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REPORT
114–597

PRESERVING ACCESS TO CRE CAPITAL ACT OF 2016

MAY 26, 2016.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 4620]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 4620) to amend the Securities Exchange Act of 1934 to exempt certain commercial real estate loans from risk retention requirements, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

Introduced by Representative French Hill on February 25, 2016, H.R. 4620, the Preserving Access to CRE Capital Act of 2016, amends the risk retention requirements mandated by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for certain "qualified" commercial real estate loans. The bill also provides modest relief for one sector of commercial mortgage-backed securities knowns as the Single Asset Single Borrower ("SASB") Market. Applying risk retention requirements mandated by the Dodd-Frank Act to commercial real estate securitizations adds costs to the security borne by borrowers, which in turn stifles economic growth and reduces investor interest in the commercial real estate market.

59–006

BACKGROUND AND NEED FOR LEGISLATION

As noted by the testimony of the representative of the Commercial Real Estate Finance Council ("CREFC") at the Capital Markets and Government Sponsored Enterprises Subcommittee hearing to examine H.R. 4620, securitization "is one of the essential processes for the delivery of capital necessary for the health of commercial real estate markets and broader macro-economic growth." Section 941 of the Dodd-Frank Act is premised on a view that by requiring securitizers to retain some credit risk or—"skin in the game"—and forcing them to bear losses if a borrower defaults, securitizers will better monitor the quality of loans that are bundled into the pool.

The purpose of risk retention is to protect investors buying conduit securitizations with dozens of assets in a pool in cases where it is difficult to analyze the underlying assets. However, the concern that the underlying assets are too complicated to analyze is not an issue for securities in the SASB Market. A SASB securitization consists of a single, large mortgage on one asset (such as a mall). Usually, a single lender does not finance these large developments, which is why it is more efficient to use commercial mortgage-backed security (CMBS) financing through the public capital markets. Investors generally are attracted to SASB securitizations because they are easy to understand and underwrite and perform well. Applying the Dodd-Frank Act's risk retention requirements to SASB securities adds increased costs to borrowers, reduces returns to investors, and could hamper competition in the financing market due to increased and burdensome compliance costs. H.R. 4620 provides modest regulatory relief by exempting SASB securities from the Dodd-Frank Act's risk retention requirements.

It is important to provide relief to SASB securities because the single-asset CMBS market is the only natural, holistic funding source for commercial properties. At the end of 2015, the Federal Reserve and Office of the Comptroller of the Currency published a bulletin warning regulated institutions against over-exposure to commercial real estate—suggesting that commercial bank lending will not be a substitute funding source for such properties and that banks will in all likelihood reduce their lending in the commercial space. This reduction in lending will reduce market capacity because banks are currently the largest lenders to commercial assets; CMBS is second. If the CMBS market becomes stagnant because of the risk retention requirements, bond prices will decrease, which will harm borrowers and investors. Current investors will be forced to write down the value of their holdings; market illiquidity could have a contagion effect on the primary lending markets, which would further increase loan rates and drive demand to insurance companies and other regulated entities that do not have sufficient capital to meet market needs. Should this occur, it will affect the prices of the underlying assets—the real estate itself. The market has witnessed the effects of a precipitous drop in real estate prices through many cycles; such drops usually do not benefit investors, owners, or taxpayers. Simply put, applying the Dodd-Frank Act's risk retention mandate to the SASB market is inappropriate, misguided, and will harm market participants, including investors.

Overall, the CMBS market is losing institutional capacity. Banks and mortgage originators are leaving the market or substantially reducing their exposure to it. Once industry capacity is lost, it takes a long time before this capacity can be regenerated. A significant driver of this deterioration in the CMBS market is burdensome regulation. While the overall intent of the regulations is well-founded, the overwhelming burden of rules not appropriately tailored to the characteristics of different asset classes provides little marginal prudential improvement, if at all. At the same time, these rules generate significant costs to the end users (i.e., borrowers and consumers) and to savers whose investments are devalued as a result. Consequently, industry participants of all types have expressed concerns that regulation is institutionalizing inefficiencies, and could even severely disable the CMBS market. As the CREFC representative testified before the Capital Markets Subcommittee, "lenders and investors agree that a dislocation in CMBS will travel quickly throughout the commercial real estate debt and equity markets, impacting valuations and fundamentals and potentially inciting a negative feedback loop throughout the sector by depressing values and increasing defaults."

