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***Submitted via email***

July 22, 2011

Jennifer J. Johnson  
Secretary,  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Re: 12 CFR Part 226: Truth in Lending: Proposed Rule Amending  
Regulation Z to Implement Ability to Repay Standards – Docket No.  
R-1417

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)<sup>1</sup> appreciates the opportunity to comment on this proposed rule which would amend the Truth in Lending Act's Regulation Z to require creditors to determine a consumer's ability to repay a mortgage before making the loan and establish minimum mortgage

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<sup>1</sup>*The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

*With nearly 5,000 members, representing more than 20,000 locations nationwide and employing nearly 300,000 Americans, ICBA members hold \$1 trillion in assets, \$800 billion in deposits, and \$700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at [www.icba.org](http://www.icba.org).*

underwriting standards. These regulatory amendments are being proposed pursuant to amendments made to the Truth in Lending Act (TILA) by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Federal Reserve's proposed rule will have significant effects on the mortgage lending business of community banks, and ICBA strongly urges the Consumer Financial Protection Bureau (CFPB) to consider the comments represented in this letter as it moves forward with finalizing the requirements.

## **Background**

Section 1411 of the Dodd-Frank Act prohibits a creditor from making a mortgage loan unless the originator makes a reasonable determination, in good faith, based on verified and documented information at the time the loan is consummated, that the consumer has the ability to repay the loan, all applicable taxes, insurance and assessments. Section 1412 states if the loan satisfies the qualified mortgage definition, it is presumed to satisfy the ability-to-repay requirements.

The Federal Reserve proposed regulations to implement the ability-to-repay requirements of the Dodd-Frank Act in April 2011. The Federal Reserve's existing Regulation Z rules prohibit a creditor from making a higher-priced mortgage loan without regard to the consumer's ability to make the loan payments from income or assets other than the property. The Dodd-Frank Act expands on the ability-to-repay requirement to cover any consumer credit transaction secured by a dwelling regardless of how the loan is priced, except that open-end credit plans, timeshare plans, reverse mortgages and temporary loans are excluded from these requirements. Pursuant to the Dodd-Frank Act, rule writing authority over Regulation Z is expected to transfer to the CFPB on July 21, 2011, and therefore this rulemaking will be completed by the CFPB.

Under the Federal Reserve's proposed rule, the regulation provides four options for complying with the ability-to-repay standard. First, a creditor can satisfy the general ability-to-repay standard by considering and verifying eight underwriting factors, which would include current or reasonably expected income or assets, other than the value of the dwelling that secures the loan; current employment status, if income is relied on to determine repayment ability; the monthly payment on the mortgage; the monthly payment on any simultaneous mortgage; the monthly payment for mortgage-related obligations; current debt obligations; the monthly debt-to-income ratio, or residual income; and credit history. The creditor would also be required to underwrite the payment for an adjustable-rate mortgage based on the fully indexed rate.

Alternatively, a creditor can originate a "qualified mortgage," which provides special protection from liability. The Federal Reserve is soliciting comment on

two alternative definitions of what would be deemed a “qualified mortgage.” Alternative 1 would operate as a legal safe harbor from the ability-to-repay requirements and define a “qualified mortgage” as a mortgage for which the loan does not contain negative amortization, interest-only payments, a balloon payment, or a loan term exceeding 30 years; the total points and fees do not exceed 3 percent of the total loan amount; the income or assets relied upon in making the ability-to-repay determination are considered and verified; and the underwriting of the mortgage (1) is based on the maximum interest rate that may apply in the first five years, (2) uses a payment schedule that fully amortizes the loan over the loan term, and (3) takes into account any mortgage-related obligations.

Alternative 2 would provide a rebuttable presumption of compliance, not a safe harbor, and would define a “qualified mortgage” to include all the criteria listed under Alternative 1, as well as additional underwriting requirements from the general ability-to-repay standard. Thus, under Alternative 2, a creditor would also have to consider and verify the consumer’s employment status, the monthly payment for any simultaneous mortgage, the consumer’s current debt obligations, the monthly debt-to-income ratio or residual income, and the consumer’s credit history, in addition to the loan requirements under Alternative 1.

Even though both alternative definitions of “qualified mortgage” exclude balloon payment loans, the proposed rule would allow some creditors operating predominantly in rural or underserved areas to originate balloon-payment qualified mortgages that meet certain loan requirements. Under this option, some creditors can make a balloon-payment qualified mortgage with a loan term of five years or more by complying with the requirements for a qualified mortgage and underwriting the mortgage based on the scheduled payment, except for the balloon payment.

Under the proposed rule, a creditor can also refinance a “non-standard mortgage” with less conventional features into a more stable “standard mortgage.” Under this option, a creditor complies by refinancing the loan into a “standard mortgage” that has limits on loan fees and that does not contain certain features such as negative amortization, interest-only payments or a balloon payment; considering and verifying the underwriting factors listed in the general ability-to-repay standard, except the requirement to consider and verify the consumer’s income or assets; and underwriting the “standard mortgage” based on the maximum interest rate that can apply in the first five years.

In addition, the Federal Reserve’s proposed rule would implement the Dodd-Frank Act’s limits on prepayment penalties; lengthen the time creditors must retain records that evidence compliance with the ability-to-repay and prepayment

penalty provisions; and prohibit evasion of the rule by structuring a closed-end extension of credit as an open-end plan.

