THE REPUBLICAN STUDY COMMITTEE

Financial Services Working Group

Congressman Jim Jordan (R-OH), RSC Chairman
Congressman Randy Neugebauer (R-TX), FSWG Chairman
Congressman Jim Renacci (R-OH), FSWG Vice-Chairman

WEEKLY UPDATE

June 24, 2011

In This Newsletter:
- Housing Finance Reform: QRM?
- To amend the Federal Deposit Insurance Act to replace the Director of the Bureau of Consumer Financial Protection with the Chairman of the Board of Governors of the Federal Reserve System as a member of the Board of Directors of the Federal Deposit Insurance Corporation (Rep. Rennacci)

Housing Finance Reform Proposal: QRM?

On Tuesday, May 29th 2011, as part of the Dodd-Frank rulemaking, regulators proposed a rule which imposed stricter standards on the private mortgage industry and shift more business toward the federal government. Rep. John Campbell on May 31st wrote a letter, supported by over three hundred bi-partisan Members of Congress to have this rule rewritten.

What is QRM?

Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 includes language establishing standards for a Qualified Residential Mortgage (QRM). QRM refers to the rule that regulators have proposed, and the rule requires a 20% down payment and strict loan to value (LTV) and debt to income (DTI) ratios to qualify as a QRM loan. Loans outside the QRM would be subject to risk retention and most likely higher rates. This proposal would reduce the availability of affordable mortgage capital for otherwise qualified consumers.

Background on QRM?

The QRM is part of a risk-sharing provision in the Dodd–Frank financial regulation bill that requires lenders to do a better job of underwriting mortgages. Under the old system, lenders and brokers received a fee for writing a loan and another fee for selling it to underwriters, who included it in mortgage-backed securities. Since their income came from the fees, these brokers and lenders had no further interest in the loan and found they could maximize their income by making dozens of loans, regardless of whether the borrowers had any ability to repay the mortgages. The flood of bad mortgages caused billions of dollars in losses to homeowners, lenders, and investors.

Congress responded by including a risk-retention rule that would require the creators of mortgage-backed securities to retain 5 percent of the pool. Since they would share in any losses, legislators felt that this would encourage securitizers to ensure that the mortgages they buy meet good credit standards. As a further incentive to quality underwriting, securitizers would not be required to retain a 5 percent share of securities that meet specific minimum credit standards defined in the QRM regulations. Lenders and securitizers will be exempt from retaining 5% of the risk only on mortgages that meet the QRM standards. However Fannie Mae, Freddie Mac and the Federal Housing Administration would be exempt from having to meet these standards. **Some Conservatives argue that the proposed rules would drastically expand Fannie Mae, Freddie Mac and the Federal Housing Administration shifting more buyers toward government backed loans.**

Many conservative have argued that the risk retention rules from day one of Dodd-Frank enactment was a step in the wrong direction because the law did not do anything to reform the entities that contributed to the problem. Peter Wallison of AEI writes, "the principal error of the act's sponsors—in common with many on the left—was to see the decline in mortgage underwriting standards and the buildup of weak mortgages in the financial system as the result of greed among originators and securitizers, abetted by lax or nonexistent regulation. In this view, mortgage originators and securitizers—by making and distributing subprime and other risky loans—drove the growth of a housing bubble full of low-quality loans, eventually causing the 2008 financial crisis… if the purpose of the risk-retention requirements is to encourage better-quality mortgages by requiring securitizers to take on a portion of the risk they are securitizing, Fannie and Freddie—which guarantee 100 percent of the promised payments of principal and interest on the pooled mortgages—were already taking 100 percent of the risk. As a policy matter, however, **this decision is disastrous and inconsistent with the purported objectives of the act**. It creates another even larger FHA-type incentive for originating low-quality, non-QRM mortgages. Again, as in the years leading up to the financial crisis, Fannie and Freddie could become a conduit for weaker and weaker mortgages and will be required by Congress to take on greater risk. Eventually, as they are today, they will become another source of bailout costs for taxpayers." The Treasury Department signaled on Friday, June 24th, 2011, that regulators might draw back on the risk-retention proposal in search of common ground with industry and consumer groups, it remains to be seen how this final rule will unfold.

Rep. Renacci Seeks Co-Sponsors To Amend the Federal Deposit Insurance Act to Replace the Director of the Bureau of Consumer Financial Protection with the Chairman of the Board of Governors of the Federal Reserve System as a Member of the Board of Directors of the Federal Deposit Insurance Corporation

The bill would replace the CFPB Director with the Chairman of the Fed on the Board of the FDIC. Under Dodd-Frank, when the OTS is merged with the OCC, the CFPB Director will fill the vacant slot on the FDIC Board, despite having no mission for institutional safety and soundness. Removing the CFPB Director from the FDIC's board will also take away any actual or perceived conflict of interest that exists with the FDIC Chair's role on the FSOC to review CFPB rulemakings. The FDIC should be focused on safety and soundness, and the FSOC should be able to conduct meaningful oversight and review of CFPB rulemakings, free from conflicts of interest. In the words of the Ohio Bankers League, "other than the Durbin amendment, having the consumer czar on the Board of a safety and soundness agency is the second-worst idea in a huge bill full of bad ideas."

Question or comments regarding RSC Financial Services Working Group items should be directed to Ja'Ron K. Smith, Ja'Ron.Smith@mail.house.gov.