INDEPENDENT COMMUNITY
BANKERS of AMERICA®

October 25, 2010

By electronic delivery to:
regs.comments@federalreserve.gov

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

Re: Proposed Rule to Amend Regulation Z (Truth in Lending Act) to Implement Section 1461 of the Dodd-Frank Wall Street Reform and Consumer Protection Act [Docket No. R-1392]

Dear Ms. Johnson:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on this proposed rule that would implement Section 1461 of the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act. This section amends the Truth in Lending Act (TILA) to provide a separate, higher threshold for determining coverage of the Federal Reserve's escrow requirement applicable to higher priced first lien mortgage loans, for

[1] *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.

those loans that exceed the maximum principal balance eligible for sale to Freddie Mac.

While the proposed change is expressly required by the Dodd-Frank Act, ICBA strongly urges the Federal Reserve to specifically exempt from this escrow requirement mortgage loans originated and held by depository institutions in portfolio. Congress expressly provides this regulatory exemption authority in the Dodd-Frank Act, which states that, "The Board may, by regulation, exempt from the requirements of subsection (a) a creditor that— (1) operates predominantly in rural or underserved areas; (2) together with all affiliates, has total annual mortgage loan originations that do not exceed a limit set by the Board; (3) retains its mortgage loan originations in portfolio; and (4) meets any asset size threshold and any other criteria the Board may establish, consistent with the purposes of this subtitle."[2]

Many community banks do not require escrows for loans they hold in portfolio due to the cost of establishing and maintaining an escrow service. Furthermore, since these community banks hold their loans in portfolio, they have every reason to ensure that their customers can afford to and do pay property insurance premiums and property taxes, rendering these escrow requirements unnecessary. The implications for these escrow requirements are that many community banks are no longer offering residential mortgage loans to hold in portfolio – mortgages that they have safely and soundly offered for decades. As a result, consumers will have an important credit source cut off – one that in many cases cannot be replaced.

Attached are an Executive Summary and ICBA survey results from a January 2010 survey conducted among 820 community banks regarding the recent Regulation Z escrow requirements for higher priced mortgage loans. These results highlight the cost and expense of escrow requirements for community banks that hold their loans in portfolio, and the ramifications of these requirements on the availability of credit in smaller and more rural communities. It was due to these very issues that Congress provided the regulatory authority to exempt certain mortgage loans, such as loans retained in portfolio, from the escrow requirements.

If the Federal Reserve does not provide an exemption for mortgage loans held in portfolio by financial institutions, ICBA strongly urges that the threshold for first lien loans be 2.5 percentage points over the average prime offer rate for all first lien mortgage loans, not just jumbo loans, and 5 percentage points over the average prime offer rate for loans secured by a subordinate lien on a dwelling. This threshold would better represent what a "higher priced" mortgage loan would be in this current interest rate environment. Under the proposed threshold, presumably all or most mortgage loans would be required to provide the escrow accounts because they would all be considered "higher priced."

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[2] Public Law 111–203, § 1461, 124 Stat. 1376, 2178–81 (to be codified at 15 U.S.C. 1639D).

ICBA hopes that the Federal Reserve carefully considers our comments and the intent of Congress when finalizing these regulatory requirements. If you have any questions or wish to speak with us or our bankers in further detail about community bank mortgage loans, please do not hesitate to contact me at 202-659-8111 or by email at Elizabeth.Eurgubian@icba.org.

Sincerely,

/s/

Elizabeth A. Eurgubian
Vice President & Regulatory Counsel

Attachment

Executive Summary

The Federal Reserve published amendments to Regulation Z (Truth in Lending) regarding "higher-priced mortgage loans" in July 2008, with an effective date of April 1, 2010 for escrow requirements for mortgage loans deemed "higher-priced." "Higher-priced mortgage loans" are defined by the Regulation Z amendments as loans that have an annual percentage rate 1.5 percentage points above the average prime offer rate for a comparable transaction as of the date the interest rate is set for first lien loans, and 3.5 percentage points above the same rate for subordinate lien loans. For higher-priced mortgage loans that are first lien loans, escrow accounts for payment of property taxes and insurance are mandatory, with creditors being permitted to offer borrowers an option to cancel the escrow account 12 months after consummation.

The Federal Reserve stated in their summary of the final rules that "Brokers and loan officers operating in a market where escrows are not common generally quote monthly payments of only principal and interest," and that "[t]hese originators have little incentive to disclose or emphasize additional obligations for taxes and insurance." [73 FR 44558]. However, escrow accounts are not necessary if the loans are properly underwritten to ensure the borrower has the financial ability to pay the loan, insurance and property tax payments. Community bankers have close relationships with their customers, and explain the tax and insurance payment obligations to borrowers so they do understand all their payment obligations. Furthermore, most of these banks hold their loans in portfolio, so they have a vested interested in how the loan performs and the financial well-being of their customers.

As we approach the implementation date for the escrow requirements, the implications of the regulatory amendments have become more daunting for community bankers, especially given the current interest rate environment where a higher-priced mortgage loan under the Federal Reserve's established threshold could have an annual percentage rate of less than 6.5 percent for a first lien mortgage.

Since the publication of the Regulation Z amendments, ICBA has heard from many of its members that they must stop making residential mortgage loans that they hold in portfolio – mortgages they have safely and soundly offered for decades. As a result, many consumers will have an important credit source cut off – one that in many cases cannot be replaced. Unfortunately, this will make affordable credit unavailable to consumers at a time when it is needed most.

Why Are Many Community Bank Mortgage Loans "Higher-Priced"?

Many community bank mortgage loans are covered under the Regulation Z "higher-priced" definition. These are loan products that community banks have been providing to consumers in their communities for decades, with no problems; loans which bear no resemblance to the poorly underwritten loans offered by large lenders and mortgage brokers that the Federal Reserve's escrow requirements intended to address.

These particular loans are traditional community bank products that require a down payment but that also may include higher interest rates. Community banks use this structure to match the maturity of their deposit base which provides funding for these loans. Generally, these mortgage loans are not saleable to the secondary market or the bank does not generate enough volume to justify the staff commitment to develop a secondary market relationship because of the small size of its market.

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.

These community bank mortgage loans do not fall into the "high-cost" category of mortgages covered by the Home Ownership and Equity Protection Act (HOEPA).