### **ICBA Position**

The proposed “ability-to-repay” and “qualified mortgage” requirements under Title 14 of the Dodd-Frank Act have the same objective as the Dodd-Frank Credit Risk Retention and “Qualified Residential Mortgage” requirements, in that they seek to insure that only solid and safe residential mortgage loans are provided to consumers.

While ICBA understands the need for more and better regulation to police the practices of irresponsible lenders, we are fearful that much of this regulation will lead to an economic environment where only a few larger lenders may compete and do business, because they, unlike smaller community banks, are better able to absorb the increased regulatory burden. The reality would contravene the measures contained in the Dodd-Frank Act that seek to reduce systemic risk and eliminate too-big-to-fail, not perpetuate it.

One way to enable community banks to effectively compete in the mortgage market is to allow a safe harbor for qualified mortgages from the ability-to-repay requirements, and to ensure atypical loans that are often provided to community bank customers, such as balloon payment mortgages, can continue to be made available to the consumers who need them. A clear and bright-line definition of qualified mortgage operating as a safe harbor would better assure that community banks continue to provide mortgage loans, because they have the ability to assure their regulatory compliance. But, too narrow a definition would impede the ability of community banks to provide mortgage loans, which would limit access to credit for many borrowers.

### **Summary of ICBA Comments**

ICBA’s key comments expressed in this letter can be summarized as follows:

- The CFPB should recognize the differences between community banks and the larger lenders and mortgage brokers when implementing final requirements for mortgage lending.
- The CFPB should consider the regulatory burden imposed on smaller lenders as it drafts final regulatory requirements.
- ICBA encourages the CFPB to re-propose the rulemaking for public comment, given the complexity of the requirements and the various options for comment presented by the Federal Reserve.

- The CFPB should actively engage community bankers in industry outreach meetings before developing the final regulatory requirements on the ability to repay and qualified mortgages.
- The CFPB should allow a safe harbor for “qualified mortgages” from the ability-to-repay requirements.
- Home Equity Lines of Credit (HELOCs) should not be included in the definition of simultaneous loans, under the ability-to-repay standard.
- Balloon mortgage loans held in portfolio by financial institutions should be permitted under the safe harbor definition of “qualified mortgage.”
- The proposed definitions of “rural” and “underserved” under the balloon payment exemption are complicated and would exclude many community banks that should be covered by the exemption.
- The Federal Reserve’s proposed alternatives for the prohibited sale of balloon payment loans should be re-examined, and should clarify that any balloon payment loan held in portfolio by the financial institution can be a “qualified mortgage,” if the other loan criteria is satisfied.
- The CFPB should not make any changes to the “annual percentage rate” calculation for higher-priced covered transactions at this time.
- The CFPB should pursue a points and fees calculation for smaller loans that mirrors the structure of the proposed Alternative 1, but includes higher percentage amounts for smaller loans, to insure they will be included as “qualified mortgages.”
- Loan originator compensation should not be included in the calculation for points and fees, to determine if a loan is a “qualified mortgage.”
- The definition of “loan originator” should not include people who solely represent to the public that they can offer or negotiate mortgage terms. The definition should be consistent with the definition under the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act).
- Points and fees paid after loan closing that are not reflected or known at loan closing should not be included in the points and fees calculation for determining a “qualified mortgage.”

## **The Business Model of Community Banks**

Community banks play an important role in our nation's economy. Because most community banks are locally owned and operated, they have strong ties to their local communities. Community bankers also have a close relationship with their customers and consequently, are very familiar with their customers' financial condition, history and ability to repay mortgage loans.

Because community banks have a vested interest in the economic well-being of their customers and communities, they do not engage in abusive lending practices, such as lending with limited documentation and few underwriting criteria, providing less conventional loans to individuals without proper underwriting or substantial down payments, and steering consumers to loan products that are not in their best financial interest. ICBA understands the intent of Congress to further regulate the mortgage industry to prevent these abuses from occurring in the future, and further stabilize the housing market. Nevertheless, the reality is that narrowly constructed rules could further stymie the housing market and community banks' ability to provide mortgage loans to their customers.

When drafting final amendments to Regulation Z, ICBA urges the CFPB to remember that community banks have always engaged in responsible mortgage lending practices due to their vested interest in their communities and the consumers they serve. Operationally, many community bank mortgage loans are held in portfolio and are not sold on the secondary market; therefore the underwriting for these loans has historically been more conservative since the banks have a vested interest in how the loans perform. They have obtained 100 percent of the risk in the loan. Community banks also take great time to educate and inform their customers about the consequences of their borrowing decisions because of the banks' vested interest in the performance of these loans and the more familiar relationship community bankers have with their customers.

Furthermore, for many community banks, mortgage loan transactions are often not the cookie-cutter loan transactions found in the suburban and urban housing markets where there are rows and rows of similar houses. Many times, community bank mortgage loans are provided to consumers who have a unique situation, because of the various sizes of acreages, potential for a manufactured home deal, or the atypical location of the home. These situations do not fit the typical 30-year mortgage loan model because of the atypical nature of the property and the consumer's financial situation. Many of these loans are not eligible for sale in the secondary market. Community banks are especially adaptable at making such loans because the bankers know their customers and community members, and have extensive knowledge of the home properties.

The differences between the lending practices of community banks and the larger national financial institutions should be considered in the final rulemaking. The “one size fits all” approach to recent mortgage laws and regulations does not account for the fact that atypical mortgage products are effective for many consumers, if the loans are provided by honest lenders such as community banks.

