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A Brief Overview of H.R. 1210, the Portfolio Lending and Mortgage Access Act

H.R. 1210, the Portfolio Lending and Mortgage Access Act, was ordered to be reported by the House Committee on Financial Services. It would, among other things, attempt to increase the credit available to consumers and reduce the regulatory burden on lenders by establishing a new Qualified Mortgage (QM) category for certain mortgages held in portfolio by the originating lender.

Ability-to-Repay Rule and Qualified Mortgages

Title XIV of the Dodd-Frank Act established the ability-to-repay (ATR) requirement. Under the ATR requirement, a lender must determine based on documented and verified information that, at the time a mortgage loan is made, the borrower has the ability to repay the loan. A lender must consider and verify certain types of information prior to originating a loan, including the applicant's income or assets, credit history, outstanding debts, and other criteria. Lenders that fail to comply with the ATR rule could be subject to legal liability, such as the payment of certain statutory damages.

A lender can comply with the ATR requirement in different ways, one of which is by originating a Qualified Mortgage (QM). When a lender originates a QM, then it is presumed to have complied with the ATR requirement, which consequently reduces the lender's potential legal liability of its residential mortgage lending activities. The definition of a QM, therefore, is important to a lender seeking to minimize its *legal risk* of its residential mortgage lending activities, specifically its compliance with the statutory ATR requirement. Some are concerned that, at least in the short term, few mortgages will be originated that do not meet the QM standards due to the legal protections that QMs afford lenders, even though there are other means of complying with the ATR requirement.

The liability and the minimum underwriting standards enacted as part of the Dodd-Frank Act are intended to address market failures that some policymakers believed fueled the housing bubble that precipitated the financial crisis. Some argue that they have led to an unnecessary constriction of credit and have been unduly burdensome on lenders.

The Dodd-Frank Act provides a general definition of a QM, but also authorizes the Consumer Financial Protection Bureau (CFPB) to issue "regulations that revise, add to, or subtract from" the general statutory definition. The CFPB-issued QM regulations establish a "Standard QM" that meets all of the underwriting and product feature requirements outlined in the Dodd-Frank Act. However, the QM regulations also establish several additional categories of QM, which provide lenders the same presumption of compliance with the ATR requirement as a Standard QM. One of these additional categories is referred to as the Small Creditor Portfolio QM, which is similar to the QM that would be created by H.R. 1210 (described in more detail below). Compared to the Standard QM, the Small Creditor Portfolio QM has less prescriptive underwriting requirements and is intended to reduce the regulatory burden of the ATR requirement for certain small lenders.

Small Creditor Portfolio Qualified Mortgages

A mortgage can qualify as a Small Creditor Portfolio QM if three broad sets of criteria are satisfied. First, the loan must be held in the originating lender's portfolio for at least three years (subject to several exceptions). Second, the loan must be held by a "small creditor," which is defined as a lender who originated 2,000 or fewer mortgages in the previous year and has less than $2 billion in assets. Third, the loan must meet the underwriting and product-feature requirements for a Standard QM except for the debt-to-income ratio.

At issue in H.R. 1210 – Should the Small Creditor Portfolio QM be expanded?

While the Small Creditor Portfolio QM has less prescriptive underwriting requirements than the Standard QM, the Small Creditor Portfolio QM requires a lender to hold the loan in portfolio and limits it to small lenders. The CFPB justified establishing the Small Creditor Portfolio QM on the basis that even though the underwriting standards have been reduced (potentially making it easier for some borrowers to qualify), certain factors unique to portfolio loans and to small lenders provide added incentives that ensure that a lender utilizing the Small Creditor Portfolio QM will accurately assess whether a borrower can repay the mortgage. The CFPB believes both the portfolio requirement and small lender limitation are necessary to justify the less prescriptive underwriting standards. For example, the CFPB argues that small lenders are more likely than large banks to use a relationship-based lending model (which involves developing close familiarity with their respective customer bases) that may yield a more accurate assessment of the borrower.

