INDEPENDENT COMMUNITY BANKERS of AMERICA®

JOHN H. BUHRMASTER
Chairman
JACK A. HARTINGS
Chairman-Elect
REBECA ROMERO RAINEY
Vice Chairman
PRESTON KENNEDY
Treasurer
TIMOTHY K. ZIMMERMAN
Secretary
WILLIAM A. LOVING, JR.
Immediate Past Chairman

CAMDEN R. FINE
President and CEO

March 18, 2014

United States Senate
Washington, D. C. 20510

Dear Senator:

On behalf of the nearly 7,000 community banks represented by ICBA, I would like to use this opportunity to respond to a letter sent by the Center for Responsible Lending, Consumer Federation of America, Empire Justice Center, and National Consumer Law Center ("the CRL letter") raising objections to the CLEAR Relief Act (S. 1349), a bipartisan bill strongly supported by ICBA because it would provide measured, targeted regulatory relief for community banks without compromising safety and soundness or vital consumer protections. We strongly believe that the objections stated in the letter are unfounded and without merit and welcome the opportunity to address them.

The CRL letter raises objections to the following two provisions of S. 1349:

- Qualified mortgage (QM) status for first lien mortgage loans originated and held in portfolio for at least three years by banks with assets of less than $10 billion; and
- Waiver of escrow requirements for tax and insurance payments for first lien mortgage loans originated and held in portfolio for at least three years by banks with assets of less than $10 billion.

Portfolio lending is, by its very nature, safe and conservative

The principal rationale for both of these provisions, and the reason they can be safely enacted, is that they apply only to loans originated and held in portfolio by community banks. QM defines mortgages that are either "conclusively" or "presumptively" deemed to comply with the Dodd-Frank Act "ability-to-repay" requirements. As relationship lenders, community bankers are in the business of knowing their borrowers and assessing their ability to repay a loan. What's more, when a community bank holds a loan in portfolio it holds 100 percent of the credit risk and has an overriding incentive to ensure that the loan is well underwritten and affordable to the borrower. In a typical community bank portfolio, even a small number of defaults can put a bank at risk. Community bank portfolio lenders ensure they understand the borrower's financial condition and structure the loan accordingly. If the borrower has trouble making payments due to job loss or other unforeseen circumstances, a community bank portfolio lender will work with the borrower to restructure the loan and keep the borrower in their home. By the same token, a portfolio lender will protect their collateral by ensuring the borrower remains current on tax and insurance payments. For this reason, the escrow requirement, which must be outsourced at a relatively high cost by community banks with a low volume of mortgages, is unnecessary when a loan is held in portfolio.

$10 Billion is a widely-accepted community bank threshold, with good reason

The CRL letter characterizes banks between $2 billion and $10 billion in assets as "larger" banks. However, the Federal Reserve uses a $10 billion threshold to define community banks. The Government Accountability Office

(GAO) used that threshold in a recent study of community banks.[1] Most of the exemptions in the Dodd-Frank Act use the $10 billion threshold. While there's no consensus on the definition of a community bank, in choosing a $10 billion threshold for the provisions noted above, the authors of S. 1349 selected a widely-accepted demarcation.

We believe the $10 billion threshold is well founded. A $10 billion asset community bank is only a fraction of the size of most regional banks (which typically range from about $50 billion to about $300 billion), not to mention the megabanks whose assets are in the trillions. More importantly, banks up to $10 billion (and many that are larger) have the character and features of true community-based institutions including local deposit funding, narrow footprint with a local focus, personalized service, and specialization in traditional products and services.

Community bank mortgages have very low default rates

The very low mortgage default rates experienced by community banks also justify the QM and escrow provisions of S. 1349. Community banks use conservative underwriting practices, as confirmed by Federal Reserve data. In recent years, the delinquency rate of mortgages held by community banks up to $10 billion in assets never exceeded 4 percent, compared to 8 percent to 12 percent for GSE mortgages, 22 percent for fixed rate subprime mortgages and 46 percent for subprime variable rate mortgages. In fact, community bank mortgages have outperformed fixed-rate, prime loans, thought to be the best-performing category of all loans.[2]

