

AMERICAN BANKERS ASSOCIATION

STATEMENT FOR THE RECORD

**CAPITAL MARKETS SUBCOMMITTEE OF THE HOUSE FINANCIAL SERVICES
COMMITTEE**

HEARING ON PROPOSED RISK RETENTION RULES

APRIL 14, 2011

The American Bankers Association is pleased to submit the following statement for the record for the Capital Markets Subcommittee hearing on proposed new risk retention rules required under Section 941 of the Dodd/Frank Act.

The ABA believes that the newly proposed rules are significantly flawed and are likely to drive many community banks out of mortgage lending if widely applied.

The housing and mortgage markets have been battered in recent years and are still struggling to recover. Addressing the systemic problems which led to the crisis is critical, but care must be taken to avoid unnecessary actions that do not address systemic issues and which could further destabilize the fragile recovery. *We have grave concerns that the risk retention proposal recently issued by the regulators will drive community banks from mortgage lending and shut many borrowers out of the credit market entirely.* It is true that the proposal's immediate impact is muted by the fact that loans sold to Fannie Mae and Freddie Mac while they are in conservatorship escape risk retention. However, once the rule's requirements are imposed broadly on the market (should they be adopted) they would shut out many borrowers entirely and act to destabilize an already fragile market. Since it is also the stated goal of both the Congress and the Administration to end the conservatorship of Fannie and Freddie, it is important that risk retention requirements be rational and non disruptive when they are applied broadly to the market. The rule as proposed does not meet those tests.

Therefore, ABA urges Congress to ensure that the regulators revise the risk retention regulation before it is imposed on the mortgage market broadly. Specifically we recommend:

- *Exemptions from risk retention provisions must reflect changes in the market already imposed through other legislative and regulatory change.*

In the Dodd-Frank Act, Congress determined that some form of risk retention was desirable to ensure that participants in a mortgage securitization transaction had so-called “skin in the game.” The goal was to create incentives for originators to assure proper underwriting (e.g., ability to repay) and incentives to control default risk for participants beyond the origination stage. There have already been dramatic changes to the regulations governing mortgages.¹ The result is that mortgage loans with lower risk characteristics – ***which include most mortgage loans being made by community banks today*** – should be exempted from the risk retention requirements – regardless of whether sold to Fannie Mae and Freddie Mac or to private securitizers. Exempting such “qualified residential mortgage” loans (QRM) is important to ensure the stability and recovery of the mortgage market and also to avoid capital requirements not necessary to address systemic issues. However, ***the QRM as proposed is very narrow and many high-quality loans posing little risk will end up being excluded. This will inevitably mean that fewer borrowers will qualify for loans to purchase or refinance a home.***

For example, for the loan to qualify, borrowers must make at least a 20 percent down payment – and at least 25 percent if the mortgage is to be a refinance (and 30 percent if it is a cash-out refinance).

Certainly loans with lower loan-to-value (LTV) ratios are likely to have lower default rates, and we agree that this is ***one*** of a ***number*** of characteristics to be considered. However, the LTV should not be the ***only*** characteristic for eligibility as a “Qualified Residential Mortgage,” and it should not be considered in isolation. Setting the QRM cutoff at a specific LTV without regard to other loan characteristics or features, including credit enhancements such as private mortgage insurance, will lead to an unnecessary restriction of credit. To illustrate the severity of the proposal, even with ***private mortgage insurance***, loans with less than 20 percent down will ***not*** qualify for the QRM.

ABA strongly believes that creating a narrow definition of QRM is an inappropriate method for achieving the desired underwriting reforms intended by Dodd-Frank.

¹ For example, changes have been made under the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA), and the Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act. In addition, the federal bank agencies have just announced significant changes to appraisal standards.

- ***The Risk Retention Requirements as proposed will inhibit the return of private capital to the marketplace and will make ending the conservatorship of Fannie Mae and Freddie Mac more difficult.***

The proposal presented by the regulators will make it ***vastly more difficult to end the conservatorship of Fannie and Freddie*** and to ***shrink FHA*** back to a more rational portion of the mortgage market. As we observed earlier, under the proposed rule, loans with a federal guarantee are exempt from risk retention – including loans sold to Fannie Mae and Freddie Mac while they are in conservatorship. Because of their conservatorship status, the GSEs have the backing of the federal government. FHA loans (as well as other federally insured and guaranteed loan programs) are also exempt. Since almost 100 percent of new loans being sold today are bought by Fannie and Freddie or insured by FHA – and as long as these GSEs can buy loans without risk retention – it will be dramatically more difficult for private securitizers to compete. In fact, the economic incentives of the proposed risk retention strongly favor sales of mortgages to the GSEs in conservatorship and not to private securitizers. Thus, this proposal does not foster the growth of private label securitizations that would reduce the role of government in backing loans.

Equally important is the fact that the conservatorship situation is unsustainable over the long term. That means that eventually these highly narrow and restrictive rules would apply to a much, much larger segment of the mortgage market. That means that fewer borrowers will qualify for these QRM mortgage loans and the risk retention rules make it less likely that community banks will underwrite non-QRM – ***but prudent and safe*** – loans. Some community banks may stop providing mortgages altogether as the requirements and compliance costs make such a service unreasonable without considerable volume. Driving community banks from the mortgage marketplace would be counterproductive as they have proven to be responsible underwriters that have served their borrowers and communities well.

The imposition of risk retention requirements to improve underwriting of mortgage loans is a significant change to the operation of the mortgage markets and must not be undertaken lightly. ***ABA urges Congress to exercise its oversight authority to assure that rules adopted are***

consistent with the intent of the statute and will not have adverse consequences for the housing market and mortgage credit availability.

There are other related concerns affecting housing that need to be addressed by Congress as well. In particular, Congress needs to make the “Qualified Mortgage” in Title XIV a true safe harbor and ensure that it does not unnecessarily constrict credit. Title XIV of Dodd-Frank sets out new consumer protections for mortgage loans. As defined in Title XIV, a Qualified Mortgage (QM) is one which has specific features and is underwritten in such a way that it is presumed to meet these consumer protection standards. That presumption, however, can be rebutted – subjecting the lender to significant potential liability. The Qualified Mortgage definition (as set in statute and as refined through regulation) also serves as a limitation on the Qualified Residential Mortgage (QRM) standard discussed above because the QRM cannot be broader than the QM. As the law stands now, the Federal Reserve Board (and eventually the CFPB after the transfer of powers) can unilaterally narrow both the QM and QRM.

To avoid inadvertent and unintended impacts on safety and soundness as well as credit availability, ABA strongly urges Congress to require that any changes which could narrow the eligibility requirements for the QM be undertaken jointly with the regulators responsible for determining eligibility under the QRM.