### **Regulatory Burden Will Eliminate Community Bank Mortgage Lending**

While ICBA understands that some regulation is needed, we are quite concerned that Congress and the financial regulators have allowed the pendulum to swing too far in the other direction, which will severely impact the mortgage business of community banks and the availability of credit in their communities. Community banks are smaller financial institutions that serve their communities, and by nature do not have the extensive legal and compliance resources to absorb all of the often superfluous regulatory changes that have occurred in the last three years. To illustrate, from 2008 – 2011, the following regulatory changes regarding mortgage lending have been proposed or finalized:

- Home Ownership and Equity Protection Act (HOEPA), Final Rule (July 30, 2008)
- Mortgage Disclosure Improvement Act, Final Rule (May 19, 2009)
- Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act), Final Rule (July 28, 2010)
- Mortgage Disclosure Improvement Act, Interim Final Rule (Sept. 24, 2010)
- Helping Families Save Their Homes Act – Mortgage Transfer Disclosure, Final Rule (Sept. 24, 2010)
- Loan Originator Compensation, Final Rule (Sept. 24, 2010)
- Dodd-Frank Act – Appraisal Independence, Interim Final Rule (Oct. 28, 2010)
- Dodd-Frank Act – Escrow Account, Final Rule (March 2, 2011)
- Regulatory Review of Disclosure Rules for Closed-end Mortgages (Aug. 26, 2009)
- Regulatory Review of Disclosure Rules for Home Equity Lines of Credit (Aug. 26, 2009)
- Regulatory Review of Mortgage Disclosure Rules (Sept. 24, 2010)
- Dodd-Frank Act – Escrow Account Disclosures (March 2, 2011)
- Dodd-Frank Act - Interagency Proposed Rule on Qualified Residential Mortgages (Mar. 29, 2011)
- Dodd-Frank Act – Ability to Repay/Qualified Mortgages (May 11, 2011)

This massive amount of regulatory change has amounted to thousands of pages

of requirements and explanatory text that a small community bank staff must read, understand and implement. Community banks must also write policies and procedures for regulatory changes and provide training for their staff.

This amount of regulatory change has led many community banks to limit or completely eliminate their mortgage business due to their inability to absorb all of the regulatory changes. To illustrate this reality, since the Federal Reserve's escrow requirements for higher-priced mortgage loans became effective, a survey of 677 of our members indicated that 37 percent of the bank respondents completely stopped making the types of mortgages that would trigger the Regulation Z escrow requirements, thus completely limiting or eliminating their mortgage business and the options available for their customers to access credit.

In regard to regulatory burden, President Obama asked the independent regulatory agencies to streamline the regulatory process in order to make agencies' programs more effective and less burdensome.<sup>2</sup> The Executive Order states that "Wise regulatory decisions depend on public participation and on careful analysis of the likely consequences of regulation.... To the extent permitted by law, such decisions should be made only after consideration of their costs and benefits (both quantitative and qualitative)."

ICBA encourages the CFPB to follow President Obama's direction and consider the burdensome cost of further regulation on the community banking industry before finalizing these requirements.

### **The CFPB Should Re-Propose the Ability-to-Repay Regulatory Amendments**

The Federal Reserve's proposed rule contains many general and specific policy questions, and asks for data and feedback from financial institutions. Because of the extensive feedback being requested, ICBA requests that the CFPB gather further information from industry outreach, and re-propose another rulemaking for public comment. Many questions being asked by the Federal Reserve in this proposed rule could receive responses that lead the CFPB to decide on completely different regulatory requirements, rendering a re-proposal for public comment necessary. Furthermore, given the considerable requirements in this proposed rulemaking and the effect these requirements will have on the mortgage industry and consumers across the country, a re-proposed rule for additional public comment would be a more prudent strategy for the CFPB.

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<sup>2</sup> See Executive Order—Regulation and Independent Regulatory Agencies, July 11, 2011.

### **The CFPB Should Actively Engage Community Banks in Developing Regulatory Amendments**

ICBA encourages the CFPB to seek input about operational and other technical issues from community banks before taking additional steps to finalize the proposed rulemaking. Additional feedback can be sought through industry outreach meetings with community bankers throughout the country. While ICBA acknowledges the guidance that can be obtained through the public comment process, we are concerned there was not enough industry outreach conducted, particularly to community banks, when developing these proposed rules. This fact seems evident by the extensive questions asked in the rulemaking and the several options being proposed for public comment. Information obtained through industry outreach meetings would be useful in understanding the impact these proposed rules will have on financial institutions of all sizes and types throughout the country. This impact does not always resonate through the comment letters.

ICBA would welcome the opportunity to organize a meeting in Washington with community bankers and CFPB staff, so that bankers can share their specific experiences with providing mortgage loans and the operational difficulties and compliance burden related to this proposed rulemaking.

### **The CFPB Should Allow a Safe Harbor for Qualified Mortgages from the Ability-to-Repay Requirements**

Consistent with the Dodd-Frank Act, the proposal provides a creditor may not make a covered mortgage loan unless the creditor makes a reasonable and good faith determination, based on verified and documented information, that the consumer will have a reasonable ability to repay the loan, including any mortgage-related obligations (such as property taxes). TILA Section 129C; 15 U.S.C. 1639C. As stated previously, the Dodd-Frank Act and the proposal provide four options for complying with the ability-to-repay requirements.

In its proposed rule, the Federal Reserve questions whether satisfying the test for a “qualified mortgage” was intended to be a safe harbor from the “ability-to-repay” standard or instead merely a rebuttable presumption that the standard has been satisfied. The Federal Reserve stated the statute is unclear on this question and proposes for public comment two alternatives for what is deemed a “qualified mortgage.”