Current "small creditor" accommodations do not go far enough

As the CRL letter notes, the final QM rule makes accommodations for "small creditors," defined as banks that originate fewer than 500 mortgage loans annually and have less than $2 billion in assets. Loans originated and held in portfolio by small creditors receive QM status -- provided they meet a number of limiting conditions and subject to a prescriptive compliance analysis. However, the CRL letter implies that the current "small creditor QM" is the equivalent of QM under S. 1349, except for the lower qualifying threshold. This is not true. For example, for a balloon loan to qualify for a small creditor QM, the bank must have made at least 50 percent of their first lien mortgages in rural or underserved counties under unreasonably narrow definitions of "rural" and "underserved." Though the CFPB has suspended application of the rural definition for small creditors until 2016, this deferral does not provide community bankers with the certainty required for long-term business planning. Community banks make balloon loans to manage their interest rate risk on loans that are not eligible for sale into the secondary market, such as loans collateralized by unique rural properties. Another example: small dollar loans, which are common in many parts of the country for purchase or refinance, face an unreasonably low ceiling on closing fees in order to qualify the current QM rule.[3] Finally, the current QM rule requires a very prescriptive and fully documented analysis of the borrower's income and debt, which is particularly difficult for first time homebuyers. All of the above hurdles apply even under the broader terms available to "small creditors." Community banks need a solution that will provide for more clarity and simplicity in QM designations without tortuous analysis.

---

[1] These examples were noted in a recent Working Paper published by the Mercatus Center, "How are Small Banks Faring Under Dodd-Frank?" February 2014. Board of Governors of the Federal Reserve System, *Supervisory Policy and Guidance Topics: Community Banks.* ("In general, community banks can be defined as those owned by organizations with less than $10 billion in assets.") GAO Community Bank Study. ("Almost 7,400 (about 99 percent) of all banks had less than $10 billion in assets in 2011 and thus fell within our definition of a community bank."

[2] This data is from "Community Banks and Mortgage Lending," Remarks by Federal Reserve Governor Elizabeth Duke. November 9, 2012. Page 9.

[3] The fee cap is applied on a sliding scale. A loan between $60,000 and $100,000, for example, would face a $3,000 cap, which is not feasible for a community bank.

In addition, as noted above, many banks that fail either the loan volume or the asset test or both of the small creditor definition are in fact authentic community banks. What's more, the loan volume test is not consistent with the asset test. A $400 million ICBA member bank, well below the "small creditor" threshold, has an annual loan volume which, while variable from year to year depending on demand, is uncomfortably close to the threshold. Under the current rule, this community bank has no incentive to increase its loan volume and thereby lose its small creditor status. While we don't have data comparing loan volume to asset size, we do not believe this bank is atypical.

S. 1349 provides clear, simple test for qualifying conservative community bank mortgages

In short, the current small creditor QM is an insufficient solution. The QM provision under S. 1349, by contrast, would apply regardless of where the lender operates. It has the virtue of being simple, straightforward, and easy to apply. ICBA believes withholding safe harbor status for loans held in portfolio by community banks with up to $10 billion in assets, and exposing the lender to litigation risk, will not make the loans safer, nor will it make underwriting more conservative. Costly escrow requirements will not protect consumers or portfolio lenders. They will merely deter community banks from making such loans and curtail access to mortgage credit.

S. 1349 enjoys broad bipartisan support

ICBA is very pleased that S. 1349 has drawn 27 cosponsors to date. What's more, the bipartisan mix and political range of the cosponsors – spanning the full width of the political spectrum – is testimony that the provisions of the bill represent a set of genuinely consensus solutions to ensure continued access to consumer credit and other banking services. The House counterpart bill, H.R. 1750, has over 120 cosponsors with a similar bipartisan composition.

In closing, ICBA urges you to cosponsor S. 1349 because the QM and escrow provisions discussed above, as well as additional provisions of the bill, provide sensible regulatory relief for community banks. S. 1349 will help community banks serve their customers and communities. It will help deter further industry consolidation that would leave many rural and small town communities without access to customized and competitively-priced banking services.

Thank you for your consideration.

Sincerely,

/s/

Camden R. Fine
President & CEO

1615 L Street NW, Suite 900, Washington, DC 20036-5623 | 800-422-8439 | FAX: 202-659-1413 | Email: info@icba.org | Website: www.icba.org