Estimated Costs to Service Escrow Accounts

Because of the staff and monetary resources of community banks and the relatively small size of their mortgage portfolios, most community banks will be required to outsource the legally required escrow accounts to a third party servicer. ICBA has not been able to find affordable outside servicers that provide only this escrow service. One servicer, Dovenmuehle, provides escrow services for banks as part of a broader required servicing package. Cost estimates for their services include the following:

For community banks which don't have 1,000 loans
- Maintenance fee is $1,000 per month
- Set up fee is $15 per loan
- $6.50 monthly for fixed rate / $7.50 monthly for ARMs
- $25 monthly fee for loans 60 days past due

This cost data, combined with estimated additional staffing costs for community banks, will render these escrow requirements unaffordable for many community banks, which will limit or completely eliminate their mortgage business.

Survey Findings

ICBA conducted a survey of community banks throughout the country that provide consumer mortgages, with 820 received responses. Data from this survey is attached as Appendix A. The survey included questions about escrow costs for banks that currently provide escrow accounts for their mortgage customers, and estimates of potential costs for community banks that do not currently provide escrow accounts. The survey also asked what the effects of the Regulation Z escrow requirements would be for community banks and their mortgage market.

Findings based on this survey include the following:

Characteristics of Bank Respondents

- Seventy percent of banks indicated that their general market area is rural.
- Seventy-two percent of banks responded that at least 50 percent of the residential mortgages they originated were retained in portfolio and serviced until maturity or until the loan is repaid, with 50 percent of banks responding that 100% of the residential mortgages they originated were retained in portfolio and serviced until maturity or until the loan is repaid.
- Based on current rates, 44 percent of banks responded that over 70 percent of their mortgage loans would be considered "higher-priced mortgage loans" under the current Regulation Z definition.
- For banks that responded that some of their mortgage loans would be deemed "higher-priced," 62 percent stated this is because the cost of funds results in a relatively higher APR. That is, because there is no secondary market for these mortgages, community banks must fund these mortgages from certificates of deposits. As a result, the banks have a higher cost of funds for these loans than for loans which could be sold into the secondary market. Because the Federal Reserve regulations use secondary market rates as the basis for the definitional index, these loans are more likely to fall into the "higher-priced" category.

Estimated Costs to Establish Escrow Accounts

- Seventy-three percent of banks responded that their bank does not currently escrow for taxes and insurance on mortgages. Of these banks, 92 percent claimed that one reason for not escrowing was the lack of available staff resources. Seventy-six percent of these banks also listed "Cost" as a reason for not providing escrow accounts.

- *Initial Costs* – In order to provide escrow account services, a bank needs to make an initial investment in systems and software, employee training and legal fees. For banks that do not currently provide escrow accounts, 39 percent estimated the initial cost to provide escrow accounts would be over $25,000. This figure included 23 percent of banks that stated costs would be $25,000 – 49,999, 13 percent of banks that stated costs would be $50,000 – 99,999 and 3 percent of banks that stated costs would be over $100,000.

- *Ongoing Costs* – In addition, banks would have ongoing costs of monthly servicing fees, in-house staff costs and software and systems maintenance fees. Forty-one percent of banks stated the annual cost per loan would be $100-249, and 35 percent of banks stated the loan cost would be over $250 per loan. Fifty-six percent of banks estimated they would need to hire at least 1 full-time employee to maintain these escrow accounts, which included 19 percent of banks that responded they would need at least 1.5 full-time employees to maintain these accounts.

Current Costs to Establish Escrow Accounts for Banks that Escrow

- Twenty-seven percent of community banks offer escrow accounts for their customers, 57 percent of which provide escrow accounts for less than half of the mortgages they originate.

- *Initial Costs* – Of the community banks that do provide escrow services, 39 percent responded that the initial cost of providing escrow accounts was at least $10,000. Twenty-four percent of these banks responded that the initial cost was between $10,000 - $24,999, 9 percent stated it was between $25,000 - $49,999 and 6 percent of these banks responded that the cost was over $50,000. We expect those institutions with the opportunity to inexpensively implement escrow accounts are more likely to have already done so.

- *Ongoing Costs* - Of community banks that currently provide escrow accounts, 37 percent responded that the annual cost of providing escrow accounts was between $100 – 249 per loan. Nine percent responded that the annual cost of providing escrow accounts was between $250 – 499 per loan and 2 percent of banks responded that the annual cost was between $500 – 999 per loan.

- Of community banks that currently provide escrow accounts, 48 percent responded that the bank required at least one full-time employee to maintain the escrow accounts that they do provide. Twelve percent of these banks stated they required at least 2 full-time employees to maintain the escrow accounts that they provide (*note*: keep in mind that most of the community banks that currently provide escrow accounts to their customers provide them for less than half of the mortgages they originate).

Adverse Effects of Escrow Requirements on Community Banks and their Customers

- Among all of the bank respondents, twenty-eight percent stated that interest rates on their loans would increase by 26-50 basis points due to these escrow requirements. Thirteen percent of banks estimated an increase of 51-75 basis points per loan and 13 percent of banks estimated an increase of 76 - over 100 basis points per loan.

- Thirty-three percent of all banks responded that these escrow requirements would make them stop making the types of mortgages that would trigger the requirements. <u>Sixty-two percent of banks stated if they stopped making mortgages due to these requirements, borrowers in rural areas would be the most impacted</u>.

ICBA Solutions

- Because community bank loans are often held in portfolio by the banks, they have a vested interest in how the loans perform and in ensuring that the loans, including monthly costs of taxes and insurance, are affordable for borrowers. As a result, community bank loans held in portfolio should be exempt from the higher-priced mortgage loan escrow requirements.

- Ninety-four percent of community banks stated that loans that are originated and held in portfolio by the bank until maturity, or until repaid, should be exempt from the escrow loan requirements for higher-priced mortgage loans.

Appendix A

Federal Reserve Regulation Z
"Higher-Priced" Mortgage Loan
Survey

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Respondent Demographics

- 820 community bank respondents
- 69% originate fewer than 150 mortgage loans annually
- Sample skews toward rural institutions with a response rate 17 percentage points higher than membership distribution.

