Political Actions by Private Interests: Mortgage Market Regulation in the Wake of Dodd-Frank[1]

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I. Introduction

What is the constellation of public and private actors that shape public policy in the United States? In the realm of regulation, an oft-voiced concern is that the regulated industry itself will come to dominate the crafting of regulatory policy by virtue of its superior organizational, informational, and financial resources. This disproportionate influence may manifest itself in the legislative phase, when industries under threat can allocate lobbying resources and campaign expenditures to convince legislators (or a subset thereof) to soften their positions on the stringency of the rules that are to govern the industry. Or, insofar as regulatory responsibilities are invariably delegated to administrative agencies and independent commissions charged with fleshing out the details of authorizing legislation, regulated industries may have the upper hand *ex post* as well – lobbying the bureaucracy directly or continuing to expend resources to convince Congress to reign in agencies otherwise inclined to interpret statutory delegations

[1] We gratefully acknowledge the helpful comments of David Brady, Charles Calomiris, and the participants at the Hoover Institution's Regulation and Rule of Law Conference on March 4, 2016.

expansively. The result, in either case, is the weakening of regulatory stringency, potentially beyond that preferred by a majority of citizens.[2]

Some organizations of citizens, furthermore, may see their interests furthered by the weakened regulations sought by the industry. Strategically, the industry can make allies of these organizations in influencing legislators and regulators. Coalescing with citizen organizations can be an important step in supplementing industry lobbying and political expenditures.

According to both ex ante and ex post accounts, we would expect to see spikes in the political expenditures made by industry interests when new regulatory authority over that industry is under active consideration by Congress or when regulators draft new rules. This possible relationship between political expenditures and the scope of regulatory authority (Gordon and Hafer 2007) has been cited by conservatives as evidence in favor of the proposition that getting money out of politics requires shrinking the span of government (Lott 2000).

We examine the interplay of delegated regulatory authority and influence in the policy making process in the context of the passage and implementation of residential mortgage market regulation under the Dodd-Frank Act of 2010. We pay particularly close to two closely related issues. The first is the definition of a "qualified mortgage" (QM), delegated by Congress to the newly-formed Consumer Financial Protection Bureau (CFPB). Lenders issuing QM mortgages would be given a safe harbor from liability under the Truth-in-Lending Act as amended by Dodd-Frank. The second is the definition of a "qualified residential mortgage" (QRM) as part of a broader rule on *credit risk retention*, which Dodd-Frank assigned to six agencies with financial regulatory authority to craft. Credit risk retention requires that securitizers of asset backed

[2] For a brief summary of how both the legislative and regulatory cards were played by industry and others in mortgage policy following Dodd-Frank, see Bair (2012, pp. 234-237).

securities retain "skin in the game" – that is, an unhedged interest in the credit risk related to a security's underlying assets. Section 941 of the Dodd-Frank Act amended Section 15G of the Securities Exchange Act of 1934 by introducing the notion of a five percent credit risk retention requirement, but delegated to the regulators the task of defining *which* five percent.[3] Critically, mortgages that fit the definition of a QRM are exempt from the five percent credit risk retention requirement altogether. As rulemaking proceeded, the central policy issues boiled down to whether a down payment requirement would be included in the QRM standard and, to a lesser degree, the maximum debt-to-income ratios for borrowers. In the end, the regulators caved and aligned QRM with the more relaxed standards CFPB had crafted for QM—eliminating the down payment requirement altogether and raising the debt-to-income ratio maximum to 43 percent.

While this aspect of the regulation of mortgage markets may seem obscure at first blush, it is in fact critically important to the functioning of the real estate market. Securitizers might be reluctant to include non-qualified assets when packaging mortgages, potentially constraining credit availability and pushing up interest rates on prospective homebuyers at the lower end of the economic spectrum.[4] By the same token, a lax definition of QRMs might reintroduce the very

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[3] Many aspects of credit risk retention, such as Premium Cash Reserves, horizontal vs. vertical requirements, and measures related to non-residential securities, are beyond the scope of this paper.

[4] Mortgages with less than 20 percent down payments that were bought by Fannie Mae and Freddie Mac were required to have mortgage insurance, which was the case before the financial crisis (Johnstone 2004). The Tax Relief and Health Care Act of 2006 made the insurance payments tax deductible for taxpayers with low AGI, starting in 2007. For details, see IRS publication 936. Deductibility was extended in 2015, but without further congressional action,

sorts of systemic risk that, in the wake of the financial crisis, had motivated the credit risk retention requirement in the first place. Moreover, even post-subprime, residential mortgage lending constitutes an enormous fraction of the U.S. economy. The Federal Reserve reported Q4 2015 total mortgage debt outstanding of $13.8 trillion, the equivalent of 69% of Gross Domestic Product.[5] Nearly $10 trillion of this total was for one-to-four family residences, the category impacted by the QM and QRM rules. In 2013 (the most recent year for which we have data) alone, lenders extended $1.6 trillion in residential loans. The question of how these regulations are made thus has profound distributive implications, affecting who is ultimately able to afford a home, as well as implications for how systemic risk is constrained or unconstrained in financial markets more generally. Further, the "Great Recession" essentially forced the issue of mortgage market regulation onto the political agenda in 2009-2010. Accordingly, a focus on this issue is particularly helpful in examining how the political behavior of affected interests responds to the prospect of new regulatory authority.

We proceed as follows: first, we discuss the underlying issues surrounding mortgage markets, securitization, and the regulation of both. Then, we test the hypothesis that the threat of regulations threatening lenders led to a spike in industry political expenditures during debates over the Dodd-Frank Act itself and rules pursuant to Dodd-Frank. We find no evidence of a significant uptick in either political contributions or overall lobbying expenditures at these points

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will expire in 2016. Implicitly, borrowers unable to put down 20 percent would pay more "interest", regardless of QRM. Understandably, mortgage insurers were highly favorable to eliminating a down payment standard. In any event, on a "temporary" basis, any mortgages bought by FHA and the GSEs are automatically QM and QRM.

[5] https://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm

in time, although we do find a contemporaneous shift in the fraction of lenders' PAC contributions going to Republican candidates.

We then examine the politics surrounding the QRM definition in detail. The Dodd-Frank Act specified that six agencies – the Federal Reserve, FDIC, FHFA, OCC, SEC, and HUD – would jointly issue a rule on credit risk retention. The preliminary rule published by the agencies in 2011 specified a 20% down payment requirement for mortgages to be considered QRMs. As we explain below, this requirement would have placed a large slice of residential mortgages outside of QRM status, despite their meeting other standards. The regulators acted aggressively on this despite warning signs from Congress that there would be significant opposition to the move. The 20% down payment ignited a firestorm of protest, but critically, this protest came not only from the lending industry and fellow travelers in the realty, mortgage insurance, and construction industries; but also from borrowers, civil rights and other left-leaning organizations, and an ideologically heterogeneous swath of members of Congress. By 2013, with the most aggressive regulators (acting FHFA chair Edward DeMarco and FDIC chair Sheila Bair) having exited the stage, a revised rule eliminated the down payment requirement as the QRM definition was aligned with QM.