Risk retention regulatory relief for qualified CMBS loans

H.R. 4620 provides limited relief for qualified CMBS loans. Under current law, only a small percentage of CMBS loans are considered qualified commercial real estate (QCRE) loans and therefore exempt from risk retention requirements. Inexplicably, regulators used different factors for determining qualified residential mortgage-backed securities as compared to qualified commercial real estate mortgage-backed securities. More than 85% of today's residential mortgage-backed securities (RMBS) loans would qualify for an exemption from risk retention; however, in the CMBS market, only 3–8% of all CMBS loans would qualify. The current inconsistent treatment of qualified commercial versus residential mortgage-based securities defies logical explanation, given that failed housing policies precipitated the financial crisis. Accordingly, H.R. 4620 affords similar and appropriate treatment to qualified CMBS loans.

Representative Hill's legislation restores the proper balance between risk retention and a healthy, functioning CMBS market for borrowers and employers across the United States. Specifically, H.R. 4620: (1) exempts SASB securities from the Dodd-Frank Act's risk retention requirements; (2) sets reasonable parameters for regulating and designating certain high-quality commercial loans as "qualified" and therefore exempt from the risk retention rules; and (3) provides flexibility to suit investors by making risk retention requirements applicable to third party purchasers of commercial real estate loans less onerous.

Required rulemaking

The Committee believes that regulators had the authority to limit the application of the Dodd-Frank Act's risk retention requirements to commercial mortgages because of the inclusion of language within Section 941(b), which added Section 15G to the Securities Exchange Act of 1934. The regulators' decision not to exercise this authority necessitated H.R. 4620, which requires the issuance of one joint rule by the prudential regulators and the Securities and Exchange Commission to provide relief for a subset of commercial mortgages known as the "qualified" commercial real estate loan.

Hearings

The Committee on Financial Services' Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing examining matters relating to H.R. 4620 on February 24, 2016.

Committee Consideration

The Committee on Financial Services met in open session on March 2, 2016, and ordered H.R. 4620 to be reported favorably to the House without amendment by a recorded vote of 39 yeas to 18 nays (recorded vote no. FC–101), a quorum being present.

Committee Votes

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole record vote in Committee was a motion by Chairman Hensarling to report the bill favorably to the House without amendment. That motion was agreed to by a recorded vote of 39 yeas to 18 nays (Record vote no. FC–101), a quorum being present.

Record vote no. FC-101

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling	X			Ms. Waters (CA)		X	
Mr. King (NY)	X			Mrs. Maloney (NY)		X	
Mr. Royce	X			Ms. Velázquez		X	
Mr. Lucas	X			Mr. Sherman		X	
Mr. Garrett	X			Mr. Meeks		X	
Mr. Neugebauer	X			Mr. Capuano		X	
Mr. McHenry	X			Mr. Hinojosa			
Mr. Pearce	X			Mr. Clay		X	
Mr. Posey	X			Mr. Lynch		X	
Mr. Fitzpatrick	X			Mr. David Scott (GA)	X		
Mr. Westmoreland				Mr. Al Green (TX)		X	
Mr. Luetkemeyer	X			Mr. Cleaver		X	
Mr. Huizenga (MI)	X			Ms. Moore		X	
Mr. Duffy	X			Mr. Ellison		X	
Mr. Hurt (VA)	X			Mr. Perlmutter		X	
Mr. Stivers	X			Mr. Himes		X	
Mr. Fincher	X			Mr. Carney	X		
Mr. Stutzman	X			Ms. Sewell (AL)		X	
Mr. Mulvaney				Mr. Foster	X		
Mr. Hultgren	X			Mr. Kildee		X	
Mr. Ross	X			Mr. Murphy (FL)	X		
Mr. Pittenger	X			Mr. Delaney	X		
Mrs. Wagner	X			Ms. Sinema	X		
Mr. Barr	X			Mrs. Beatty		X	
Mr. Rothfus	X			Mr. Heck (WA)		X	
Mr. Messer	X			Mr. Vargas	X		
Mr. Schweikert	X						
Mr. Guinta	X						
Mr. Tipton	X						
Mr. Williams	X						
Mr. Poliquin	X						
Mrs. Love	X						
Mr. Hill	X						
Mr. Emmer	X						

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 4620 will reduce costs to borrowers, increase returns to investors, and increase competition amongst credit providers by modifying the Dodd-Frank Act's risk retention requirements for certain commercial real estate loans and by providing modest relief for the Single Asset Single Borrower (SASB) market.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, May 23, 2016.