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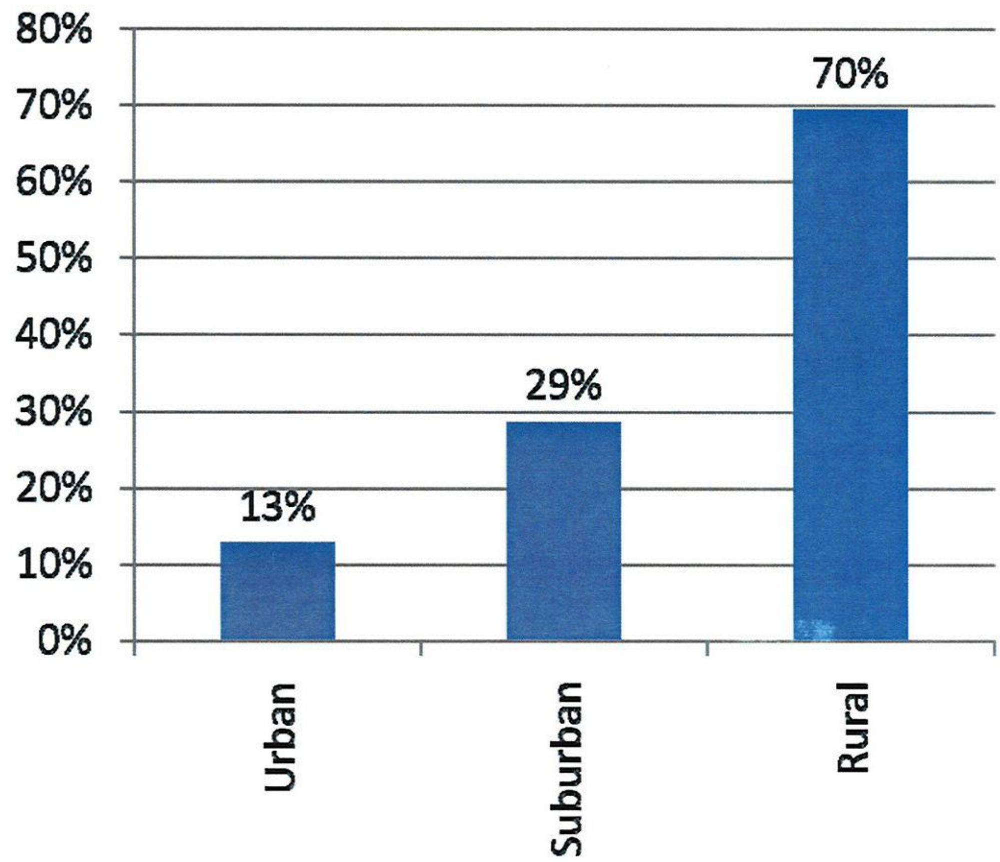
Note: (1) Percentages may not add exactly to 100% due to rounding. (2) Figures are based on responses from all respondents, unless otherwise indicated on the slide.

Please describe your general market area?

[Respondents could select more than one answer]



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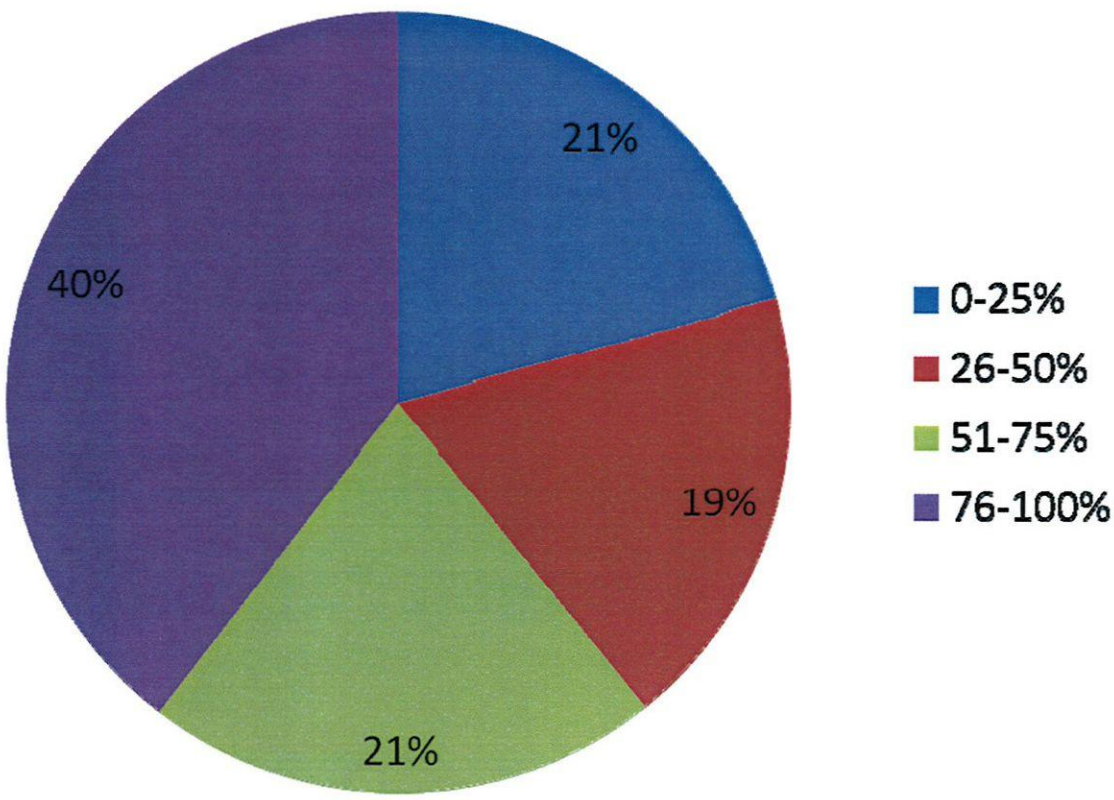
What percentage of your market area is rural?



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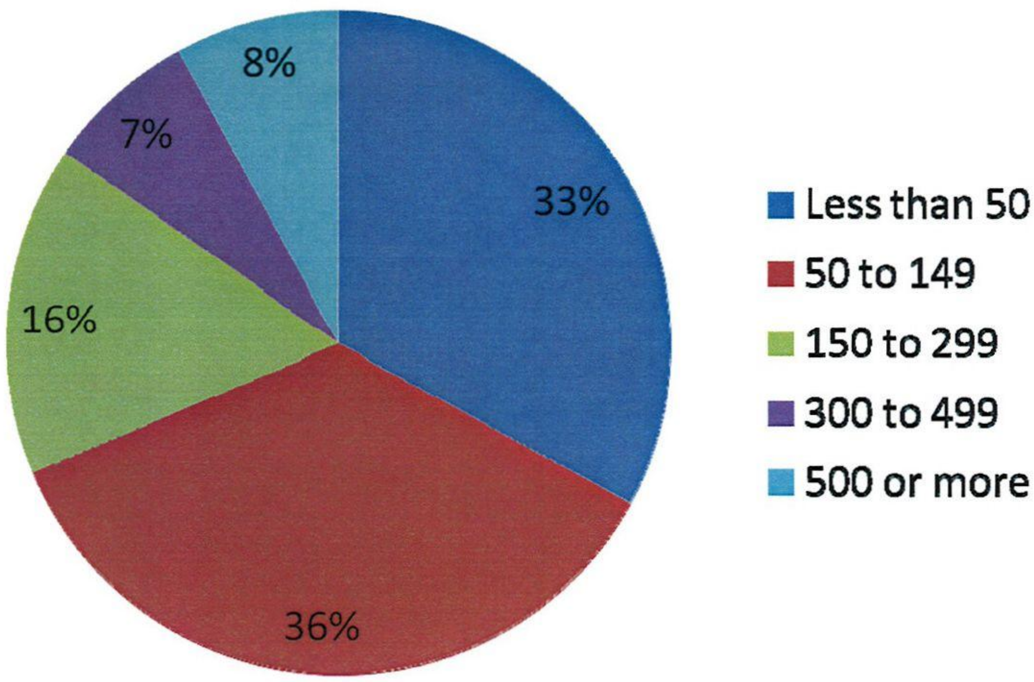
How many residential mortgage loans does your bank originate annually?