#### *ICBA Comments:*

In order to ensure access to credit for a broad range of consumers, ICBA strongly urges the CFPB to enact a safe harbor for what is considered a

“qualified mortgage.” This safe harbor must include clear “bright-line” requirements, so that community banks can easily determine and document their compliance. In exchange for providing consumers with the loan features of a qualified mortgage, creditors should be provided with reduced risk of liability and guaranteed compliance for purposes of examinations.

The Alternative 2 “qualified mortgage” option, which would provide a presumption of compliance for loans that satisfy the requirements, is practically the same as the ability-to-repay standard, only the creditor would receive a rebuttable presumption, providing community banks with little compliance or litigation protection. Furthermore, Alternative 2 requires more factors for underwriting consideration, whereas it would be better for community banks to have more flexibility in underwriting decisions, so that banks can more effectively satisfy the particular needs of the customers in their communities.

Currently, community banks are facing an increasingly harsh examination environment. Consequently, few, if any, banks would risk providing a mortgage that only has a rebuttable presumption of compliance. While the ability-to-repay test is fairly subjective, banks may be concerned that they somehow missed some documentation even if they have amply documented and verified the information to underwrite the loan. If these banks cannot rely on a safe harbor, the risk will inhibit them from making the loan at all. Originating “qualified mortgages” that satisfy safe harbor requirements would much more likely reduce the compliance and litigation risk for community banks.

Under the safe harbor definition of “qualified mortgage,” ICBA recommends the CFPB structure the criteria to allow for flexibility in verifying a borrower’s income and assets. For example, underwriting requirements should allow banks to provide loans in specific situations, such as in the case of a farmer who has an annual or semi-annual income, where the community bank may require semi-annual mortgage payments. Community banks provide mortgage loans to a wide variety of consumers, and therefore flexibility is needed in underwriting to insure the needs of consumers are met.

Also, the “qualified mortgage” provisions should make clear that compliance with the requirements will be examined based on the credit information reasonably available to the creditor at the time of loan underwriting and loan closing. Community banks should not be held responsible for information discovered outside of their routine due diligence in originating the loan.

### **HELOCs Should Not Be Included in Ability-to-Repay Standard**

Under the general ability-to-repay standards, there are no restrictions on the loan’s features, terms, or points and fees, but the creditor must follow certain

underwriting requirements and payment calculations. Consistent with the Dodd-Frank Act, the proposed rule requires creditors to consider eight underwriting facts as stated above. The proposed rule is generally consistent with the Act, except the Act does not require the creditor to consider simultaneous loans that are home equity lines of credit (HELOCs), but the Federal Reserve is including HELOCs within the definition of simultaneous loans.

*ICBA Comments:*

ICBA does not agree with the Federal Reserve's inclusion of HELOCs in the ability-to-repay standard, as there is no persuasive policy argument for differing from the statute. The CFPB should maintain the integrity of the statute and not include HELOCs in the definition of simultaneous loans.

### **Regulatory Requirements for Balloon Mortgage Loans**

The Federal Reserve is exercising the authority provided under the Dodd-Frank Act to provide an exception to the definition of "qualified mortgage" so that a balloon payment loan made by a creditor that meets the criteria set forth in the Act will be considered a "qualified mortgage." The Federal Reserve has acknowledged that some community banks make short-term balloon loans to hedge against interest rate risk, and that community banks typically hold these loans in portfolio.

The Federal Reserve's proposed rule provides an exception for a creditor that meets the following four criteria, with some alternatives:

- (1) Operates in predominantly rural or underserved areas. The creditor, during the preceding calendar year, must have extended more than 50% of its total covered transactions that provide for balloon payments in one or more counties designated by the Federal Reserve as "rural" or "underserved."
- (2) Total annual covered transactions. Under Alternative 1, the creditor and its affiliates extended covered transactions of some dollar amount or less during the preceding calendar year. Under Alternative 2, the creditor and its affiliates extended some number of covered transactions or fewer during the preceding calendar year.
- (3) Balloon loans in portfolio. Under Alternative 1, the creditor must not sell any balloon-payment loans on or after the effective date of the final rule. Under Alternative 2, the creditor must not have sold any balloon-payment loans during the preceding and current calendar year.
- (4) Asset size. The creditor must meet an asset size threshold set annually by the Federal Reserve, which for calendar year 2011 would be \$2 billion.

*ICBA Comments:*

There should be a total exemption for portfolio loans.

The CFPB should allow a total exemption for balloon mortgage loans that are held in portfolio for the life of the loan, without requiring the additional criteria.

Balloon mortgage loans provided by community banks are not the high-risk products that were provided by un-regulated mortgage lenders and large financial institutions that led to many foreclosures for consumers. Community bank balloon loans have been provided in small communities for decades, with no problems. These traditional products require a sizeable down payment and may include a higher interest rate. Community banks use this structure to match the maturity of their deposit base which provides funding for these loans. These mortgage loans are held in portfolio by community banks for the life of the loan.

Community banks provide these loans as a service to their community, as it may be the borrower's only credit option. These loans are especially significant for consumers in rural communities where it is difficult to impossible to sell the loans into the secondary market due to the unique nature of rural properties and the associated challenges in getting comparable sales for appraisals that meet secondary market standards, such as distance to comparable properties or the number of adjustments to the value because rural properties do not all look alike. Therefore, the only way the bank can safely and soundly extend credit is to structure the transaction as a higher interest balloon loan, which is generally renewed at maturity.