Hon. JEB HENSARLING,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 4620, the Preserving Access to CRE Capital Act of 2016.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

KEITH HALL.

Enclosure.

H.R. 4620—Preserving Access to CRE Capital Act of 2016

Under current law, issuers of securities that are backed by a pool of financial assets must retain an economic interest in the assets underlying the securities that they issue, a feature known as risk retention. H.R. 4620 would exempt from that requirement a class of securities related to commercial real estate if the securitized mortgage is backed by a loan, or group of loans, on commercial properties under common ownership or control. (Such securities are known as the Single Asset Single Borrower security class.) H.R. 4620 also would exempt some qualified commercial real estate loans from the risk-retention requirement. Finally, H.R. 4620 would change the requirements regarding who may purchase residual risk from an issuer and how it is retained.

The bill would direct the federal banking agencies—the Federal Reserve, Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC)—and the Securities and Exchange Commission (SEC) to issue the standards required to qualify for the exemption and those agencies would need to revise current regulations concerning exemptions to risk-retention requirements.

Based on information from those four agencies, CBO estimates that the costs of revising the regulations would not be significant. The SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending would be negligible, assuming appropriations actions consistent with that authority.

Costs incurred by the FDIC and the OCC are recorded in the budget as increases in direct spending. Those two agencies are authorized to collect premiums and fees from insured depository institutions to cover administrative expenses. CBO expects that they would do so to recover any costs associated with amending current regulations under the bill. Costs to the Federal Reserve System are reflected on the federal budget as a reduction in remittances to the Treasury (which are recorded in the budget as revenues). Because enacting H.R. 4620 would affect direct spending and revenues, pay-as-you-go procedures apply. However, CBO estimates that the net effects would be insignificant for each year. CBO estimates that enacting H.R. 4620 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2027.

H.R. 4620 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments.

If the SEC, FDIC, or OCC increase fees to offset the costs of implementing the bill, H.R 4620 would increase the cost of an existing mandate on private entities required to pay those fees. Based on information from the affected agencies, CBO estimates that the incremental cost of the mandate, if imposed, would be minimal and would fall well below the annual threshold for private-sector mandates established in UMRA ($154 million in 2016, adjusted annually for inflation).

The CBO staff contact for this estimate is Stephen Rabent. The estimate was approved by H. Samuel Papenfuss, Deputy Assistance Director for Budget Analysis.

Federal Mandates Statement

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates reform Act.

Advisory Committee Statement

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

Applicability to Legislative Branch

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

Earmark Identification

H.R. 4620 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

Duplication of Federal Programs

Pursuant to section 3(g) of H. Res. 5, 114th Cong. (2015), the Committee states that no provision of H.R. 4620 establishes or reauthorizes a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

Disclosure of Directed Rulemaking

Pursuant to section 3(i) of H. Res. 5, 114th Cong. (2015), the Committee states that H.R. 4620 contains one directed rulemaking.

Section-by-Section Analysis of the Legislation

Section 1: Short title

This section cites H.R. 4620 as the “Preserving Access to CRE Capital Act of 2016”.

Section 2: Exemption for certain commercial real estate loans from risk retention requirements

This section amends Section 15G of the Securities Exchange Act of 1934 to exempt single loan commercial real estate securities from the risk retention requirements mandated by the Act. In addition, this section exempts qualified commercial real estate loans from the risk retention requirements, and directs the federal regulators to consider specific standards when adopting the qualified commercial real estate loan exemption. This section also provides flexibility to structure the retained interest to third-party purchases of Commercial Mortgage Backed Securities (CMBS).

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

SECURITIES EXCHANGE ACT OF 1934

* * * * * * *

TITLE I—REGULATION OF SECURITIES EXCHANGES

* * * * * * *

SEC. 15G. CREDIT RISK RETENTION.

(a) DEFINITIONS.—In this section—

(1) the term "Federal banking agencies" means the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation;

(2) the term "insured depository institution" has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c));

(3) the term "securitizer" means—

(A) an issuer of an asset-backed security; or

(B) a person who organizes and initiates an asset-backed securities transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer; and

(4) the term "originator" means a person who—

(A) through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security; and

(B) sells an asset directly or indirectly to a securitizer.

(b) REGULATIONS REQUIRED.—

(1) IN GENERAL.—Not later than 270 days after the date of enactment of this section, the Federal banking agencies and the Commission shall jointly prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party.

