Dodd-Frank is One! And We Still Don't Know What a Resi Mortgage is Going to Look Like

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Ah, baby is one. I remember when mine was -- complete with an over-the-top celebration for an infant who had no idea what was going on and would remember nothing of it. The food, the drink, the fancy cake, the ridiculous crown… I chalk it up to a rite of passage for a parent to throw at least one of those unnecessary first birthday parties. On this, Dodd-Frank's first birthday, I'm not so sure those who birthed it are donning hats, eating cake and sipping champagne in celebration.

On July 19, the Government Accountability Office (the "GAO") published an 83 page report entitled "MORTGAGE REFORM Potential Impacts of Provisions in the Dodd-Frank Act on Homebuyers and the Mortgage Market." The report addresses the potential impact on the mortgage market of qualified mortgage ("QM") criteria, the credit risk retention requirement, provisions concerning homeownership counseling and regulation of high-cost loans. By examining mortgage loans made from 2001 through 2010 in CoreLogic, Inc.'s database, the GAO has drawn some practically meaningless conclusions about the mortgage market. For starters, the GAO acknowledges that the data used for its examination was not necessarily a representative sample. Furthermore, on several occasions throughout the report, the GAO hedges its analysis to the point of, well, uselessness.

In the realm of mortgage reform, the Dodd-Frank Act was designed to prohibit lenders from steering any consumer toward a residential mortgage loan that the consumer cannot repay or that has predatory characteristics and from steering consumers away from QMs and toward non-QMs. Under the Dodd-Frank Act, a mortgage lender is presumed to have satisfied the ability-to-repay requirement and receives some protection from liability when it originates a QM (and exactly how much protection is still open to debate). (See our OnPoint explaining the difference between the proposed safe harbor and rebuttable presumption alternatives for QM).

The GAO analyzed a proprietary database of loans originated from 2001 through 2010 from CoreLogic, Inc. to assess the potential impact of mortgage-related provisions in the Dodd-Frank Act on the availability and affordability of mortgage credit. The GAO notes up front that such analysis may not be fully representative of the mortgage market as a whole. It also reviewed housing and mortgage market research and interviewed mortgage industry stakeholders-- including those representing mortgage lenders, securitizers, investors and consumers.

What I'll call an "abstract" of this GAO report can be found on page 58. Here, the report states that limited data and research show that certain provisions could provide benefits to homebuyers and the larger mortgage market, but that the ultimate impact of the Dodd-Frank Act's mortgage-related requirements is not yet known and will depend, in part, on regulatory actions, decisions to fund housing counseling and mortgage market adjustments that have not yet occurred.

On the up side, it appears that the bulk of loans do meet QM criteria; on the down side, there's a sizable hole in the data and final regs may exclude even more loans.

Let's take a look at what the report says:

The Dodd-Frank Act specifies nine QM criteria, but gives regulators the authority to add, subtract or modify the QM criteria as they see fit. The GAO examined five of the nine QM criteria specified and states that it generally found that most mortgages would likely have met such individual QM criteria. However, the GAO notes that the impact of the full set of QM criteria is uncertain, partly because it could not analyze the other four QM criteria and partly because federal agencies could establish different criteria as final regulations are developed. Maybe I'm not grasping the extent of the usefulness of this examination because it seems rather useless. Moving on…

Generally, the Dodd-Frank Act requires securitizers of RMBS to retain at least five percent of the credit risk of any residential mortgage securitized that does not meet specified criteria. In its report (which focuses on risk retention for RMBS), the GAO notes that key decisions that have yet to be made (including the characteristics of mortgages that would be exempt from risk retention requirements, the form(s) of risk retention that would be allowed, the percentage that securitizers would be required to retain and risk sharing arrangements between lenders and securitizers) could affect the availability and cost of mortgage credit as well as the viability of a private mortgage securitization market. However, the GAO report makes a number of recommendations for rulemakers to consider when crafting the final risk retention requirement, including a recommendation that the requirement be tailored to each major class of securitized assets.

Additional uncertainty arises, the GAO notes, from provisions in the Dodd-Frank Act concerning homeownership counseling and regulation of high-cost loans which could enhance consumer protections and improve mortgage outcomes for some borrowers. As required under the Dodd-Frank Act, HUD has initiated plans to establish an Office of Housing Counseling to perform a number of functions related to homeownership and rental housing counseling, including establishing housing counseling requirements and standards and performance measures; certifying individual housing counselors; conducting housing counseling research; and performing public outreach. Findings from the GAO's limited research on housing counseling for mortgage borrowers are reported to be mixed, with some studies suggesting that some types of counseling can improve mortgage outcomes and other studies' findings less clear.

Yet again, the GAO acknowledges data limitations and notes that although lenders have generally avoided making "high-cost loans," additional information on mortgage costs would be needed to assess the extent to which a newly expanded definition of high-cost loans under HOEPA would affect mortgages that may be made in the future. In addition to expanding the definition of high-cost loans, the Dodd-Frank Act requires that borrowers undergo counseling with a HUD-approved counselor before taking out a high-cost loan. Industry stakeholders who spoke with the GAO indicated that the new definition of high-cost loans would further increase disincentives for originating mortgages with potentially predatory terms and conditions. Additionally, they said that lenders would likely continue to avoid offering high-cost loans because the strict penalties and liabilities attached to such loans make them risky to originate and difficult to securitize.

So far this birthday party leaves a lot to be desired.