Proposed Changes to the QM Rule

Some in Congress believe the Small Creditor Portfolio QM is too narrow and should be expanded to provide more relief to lenders and more credit to potential borrowers.

H.R. 1210 would establish an additional portfolio QM option that, in comparison to the Small Creditor Portfolio QM (see **Table 1**), would be available to a larger pool of lenders and impose less prescriptive underwriting and product-feature requirements, but require more stringent portfolio guidelines.

Under H.R. 1210, a mortgage would receive QM status if:

- it is retained in portfolio by the originating institution for the life of the loan (with some limited exceptions);
- it is originated by any lender regardless of size that is a depository institution (a financial institution that accepts deposits); and
- it satisfies certain limitations on prepayment penalties.

Table 1. Comparison of the Small Creditor Portfolio QM and H.R. 1210

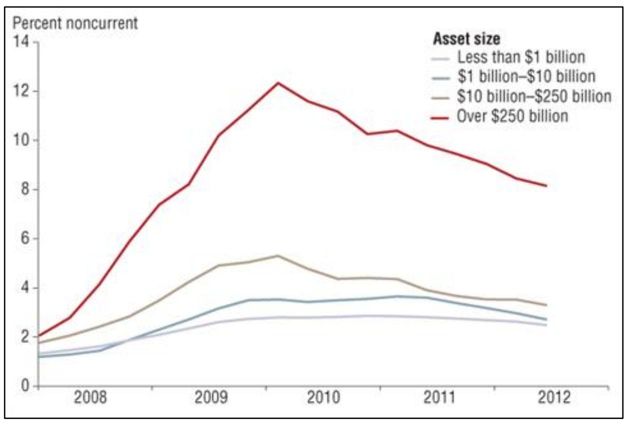
	CFPB's Small Creditor Portfolio QM	H.R. 1210
Portfolio Requirements	Mortgage must be held in portfolio for three years. It may be transferred to another small lender and retain QM status.	Mortgage would have to be held in the portfolio of the originating institution for the life of the loan, with some limited exceptions.
Lender Restrictions	Limited to small lenders, those with less than $2 billion in assets and fewer than 2,000 originations (excluding those held in portfolio).	Any depository institution.
Loan Criteria	Loan must satisfy the underwriting and product-feature requirements of the Standard QM Option, with the exception of the Standard QM Option's DTI requirement.	Loan must comply with certain limitations on prepayment penalties.

Source: Table created by CRS.

Supporters of H.R. 1210 generally argue that not all of the lender and underwriting requirements included in the Small Creditor Portfolio QM are essential to ensuring that a lender will verify a borrower's ability to repay, and instead argue that holding the loan in portfolio is sufficient to encourage thorough underwriting. By keeping the loan in portfolio, lenders have added incentive to consider whether the borrower will be able to repay the loan. Keeping the loan in portfolio means that the lender retains the default risk and could be exposed to losses if the borrower does not repay. This retained risk, the argument goes, would encourage small creditors to provide additional scrutiny during the underwriting process, even in the absence of a legal requirement to do so. The expanded portfolio option would, according to supporters, spur lenders to offer more mortgages and it would reduce the burden associated with the more prescriptive underwriting standards of the existing QM options. The less prescriptive standards could most benefit creditworthy borrowers with atypical financial situations, such as self-employed individuals or seasonal employees, who may have a difficult time conforming to the existing standards.

Not all mortgages held in portfolio, however, have performed well, which is a concern to be considered in evaluating the modifications proposed in H.R. 1210. Research from the Federal Reserve Bank of Dallas, presented in **Figure 1**, shows the delinquency rate of mortgages held in portfolio by banks of different sizes in the aftermath of the bursting of the housing bubble. Banks of all sizes had similar delinquency rates at the beginning of 2008, but the rates diverged over the next four years. The larger banks experienced higher delinquency rates on mortgages held in portfolio, while smaller banks saw less of an increase. Performance during the most recent crisis, however, may not be indicative of future performance.

Figure 1. Delinquency Rates for Mortgages Held In Portfolio by Banks of Different Sizes



Source: Federal Reserve Bank of Dallas.

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