Testimony of

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Hearing on

“The Impact of Dodd-Frank’s Home Mortgage Reforms: Consumer and Market Perspectives”

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Chairman Capito, Ranking Member Maloney, and other members of this Committee, thank you for inviting me here to testify at today's important hearing. I have been asked to discuss the Securities Industry and Financial Markets Association's ("SIFMA")[1] views on the so-called "Qualified Mortgage" rulemaking proposal, and am pleased to do so. Our views on the proposal were developed by our diverse membership, which includes financial institutions that act as residential mortgage originators, securitization sponsors, broker-dealers that act as underwriters, placement agents, market makers and asset managers that include some of the largest, most experienced investors in residential mortgage-backed securities ("RMBS") and other structured finance products. SIFMA has been an active participant in this rulemaking[2] and will continue to advocate for a sensible outcome.

As you know, the Federal Reserve Board of Governors ("Board") proposed a set of rules to implement the ability-to-repay requirements found in Title XIV of Dodd-Frank on April 19, 2011. The authority of the Board in this area was transferred to the Consumer Financial Protection Bureau ("CFPB") in June 2011, and it will be the CFPB that will finalize the rulemaking later this year. The concept of a "qualified mortgage", or QM, was embedded in the statutory language of Title XIV and will be implemented by the CFPB through its regulations.

Title XIV of Dodd-Frank amends the Truth in Lending Act ("TILA") to prohibit creditors from making mortgage loans without regard to the consumer's repayment ability. Consistent with the Act, the proposal provides four options for complying with the ability-to-repay requirement.

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] See "SIFMA Submits Comments to the Federal Reserve on Proposed Changes to Regulation Z and the Definition of Qualified Mortgage" (July 22, 2011) available here: http://www.sifma.org/issues/item.aspx?id=8589934840, and "SIFMA Submits Comments to the CFPB on Qualified Mortgage Regulation" (April 30, 2012) available here: http://www.sifma.org/issues/item.aspx?id=8589938566.

1. Origination of a mortgage loan for which the lender considers and verifies eight underwriting factors (including expected income or assets, debt-to-income, credit history) to determine repayment ability assuming application of the fully indexed rate.
2. Origination of a “qualified mortgage” which provides special protection from liability under the Act.
3. Refinancing a “non-standard mortgage” into a “standard mortgage” (i.e., a mortgage that does not contain negative amortization, interest-only payments or balloon payments and has limited points and fees).
4. Origination of a balloon-payment qualified mortgage by a small lender operating predominantly in rural or underserved areas.

SIFMA’s primary focus in consideration of this topic relates to the ability of secondary market participants to provide funding for mortgage credit; this is critical, as over 90% of mortgage credit is currently funded through these markets. SIFMA’s goal is to ensure that the final rules maintain capital flow to the residential mortgage market and maintain the flow of affordable credit to qualified American consumers.

For the purposes of this hearing, focus should be drawn to the first two items above. In our view, the vast majority of future mortgage lending is likely to comport with the guidelines established by the QM definition. Due to liability, supervisory, reputational, and other concerns, we do not expect significant origination of non-QM loans. Thus focus has correctly been on the establishment of the definition of the QM.

SIFMA is very concerned that the QM regulations may be constructed in a narrow manner with parameters that will not allow for the certainty of compliance at origination. Our members believe such an outcome would restrict the availability of credit, through increased costs and restrictive underwriting, and would be detrimental to consumers.

We will address two key points in this testimony: (1) the parameters of the qualified mortgage definition must be scaled broadly, as opposed to narrowly, as QM loans will be the predominant source of widely available mortgage credit; (2) due to the risk of liability inherent in non-QM lending, the parameters of the definition must provide clear, bright lines, and a safe harbor for compliance.

1. ***Broad vs. Narrow: Mainstream Institutions Will Operate Only Within the Bounds of the QM***

SIFMA and its members strongly support the concept that lenders should determine if borrowers have an ability to repay their loans before they extend credit. Discussions with our members have made clear that the liability attendant to the failure to adequately determine such ability to repay will result in the parameters of the qualified mortgage definition, when finalized, broadly determining the availability of affordable mortgage credit. We expect that any limited lending outside of the confines of the QM definition will be performed at far greater cost to the consumer, and due to a variety of reasons, be more likely to be provided by less regulated, less well-capitalized, and possibly less reliable entities. Further, the mortgage credit products that may be offered outside of the QM parameters will likely have little appeal in secondary markets, suggesting lower consumer benefits (e.g., accessibility, transparency, affordability, and prudential terms). This makes clear the need for the creation of a broader, as opposed to narrower, definition of a QM.

As a threshold matter, the ability to repay provisions of Title XIV of Dodd-Frank were not intended to outline the parameters of mortgage lending for the most creditworthy borrowers; that is the purpose of a provision within the risk retention statute that exempts Qualified Residential Mortgages (QRMs) from those requirements.[3] Indeed, *the ability to repay provisions impose a requirement on lenders to*

[3] The QRM provisions of Dodd-Frank were intended to provide a specific, preferential treatment for higher credit quality loans. QRM was intended to create a smaller group of loans which represent higher credit quality to lenders, and for which risk would not need to be retained in securitizations. The ATR provision, on the other hand, was intended to outline a path for lenders to

determine an ability to repay on virtually every residential mortgage loan, and the QM definition is intended to define steps needed to show compliance with the ability to repay (ATR) requirement. ***Thus QM should broadly outline the parameters of responsible lending.***

Defining QM to encompass the conventional mortgage market will not result in lenders ignoring a borrower's repayment ability when underwriting a loan. The ATR analysis required by the statute and a responsible underwriting analysis are related, but separate. The analyses are related because many of the statutory factors of the ATR test—consideration and verification of current and expected income, obligations and DTI ratios—are important parts of a responsible underwriting analysis that lenders employ for all loans. However, the analyses are separate because the ATR test is a compliance matter, while a complete underwriting analysis is done to ensure safety and soundness and to meet investor demands. It is entirely possible that an underwritten loan consistent with acceptable underwriting practices will be determined by the courts to not meet the ATR requirements. Thus, defining QM broadly will create compliance guideposts for lenders that want to lend responsibly.