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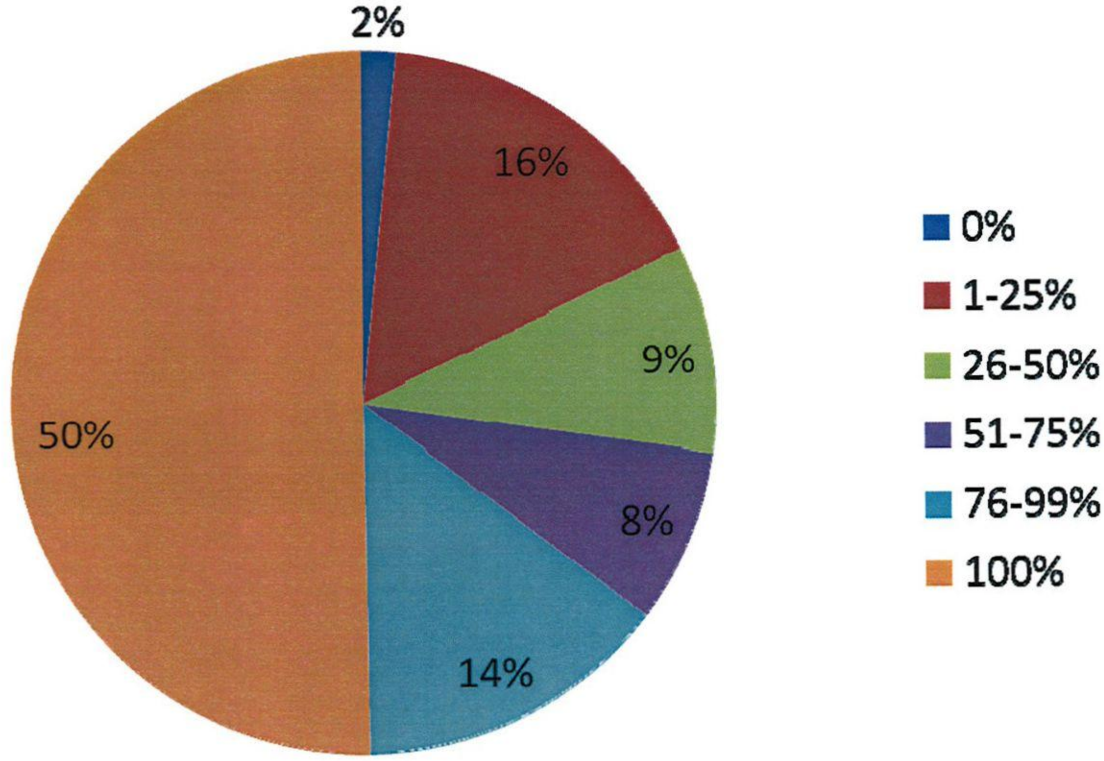
What percentage of the residential mortgages originated by your bank are retained in portfolio and serviced until maturity or until the loan is repaid?



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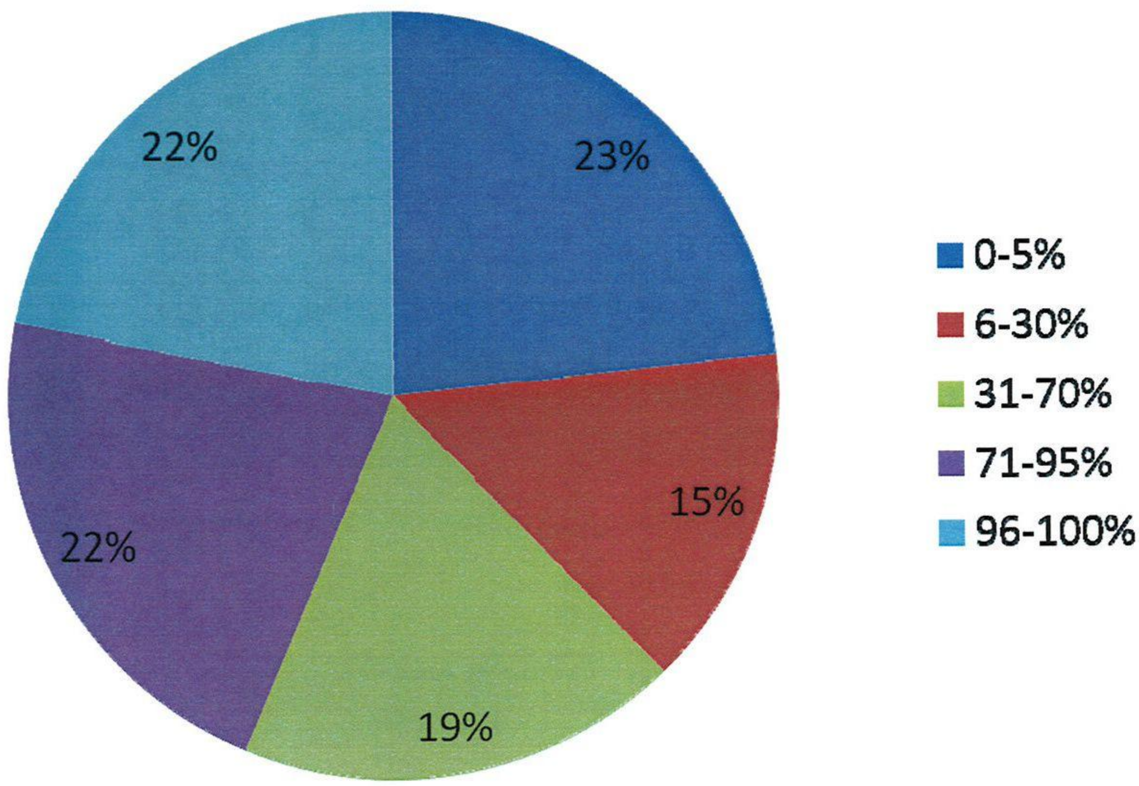
Based on current rates, what percentage of your mortgage loans would currently be considered "higher-priced mortgage loans" under the Federal Reserve's definition?