The Federal Reserve/CFPB have the authority under the Dodd-Frank Act to exempt community bank portfolio loans from the requirements, without imposing the other extensive and confusing requirements.

The Dodd-Frank Act specifically states that:

The Board may, by regulation, provide that the term 'qualified mortgage' includes a balloon loan—

- (i) that meets all of the criteria for a qualified mortgage...;
- (ii) for which the creditor makes a determination that the consumer is able to make all scheduled payments, except the balloon payment, out of income or assets other than the collateral;
- (iii) for which the underwriting is based on a payment schedule that fully amortizes the loan over a period of not more than 30 years and takes into account all applicable taxes, insurance, and assessments;

and

- (iv) that is extended by a creditor that—
- (I) operates predominantly in rural or underserved areas;
  - (II) together with all affiliates, has total annual residential mortgage loan originations that do not exceed a limit set by the Board;
  - (III) retains the balloon loans in portfolio; and
  - (IV) meets any asset size threshold and any other criteria as the Board may establish, consistent with the purposes of this subtitle.<sup>3</sup>

Nevertheless, the Federal Reserve was also granted the authority by Congress to alter the criteria of what may be a “qualified mortgage” to assure that credit remains available to consumers. The statute states, in the section entitled “Revision of Safe Harbor Criteria,” the following:

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 in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.<sup>4</sup>

ICBA has communicated with the Federal Reserve that the extensive regulatory requirements for balloon mortgage loans will prevent community banks from offering these products to consumers who may not qualify for other loans given the atypical nature of their property.

Congress provided the Federal Reserve (and later, the CFPB) the above exemption authority under the realization that the agencies had a better grasp of the mortgage market in different areas, such as rural areas. Members of Congress also understood the necessity that community banks be able to effectively provide mortgage loans in their communities. With regard to escrow requirements for higher-priced mortgage loans, members of Congress expressed this sentiment to the Federal Reserve in a letter sent to Governor Elizabeth Duke on March 18, 2010, in which 31 members of Congress urged the Federal Reserve to exempt mortgage loans originated and held by depository institutions in portfolio from the Regulation Z escrow requirements for higher-priced mortgage loans.

<sup>3</sup> Section 1412, Pub. Law 111-203—JULY 21, 2010.

<sup>4</sup> Section 1412, Pub. Law 111-203—JULY 21, 2010.

It would be difficult to even attempt to comply with and document compliance with these current requirements for balloon mortgage loans. The criteria that the Federal Reserve is proposing to allow community banks to use the exemption for balloon loans is cumbersome and unnecessarily confusing, especially to community banks that do not have large compliance departments. A simple exemption for balloon mortgage loans held in portfolio by financial institutions would have the intended result of Congress; that access to credit for rural and underserved consumers not be negatively impacted by the additional mortgage requirements. While the Federal Reserve's current proposed exemption provisions may provide a small amount of relief to community banks, a total exemption for balloon portfolio loans would be a more effective solution.

The Definition of "rural" and "underserved" is not workable.

Under the Federal Reserve's proposed exemption for balloon loans, a creditor must have made, during the preceding calendar year, more than 50 percent of its total first lien balloon loans in counties designated by the Federal Reserve as "rural" or "underserved." The Federal Reserve proposed extensive criteria for what would be considered "rural" or "underserved," which is the same criteria proposed for exempting higher-priced mortgage loans from the Regulation Z escrow requirements.

ICBA opposes this exemption requirement for balloon loans for several reasons. First, the measurement for determining what is considered a "rural" or "underserved" area is extensive and confusing, which could have the effect of community banks making the assumption they may not satisfy this definition even if they do. In today's rigorous examination environment, community banks have taken a conservative approach to regulatory compliance, for fear that a minor or technical error could lead to a violation, citation, and penalties or enforcement action.

Second, ICBA believes it is bad public policy to put community banks in the position of monitoring where exactly they are providing most of their mortgage loans so they can insure they qualify for an exemption from further regulatory requirements. Community banks should not have to incur one burden to avoid another. Community banks, by nature, operate in smaller and often rural communities, and provide a service their customers may not be able to obtain elsewhere. Therefore, these financial institutions should not be inhibited in providing mortgage products to customers in certain areas, out of concern they may run afoul of the criteria for a regulatory exemption.

Furthermore, the proposed definitions of "rural" and "underserved" are too restrictive. The Federal Reserve defines "rural" as "not a metropolitan statistical area or micropolitan statistical area as defined by the U.S. Office of Management

and Budget; not adjacent to any metropolitan area or micropolitan area; or adjacent to a metropolitan area with fewer than one million residents or adjacent to a micropolitan area and contains a town with 2500 or fewer residents.” This definition does not reflect the reality of many areas that would be considered rural. Micropolitan areas are not populous areas and these areas should be eligible for the balloon exemption. The rural definition is also quite limited because many lower population areas would not be considered rural under the rule if they happen to be near a larger metropolitan area.

There are over 7,500 community banks in the U.S., and the vast majority of these are located in communities of 50,000 or fewer residents. Yet, ICBA has heard from many of its members that they would not qualify for an exemption under the proposed standards for “rural” and “underserved.” For example, ICBA has heard from member banks that there are few banks in Texas that would actually qualify for the rural designation, even though they are very much rural community banks. The reality is there are not many counties in the United States that are not adjacent to metropolitan or micropolitan areas.