We are aware of the contention that a narrower definition of QM will not be disruptive because lenders and secondary markets will be comfortable operating outside of the protections afforded by a QM, possibly with a reasonable pricing premium for those loans. Such predictions contradict feedback from our member firms, and we believe the CFPB would be ill-advised to implement QM rules in accordance with these views. History has shown that loans that carry with them significant or uncertain liability are simply not made, or are made with a significant pricing premium, which restricts the availability and affordability of those loans. Accordingly, we believe that lenders will respond to the liability risk through very restrictive underwriting guidelines, or significant pricing premiums, or both. These actions will result in less available credit to borrowers who would have otherwise received it had the boundaries of QM

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determine a borrower's repayment ability. The QM provision was intended to be an incentive for lenders to avoid the most risky loans and products after determining a borrower's repayment ability.

been drawn more broadly. Likewise, secondary market participants will take steps to avoid or price the risk of assignee liability; this will also make loans more expensive and less available.

It is clear that the risk of liability will increase costs to consumers of non-QM loans – but SIFMA does not see a compensating benefit in a narrow QM definition. While a non-QM borrower may have more opportunity to challenge the origination of the loan, the loan may have riskier terms than permitted by a QM, will be significantly more expensive, and harder to obtain. Secondary market investors would likely demand risk-adjusted yield above what would likely be affordable for many borrowers. At the same time, non-QM borrowers would not receive significantly greater protections in the underwriting process than QM borrowers because the requirement to determine ability to repay applies to all loans. If reputable lenders are reluctant to bear the risk of liability for these loans, and secondary markets are reluctant to purchase them, there will be few avenues for their responsible production. For these reasons, we believe that the CFPB should implement broad, but sensibly structured parameters for the determination of a QM.

2. ***Bright Line Standards and a Safe Harbor Will Promote Responsible Lending; Uncertainty of Compliance will Constrain Responsible Lending***

Given the impact of assignee liability discussed above, SIFMA believes it is critical that the final rules provide for certainty of compliance with ability to repay requirements. The Board's proposal provided two options regarding assurance of compliance: a rebuttable presumption of compliance, and a safe harbor for compliance. ***SIFMA believes that consumer credit availability would be best protected through a safe harbor.*** The proposed rebuttable presumption approach could inhibit a lender's certainty of its compliance, and effectively call the compliance of many loans into question after-the-fact. Because of this lack of certainty, a rebuttable presumption may cause lenders and secondary market investors to implement standards conservatively, as an overlay comfortably within the bounds of the QM definition. Such an overlay on QM guidelines would be similar in nature to the overlay some

lenders place on Federal Housing Administration or Government Sponsored Enterprise minimum standards due to repurchase risk. Borrowers with credit profiles within but close to the edges of QM would be impacted, as credit availability under such a regime will be narrower than what was intended or envisioned by the CFPB.

Regardless of whether or not a safe harbor is provided, clear QM standards are paramount. Lenders and investors must be able to know at the time of origination whether the loan meets the QM standards. The standards that define QM compliance must be clear, objective, and verifiable. The secondary market for mortgage loans and the securitization markets will *require* verification of the QM status before a pool of loans is purchased or securitized. Not only must lenders represent and warrant that their lending practices comply with their underwriting guidelines, but also that their lending complies with all applicable laws and regulations, including the ability to repay rules. Subjective compliance standards will require increasingly costly due diligence efforts, will increase repurchase risk, and will reduce the value of loans in the secondary markets. Vague standards for QM could lead to secondary market investors imposing their own more objective requirements well within the bounds of QM to assure compliance with the standards. In other words, ***if bright lines are not implemented in the final rule, borrowers will pay more for their loans and have a harder time obtaining them.*** Objective standards will promote the legal certainty that is essential for lenders and their assignees to effectively price the mortgage loans in a manner that creates affordable outcomes for borrowers. [4]

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[4] While SIFMA is still considering this issue more fully, we express further concern about the compliance and examination process to be employed by CFPB in the context of our discussion of bright-line standards. It is imperative that the ability to repay and QM rules be based on clear and objective standards, so that judgments of compliance or non-compliance may be based on similarly objective tests. If the CFPB's regulatory examination process is other than fully objective, the subjective guidance to field examiners will result in differential application of the regulations, resulting in a functional morphing of the regulations that could negate the critically necessary assurance of compliance we discuss above.

We hope this testimony is helpful in focusing attention on what we view as two of the most critical aspects of the QM rulemaking from the perspective of the ability of the secondary markets to fund mortgage lending. Because QM will essentially define the scope of mortgage lending, it must be drawn in a responsible but broadly inclusive manner. It also must be drawn with objective, verifiable criteria, so that secondary market purchasers can avoid unexpected liability for loans they purchase in whole loan or securitized form.

Thank you.