A comparison of the politics of QRM rule with two other recent controversies concerning residential mortgage policy is instructive. The first, principal reduction, would have permitted the Government Sponsored Enterprises (GSEs), the Federal National Mortgage Corporation (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), to mark down the principal owed on underwater loans held by those organizations. Principal reduction was opposed strenuously by Edward DeMarco, the acting head of the Federal Housing Finance Adminstration (FHFA) but supported (albeit cautiously) by his successor, former Democratic congressman Mel Watt.[6] The second would be to phase out or reduce the size of the GSEs outright, which currently hold about half of the mortgage debt in the United States. Unlike the politics of the QRM rule, support for or opposition to these options break neatly along partisan lines.

We conclude with an examination of the effects of the QRM regulation on the secondary market for mortgages. Private label financial institutions issued $61.6 billion in mortgage-backed bonds in 2015, a pale shadow of the $1.19 trillion issued in 2005 at the height of the housing bubble. Most of the 2015 issues were backed by old, repackaged loans or so-called "jumbo" mortgages that, while low-risk, do not meet the criteria for purchase by the GSEs. While analysts point to the willingness of large financial institutions to hold onto the original loans rather than securitize them (Light 2016), we consider the role of regulatory policy in stymieing the reemergence of this market.

II. Background

Industry Influence in Regulatory Policy Making: Capture or Rent-Seeking?

A rich literature in political science, public administration, and economics considers the extent to which regulatory policy-making in the United States is influenced disproportionately by industry. The term "capture" to describe this phenomenon dates at least as far back as Woodrow Wilson, but the contemporary academic discourse on the subject of industry influence in regulation may

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[6] Watt was confirmed by the Senate in 2014 but announced a principal reduction policy only in April, 2016. The policy was seen as limited to only 31,000 mortgages. Watt's confirmation was subject to a lengthy hold and occurred only after the Democrats changed the filibuster rules. The confirmation vote was 51-47, with only two Republicans in support.

be divided into *ex ante* and *ex post* strands. The *ex ante* perspective suggests that regulations are designed to serve industry from the start. Kolko (1963), for example, argues that industrial interests sought out regulation during the Progressive Era to protect them from the vagaries of market competition. Stigler (1971) argues that policy makers face pressure from well-organized business interests to protect market incumbents via regulations on price, quantity, and entry, to the detriment of consumers (see also Peltzman 1976).

The *ex post* strand focuses on agencies initially constituted to perform services in "the public interest" – mitigating the adverse consequences of natural monopolies, production externalities, or coordination failures – that come to be dominated by the very industries whose behavior was to be regulated. Huntington's (1952) study of the Interstate Commerce Commission describes a Commission forced to rely on the railroad industry for political support following the decline of the agricultural-interest based coalition that brought it into existence. Bernstein (1955) observes more general tendencies in describing a regulatory agency's "life cycle."

A more recent literature expands on the notion of regulatory capture and industry influence by focusing on the role of asymmetric information. Baron and Myerson (1982), for example, consider the problem a regulator charged with setting prices for a monopolist whose costs are unknown. In an application of the revelation principle, they demonstrate that the socially optimal policy must subsidize a producer for reporting low costs, or punish producers for producing high ones. Laffont and Tirole (1991) incorporate the Baron and Myerson model into an agency-theoretic model in which a regulated firm can capture an agency by offering side payments to regulators in exchange for their collusion in misrepresenting costs. Congress, anticipating this possibility, can structure the incentive environment to reduce motivations for collusion. Gailmard and Patty (2013, ch. 7) consider a model of "delegated cheap talk," in which a political principal appoints a regulator sympathetic to an industry's point of view in order to elicit truthful revelation from the industry. Gordon and Hafer (2005, 2007) describe models in which regulated firms can make costly signals to regulators via their political expenditures, achieving reduced scrutiny in the process.

Finally, a related literature considers the extent to which regulated interests act *through* elected officials to pressure agencies into enacting favorable policies. Weingast and Moran (1983), for example, describe how a rightward shift of congressional principals led to congressional pressure on a recently activist Federal Trade Commission to reduce its regulatory activities. And Gordon and Hafer (2013) describe a differential response by the Mine Safety and Health Administration to similar mine disasters occurring during different administrations.

A number of these accounts of disproportionate industry influence in regulatory policy have been applied to the regulation of systemic risk in lending markets: recent examples include Johnson and Kwak (2010), Kwak (2013), and McCarty, Poole, and Rosenthal (2013) in relation to the financial crisis; and Romer and Weingast (1991) in relation to the thrift debacle of the 1980s.

The Dodd-Frank Act: Lead-Up and Follow-Up. [7] This section of the paper outlines the development of legislation and regulation as a response to the financial crisis. There would, almost certainly, have been nothing like Dodd-Frank without a financial crisis (or a Sarbanes-Oxley without an accounting crisis). Federal Reserve chair Alan Greenspan was said to have turned a deaf ear to Fed governor Edward Gramlich's call for regulation of subprime lending. Neither his successor Ben Bernanke nor Congress had much appetite for increased regulation

[7] Much of this section follows McCarty, Poole, and Rosenthal (2013).

before 2008. Since the politics of regulation respond to economic crises, we weave descriptions of the economy into our account of the evolution of regulation.

In 2006, the housing bubble burst. The Case-Shiller 20-City Composite Home Price index fell from its all time high of 206.49 in May of that year to 140.79 in June of 2009. Increasing number of mortgagees, particularly the "subprime" ones, became delinquent in their monthly payments. Foreclosure filings rose from 771,552 in 2006 to 2,871,891in 2010.[8] Many of the troubled mortgages were securitized in Private Residential Mortgage Backed Securities. The market for these securities collapsed. Insurers, notably American International Group (AIG), were unable to make good on the credit default swaps that insured the securities. The crisis also weighed heavily on the portfolios of Fannie and Freddie. They were placed into conservancy on September 6, 2008. After Lehman Brothers, a major investment bank, declared bankruptcy on September 15, 2008, the Fed undertook an $85 billion rescue of AIG the next day.

Main Street then woke up to an international financial crisis. Before Sept. 15, polls and prediction markets indicated an extremely close election between Barack Obama and John McCain. After Sept.15, Obama pulled ahead. Obama's victory in the November elections was complemented by increased Democratic majorities in both houses of Congress. Political winds called for new regulation of financial markets. One of the first actions of the new Congress was to pass a piece of low-hanging fruit, the "pro-consumer" credit card bill. Although the bill passed with very large majorities, 69 of the 70 House Noes were cast by Republicans, as were four of the five Senate Nays. Republican opposition signaled likely partisan differences on the big stuff,

[8] http://www.forbes.com/sites/erincarlyle/2015/01/15/foreclosure-filings-drop-by-18-in-2014-hit-lowest-level-since-2006-realtytrac-says/#2bef4243c272

the regulation of mortgage products and derivatives that many believed caused the Great Recession.