(2) RESIDENTIAL MORTGAGES.—Not later than 270 days after the date of the enactment of this section, the Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Federal Housing Finance Agency, shall jointly prescribe regulations to require any securitizer to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer, through the issuance of an asset-backed security, transfers, sells, or conveys to a third party.

(c) STANDARDS FOR REGULATIONS.—

(1) STANDARDS.—The regulations prescribed under subsection (b) shall—

(A) prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain with respect to an asset;

(B) require a securitizer to retain—

(i) not less than 5 percent of the credit risk for any asset—

(I) that is not a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer; or

(II) that is a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer, if 1 or more of the assets that collateralize the asset-backed security are not qualified residential mortgages; or

(ii) less than 5 percent of the credit risk for an asset that is not a qualified residential mortgage that is transferred, sold, or conveyed through the issuance of an asset-backed security by the securitizer, if the originator of the asset meets the underwriting standards prescribed under paragraph (2)(B);

(C) specify—

(i) the permissible forms of risk retention for purposes of this section;

(ii) the minimum duration of the risk retention required under this section; and

(iii) that a securitizer is not required to retain any part of the credit risk for an asset that is transferred, sold or conveyed through the issuance of an asset-backed security by the securitizer, if all of the assets that collateralize the asset-backed security are qualified residential mortgages;

(D) apply, regardless of whether the securitizer is an insured depository institution;

(E) with respect to a commercial mortgage, specify the permissible types, forms, and amounts of risk retention that would meet the requirements of subparagraph (B), which in the determination of the Federal banking agencies and the Commission may include—

(i) retention of a specified amount or percentage of the total credit risk of the asset;

(ii) [retention of the first-loss position by a third-party purchaser that] *retention of the first-loss position by a one or two party third-party purchaser, who may hold the retention obligation in either a senior-subordinate structure or pari passu, provided that each* specifically negotiates for the purchase of such first loss position, holds adequate financial resources to back losses, provides due diligence on all individual assets in the pool before the issuance of the asset-backed securities, and meets the same standards for risk retention as the Federal banking agencies and the Commission require of the securitizer;

(iii) a determination by the Federal banking agencies and the Commission that the underwriting standards and controls for the asset are adequate; and

(iv) provision of adequate representations and warranties and related enforcement mechanisms; and

(F) establish appropriate standards for retention of an economic interest with respect to collateralized debt obligations, securities collateralized by collateralized debt obligations, and similar instruments collateralized by other asset-backed securities; and

(G) provide for—

(i) a total or partial exemption of any securitization, as may be appropriate in the public interest and for the protection of investors;

(ii) a total or partial exemption for the securitization of an asset issued or guaranteed by the United States, or an agency of the United States, as the Federal banking agencies and the Commission jointly determine appropriate in the public interest and for the protection of investors, except that, for purposes of this clause, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation are not agencies of the United States;

(iii) a total or partial exemption for any asset-backed security that is a security issued or guaranteed by any State of the United States, or by any political subdivision of a State or territory, or by any public instrumentality of a State or territory that is exempt from the registration requirements of the Securities Act of 1933 by reason of section 3(a)(2) of that Act (15 U.S.C. 77c(a)(2)), or a security defined as a qualified scholarship funding bond in section 150(d)(2) of the Internal Revenue Code of 1986, as may be appropriate in the public interest and for the protection of investors; and

(iv) the allocation of risk retention obligations between a securitizer and an originator in the case of a securitizer that purchases assets from an originator, as the Federal banking agencies and the Commission jointly determine appropriate.

(2) ASSET CLASSES.—

(A) ASSET CLASSES.—The regulations prescribed under subsection (b) shall establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets that the Federal banking agencies and the Commission deem appropriate.

(B) CONTENTS.—For each asset class established under subparagraph (A), the regulations prescribed under subsection (b) shall include underwriting standards established by the Federal banking agencies that specify the terms, conditions, and characteristics of a loan within the asset class that indicate a low credit risk with respect to the loan.

(d) ORIGINATORS.—In determining how to allocate risk retention obligations between a securitizer and an originator under subsection (c)(1)(E)(iv), the Federal banking agencies and the Commission shall—

(1) reduce the percentage of risk retention obligations required of the securitizer by the percentage of risk retention obligations required of the originator; and

(2) consider—

(A) whether the assets sold to the securitizer have terms, conditions, and characteristics that reflect low credit risk;

(B) whether the form or volume of transactions in securitization markets creates incentives for imprudent origination of the type of loan or asset to be sold to the securitizer; and

(C) the potential impact of the risk retention obligations on the access of consumers and businesses to credit on reasonable terms, which may not include the transfer of credit risk to a third party.