In addition, one analysis of the counties in Iowa showed only 16 out of Iowa’s 99 counties would be considered “rural” under the Federal Reserve’s definition. This analysis is particularly shocking since Iowa is considered one of the most rural states in the U.S.

The proposed provision also ignores the fact that many rural areas with lower property values are located within a close vicinity to a metropolitan area. For example, ICBA has heard from community bankers in rural areas that are close to larger cities that the financial institutions in those larger cities do not want to make the smaller loans to the customers in their community because the smaller principal loans are not as profitable. We have found that community banks are frequently the go-to bank for mortgage loans that are small, such as under \$50,000 in principal amount, but these loans would not be exempt from the balloon loan requirements if the bank does not satisfy the location provisions.

The proposed rule also provides an exemption for some mortgage loans provided in “underserved” counties, but defines a county as “underserved” if, during a calendar year, no more than two creditors extends consumer credit five or more times secured by a first lien or real property or a dwelling. This criterion puts community banks in the position of having to monitor not only their own loan volume, but the loan volume of other lenders in their area. This would be a difficult standard for community banks to satisfy, and they will more likely stop providing balloon mortgage loans than take the risk that they are improperly satisfying the regulatory requirements. In addition, this requirement would place constraints on the extension of mortgage credit in rural areas, because residents in rural areas would be penalized as the rule would limit their credit options. The

rule should be written to improve access to sound credit options, not constrain it due to a limit on the number of lenders that could offer qualified mortgages in certain geographic areas. Neither the “rural” nor the “underserved” definitions are workable nor as straight-forward to apply as a clear exemption for portfolio loans would be.

The Federal Reserve’s proposed alternatives for prohibited sale of balloon payment loans should be re-examined.

As stated above, ICBA strongly urges the CFPB to exempt loans held in portfolio for the life of the loan from the balloon payment exclusion for what is deemed a “qualified mortgage.” The criterion that the creditor “retains the balloon loans in portfolio” is currently one criterion for exemption under the Dodd-Frank Act. The Federal Reserve stated in its proposed rule that read as literally as possible, this exemption requirement would apply to all balloon payment loans ever made by the creditor, even those made prior to the enactment of the statute. As a result, the Federal Reserve is proposing for comment two alternative approaches for exempting balloon mortgage loans. Alternative 1 would provide that the creditor must not sell any balloon-payment loan on or after the effective date of the final rule made pursuant to the proposal. Alternative 2 would limit the period during which the creditor must not have sold any balloon payment loan to the preceding and current calendar years.

ICBA disagrees with both approaches, and urges the CFPB to allow any balloon mortgage loan that is held in portfolio by the financial institution to be considered a “qualified mortgage.” ICBA disagrees with the Federal Reserve’s reading of the statute that the exclusion would not apply if the financial institution sold *any* of its balloon mortgage loans. The statute directly states that, “The Board may, by regulation, provide that the term ‘qualified mortgage’ includes a balloon loan... that is extended by a creditor that ... retains *the* balloon loans in portfolio.”

The statute requires the creditor retain “the” balloon loans in portfolio, which would be the ones it wishes to be allowed under the “qualified mortgage” definition. If Congress intended that creditors keep *all* of their balloon payment loans in portfolio for one to be eligible as a “qualified mortgage,” it would have stated that the creditor must retain “its” or “all” balloon loans in portfolio. Read literally, Congress intended that a balloon payment loan be eligible as a “qualified mortgage” if it is held in portfolio by the financial institution.

### **Ability-to-Repay Determination for Balloon Payment Loans**

The Federal Reserve proposes two requirements for determining a consumer’s ability to repay, if the loan is a balloon mortgage loan. First, if the mortgage is not a higher-priced mortgage loan under Regulation Z, then the Federal Reserve

proposes that the maximum payment scheduled during the first five years of the loan (measured from the closing date) be used in determining the consumer's ability to repay. If the mortgage is a higher-priced mortgage loan under Regulation Z, then the Federal Reserve proposes that the maximum payment in the payment schedule, including any balloon payment, be used for determining a consumer's ability to repay.

*ICBA Comments:*

ICBA opposes both proposed requirements, especially the second proposed requirement which would essentially prohibit a lender from providing a balloon payment loan that is a higher-priced mortgage loan, because the balloon payment would be the payment used to consider whether the consumer has the ability to repay the loan.

Many community bank balloon mortgage loans fall under the Regulation Z definition of higher-priced mortgage loan, especially given the current interest rate environment where a higher-priced mortgage loan under the Federal Reserve's established threshold would have an annual percentage rate of less than 6.5% for a first lien mortgage. The reason for the higher interest rates is that the loans are usually provided for rural or atypical properties that are not sellable on the secondary market and community banks use a lending structure to match the maturity of their deposit base which provides funding for these loans. As stated before, these higher-interest balloon payment loans are especially significant for consumers in rural communities where it is difficult to impossible to sell the loans into the secondary market due to the unique nature of rural properties and the associated challenges in getting comparable sales for appraisals that meet secondary market standards, such as distance to comparable properties or the number of adjustments to the value because rural properties do not all look alike.

Based on the nature of these loans, the Federal Reserve should not require that the balloon payment for higher-priced mortgage loans be considered in the ability-to-repay determination. For determining a consumer's ability to repay, the requirement should be that the creditor applies the highest monthly payment on the loan, excluding the balloon payment. This requirement should apply for all balloon payment loans, regardless of whether they are higher-priced mortgage loans under Regulation Z, which many are due to today's low interest rate environment. At the very least, the CFPB could require creditors to provide the ability-to-repay analysis on the highest payment for the loan, in the first seven years of the loan.