The Obama administration did not make financial regulation its major priority, instead focusing its attention on the Affordable Care Act. Congress dithered, and the president signed the act only on March 10, 2010. By then, there was a small uptick in the housing index. The unemployment rate had begun to inch off its post-Lehman high of 10 percent. The NBER had previously called the second quarter of 2009 as the end of the recession. By the time the president had signed Dodd-Frank on July 21, 2010, unemployment was down to 9.4 percent. The housing index remained above its 2009 low.

The content of the Dodd-Frank Act was undoubtedly affected by political polarization. Progressives pushed strongly for and received a Consumer Financial Protection Bureau advocated by Elizabeth Warren, chair of the Congressional Oversight Panel for TARP when Dodd-Frank was passed. The Bureau was to have a budget independent of congressional control. The CFPB provisions alone would make Dodd-Frank and future Senator Warren bêtes-noires for Republicans. Yet the legislation, tempered by moderate Democrats, left progressives unsatisfied.

Action in the Senate was pivotal to passage of Dodd-Frank. The bill had passed easily in the House. The Democrats had a large majority and could even allow some members with constituency concerns to defect. Only three House Republicans, two moderates and ranking financial services committee member, Michael Castle of Delaware, voted for Dodd-Frank. Castle was Tea Partied when he ran for the Senate in the fall of 2010. In the Senate, the Democrats were two votes shy of the 60 needed to avoid a filibuster. The two became three when progressive Russ Feingold (WI) announced he would vote against the bill because it did not go far enough. Feingold's defection meant satisfying Scott Brown (R-MA). Brown forced the bill to be stripped of a tax on banking transactions. Brown and the two Maine Republican moderates, Olympia Snowe and Susan Collins voted for the bill. Without the institutional feature of the filibuster, Dodd-Frank would have been more progressive, more populist. Strong Republican opposition gave no indication of the overwhelming bipartisan coalition that would emerge in 2011 on regulation of the mortgage market.

The parts of Dodd-Frank most relevant to our empirical analysis concern QM and QRM. The relationship between QM and QRM is specified in Section 941:

> The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency in defining the term 'qualified residential mortgage', as required by subparagraph (B), shall define that term to be no broader than the definition 'qualified mortgage' as the term is defined under section129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder.

Note that "no broader" denotes a weak inequality, thus permitting QRM to be identical to QM. Congress gave QRM mortgages an exemption from credit risk retention but provided no details beyond "no broader". Moreover, the language appears to give the Consumer Financial Protection Board, which would rule on QM under the Consumer Financial Protection Act section of Dodd-Frank, first-mover status.

The QM language is oriented to keep originators from "steering" borrowers into non-QM products. A QM product gives the originator a safe harbor from liability under section 1942, so an expansive definition of QM reduces liability concerns.

Dodd-Frank appears to give the CFPB complete discretion over QM:

> The Board may prescribe regulations that revise, add to, or subtract from the criteria that define a qualified mortgage upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers…

This language, however, is preceded by very specific language on matters such as balloon payments, points and fees, length of mortgages, ARMS, and income verification that can be considered as status quo points for the CFPB. On these matters, the CFPB largely followed

Congress,[9] and the “industry” did not contest these aspects of the QM rule. In contrast, the term “down payment” does not appear in Dodd-Frank. Similarly, the statute contains no specific numbers for (monthly) debt-to-income ratios.

The first regulatory action after Dodd-Frank was a proposed QRM rule on March 31, 2011.[10] Although the Case-Shiller 20-city index had actually gone slightly further south than its 2009 low, the overall economy continued to recover, with unemployment at 9 percent. The proposed QRM rule was tight. The “statutory” (points, balloon payments, etc.) QM standards were incorporated. Importantly, a 20 percent down payment would be required for new home purchases.[11] Monthly housing debt could be only 28 percent of income; total monthly debt could be only 36 percent of income. A recovering economy and a weak housing market set the stage for the industry actions we detail later in the paper. Even prior to the formal announcement of the standards, in a bipartisan letter on Feb. 16, 2011, senators Landrieu (D-LA), Hagan (D-NC), and Isakson (R-GA) called for not having a down payment standard in QRM.

The next regulatory step was a proposed QM rule issued by the Federal Reserve on April 29, 2011 as the CFPB was only able to begin operations on July 11. This proposal was largely a placeholder for the CFPB and solicited comments on “alternatives”. It did not include language about down payments. Also, it discussed debt-to-income ratios at length but did not propose a firm standard.

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[9] The CFPB did make exceptions for small, “community” lenders.

[10] We date proposed and final rules by their announcements. These precede publication in the Federal Register by several weeks.

[11] The 20 per cent down corresponds to a LTV of 80 percent. Even stricter LTVs were to be imposed on refinances: 70 percent on standard ones, and 75 on cash outs.

The CFPB issued a final QM rule on May 29, 2013. By then, the crisis was fading away in the rear view mirror. Unemployment was down to 7.5 percent. The Case-Shiller index had rebounded to 156.02. The rule had no down payment restriction and imposed a 43 percent total debt to income standard. Standards were "temporarily" waved for any loans purchased by Fannie, Freddie, and other agencies. Small lenders had relaxed standards. The 43 percent was only slightly below the 45 percent that the 2011 proposal had mentioned as a standard lending criterion before the crisis, and well above the 36 percent in the 2011 proposed QRM rule.

On August 28, 2013, after substantial pressure from the real estate industry, a second QRM proposal simply aligned QRM with QM. Down payments and strict debt-to-income ratios were dropped. By this time, there had been a continuing increase in housing prices and unemployment was down to 7.3 percent. The QRM rule was finalized on Oct. 22, 2014. Unemployment was then down to 6.2 percent, lower than in the same month of 2008. The Case-Shiller 20-city index was higher than its April 2008 level.

This section has outlined the path of legislation and regulation. We now turn to how private actions relate to the regulatory outcome.

III. Data

Lobbying Disclosure Data

The main data employed in this paper come from two sources. The first is data from lobbying disclosure reports mandated by the Lobbying Disclosure Act of 1995 and the Honest Leadership and Open Government Act of 2007. The LDA required federal lobbyists (both employees of lobbying firms and in-house lobbyists) to register with the Clerk of the House and Secretary of the Senate, and mandated semi-annual disclosure of lobbying contacts with Congress or executive agencies made in pursuit of influencing public policy. The 2007 act strengthened the

LDA in several respects: most important of these for our purposes was a requirement that filing be done electronically, and quarterly (starting in 2008) instead of semi-annually.

