From:

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Comments:

Re: Proposed changes to Regulation Z (Truth in Lending) Docket No. R-1305 Dear Board Members: In response to the proposed changes to the Truth in Lending regulation, we are concerned that some provisions of the amendment are too restrictive in that they will go beyond the goal of capturing sub-prime loans and impact loans in the prime market. Our primary areas of concern are as follows: • Yield spreads proposed under §35 "Higher Cost Mortgages": o The imposition of this section inaccurately assumes that all lenders utilize the same index for adjustable rate products. Our in house ARM's are tied to the much more consistent and stable Primary Credit Rate. This index fluctuates less often and therefore creates less risk of payment shock than the more volatile treasury rates. o §35 assumes that all in-house ARM products in small community banks conform to Freddie Mac and Fannie Mae standards, which requires such steps as the verification of assets. While we require verification of income and a collateral valuation on all loans, we do not require verification of assets. It should be noted that our in-house ARM's that would be subject to this section of the regulation have not suffered the types of losses that the "investment grade" loans in Freddie and Fannie's portfolios have suffered, and we certainly do not consider our in-house loans to be subprime. o The indexes used do not correctly match the maturity of the underlying mortgages – utilization of the 10 year treasury as an index for a 20 year mortgage is a mismatch in maturities. To truly compare 'apples to apples' one should use the security which best matches the maturity of the underlying loan. o Changing the index twice per month over-complicates the monitoring process and creates confusion with the provision of §32, which simply uses the rates in effect on the 15th of the preceding month. o As proposed the spread of just 3% over the treasury matching the initial fixed rate period is too low and may capture many prime-market ARM's. This artificially low trigger imposes unacceptable interest rate risk on community banks that retain most of their ARM's in their in-house portfolio. The prudent use of both periodic and lifetime caps on adjustable rate mortgage products would more effectively accomplish the goals of this section, rather than the creation of a separate index. One possible suggestion would be to consider exempting from the provisions of this section loans that are tied to a less volatile index, such as the Primary Credit Rate. • Escrow requirement under §35: o The prudent use of conservative underwriting standards, such as including taxes and insurance when calculating debt to income, eliminates the need for this provision. Use of conservative underwriting standards by many of the nation's community banks has prevented the types of losses suffered by the unregulated nationwide mortgage companies. o Requiring escrow for just one year will not accomplish the goals of this amendment, since in most cases the ARM's in question will not have reached their first adjustment period. • Requirement of early disclosures and a good faith estimate of costs on all loans secured by the borrower's principle dwelling: o Increasing the number and complexity of the disclosures given to consumers by requiring early disclosures on all loans secured by the borrower's primary dwelling will only increase the number of pages that are thrown away, unread by the customer. o Over the past thirty years the growth in the number and complexity of disclosures has obviously done little to mitigate the risk in the mortgage market, nor has it protected the consumer from unscrupulous lenders. The crises in the sub-prime mortgage market occurred in part due to unequal regulatory enforcement, not the lack of disclosures. o The practical use of periodic and lifetime caps combined with conservative underwriting standards will accomplish what additional disclosures will not, by protecting both the consumer and the bank from interest rate risk. In closing, the failure to adequately staff the enforcement arms of the regulatory agencies has further complicated the issues at hand, allowing those who have truly abused the system to escape justice while community banks are being burdened with additional requirements. A lender that is not properly advising the borrower about the affordability of the house they are purchasing or the loan they are applying for has failed in their fiduciary obligation to protect the consumer as well as the bank's depositors and shareholders. As a conservative community bank we support the efforts of the Board to adopt measures that will effectively end the abuses of the system by mortgage companies and brokers who have until now enjoyed a relatively free hand in the market. If enacted as proposed we firmly believe that some of these changes will have the result of restricting the availability of credit to the very individuals the regulation is designed to protect. Sincerely, Michael Radcliffe Asst Vice-President, Compliance & Loan Review Community Financial Services Bank

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