What Was the Legislative Intent Behind the QRM?*

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One of the often repeated allegations made after the collapse of the housing markets in 2008 was that the securitization led to the poor underwriting witnessed during the housing boom years. It soon became conventional wisdom that mortgage securitization was at fault because the mortgage lender did not have "skin in the game," and therefore was willing to write loans based on inflated statements of income and without necessary documentation. As a result, Congress included in the Dodd-Frank Act an amendment to the Securities Exchange Act of 1934 that requires securitizers to retain a 5 percent interest in the credit risk of assets that are sold into a securitization. The percent of risk retention can be changed by the regulators, and the regulators are given flexibility in implementing this requirement. In addition, the agencies are directed to jointly define a "qualified residential mortgage" or "QRM" that would be exempt from the risk retention requirement.

In March of this year, the regulatory agencies published a proposed regulation pursuant to which the QRM was given a very narrow definition. Qualified residential mortgages would require a substantial down payment — 20 percent of the purchase price — borrowers would have to have a pristine credit history and would have to meet tough debt to income ratios. The regulators explained that the legislative intent behind the QRM was for it to be a very narrow exception to the risk retention requirement, and that the general rule was that mortgage securitizations would be subject to the risk retention mandate. The regulators also explained that by having a stringent test for the QRM, it would leave a large number of well underwritten loans outside of the QRM basket, and thereby would enable a private secondary market to develop that would securitize these non-QRM mortgages.

The publication of this proposal created a storm of opposition from mortgage lenders, real estate agents, consumer groups, civil rights groups and others who protested that non-QRM loans would be more costly, and would

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have a disproportionate adverse impact on first-time homebuyers, on minorities, and on low- and moderate-income families that could afford mortgages under traditional standards, but would now be shut out of the market. These groups argued that the legislative intent was for a broad QRM that would cover a large swath of creditworthy borrowers, but that the QRM would exclude the loan products that were at the root of the mortgage failures, such as no-doc and low-doc loans, interest only loans, and loans with negative amortization.

In light of this debate about the legislative intent behind the QRM, I decided to look at the relevant documents myself, to see if I could determine the motivation behind this exemption based on the legislative history of the Dodd-Frank Act. I found that the pre-enactment legislative history was very clear. Congress was seeking a broad exemption that would include almost all well underwritten mortgage loans that complied with pre-boom year standards.

The QRM provision was not included in either the House bill or the Senate bill as reported from the Senate Banking Committee. It was added to the Dodd-Frank Act during the Senate debate on the legislation as a floor amendment. During the debate, it became clear that many Senators, on both sides of the aisle, were very concerned that risk retention would "shut down the securitization process and make less credit available."[1] One remedy came in the form of an amendment offered by Senator Corker. His amendment would have replaced the risk retention requirements with a mandatory 5 percent down payment requirement, and a study by the Federal Reserve Board on the asset-backed securitization process.[2] The Corker amendment failed, *in large part because of concern that a 5 percent down payment requirement was viewed as too restrictive.* Speaking against the amendment, Senate Banking Committee Chairman Dodd stated:

> [T]he [Corker] amendment puts in government-dictated, hard-wired underwriting standards that would have very serious consequences, . . . for first-time homebuyers, minority home buyers, and others who are seeking to attain the American dream of home ownership. . . .

[1] See, e.g., Statements of Senator Corker and Senator Isakson at 156 Congressional Record S3514 (May 11, 2010).

[2] Amendment No. 3955, 156 Congressional Record S3551 (May 11, 2010).

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> . . . [I]t does this at a time, as we all know, that the housing markets are just starting to recover, potentially putting that recovery at risk.
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> Many insured depositors (sic), of course, have mortgage programs that require less than 5 percent down payment. They are performing well, and have done so in the past. And we want low- and moderate-income families to go to banks and get loans, qualified low- and moderate-income people . . . We do not want to simply shut them off to nonprofits. We want to get them into the financial mainstream.
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> The Corker amendment would create a new barrier to accomplishing that goal.[3]

Senator Merkley also argued strenuously against a mandatory 5 percent down payment. He urged that the Senate adopt an amendment offered by himself and Senator Klobuchar in lieu of the Corker amendment.[4] The Merkley-Klobuchar amendment contained more flexible mortgage underwriting standards, as well as a requirement to verify income and assets, but no minimum down payment requirement. As explained by Senator Merkley:

> I do think it is important to recognize that the bulk of what Senator Corker addressed [in his amendment] goes right to the heart of [my] amendment as well. There is a point of distinction between the two amendments, a critical point of distinction; that is, the 5-percent underwriting absolute line. That line is a line of great concern for those of us who have had experience with first-time home buyers, those who have had experience with families who are at the bottom of the income spectrum. . . . So the inflexibility of that standard is a great concern.[5]

Based on these arguments, the Corker amendment was defeated by a vote of 42-57, and the Merkley-Klobuchar amendment was adopted by a vote of

[3] 156 Congressional Record S3518, and S3520.
[4] Amendment No. 3962, 156 Congressional Record S3552 (May 11, 2010).
[5] 156 Congressional Record S3516 (May 11, 2010).