The structure and contents of a lobbying disclosure form constrain our analysis in several important respects. The form contains, inter alia, the identity of the registrant; the identity of the client (if not the registrant itself); a list of specific issues on which lobbying occurred; and a list of agency contacts (the House and Senate are defined as agencies in disclosure parlance, as is the White House) with whom the lobbyist communicated on behalf of the client. Finally, lobbying firms are required to report a “good faith estimate” of the fees charged to the client for the activities described on the form, while in-house lobbyists are to report a similar estimate of expenses incurred for lobbying activities.

The second source of data come from Federal Election Commission campaign finance data. We aggregate these data into measures of total spending by lenders and various real estate-related trade associations.

The Center for Responsive Politics compiles the lobbying and FEC data from these forms and provides them free of charge on their “opensecrets.org” website; CRP cleans the data and assigns industry categories to specific clients. For the analysis in this paper, we use bulk data generously provided by CRP and archived on their website.

The lobbying disclosure and PAC spending data have been used ubiquitously in political science, but their limitations become particularly acute in the current context. While the lobbying disclosure data permit us to observe which agencies were lobbied on behalf of a particular client, we do not know how much of the total amount was spent on *which* agency (unless only one agency was listed on the report). Likewise, while a disclosure may list the issues on which lobbying occurred, we do not observe (a) how much was spent lobbying on which issues; (b) which agencies were lobbied on which issues; or (c) what position the client took on the issue. For example, suppose a lobbying report lists the House, Senate, Federal Reserve, Department of the Treasury, and SEC as agencies lobbied on behalf of a particular client, and includes "issues related to the implementation of Dodd-Frank" and "Qualified Mortgage Rule – ability to repay standard" along with a host of other issues. We do not know whether the Fed or Treasury or SEC was lobbied directly on either issue (or at all); or whether the client wanted Congress to lobby the Fed (or Treasury or SEC) on its behalf or to consider legislation overriding the agencies' regulatory authority. (This ambiguity will generally hold if the lobbyist lists more than one agency and more than one issue.) And the data are, of course, uninformative regarding what that client actually *wanted.*

PAC contributions, which in the aggregate are very highly correlated with lobbying expenditures, suffer different limitations. On the one hand, they give us a sense of who a donor's allies are likely to be in Congress (and thus can be used to infer a contributor's general liberalism or conservatism – see, e.g., Bonica 2013). However, they cannot in general tell us which issues a contributor specifically cares about, or the donor's position on those issues.

In light of these limitations, we rely on comments made by firms and organizations to the regulators during the "notice and comment" period that follows Notices of Proposed Rulemaking (NPRMs). Data describing comments on proposed rules is not available in as convenient a format as the lobbying disclosure (or campaign contribution) data. To uncover the identities of individuals commenting on the Qualified Mortgage and Credit Risk Retention rules, we scraped the text of all comments on those rules using the regulations.gov API and the search engines of agencies that do not archive comments on regulations.gov. This encompassed the comments made directly to the FDIC, FHFA, the Fed, HUD, OCC, SEC, and CFPB. To extract the comments from OCC and HUD from regulations.gov, we wrote a scraper which used the Search API from Regulations.gov to find every comment associated with the regulations of interest. For each comment, the scraper extracted the names and organizational affiliations of each commenter. For comments on regulations from the SEC, FRS, FDIC, and FHFA, we wrote scrapers for each website. While these websites did not have APIs, the scrapers followed the same logic as above. As commenters almost universally sent their comments to all six of the agencies charged with the rule-making, we use, because access was easiest, comments posted on the SEC website.

Using a combination of fuzzy matching algorithms and hand-coding, we cross-walked the lobbying, FEC, and comment data to three sets of organizations. First, mortgage lenders identified on the MortgageStats.com website from the first quarter of 2007 through the third quarter of 2014. This gives us data about residential mortgage lending volumes and market shares. Because there is unusual volatility for some lenders, perhaps related to reporting, we use annual as well as quarterly data. Second, the Federal Reserve's quarterly releases of lists of commercial banks with over $300 million in assets (https://www.federalreserve.gov/releases/lbr/). Third, interest groups and trade associations that were members of the Coalition for Sensible Housing Policy. The coalition appears to encompass all the major private opponents of the 20 percent down payment rule in the initial QRM proposal. The coalition listed its members on two white papers. The first, submitted on Aug. 1, 2011 opposed the initial QRM proposal. The second was submitted on Oct. 24, 2013, during the comment period on the revised QRM proposal.[12] The membership expanded over time. Several

[12] For both, see http://www.sensiblehousingpolicy.org/White_Paper.html, accessed May 22, 2011.

national, state, and local trade associations and interest groups also commented (e.g. the Georgia Bankers Association, McHenry County Association of Realtors, La Raza) but nothing with positions not spanned by the coalition.

IV. Political Economy

It's Not Just the Money. As a first cut at the data, we considered whether the introduction of new mortgage regulation on the legislative and regulatory agenda affected patterns of political expenditures among lenders. To do so, we looked for spikes in lobbying expenditures and PAC contributions at four key points in time during our narrative: the quarter preceding the passage of the Dodd-Frank Act (second quarter of 2010); the quarter during which the initial proposed QM and QRM rules were published (second quarter of 2011); and the quarters in which the revised QM and QRM rules were published (second and third quarters of 2013).

The top and middle panels of Figure 1 show average lobbying and PAC contributions, by quarter, for the set of 191 lenders that were *ever* in the top 100 by volume from 2008 to 2014.[13] Each panel shows the unadjusted quarterly means (depicted by the red line) as well as the means derived from a regression that included a firm's total lending volume in that quarter, along with lender-specific fixed effects. The former controls for idiosyncratic effects of lender business that might be spuriously correlated with the timing of the statute and pursuant regulations. The fixed effects alleviate concerns that any changes in political expenditures might be driven by entry into and exit from the market of specific high-spending or low-spending lenders. The critical regulatory junctures are depicted by the gray bands in the figures.

[13] Source of top 100: mortgagestats.com. Mortgagestats presents volumes for over 300 lenders each year. The top 100 in a given year reflects exit, entry, and changes in market shares.

FIGURE 1 ABOUT HERE

Note that for both the lobbying and PAC time series, the fixed effects do not change the overall picture. Turning attention first to lobbying expenditures, we see a dip in lobbying in 2008 and 2009, in the darkest days of the financial crisis, followed by a gradual, return to pre-crisis levels.[14] (Figures are in adjusted 2009 dollars.) Importantly, however, we see no evidence of an uptick in lobbying either immediately prior to Dodd-Frank, or in the quarters for which the rules defining specific classes of mortgages were most hotly debated. Total PAC contributions tell a similar story, although the point is obscured by the cyclical nature of those contributions (which tend to spike in the second and third quarters of presidential and congressional election years). In short, the data do not suggest either last-minute contributions to affect the content of the legislation, or that an incipient regulatory regime induced substantial increases in political expenditures.