(e) EXEMPTIONS, EXCEPTIONS, AND ADJUSTMENTS.—

(1) IN GENERAL.—The Federal banking agencies and the Commission may jointly adopt or issue exemptions, exceptions, or adjustments to the rules issued under this section, including exemptions, exceptions, or adjustments for classes of institutions or assets relating to the risk retention requirement and the prohibition on hedging under subsection (c)(1).

(2) APPLICABLE STANDARDS.—Any exemption, exception, or adjustment adopted or issued by the Federal banking agencies and the Commission under this paragraph shall—

(A) help ensure high quality underwriting standards for the securitizers and originators of assets that are securitized or available for securitization; and

(B) encourage appropriate risk management practices by the securitizers and originators of assets, improve the access of consumers and businesses to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors.

(3) CERTAIN INSTITUTIONS AND PROGRAMS EXEMPT.—

(A) FARM CREDIT SYSTEM INSTITUTIONS.—Notwithstanding any other provision of this section, the requirements of this section shall not apply to any loan or other financial asset made, insured, guaranteed, or purchased by any institution that is subject to the supervision of the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation.

(B) OTHER FEDERAL PROGRAMS.—This section shall not apply to any residential, multifamily, or health care facility mortgage loan asset, or securitization based directly or indirectly on such an asset, which is insured or guaranteed by the United States or an agency of the United States. For purposes of this subsection, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal home loan banks shall not be considered an agency of the United States.

(4) EXEMPTION FOR QUALIFIED RESIDENTIAL MORTGAGES.—

(A) IN GENERAL.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency shall jointly issue regulations to exempt qualified residential mortgages from the risk retention requirements of this subsection.

(B) QUALIFIED RESIDENTIAL MORTGAGE.—The Federal banking agencies, the Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency shall jointly define the term "qualified residential mortgage" for purposes of this subsection, taking into consideration underwriting and product features that historical loan performance data indicate result in a lower risk of default, such as—

(i) documentation and verification of the financial resources relied upon to qualify the mortgagor;

(ii) standards with respect to—

(I) the residual income of the mortgagor after all monthly obligations;

(II) the ratio of the housing payments of the mortgagor to the monthly income of the mortgagor;

(III) the ratio of total monthly installment payments of the mortgagor to the income of the mortgagor;

(iii) mitigating the potential for payment shock on adjustable rate mortgages through product features and underwriting standards;

(iv) mortgage guarantee insurance or other types of insurance or credit enhancement obtained at the time of origination, to the extent such insurance or credit enhancement reduces the risk of default; and

(v) prohibiting or restricting the use of balloon payments, negative amortization, prepayment penalties, interest-only payments, and other features that have been demonstrated to exhibit a higher risk of borrower default.

(C) LIMITATION ON DEFINITION.—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 section 129C(c)(2) of the Truth in Lending Act, as amended by the Consumer Financial Protection Act of 2010, and regulations adopted thereunder.

(5) CONDITION FOR QUALIFIED RESIDENTIAL MORTGAGE EXEMPTION.—The regulations issued under paragraph (4) shall provide that an asset-backed security that is collateralized by tranches of other asset-backed securities shall not be exempt from the risk retention requirements of this subsection.

(6) EXEMPTION FOR CERTAIN COMMERCIAL REAL ESTATE LOANS.—

(A) EXEMPTION FOR SINGLE LOAN COMMERCIAL REAL ESTATE SECURITIZATION.—A securitization of a single commercial real estate loan or a group of cross-collateralized or cross-defaulted commercial real estate loans that represent the obligation of one or more related borrowers secured by one or more commercial properties under direct or indirect common ownership or control is exempt from the risk retention requirements of this section.

(B) EXEMPTION FOR QUALIFIED COMMERCIAL REAL ESTATE LOANS.—

(i) REGULATIONS REQUIRED.—The Federal banking agencies and the Commission shall jointly maintain regulations to exempt qualified commercial real estate loans from the risk retention requirements of this section.

(ii) STANDARDS FOR REGULATIONS.—The regulations issued under clause (i) shall—

(I) include the requirements under which interest-only loans may be exempt from the risk retention requirements of this section;

(II) not impose any term requirements on the length of a qualified commercial real estate loan;

(III) if an amortization requirement is included, not impose an amortization schedule of less than 30 years; and

(IV) not impose separate loan-to-value ratio caps on qualified commercial real estate loans that are documented with appraisals that utilize lower capitalization rates than other loans.