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63-36.[6] Thus, when faced with the clear choice between a mandatory down payment requirement and more flexible underwriting, the Senate voted for the more flexible approach. The debate on the Corker amendment shows that the concept of a mandatory down payment requirement was specifically rejected, and that such leaders as Chairman Dodd of the Senate Banking Committee argued strongly against imposing such a requirement. His views prevailed when the amendment was defeated

Soon after the defeat of the Corker Amendment, the Senate took up an amendment offered by Senators Landrieu and Isakson, among others.[7] This is the amendment that created an exemption for Qualified Residential Mortgages, and can be found, with minor changes, as section 941 of the Dodd-Frank Act.

Senator Isakson explained that the QRM exemption was necessary because he believed that risk retention would not work in practice, and therefore without a QRM there "would be no loans."[8] Obviously, this view is not consistent with the position that the QRM was intended to be a narrow carve out for only the very strongest loans. Rather, since the concern behind the amendment was that no loans would be made subject to a risk retention requirement, then QRM loans should encompass the vast majority of loans that meet traditional underwriting standards.

The concept was made clear by Senator Isakson, who stated that the amendment would force lenders to go back to "good-old-day" loans where the borrower is qualified to borrow the money. As a result, "the only risk retention that will be required is when someone is making a bad loan, which means people will stop making bad loans."[9]

Senator Isakson explained what he considered to be a "good-old-day" loan as one in which the borrower's income is verified, the borrower has ratios that meet the tolerance levels for a qualified loan, there is equity of 20 percent in every loan, either through a down payment or if the down payment is less than 20 percent, having mortgage insurance; in other words,

[6] 156 Congressional Record S3574 (May 12, 2010).

[7] Amendment No. 3956, 156 Congressional Record S3575 (May 12, 2010). The amendment was co-sponsored by Senators Hagan, Warner, Menendez, Tester, Lincoln, Levin, Burr and Hutchison.

[8] 156 Congressional Record S3576 (May 12, 2010).

[9] Id.

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by returning to "*the way things used to work.*"[10]

The Landrieu-Isakson amendment was not opposed by any Senator, and was agreed to by consent without a roll call vote.[11] In approving the final bill, the Conference Committee retained the Landrieu-Isakson amendment with minor changes.[12] One change was to specifically cross reference the standard for a "qualified mortgage" in Title XIV of the Dodd-Frank Act, which relates to underwriting standards applicable to all mortgage originations. The cross reference provides that the QRM may be no broader than the standard for a qualified mortgage in Title XIV.[13]

In summary, the legislative history of the QRM is clear. The sponsors of the amendment were of the belief that the risk retention requirement would inhibit mortgage securitization to such an extent that virtually no mortgages would be securitized. The QRM was intended to prevent this result by exempting "good-old-day" loans from risk retention. A "good-old-day" mortgage was conceived as a loan that was underwritten "the way things used to work," i.e., fully documented, appropriate debt to income ratios, down payment requirements that consider private mortgage insurance, and the other traditional underwriting criteria.

As noted, the Conference Committee essentially adopted the Senate amendment. There is no legislative history or other indication that the Committee sought to change the basic goal of the amendment: to create a QRM that encompasses all of the "good-old-day" mortgage loans that are underwritten under the traditional standards used prior to the housing boom of the mid-2000s. The QRM was never intended to only include a narrow class of super-high quality loans, and it was never intended to impose high down payment requirements that would adversely affect first-time homebuyers and economically disadvantaged groups. In fact, an amendment that would have imposed a hard wired minimum down payment was specifically rejected.

This conclusion is directly supported by a statement by Senator Isakson made on the Senate floor following final passage. In this statement, Senator Isakson explained the intent behind the amendment as follows:

[10] Id.
[11] 156 Congressional Record S3625 (May 12, 2010).
[12] House Report No. 111-517, (June 29, 2010).
[13] Section 15G(d)(4)(C) of the Dodd-Frank Act.

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> Earlier this year, I began working with Senators *Landrieu* and *Hagan* to develop the concept of a qualified residential mortgage, QRM or, as I call it, a "new gold standard" for residential mortgages, which ultimately was included in the credit risk retention title of 941(b) in the financial reform bill. While risk retention can serve as a strong deterrent to excessive risk taken by lenders, it also imposes the potential of a constriction of credit in the mortgage market.
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> I want to make this point clear. The risk retention provision of the Dodd-Frank bill would require an originator of a mortgage to retain 5 percent of that mortgage as risk retention. . . . What is going to happen is that very few mortgages will be made, and those that will be made will be only the most pristine ones, not necessarily the ones that meet the needs of middle America. . . .
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> . . . But in terms of mainstream America, we need to go back to the good old days of the 1960s, 1970s, and 1980s, . . .
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> . . . [T]he easy underwriting that started in 2006, and then accelerated, caused us lots of problems. That is what we are here to try to stop today. I am optimistic that our amendment will be the first step to correct the lending practices of the past and will set on a better path in the future. . . .
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> . . . It is my hope that these regulators will follow the intent of the legislation, by ensuring a broad spectrum of qualified borrowers will fit under the umbrella of protection under the qualified residential mortgage safety and soundness provisions.[14]

An objective review of the pre-enactment legislative history that Senator Isakson's statement accurately reflects the legislative intent as expressed during the floor debate, and therefore should serve as a guide to the regulatory agencies implementing the QRM provisions.

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[14] 156 Congressional Record S10441 (Dec, 17, 2010); italics added

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