A somewhat different picture emerges in the third panel of Figure 1. This panel shows the fraction of PAC contributions favoring Republican candidates. Here, we see a substantial shift beginning in the third quarter of 2009 – a shift consistent with media reports of general dissatisfaction in the financial services industry with the Democratic majority at the time. The shift is also consistent with anticipation of the switch in control of the House of Representatives brought about by the 2010 midterm elections. Similarly, McCarty, Poole, and Rosenthal (2013, p. 88) show that financial services contributions reflect partisan control of the Presidency and

[14] These results echo McCarty, Poole, and Rosenthal (2013, p. 85) who show that campaign contributions from the financial services sector soared from 1990 to 2008 as financial markets were deregulated, and the plummeted in 2010. Importantly, conservatorship has neutered lobbying and campaign contributions by the GSEs.

Congress. Note, however, that the introduction of the proposed QRM rule did not increase the industry's enthusiasm for Republican candidates beyond the level it had already reached by mid-2010, when hostility related to Dodd-Frank's passage had peaked.

Comments and Coalition Building. Upon publication of the initial credit risk retention rule in 2011, a group labeling itself the Coalition for Sensible Housing Policy (CSHP) submitted a white paper entitled, "Proposed Qualified Residential Mortgage Definition Harms Creditworthy Borrowers While Frustrating Housing Recovery," as a comment to the heads of the six agencies charged with crafting the rule. The gist of the comment was that Congress had rejected including a down payment requirement as part of the QRM definition during debates over the relevant section of Dodd-Frank, and that the requirement would harm low income and first-time buyers. The coalition argued that the marginal benefit of the down payment requirement in terms of default risk was small when combined with the other underwriting standards included in the definition, but that the cost to home buyers excluded from the QRM designation would be high: on the order of 80 to 185 basis points, stemming from enhanced capital costs of 5% risk retention for non-QRM loans, a smaller market of securitizers with portfolios large enough to permit 5% retention, and reduced liquidity stemming from perceived riskiness of non-QRM loans. The white paper concluded that the down payment would harm consumers, stunt the recovery of the housing market, and fail to shrink government presence in the housing market (by driving non-QRM borrowers to take out FHA loans). Ultimately the CSHP would propose aligning the QM and QRM standards.

What was perhaps more important than what was said in the white paper was who was saying it. Unsurprisingly, a number of trade associations representing financial, insurance, and real estate interests were on board: these included the American Bankers Association, the

Community Lenders Association, the Mortgage Bankers Association, and the National Association of Realtors (on whose data the analysis in the white paper was based). The Mortgage Insurance Companies of America also joined: borrowers with mortgages with a loan-to-value ratio above 80% must buy mortgage insurance for Fannie and Freddie to purchase them, creating a significant interest for the insurers in a high volume of loans with small down payments.

The participation of several trade associations representing banks in the CSHP masked some apparent dissension in the ranks. In a separate comment, a representative from JP Morgan Chase voiced approval for the loan-to-value threshold, calling it “appropriate” as it would contribute to a decreased rate of default. A comment from Wells Fargo suggested possibly raising the LTV from 80 to 90%, but not necessarily doing away with the requirement altogether. (It should be noted that each of these lengthy comments devoted far more of their attention to aspects of the Credit Risk Retention rule other than the QRM rule. Lengthy comments on credit risk attention from Bank of America and Citi ignored QRM. Wells, Chase, BofA, and Citi had the four highest mortgage volumes in 2011 and represented over 50% of volume in that year. Similarly, the fifth largest lender, Ally, commented only through a joint comment on auto loan securitization, signed with automobile manufacturers and other finance companies. SunTrust only commented on asset-based commercial paper.) In contrast to dissention from large banks, Quicken Loans, U.S. Bank Home Mortgage, Umpqua, a small regional bank, Guaranteed Rate, Mortgage America, and Reading Co-operative Bank, focused only on QRM and largely echoed the CHSP position. The CHSP attack on the down payment requirement was joined by PHH, although PHH’s comment spilled over into other issues.

Along with industry trade associations, however, CSHP also contained a number of community advocacy, left-wing, and civil rights organizations as signatories. These included the

NAACP, the National Urban League, Habitat for Humanity, Consumer Federation of America, and the National Fair Housing Alliance. By 2013, the Center for American Progress joined in. Figure 2 depicts the members of the coalition ranked by their lobbying expenditures. Red dots represent expenditures in the second quarter of 2011 (when the initial credit risk retention rule was under consideration) and blue dots the third quarter of 2013 (during the comment period for the revised rule).

FIGURE 2 ABOUT HERE

Two features of the figure are of note. First, nearly half of CSHP members report zero lobbying expenditures in both time periods, despite their apparent participation in political advocacy.[15] Second, those lobbying expenditures are fairly uniform across time for the organizations that do lobby: the National Association of Realtors was a very large spender in both 2011 and 2013. Parenthetically, we note that high lobbying expenditures are extremely highly correlated with PAC contributions – the pairwise correlation between lobbying in 2011 and PAC contributions summed over the 2010 and 2012 cycles was 0.96.

Notwithstanding the substantial lobbying expenditures made by the member organizations of the CSHP, it is notable that CSHP itself did not itself disclose any such expenditures. Moreover,

[15] The Lobbying Disclosure Act does not requiring reporting expenditures less than $20,000 in a quarter – a sum that likely exceeds the cost of lending one's organization's name to a list of coalition members.

the public relations firm that helped to organize the Coalition – Rasky Baerlein – did not disclose either the CSHP or any of its member organizations as clients in 2011 or 2013.[16]

Pressure from Congress. During Senate debate on Dodd-Frank, Senator Bob Corker (R-TN) proposed an amendment that would require a 5 percent down payment on new mortgages, and additional credit and income history reporting for borrowers with more than 80 percent loan-to-value. Amendment 3955, which was was co-sponsored by Senators Gregg (R-NH), LeMieux (R-FL), Coburn (R-OK), and Brown (R-MA), was defeated 42-57. In its stead, the Senate agreed by unanimous consent to amendment 3956, offered by by Senators Landrieu (D-LA), Hagan (D-NC) and Isakson (R-GA), which created the QRM exception.

The CSHP noted the rejection of the down payment requirement in its 2011 and 2013 white papers. But it needn't have. In the months following the agencies' 2011 proposal 301 members of the House wrote to the agencies opposing the down payment requirement – most (282) as signatories to a single petition that circulated the House. The ideological heterogeneity of the commenters mirrored that in the CSHP. Figure 3 displays smoothed density estimates of first dimension DW-Nominate scores (McCarty, Poole, and Rosenthal 1997) for the members of Congress who did (red) and did not (green) oppose the down payment requirement. As is evident from the picture, the opponents of the requirement came from both sides of the aisle.[17]

FIGURE 3 ABOUT HERE

[16] We only know of the firm's involvement because it lists CSHP as a success story on its website. Rasky also lists U.S. Mortgage Insurance (formerly Mortgage Insurance Companies of America) as a client, although the relationship is not documented in lobbying disclosure reports.