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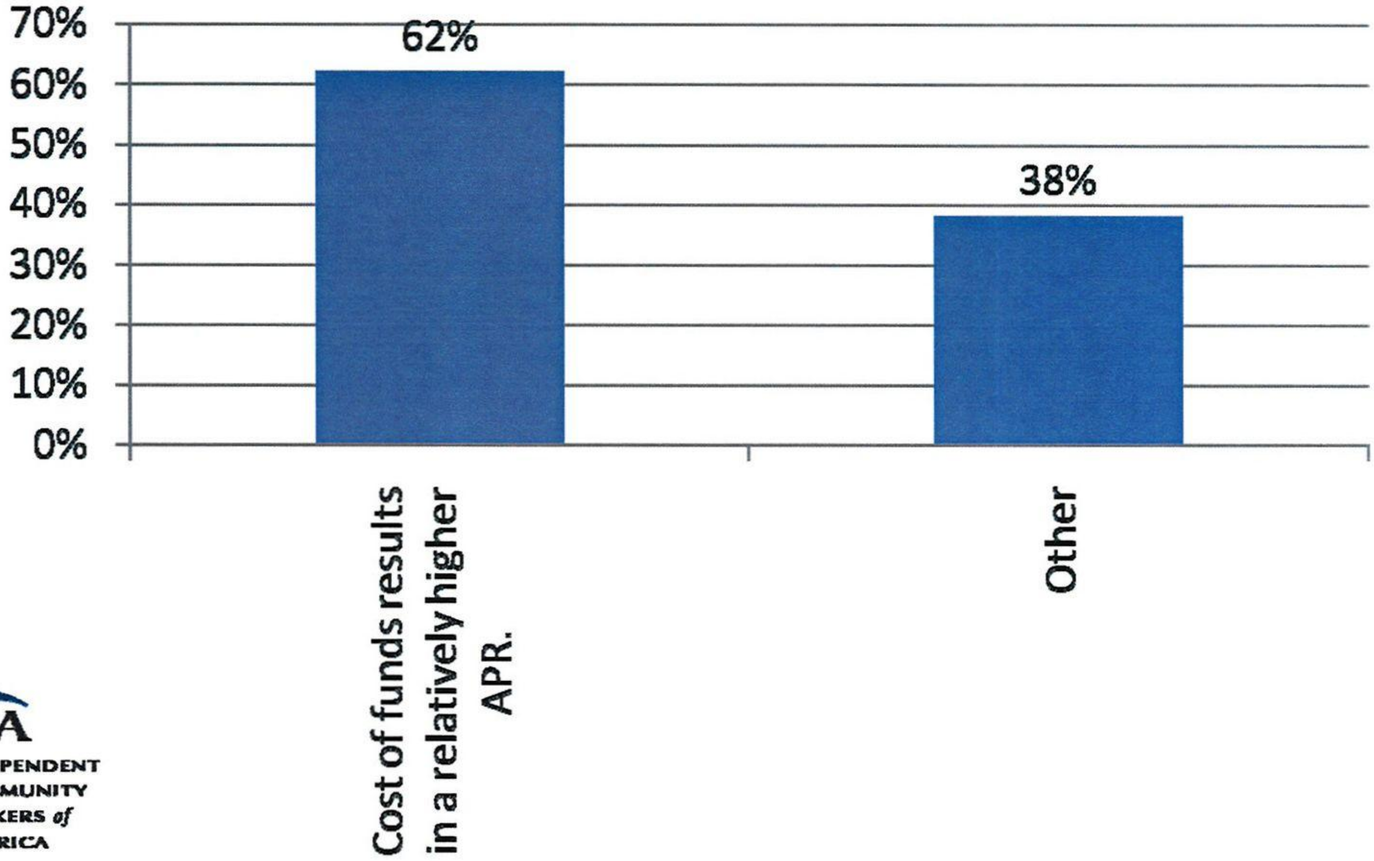
If some or all of you mortgage loans meet this definition of a "higher-priced mortgage loan," then why?



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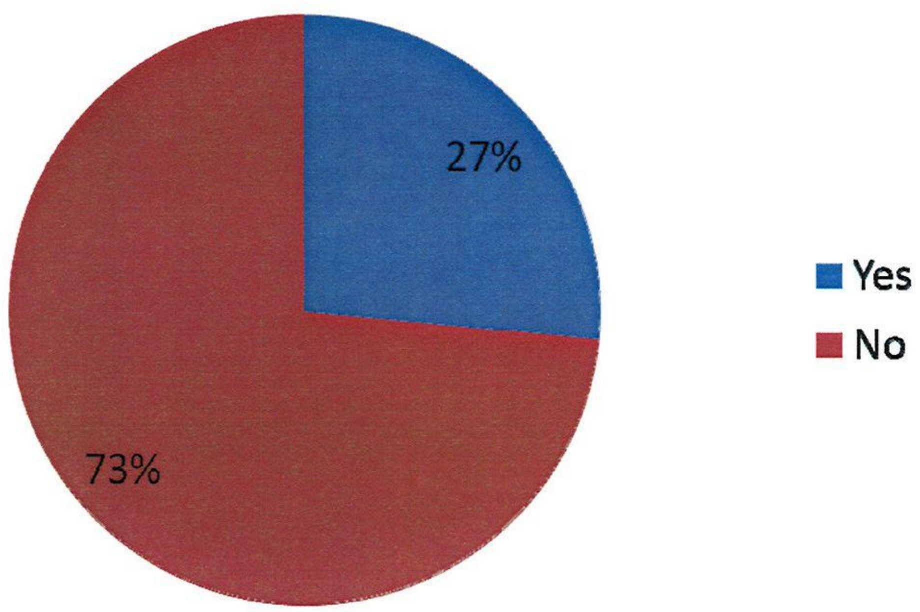
Does your bank currently escrow for taxes and insurance on mortgages, in full or in part?