### Calculation for Jumbo Balloon Payment Loans

The Federal Reserve also notes that “jumbo” loans typically have a higher interest rate to reflect the increased credit risk of such loans. The Federal Reserve acknowledges that these loans are more likely to exceed the average prime offer rate coverage threshold and be considered higher-priced covered transactions. Therefore, the Federal Reserve seeks comment on whether it should use the separate coverage threshold of 2.5 percentage points in the proposed definition of “higher-priced covered transaction” to permit more “jumbo” balloon loans to benefit from the payment calculation rules that determine a consumer’s ability to repay the loan.<sup>5</sup>

#### *ICBA Comments:*

ICBA agrees that jumbo loans should include the 2.5 percentage point threshold. The CFPB should also change the threshold for all first lien loans, not just jumbo mortgage loans, to 2.5 percent points. Such a change is more appropriate given today’s lower interest rate environment, where most loans would be considered higher-priced loans.

### Transaction Coverage Rate Definition

Proposed Section 226.43(b)(4) defines a “higher-priced covered transaction” to mean a covered transaction with an annual percentage rate (APR) that exceeds the average prime offer rate for a comparable transaction as of the date the interest rate is set by 1.5 or more percentage points for a first-lien covered transaction, or by 3.5 or more percentage points for a subordinate-lien covered transaction. The proposed definition of “higher-priced covered transaction” differs from the Federal Reserve’s definition of “higher-priced mortgage loan” in that the definition of “higher-priced covered transaction” would provide that the APR, rather than the “transaction coverage rate” is the loan pricing metric to be used to determine whether a transaction is a higher-priced covered transaction; “higher-priced covered transactions” would cover consumer credit transactions secured by a dwelling, and would not be limited to transactions secured by the consumer’s principal dwelling; and the applicable thresholds in “higher-priced covered transactions” would not reflect the separate coverage threshold of 2.5 percentage points above the average prime offer rate for “jumbo” loans, as provided in the Federal Reserve’s 2011 escrow proposed rule and 2011 Jumbo Loan Escrow Final Rule.<sup>6</sup>

<sup>5</sup> See 12 CFR Section 226.43(c)(5)(ii)(A)(1).

<sup>6</sup> See 76 FR 11598, 11608-09, Mar. 2, 2011; 76 FR 11319, Mar. 2, 2011.

As a result of these differences, the Federal Reserve is proposing to replace “annual percentage rate” with “transaction coverage rate” as the loan pricing benchmark for higher-priced covered transactions.

*ICBA Comments:*

ICBA encourages the CFPB not to make any changes to this loan pricing benchmark until it can be reviewed as part of the TILA/RESPA disclosure integration project. Providing massive changes to these rate calculation rules in a piecemeal fashion is incredibly confusing and burdensome for community banks, and these potential changes should be considered and included with the changes to the TILA/RESPA disclosures.

**Three Percent Cap on Points and Fees**

Proposed Section 226.43(d)(2)(ii)(B) implements the Dodd-Frank Act provisions that prohibit creditors from charging points and fees on the mortgage transaction of more than three percent of the total loan amount, with certain exceptions for small loans. The Federal Reserve proposes two alternative calculations for the qualified mortgage points and fees test.

The Federal Reserve was granted the authority under the Dodd-Frank Act to make adjustments to the 3% points and fees provisions. The Dodd-Frank Act states:

The Board shall prescribe rules adjusting the criteria under subparagraph (A)(vii) [regarding points and fees] in order to permit lenders that extend smaller loans to meet the requirements of the presumption of compliance under paragraph (1). In prescribing such rules, the Board shall consider the potential impact of such rules on rural areas and other areas where home values are lower.

The Federal Reserve stated it considered this statutory provision in drafting the proposed calculation alternatives, and also consulted with industry and consumer groups in determining what calculations would best represent the intent of Congress.

Percentage for Calculation

Under either alternative for “qualified mortgage,” points and fees are generally limited to 3 percent of the “total loan amount.” Under Alternative 1, a covered transaction is not a “qualified mortgage” unless the total points and fees do not exceed:

- For a loan of \$75,000 or more, 3 percent of the total loan amount;
- For a loan of at least \$60,000 but less than \$75,000, 3.5 percent of the total loan amount;
- For a loan of at least \$40,000 but less than \$60,000, 4 percent of the total loan amount;
- For a loan of at least \$20,000 but less than \$40,000, 4.5 percent of the total loan amount; and
- For a loan of less than \$20,000, five percent of the total loan amount.

Under Alternative 2, the Federal Reserve proposes that a covered transaction is not a “qualified mortgage” unless the total points and fees do not exceed:

- For a loan of \$75,000 or more, 3 percent of the total loan amount;
- For a loan of at least \$20,000 but less than \$75,000, 3.5 percent of the total loan amount, the following formula:
  - Total loan amount - \$20,000 = \$Z
  - $\$Z \times 0.0036 = Y$ ;
  - $500 - Y = X$ ; and
  - $X \times 0.01 =$  Allowable points and fees as a percentage of the total loan amount; and
- For a loan of less than \$20,000, five percent of the total loan amount.

*ICBA Comments:*

ICBA supports a formula consistent with Alternative 1, except ICBA recommends the following scale:

- For a loan of \$150,000 or more, 3 percent of the total loan amount;
- For a loan of at least \$100,000 but less than \$150,000, 3.5 percent of the total loan amount;
- For a loan of at least \$75,000 but less than \$100,000, 4 percent of the total loan amount;
- For a loan of at least \$40,000 but less than \$75,000, 4.5 percent of the total loan amount; and
- For a loan of less than \$40,000, five percent of the total loan amount.