[17] As of writing we are still gathering data but this appears to be mirrored in the Senate.

Interestingly, immediately following the preliminary rule's publication in April, 2011, sixteen Democratic members of the House Financial Services Committee sent a letter to the regulatory agencies suggesting that while "it does seem appropriate to establish some down payment requirement (and inversely a loan to value requirement) … we are very concerned that the high 20% down payment requirement in the draft rule inappropriately excludes too many otherwise qualified homebuyers…" The letter pointed to the FHA's 3.5% cash down and Fannie and Freddie 10% down payment requirements as more appropriate standards to contemplate. Nonetheless, pressure to eliminate the down payment requirement altogether soon came to a head, and twelve of those sixteen signatories to the letter encouraging moderation ultimately modified their positions in favor of outright elimination of the requirement.

Time Was on the Side of the Coalition. After the publication of the draft QRM rule in March of 2011, the economy continued to improve, as we discussed previously. As the crisis receded, policies aimed at preventing a future crisis were less appealing. Moreover, agency heads who may have been committed to a stiff standard were replaced. Table 1 details the timing of replacements and the development of QRM. At the SEC, Mary Jo White replaced Mary Schapiro. President Obama nominated Melvin Watt to head the FHFA on May 13, 2013. Although Edward DeMarco remained as acting head of FHFA at the time of the proposed revision, he was clearly a lame duck. At the FDIC, Sheila Bair, a Republican and former counsel to Senate majority leader Bob Dole, had given way to Martin Gruenberg, who came to the FDIC from the staff of Democratic senator Paul Sarbanes. When the final QRM was issued, Bair continued to voice support for an 80 percent down payment standard.[18]

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[18] "U.S. Regulators Approve Eased Mortgage Lending Rules", *New York Times*, Oct. 22, 2014

TABLE 1 ABOUT HERE

V. Are the QM and QRM Rules Exceptions?

In the previous section, we demonstrated that a broad coalition arose to bring down the strict down payment and debt-to-income rules of the initial QRM rule. The Coalition for Sensible Housing Policy grouped lenders, mortgage insurers, realtors, builders and remodelers, servicers, and title insurers. These real estate industry organizations forged an alliance with progressive, low income housing, and minority advocacy groups. The Coalition found more than a few sympathetic ears in Congress, with members across the ideological spectrum fighting the proposed rule. This was particular true in the House, where 282 members jointly signed a comment and another 19 commented alone or in small numbers.

Clearly, as we showed above, a broad, bipartisan coalition could not be used to support or block Dodd-Frank where the “statutory” markers of QM and QRM were initially put down and the CFPB created. Legislators on the right strenuously opposed the CFPB, and there were likely to be some against any form of market regulation. The Coalition was thus savvy in limiting the fight to a single aspect of regulation.

By contrast, we would argue that most aspects of government regulation of the mortgage market are ideological and partisan. As examples, consider principal reduction and foreclosure relief. Mian, Sufi, and Trebbi (2010) show that NOMINATE scores correlate highly with voting on the American Housing Rescue and Foreclosure Prevention Act in 2008. The issue of principle reduction led to progressive calls for removal of Edward DeMarco as acting head of the FHFA and conservative votes against the confirmation of Melvin Watt as his replacement.

Greater long-run consequences pertain to the status of Fannie and Freddie. Dodd-Frank kicked this can down the road by requiring that Treasury study ending the conservatorship and reforming the housing finance system. Section 1941 gives a "sense of Congress" that is rather unfriendly to the low-income housing policies of Fannie and Freddie and calls for reform. The cheap talk apparently did little to change the partisan divide on passage of the bill. In every year since 2013, Congress has seen Republican and bipartisan attempts at changing the status of the GSEs, but the status quo has held. No bill has received a floor vote. The Obama administration appears to support the status quo. (See Gretchen Morgenson, "The Secrets of a Bailout With No Exit", *New York Times*, May 22, 2016.) Some of the administration's opponents would not only like to liquidate Fannie and Freddie and government guarantees on housing but also dispense entirely with QM and QRM.

VI. Effect on Markets

What are the market effects of QM and QRM? There is no ready answer. Housing and mortgage markets respond to interest rate policy, economic growth and distribution, and other factors as well as regulation. Moreover, economic agents have had limited time to adjust to regulatory changes.

To capture the viewpoint of home builders, we look at new home sales. These peaked at 1,283,000 in 2005 and fell to 306,000 in 2011. They were only 501,000 in 2015, still far down from the 877,000 in the pre-subprime year of 2000. (Sales data from https://www.census.gov/construction/nrs/pdf/soldann.pdf).

Realtors, who deal mainly in the sale of existing homes, have had a better recovery than builders. Although sales were running over 6,500,000 quarterly in 2006, they were just under 5,500,000 in some recent quarters. As many units are turning over today as at the turn of the century. (Sales data from http://www.tradingeconomics.com/united-states/existing-home-sales).

The stock of mortgage debt has shrunk back to the benchmark of the last two decades of the twentieth-century when mortgage debt was 60-70% if GDP. It is back there today after exceeding 100% in 2005-08.

The mortgage market appears to have undergone substantial changes after the crisis and the adoption of the QM and QRM rules. Non-bank lenders have displaced banks and credit unions as the primary source of residential mortgages. Internet origination, most notably with Quicken Loans, continues to grow. The leading lender in 2007 was Countrywide, with the top 10 rounded out by Wells Fargo, Chase, CitiMortgage, Bank of America, Washington Mutual, Wachovia, Ally, One West, and Sun Trust. Six of the ten were gone in 2013, replaced by Quicken (rank 24 in 2007), U.S. Bank Home Mortgage (rank 17), PHH, Flagstar (rank 19), Penny Mac (rank 13), and Branch Banking & Trust. (rank 26). (Source, mortgagestats.com)

The QM rule, which was finalized in May, 2013 may have had an immediate impact on the changed set of market participants. From its 21st Real Estate Lending Survey, the American Bankers Association reported that 84 percent of all mortgages in 2013 were QM compliant. (See http://www.aba.com/tools/function/mortgage/documents/2014_realestatesurvey.pdf). Lender focus on QM is indicated by a statement by Sun West that it would make only QM compliant loans in 2014. (See https://www.swmc.com/swmc/lender_alerts/2014/January/30/qualified_mortgages.php.)

Some 80 percent of respondents saw QM as leading to a reduction in credit availability. The majority of all mortgages in 2013 were 30-year fixed rate. Getting rid of the down payment requirement may have had a large effect. One-third of all mortgages originated on 1-4 family loans in 2013 would not have been QRM under the originally proposed 80% LTV. Certainly to the delight of the mortgage insurers, 81 percent of the high LTV mortgages were written with mortgage insurance.