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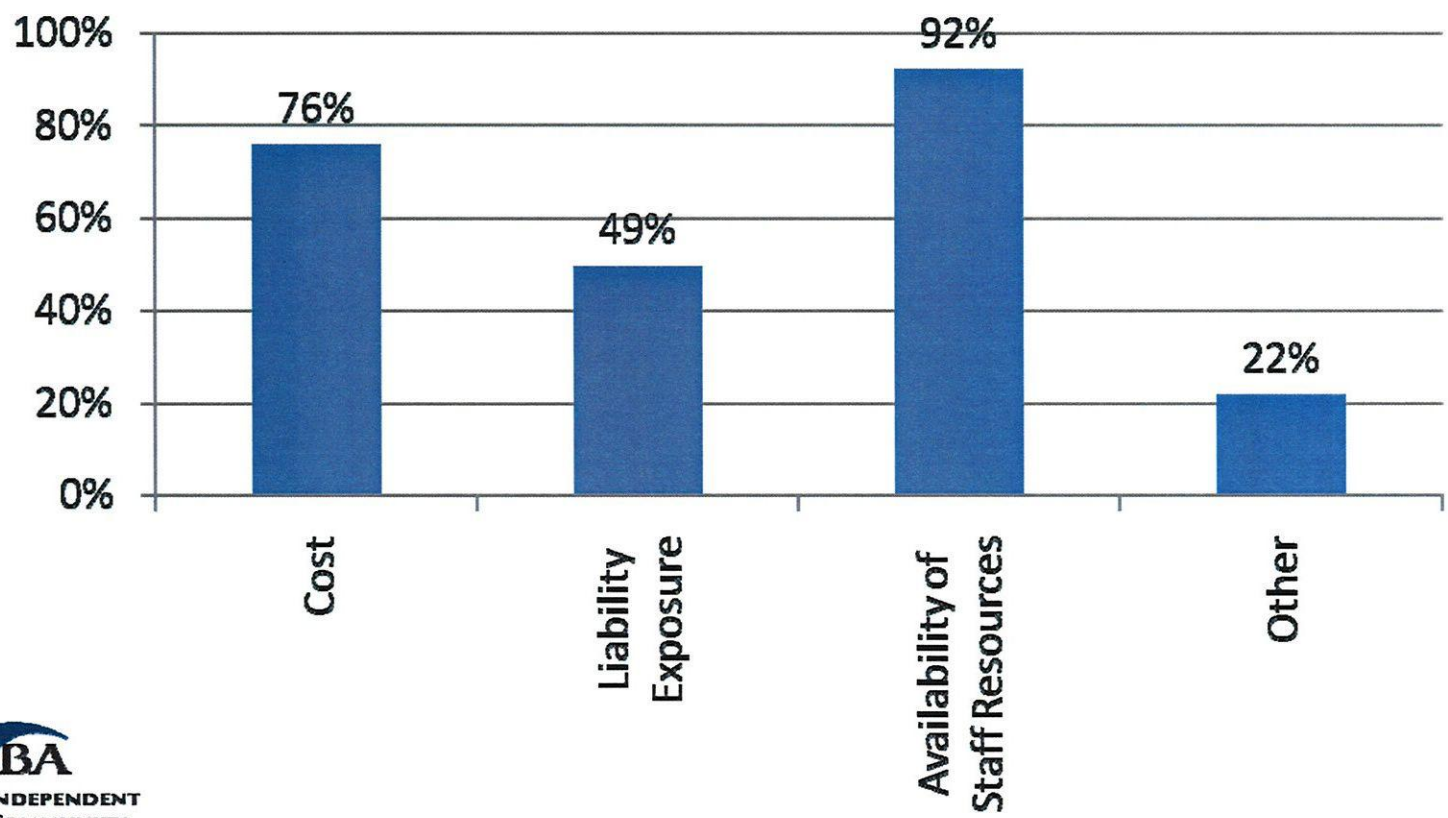
What are the primary reasons that your bank does not escrow?

[Respondents could select more than one answer]



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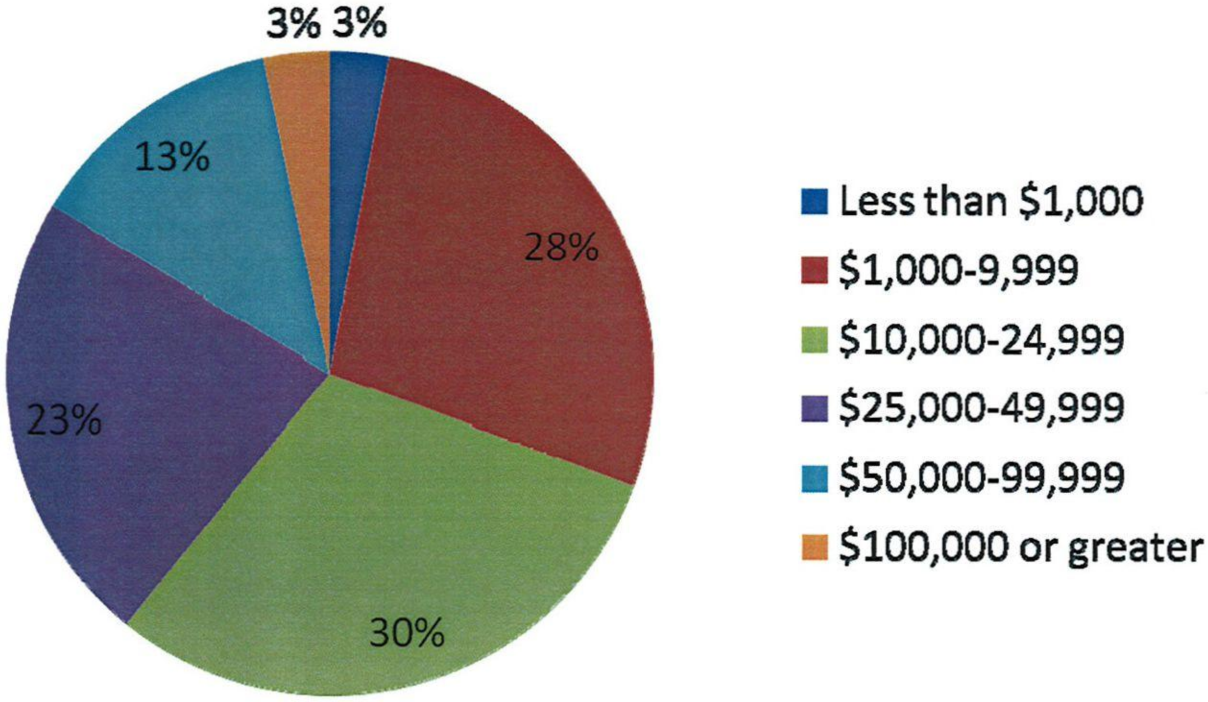
Percentages among 73% of respondents that do not offer escrow accounts.