[(6)**]** *(7)* CERTIFICATION.—The Commission shall require an issuer to certify, for each issuance of an asset-backed security collateralized exclusively by qualified residential mortgages, that the issuer has evaluated the effectiveness of the internal supervisory controls of the issuer with respect to the process for ensuring that all assets that collateralize the asset-backed security are qualified residential mortgages.

(f) ENFORCEMENT.—The regulations issued under this section shall be enforced by—

(1) the appropriate Federal banking agency, with respect to any securitizer that is an insured depository institution; and

(2) the Commission, with respect to any securitizer that is not an insured depository institution.

(g) AUTHORITY OF COMMISSION.—The authority of the Commission under this section shall be in addition to the authority of the Commission to otherwise enforce the securities laws.

(h) AUTHORITY TO COORDINATE ON RULEMAKING.—The Chairperson of the Financial Stability Oversight Council shall coordinate all joint rulemaking required under this section.

(i) EFFECTIVE DATE OF REGULATIONS.—The regulations issued under this section shall become effective—

(1) with respect to securitizers and originators of asset-backed securities backed by residential mortgages, 1 year after the date on which final rules under this section are published in the Federal Register; and

(2) with respect to securitizers and originators of all other classes of asset-backed securities, 2 years after the date on which final rules under this section are published in the Federal Register.

* * * * * * *

MINORITY VIEWS

H.R. 4620, the "Preserving Access to CRE Capital Act of 2016," would weaken the risk retention rules promulgated under the Dodd-Frank Wall Street Reform and Consumer Protection Act as they apply to the Commercial Mortgage Backed Securities (CMBS) market. This bill is yet another piece of legislation that deliberately ignores the financial crisis of 2008, the failure of the securitization model during that crisis, the broad devastation the crisis and the residential mortgage-backed securities (RMBS) market brought to our economy and the millions of Americans who lost their homes. While most attention and blame for the crisis fell on the actions in the RMBS market, Democrats recall that concerns about the credit quality of Lehman Brothers' commercial real estate loan warehouse directly led to Lehman's bankruptcy, which precipitated the complete shutdown of our credit markets in September of 2008.

Democrats understand that the financial crisis did not only expose the weaknesses of the RMBS model, but the entire process of securitization. For example, economists at the Federal Reserve Bank of New York found that "investors" aversion to . . . CMBS . . . increased steadily from 2007 and reached staggering proportions in late 2008. It reflected anxiety over a possible rapid increase in commercial mortgage loan defaults driven by the decline in credit standards and high leverage of many properties in CMBS loan pools as well as the potential for a severe economic downturn." Not surprisingly, new issuances of CMBS, as with private RMBS, all but disappeared between 2008 and 2009 as investors fled this market. Investors had learned that the underlying commercial mortgages were poorly underwritten, with excessive leverage and unrealistic appraisals.

In passing financial reform, Congress recognized that every asset-backed security, including CMBS, can fall into the trap of "originate-to-distribute," whereby a lender makes a loan without regard to whether the borrower can repay because the loan can be packaged up into a security and sold to unsuspecting investors who bear all the risk. Congress realigned the market incentives by requiring either the lender or the securitizer of all types of assets, including credit cards, commercial loans, auto loans, residential mortgages and commercial mortgages, to have "skin in the game," by retaining five percent of the credit risk of the security. By retaining this slice of the risk, the securitizer becomes more concerned with the quality of the underlying loans because its money is also at stake.

Dodd-Frank also recognized that if a security was backed by only the most pristine loans, there was no need to require "skin in the game;" however, H.R. 4620 undermines this gold standard by expanding the exemption to interest only loans, removing term requirements, lengthening amortization requirements and removing restrictions designed to limit the industry's use of unrealistic appraisals. The bill would also create a loophole from the rules by exempting CMBS comprised of one or more loans to a single business. When crafting the risk retention rule, the financial regulators considered and rejected each of the proposals included in H.R. 4620 because, after evaluating extensive public comment, they determined that they are not in the public interest. And to be clear, securitizers can still package up the loans that fail to meet the gold standard, but because of the loans' heightened risk, they must retain a portion of the credit risk.

Democrats worked in a bipartisan fashion to put in place key reforms to not only prevent a repeat of the 2008 financial crisis, but to also eliminate flawed incentives throughout the financial markets to prevent future crises. H.R. 4620 would undo some of these reforms, and for these reasons, Democrats oppose it.

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