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September 21, 2009

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Regulation Z Final Rules – Higher Priced Mortgage Loans

Dear Ms. Johnson:

The Independent Bankers Association of Texas (IBAT), a trade association representing approximately 600 independent community banks domiciled in Texas, offers these comments on certain aspects of the final revisions to Regulation Z (Reg Z). All members of IBAT make residential mortgage loans and are affected by these changes.

IBAT and its members stand firmly in opposition to predatory lending, and we encourage Congress and the federal financial institution regulators to carefully craft laws and rules that halt these unscrupulous lending practices without inflicting irreparable damage to our members' legitimate lending operations, which are the financial lifeblood of their local communities. Unfortunately, the changes to Reg Z, though well-intentioned, were not crafted in such a manner. As adopted, the changes to Reg Z will likely cause community banks to substantially scale back or, in some instances, completely shut down their residential mortgage lending operations. That is a shame considering that this will force many residential mortgage borrowers into the hands of the very predators whose actions compelled the changes.

Section 226.35, relating to prohibited acts or practices in connection with higher-priced mortgage loans, has a flawed definition of a "higher-priced" loan. A significant number of typical mortgage loans are categorized as "higher-priced." (For jumbo loans, the potential is even greater that the loans will be considered higher-priced.) Here are two <u>real-world</u> examples of formerly prime loans that are now considered "higher-priced" mortgage loans. These were sent to us by one of our members:

> We have always done a lot of 20 to 30 year loans that are adjustable annually. The current index for a one year adjustable is 3.32%. If you add 1.50% to this you are at 4.82% and that is a high-priced mortgage loan. Not many of our borrowers can pass that test.
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> Another loan we have used quite a lot is a 15 to 30 year amortization with a five year balloon. The five year balloon is effectively prohibited because of having to show debt service for the first seven years. The current index for a 15 and 20 year fixed is 4.61%, so add the 1.5% and you get 6.11%. 30 year is 5.13%, add the 1.5% and get 6.63%. 20 year FHLB money is selling for 4.484% plus 0.25% or 4.734%, so we can

> get a spread of 1.376%. In normal times a prime rate plus 1 – 2% is a decent rate. As we all know we are not in normal times. The current 6 month T-bill rate is 0.10%, however my 6 month C.D. rate is 1.5%. Cut expenses as we may, you can only get so low. We have tried to maintain loan rates at 5% + in order to have a decent spread.

The consequences of falling into the higher-priced category present a significant regulatory burden for community banks who, for the most part, keep their mortgage loans in-portfolio. At this time, we believe that only about 40% of mortgage loans in Texas are escrowed for insurance and taxes. If a significant number of loans are now considered "higher-priced" with the requirement for escrows, many lenders will be forced to either acquire systems to collect, maintain, service, and report escrow accounts or get out of residential mortgage lending altogether. These systems require data processing and personnel changes, which represent significant initial and ongoing costs, particularly to smaller financial institutions. In addition to the increased regulatory burden, this arbitrary requirement of escrows also creates a potential customer relations problem. Certain customers do not want the bank to manage their escrow accounts. Rather, they are disciplined enough to establish their own system to manage insurance and taxes, whether through their own savings account or through use of anticipated year-end income sources. The final rule only permits the consumer to cancel the escrow after one year. Consumers should be able to make this request before closing, if not for all mortgage loans, at least with respect to in-portfolio loans.

A higher-priced mortgage loan that has a balloon that comes due before the end of seven years poses yet another problem. The balloon payment must be considered in determining the borrower's ability to repay the loan. The problem is described in FDIC's Summer 2009 Supervisory Insights:

> This seemingly innocuous provision of the Regulation Z amendments has the potential to significantly impact real estate lending activity among banks, predominately smaller banks, which commonly originate and portfolio three- or five-year balloon mortgages. These mortgage loans are originated in this manner because they often do not qualify for sale into the secondary mortgage market. Banks offering these short-term, in-house mortgage loans tend to charge more in interest, but often less in fees, than loans conforming to and sold into the secondary mortgage market.
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> Typically, the interest rates charged for these mortgage loans qualify them as higher-priced mortgages and, therefore, subject them to the repayment ability standard of the Regulation Z amendments. Consumers seeking these three- or five-year balloon mortgage loans likely will not satisfy the repayment ability standard owing to the balloon payment. Banks continuing to offer these mortgage loans on or after October 1, 2009, likely will have to reduce the APR charged to prevent these loans from being higher-priced mortgages.
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> Many banks adopting this approach might consider compensating for the APR reduction by increasing loan fees. However, banks contemplating any such rate or fee restructuring must take into account whether the fees are finance charges under Regulation Z and therefore must be included in the APR calculation.

The only inaccuracy in the FDIC's description of the problem is that the threshold for higher-priced mortgage loans is so low that community banks can't reasonably be expected to further reduce the APR charged. And in Texas, loan fees that a bank can charge for a subordinate lien mortgage loan are so restrictive that fee restructuring is nearly impossible.

Another interesting dilemma posed by this final rule is the collision with the safety and soundness requirements for asset/liability management. Community banks typically look to their cost of funds in pricing their residential mortgage loans. Their asset/liability committees are tasked with maintaining an appropriate, safe margin between their cost of funds and the interest rates on various products. The definition of higher-priced mortgage loans is counter to the banks' efforts to operate in a safe and sound manner, with appropriate pricing mechanisms.

Community banks do not engage in irresponsible and predatory lending. Instead, community banks listen to their customers and offer mortgage loans that are priced fairly and tailored to their specific needs. These are not cookie-cutter loans from some Wall Street lender. They are the loans the local community want; not the loans Wall Street or the secondary market has told them they can have. These are not predatory loans. They are not high-priced loans. They are prime loans at rates that are fair both to the lender and the borrower.

This final rule punishes already heavily-regulated community bank mortgage lenders who played by the rules, abstained from offering exotic loans, shunned predatory practices, and, in general, did not contribute to the current lending crisis. Community banks have not and are not standing in line for a handout, but for some reason they are getting a backhand. And when the community banks of this nation get a backhand so do citizens of its communities.

We strongly object to these rules as adopted and urge you to consider amending these final rules so that they apply only to nontraditional lending products and predatory lending practices. We cannot imagine that it was anyone's intention to inflict hardships on community banks and their customers with these amendments; and, therefore, we assume that you'll agree that their unintended consequences must be unraveled before irreparable harm is done. If you feel like your hands are tied by MDIA, we urge you to let us know and then stand by us as we seek relief from Congress for the nation's mortgage borrowers, communities, and community banks.

We look forward to your response to our request. If you would like to discuss this issue, please do not hesitate to call.

Cordially,

Christopher L. Williston

Christopher L. Williston, CAE
President and CEO

cc: Hon. Timothy F. Geithner
Hon. Christopher J. Dodd
Hon. Barney Frank
Professor Elizabeth Warren
Members, Texas Congressional Delegation