What is the estimated initial cost of implementing escrow accounts at your bank for higher-priced mortgage loans?

Please include the cost of systems & software, training, legal counsel and staff resources in your estimate.



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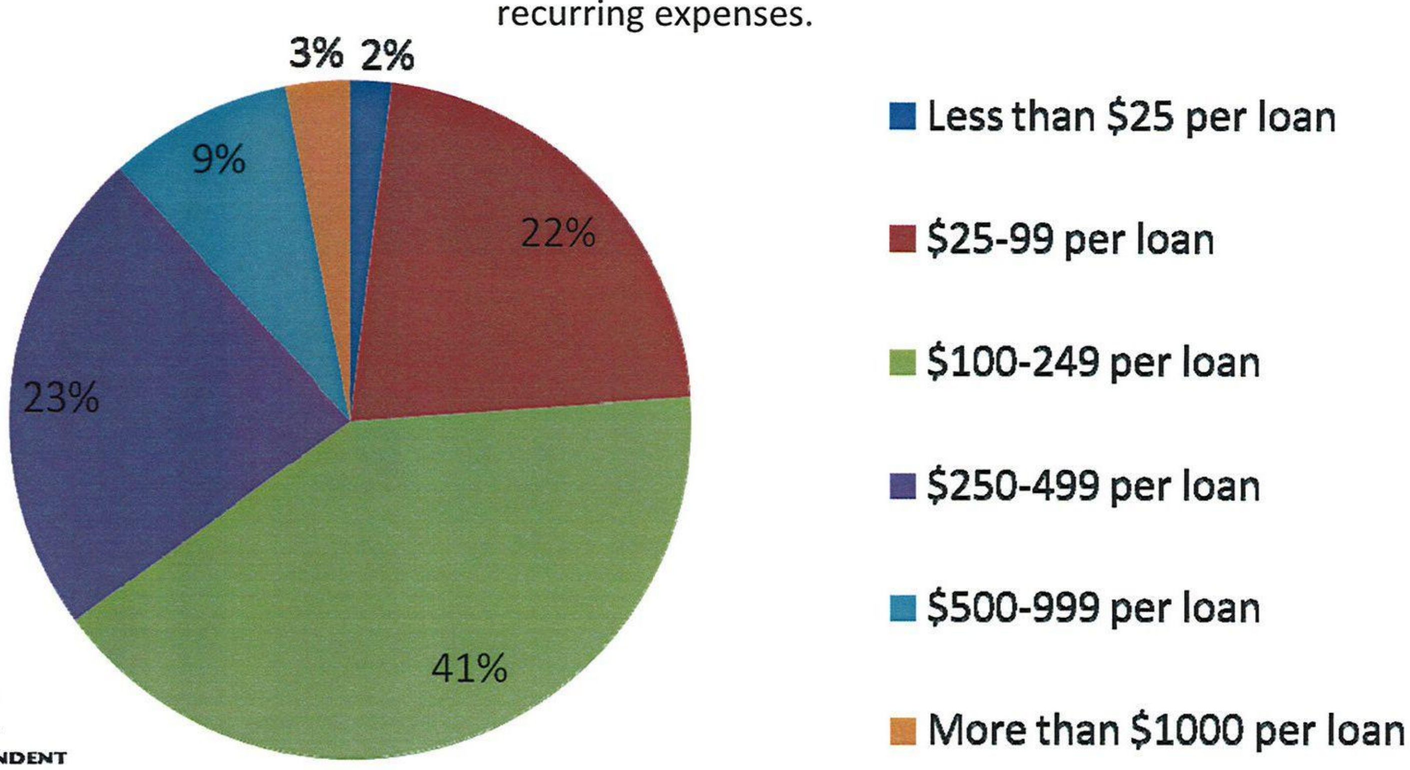
Percentages among 73% of respondents that do not offer escrow accounts.

What is the estimated ongoing annual cost of maintaining escrow accounts at your bank per loan originated that meets the definition of "higher-priced mortgage loan"?

Your estimate should include staff time, systems resources, account maintenance and any other recurring expenses.



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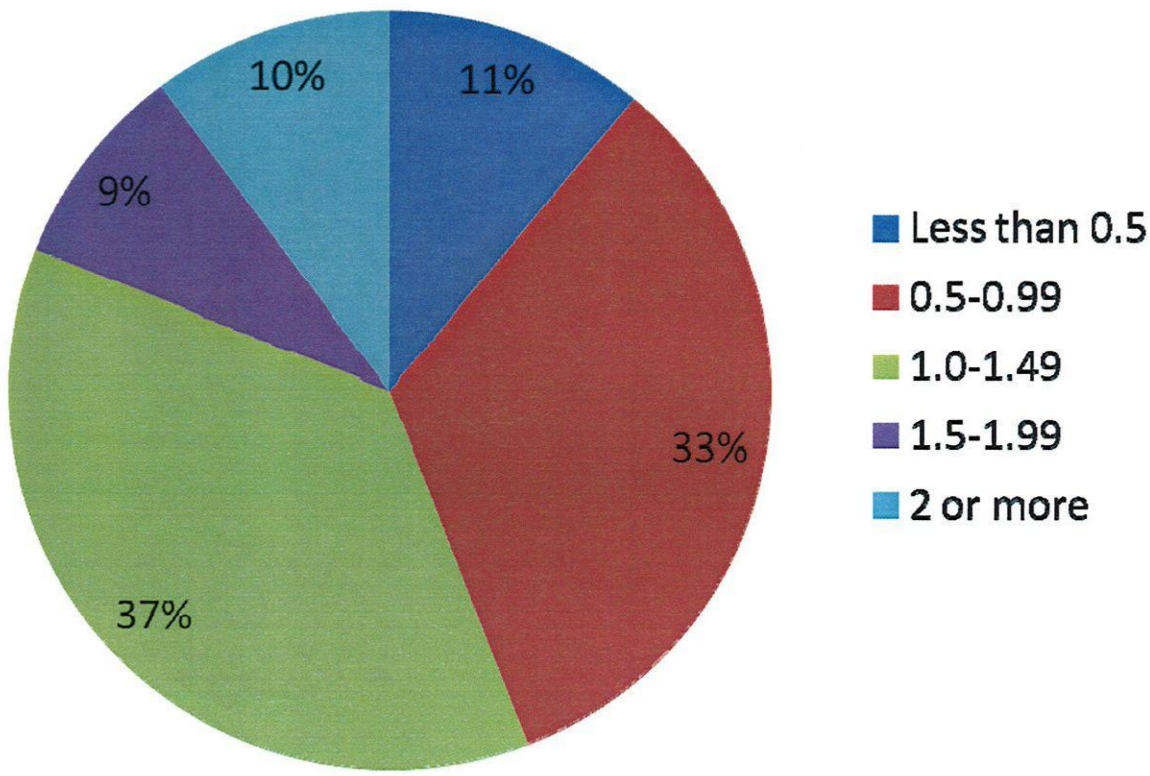
Percentages among 73% of respondents that do not offer escrow accounts.