As we indicated in the introduction, private label securitization is a whimper of what it was pre-crisis. Indeed, 95 percent of the respondents to the ABA survey reported that they would hold their non-QM loans as portfolio investments. In contrast, the public sector had a Bikini moment in 2010. Fannie Mae went from holding $417 billion in the last quarter of 2009 to $3,000 billion in the first quarter of 2010. Over the same two quarters, Freddie Mac went from $139 billion to $1,933 billion. (Source: Federal Reserve.) Current holdings are in these magnitudes. And while the Mortgage Bankers Association supports reforms that transfer risk to the private sector, it still seeks “an explicit federal guarantee for mortgage securities to promote liquidity and stability, and ensure that U.S. mortgage markets remain connected to global capital through all economic cycles” and “ a Federal Deposit Insurance Corporation (FDIC)-like federal insurance fund in the event of catastrophic losses.” (See https://www.mba.org/issues/residential-issues/gse-reform-legislation). That is, an upside for capitalists and a downside for socialists.

VII. Discussion and Conclusion

The importance of commenting and coalition-building in the shaping of the final QRM rule suggests several valuable lessons for scholars conducting research on the political economy of influence in regulatory policy-making. The first of these is that the most important investments made by private actors seeking to affect policy may not be captured in the data on political expenditures in lobbying and campaign expenditures. When Barry L. Zubrow, Executive Vice President of JP Morgan Chase submitted a 67 page comment on credit risk retention (only part of which concerned QRM), the opportunity cost of his time and staff costs will not be reflected in the lobbying disclosure data. Likewise, the effort that the Mortgage Bankers Association employees put into the data analysis that ultimately makes its way into a coalition white paper are not counted, despite their clear importance to framing the debate. These costs are not the oft-maligned compliance costs of regulation but rather political expenditures directed at affecting regulation.

The second observation concerns the role of information and expertise in the rulemaking process. Few ordinary citizens comment on regulatory rules. Some citizen comments are just venting steam.[19] But even those that overcome the barriers to entry are rarely going to be able to put forth a quantitative analysis of the costs and benefits of a proposed rule. One who did was David A. Levine, presumably the former chief economist of Sanford C. Bernstein & Company. But his analysis lacks the political savvy of the Coalition White Paper. Levine supported the down payment standard but followed with an intelligent argument against a political untouchable, 5% retention. Personal positions, if expressed, are likely to be much less effective than those from organized interests.

To some degree, the organized interests have an informational advantage with respect to the agency. However, the advantage should not be exaggerated. The first QRM proposal refers to an abundant academic literature that guided the policy. The Federal Reserve, one of the six agencies charged with credit risk retention, has over 300 Ph.D. economists on its research staff. If the regulators did not rebut the comments calling for the alignment of QRM on QM, it is likely that they chose to acquiesce for political reasons, Accommodation was facilitated by, in the years

[19] For example, on March 31, 2011, Larry G. Walker wrote: “5% is to small of a risk, i know for a fact that the big banks, and servicing companies have------------= (sic) diservice to many people over the past 5+ years, and 5% of these loans would not make them follow rules and guide lines already in place. thanks, larry.”

following the proposed rule, by replacement of “hawk” regulators such as Sheila Bair. Accommodation is also a response to the way that courts have interpreted the notice and comment provisions of the Administrative Procedure Act -- requiring, for example, that agencies respond to comments in revised rules. Even absent an obligation to comply with a comment, if an agency chooses not to rebut it, what can it do but alter the rule in accordance with the commenters' wishes, lest it be overturned as arbitrary and capricious in court?

A third observation is that political expenditures benefit from organization. Public relations/consulting firms provide organization as well as engaging in direct lobbying. We pointed to how Rasky Baerlin organized the Coalition for Sensible Housing Policy.[20] Rasky Baerlin also organized the trade association U.S. Mortgage Insurers.[21] Forming a coalition is not a new strategy, of course. The National Consumer Bankruptcy Coalition was a coordinated effort to “reform” consumer bankruptcy law (Nunez and Rosenthal 2004). But we emphasize that uncoordinated lobbying may not represent productive expenditure.

Finally, we note how different aspects of a complex policy issue (in this case, risk regulation in mortgage markets) may or may not map onto underlying ideological cleavages in contemporary U.S. politics. As noted above, the opposition to the proposed down payment rule was broad-based and bipartisan. Other policy solutions -- such as shrinking GSEs or principal reduction -- have a distinctly partisan edge. The extent to which the policy in question maps to

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[20] http://www.rasky.com/success-stories/coalition-for-sensible-housing-policy/

[21] http://www.rasky.com/success-stories/us-mortgage-insurers-usmi/. The tactical advantage of the new association was that it was able to claim that its members remained solvent during the crisis and paid claims. See http://www.usmi.org/issues/. In fact, several mortgage insurers failed in the crisis.

partisan divisions has important consequences for a policy's viability, as well as the chances that such a policy will make it onto the agenda in the first place. A president backed by majorities in both houses of Congress will naturally employ a different set of levers than one facing a hostile Congress. A president facing a hostile Congress can still maintain the status quo—with respect to the GSEs for example—if opponents fail to have veto-proof majorities. Bankruptcy “reform” required nine years of Coalition activity partly because of opposition of the Clinton administration and some Senate Democrats. The bipartisan adjustment of QM and QRM, by contrast, was almost immediate.

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Table 1. Time line of QRM rule, agency heads, and significant political events.

Date	Event	Agency Heads					
		FDIC	FHFA	SEC	FED	COC	HUD
Feb. 4, 2010	Scott Brown's election increases Republican Senate seats to 41.						
July 21, 2010	Dodd-Frank signed by Pres.	Sheila Bair	Edward DeMarco (acting only)	Mary Schapiro	Ben Bernanke	John C. Dugan	Shaun Donovan
March 31, 2011	**Proposed QRM, 20% Down**	Sheila Bair	Edward DeMarco	Mary Schapiro	Ben Bernanke	John Walsh (acting only)	Shaun Donovan
April 29, 2011	*QM rule proposed by FED*						
July 9, 2011		Martin Gruenberg	Edward DeMarco	Mary Schapiro	Ben Bernanke	John Walsh	Shaun Donovan
April 9, 2012		Martin Gruenberg	Edward DeMarco	Mary Schapiro	Ben Bernanke	Thomas Curry	Shaun Donovan
Nov. 6, 2012	Republicans win midterm elections.						
Dec. 14, 2012		Martin Gruenberg	Edward DeMarco	Elisse Walter	Ben Bernanke	Thomas Curry	Shaun Donovan
April 10, 2013		Martin Gruenberg	Edward DeMarco	Mary Jo White	Ben Bernanke	Thomas Curry	Shaun Donovan
May 29, 2013	*CFPB issues final QM rule*						
August 28, 2013	**Proposed revised QRM, 0% Down**	Martin Gruenberg	Edward DeMarco	Mary Jo White	Ben Bernanke	Thomas Curry	Shaun Donovan
Jan. 6, 2014		Martin Gruenberg	Melvin Watt	Mary Jo White	Ben Bernanke	Thomas Curry	Shaun Donovan
Feb. 1, 2014		Martin Gruenberg	Melvin Watt	Mary Jo White	Janet Yellen	Thomas Curry	Shaun Donovan
July 28, 2014		Martin Gruenberg	Melvin Watt	Mary Jo White	Janet Yellen	Thomas Curry	Julian Castro
Oct. 22, 2014	**Final QRM, 0% Down**	Martin Gruenberg	Melvin Watt	Mary Jo White	Janet Yellen	Thomas Curry	Julian Castro

