of default. MBA believes that these major countercyclical forces need to be taken into account in Moody's model including the shock scenarios.

Likewise, on page 11 Moody's presumes that the quality of underwriting represents approximately the median standards expected over the long term. It states, "By comparison the current underwriting environment is likely stronger than the environment in the data used to calibrate the model." MBA believes that the new Ability to Repay rules and other controls put in place after the Great Recession will continue to favorably influence the underwriting and documentation standards. Thus, this "sandbagging" of the assumptions throughout the model all head in the same direction. Moody's underwriting assumption is layered on top of the harsh, long duration recovery assumptions and on top of a flat interest assumption. This layering of negative assumptions without regard to mitigating factors will likely lead to a worse case beyond any historical events or scenarios.

[2] According to the FHFA index. The Case Shiller index is more volatile and showed a 30 percent drop.

Possible Impact on Credit Availability

Since 2008, Congress, bank regulators, housing regulators, and others have promulgated laws, rules and regulations that individually seem appropriate. Further, efforts by FHA, Fannie Mae and Freddie Mac to require originators to repurchase loans for minor violations have resulted in significant costs and penalties to originators. This layering of laws, rules and regulation coupled with harsh enforcement of reps and warranties has created an environment where lenders are creating credit overlays and taking other defensive measures in order to minimize risk. The rating agencies were harshly criticized during the recent crisis, and the assumptions in their new models are an overeaction – adding another layer that may impede credit availabilty to creditworthy borrowers. As Moody's reviews responses from market participants to its Proposed Approach, we ask that Moody's question whether their assumptions have gone too far and may further tighten credit overlays, putting homeownership out of reach for otherwise creditworthy borrowers.

Barriers to Entry

We note on page 4 of the Proposed Approach, Moody's states. "… we generally supplement the portfolio analysis with assessments on (1) originator, (2) servicer, and (3) data quality. We generally do not include these various assessments in our analysis for frequent issuers whose origination and servicing processes have not changed." If those assessments indicate nothing wrong with the seller, servicer or data quality, will the new player's securitization get the same level of subordination as a frequent issuer, if the portfolio analsys is identical? If not, MBA objects to what would end up being a barrier to entry for new players in the market.

Benchmark Loan Property Value

Page 15 (Item K) of the Proposed Approach states, "Milan model generally decreased the PD for property values greater than the benchmark loan property value. The value of the property securing the mortgage at origination correlates negatively with probability of default; that is, higher-priced homes tend to have a lower probability of default. Given prudent underwriting standards, lenders grant loans for more valuable property to borrowers with higher income and more assets. These borrowers will typically have greater means to make mortgage payments." Page 12 indicates a benchmark property value of $300,000.

MBA notes that all loans should be underwritten such that the borrower has the ability to repay under the Dodd-Frank Act and resulting rules. If this benchmark property value assumption is based upon historic information, MBA notes that new underwriting, documentation and product standards will significantly reduce probability of default when compared with historic trends. MBA asks that Moody's re-visit this algorithm so that the model does not discriminate against borrowers in low income or rural areas of the country or against first time homebuyers.

Interest Rate Spread As a Strong Indicator of PDs

Page 3 of the Proposed Approach indicates, "The interest rate that a lender charges a borrower is a strong indicator of risk…" It further states, "A higher credit spread at the time the mortgage rate was locked in signals an increase in the borrower's [probability of default]." MBA believes that this is true but it might be tough to discern unless buy up and buy down charges are taken into account. Likewise, the interest rate spread could be indicative of other factors already taken into account in the model like occupancy, documentation type, LTV, FICO score etc. This is another possible example of the "one way street" phenomenon that MBA describes in its overarching comments above.

Deriving the Portfolio EL

Does Moody's perform a true "like-to-like" analysis? Are jumbo loans today correlated to the experience of similar jumbo collateral of yesterday? Are the FICO scores, LTVs, loan types, level of documentation, DTI's and other factors comparable? Or, do the reference portfolios consist of loans underwritten prior to 2008 which contain significantly different risks coupled with a layering of risks during that period? Further, MBA would like to know if Moody's has back-tested the Proposed Approach against prior deals (from vintage years 2006-2007, for example) and compared "realized performance" against the projected results from the Proposed Approach? MBA believes that this would be an effective way to calibrate the model. In light of MBA's observations in comments above titled *Proposed Aaa Scenario Is Too Harsh* and *Cumulative Affect of Layering of Negative Assumptions,* MBA recommends that Moody's should make sure that its testing and calibration of the model are appropriate in the circumstances.

MBA appreciates the opportunity to comment on the Proposed Approach. Any questions concerning these comments should be addressed to Jim Gross at jgross@MBA.org or 202-557-2860 or Dan McPheeters at dmcpheeteres@MBA.org or 202-557-2780.

Sincerely,

David H. Stevens
President and Chief Executive Officer