We believe the above calculation changes better reflect the intent of Congress to insure that smaller loans are not inadvertently excluded from the qualified mortgage definition. There are fixed costs for mortgage loans, regardless of the size of the principal amount. Since the points and fees are often the same for smaller and larger loans, the fees would represent a larger percentage for the smaller loans, placing them at a regulatory disadvantage. Smaller loan amounts

are more common among low-to-moderate income and rural populations, and these classes should not be inadvertently affected by the Federal Reserve's loan amount calculation.

Alternative 2 is entirely too confusing, and even if it would permit more smaller loans to be included under the qualified mortgage definition, it is likely community banks would not implement this formula for fear of miscalculation and a compliance violation. As stated previously, in today's environment of rigorous bank examinations, community banks have taken a conservative approach to regulatory compliance, for fear that even the most minor technical error could lead to a violation. The formula in Alternative 2 would be more difficult for community banks to integrate in their lending operations than Alternative 1. A more straight-forward scale as we have expressed would be effective for purposes of insuring compliance and would prevent smaller loans from being excluded from the "qualified mortgage" definition.

Loan originator compensation should not be included in calculation.

In calculating points and fees, a creditor may exclude bona fide third party charges if the charges are not retained by the creditor, loan originator, or an affiliated entity of the creditor or originator. The Federal Reserve's proposed rule requires that all loan originator compensation paid by the lender or the consumer be included in the points and fees calculation.

*ICBA Comments:*

ICBA urges the CFPB to exclude from the points and fees calculation any payments related to loan originator compensation paid by the creditor. The Federal Reserve's proposed provisions regarding what would be considered loan originator compensation is confusing and cumbersome, which could create uncertainty of compliance.

In addition, the payments for loan originators are already heavily regulated by the recent amendments to Regulation Z regarding compensation. There are also regulatory requirements for loan originators under the SAFE Act, which require loan originators to provide a detailed registration with a national registry, that includes extensive background information and fingerprint documentation. These additional regulatory requirements are extensive and go well beyond protecting consumers from the abusive practices mortgage brokers engaged in to steer consumers to risky loans for greater profit and bonuses.

The Definition of Loan Originator

The Federal Reserve also solicits comment on the definition of "loan originator"

for purposes of determining compensation. The definition of “loan originator” in Section 226.36 includes all of the activities listed in the Dodd-Frank Act as part of the definition of “mortgage originator,” except the current Regulation Z definition does not include “any person who represents to the public, through advertising or other means of communicating or providing information (including the use of business cards, stationery, brochures, signs, rate lists, or other promotional items) that such person can or will provide any of the activities” of a loan originator. The Federal Reserve seeks comment on whether the definition of “loan originator” should include these additional requirements.

*ICBA Comments:*

ICBA agrees with the Federal Reserve that adding this element of the definition of “mortgage originator” to Regulation Z’s definition of “loan originator” is unnecessary, since a person who solely represents to the public that s/he is able to offer or negotiate mortgage terms for a consumer has not yet received compensation for doing so, and there would be nothing to account for in calculating “points and fees” for a loan transaction. This provision would not be a useful regulatory change.

Points and fees paid after closing should not be included in calculation.

The Federal Reserve states it is concerned that some fees that occur after closing, such as fees to modify a loan, might be deemed to be points and fees. Thus, calculating the points and fees to determine whether a transaction is a qualified mortgage may be difficult because the amount of future fees cannot be determined prior to closing. The Federal Reserve states this uncertainty could expose creditors to litigation risk, which could discourage creditors from making qualified mortgages.

*ICBA Comments:*

ICBA agrees with the concerns communicated by the Federal Reserve in the Supplementary Information, and strongly advises that fees paid after closing be expressly excluded from the points and fees definition unless these fees are known charges at or before closing. This clarification in the rule would eliminate the uncertainty regarding unknown fees that occur subsequent to loan closing. Any regulatory requirement to the contrary would place community banks in a position of guessing their compliance with the requirements, and would therefore discourage mortgage lending.

## Conclusion

The Truth in Lending Act (TILA), as amended by the Dodd-Frank Act, states it is the purposes of the ability-to-repay requirements to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans. TILA Section 129(B)(a)(2); 15 U.S.C. 1639b(a)(2). It would be devastating to the U.S. economy if regulatory restrictions inhibited community banks from offering residential mortgage loans at all, for fear of regulatory compliance citations or litigation. A more restrictive and burdensome rule will achieve that result, contradicting the intent of Congress. ICBA recognizes the U.S. economy is now at a crossroads, and we urge the CFPB to take the path that will enable community banks, our country's honest lenders, to continue to provide all types of mortgage loans to their customers free from unnecessary regulatory restraints.

Thank you for considering our comments. ICBA plans to provide additional comments throughout the process of developing a final rule, as we assess further the affect these potential requirements will have on community banks and their customers. Please feel free to contact ICBA any time for additional feedback, or to discuss our comments and thoughts in more detail.

If you have questions or need additional information about our thoughts in this letter, please do not hesitate to contact me at 202-659-8111 or by email at [Elizabeth.Eurgubian@icba.org](mailto:Elizabeth.Eurgubian@icba.org).

Sincerely,

/s/

Elizabeth A. Eurgubian  
Vice President & Regulatory Counsel

CC: Patricia McCoy,  
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