Figure 1. Lobbying Expenditures by Top 100 Mortgage Lenders

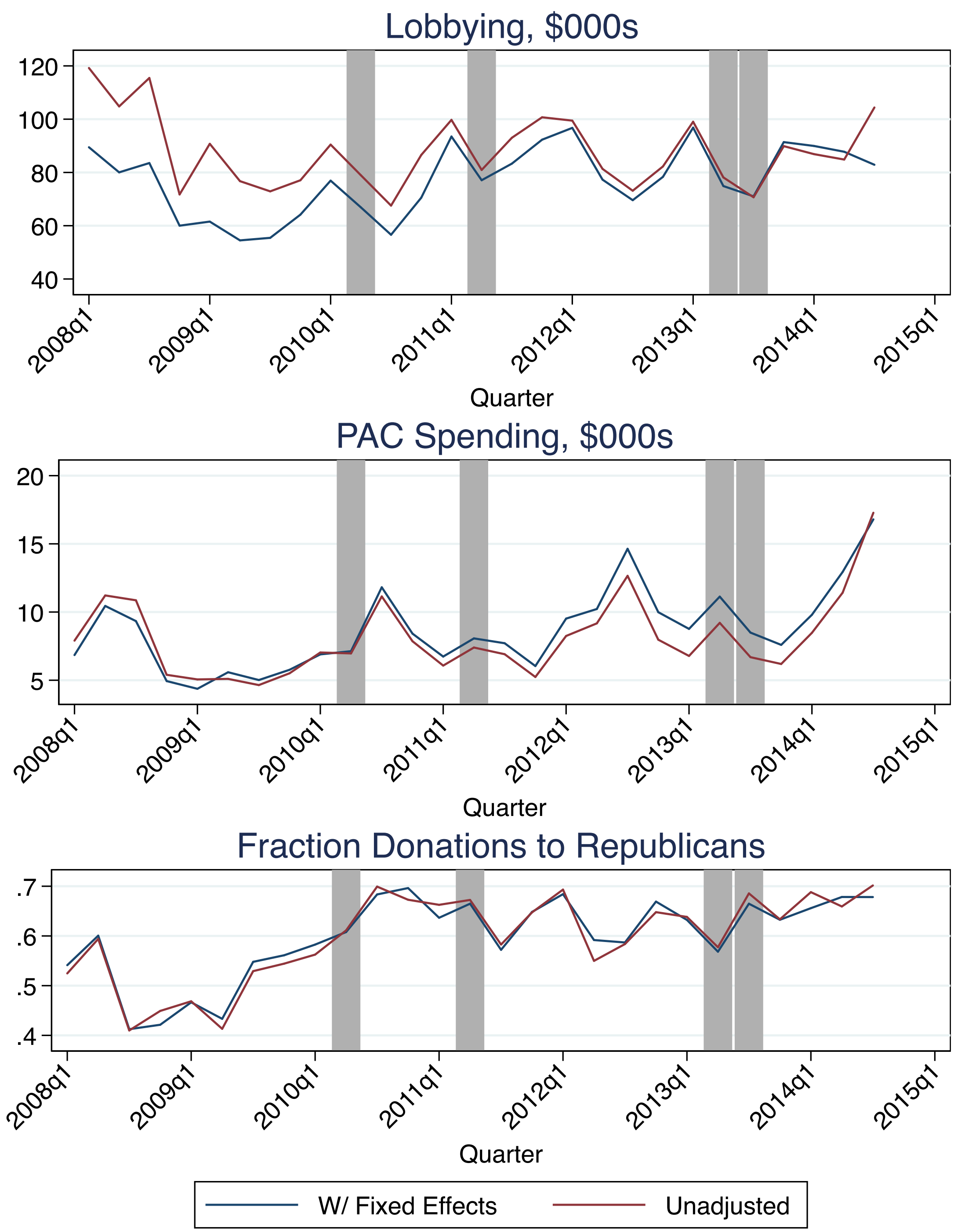

Figure 2. Lobbying Expenditures by Members of the Coalition for Sensible Housing Policy

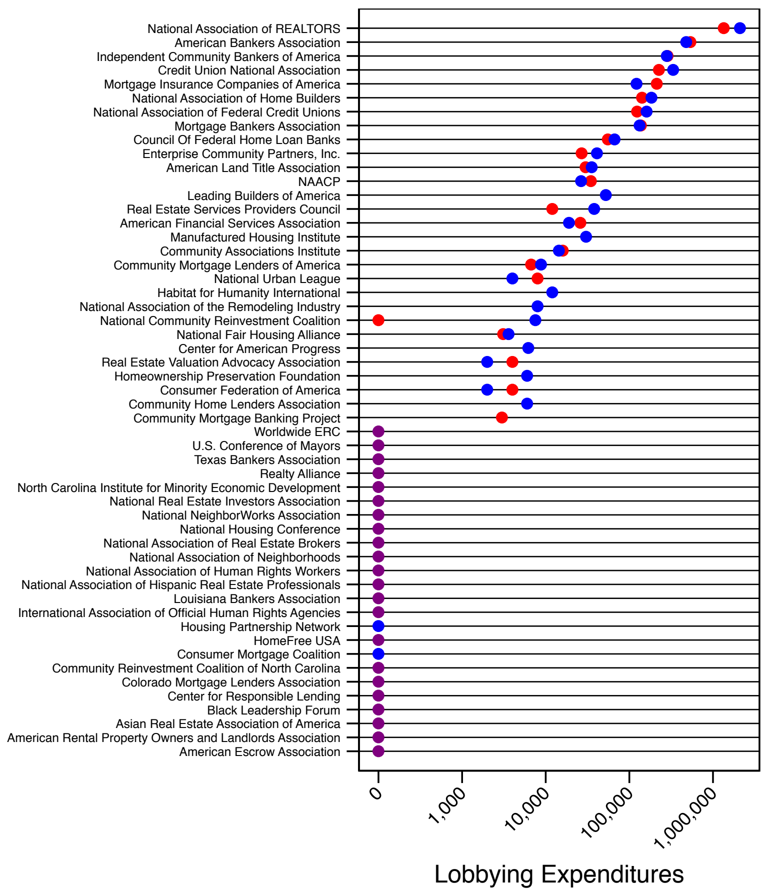

Figure 3. Ideology of 282 House Members Opposed to 20% QRM Down Payment Proposal and Members Not Signing Comment.