How many full-time equivalent employees would you estimate your bank would need in order to maintain escrow accounts for higher-priced mortgage loans?



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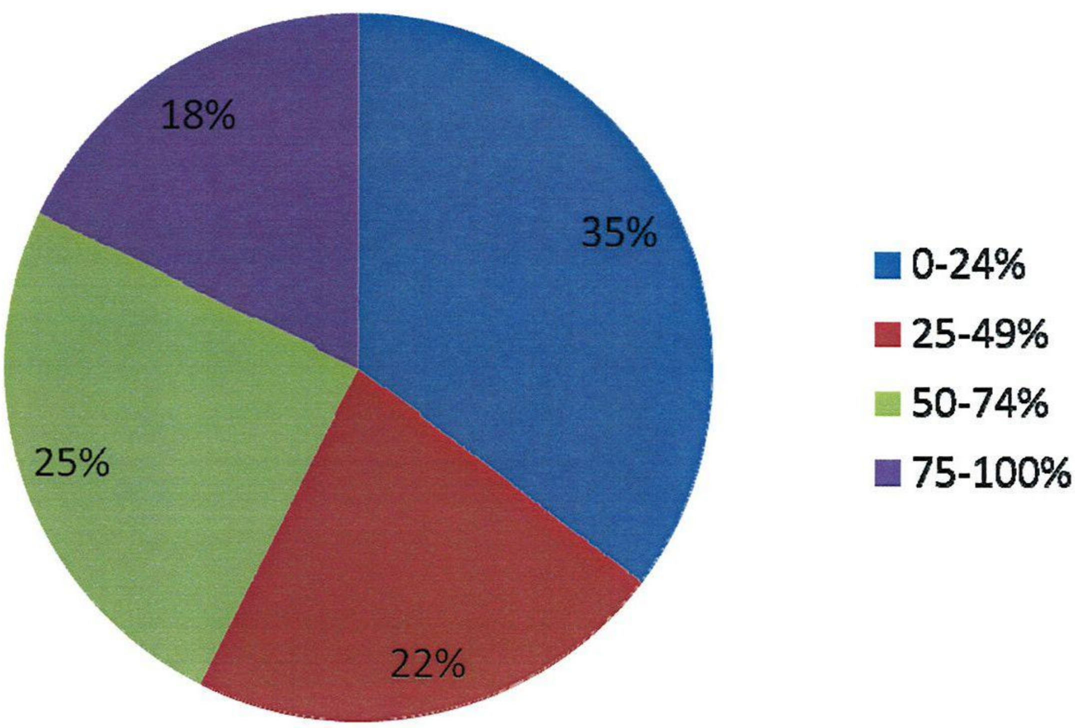
Percentages among 73% of respondents that do not offer escrow accounts.

What percentage of mortgages originated have escrow accounts?



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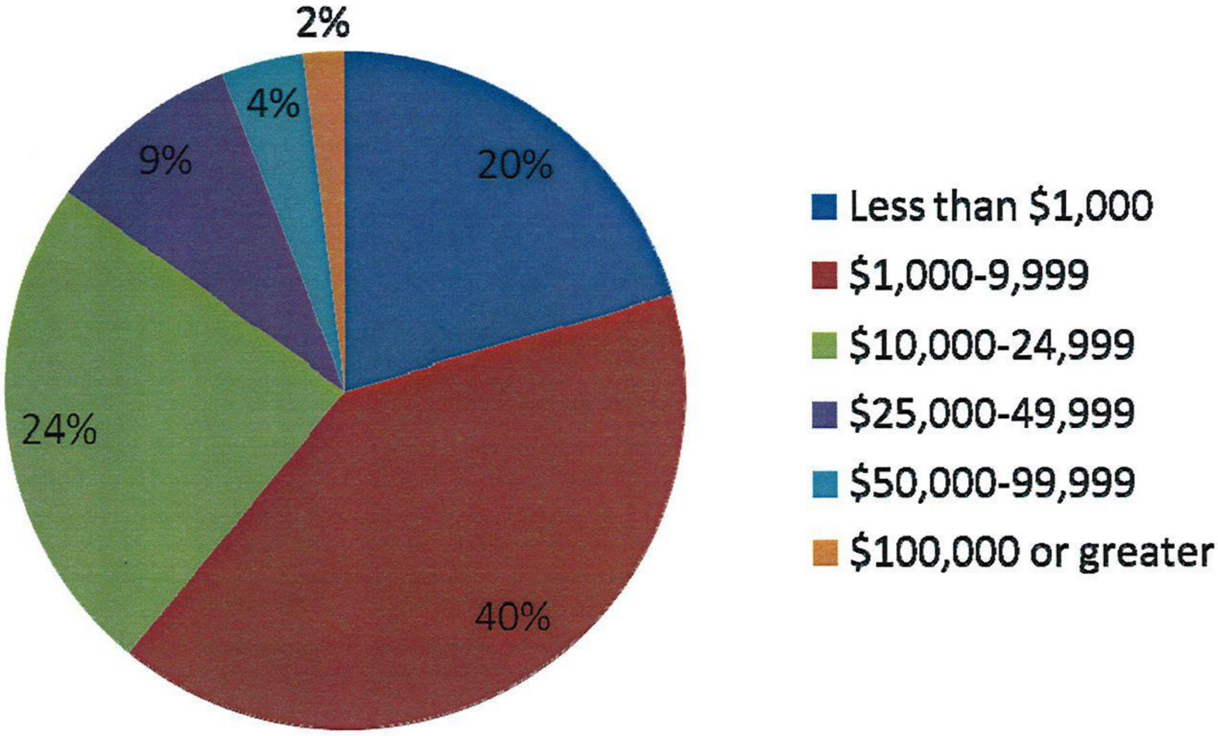
Percentages among 27% of respondents that already offer escrow accounts.

What was the initial cost of implementing escrow accounts at your bank?

Please include the cost of systems & software, training, legal counsel and staff resources in your estimate.



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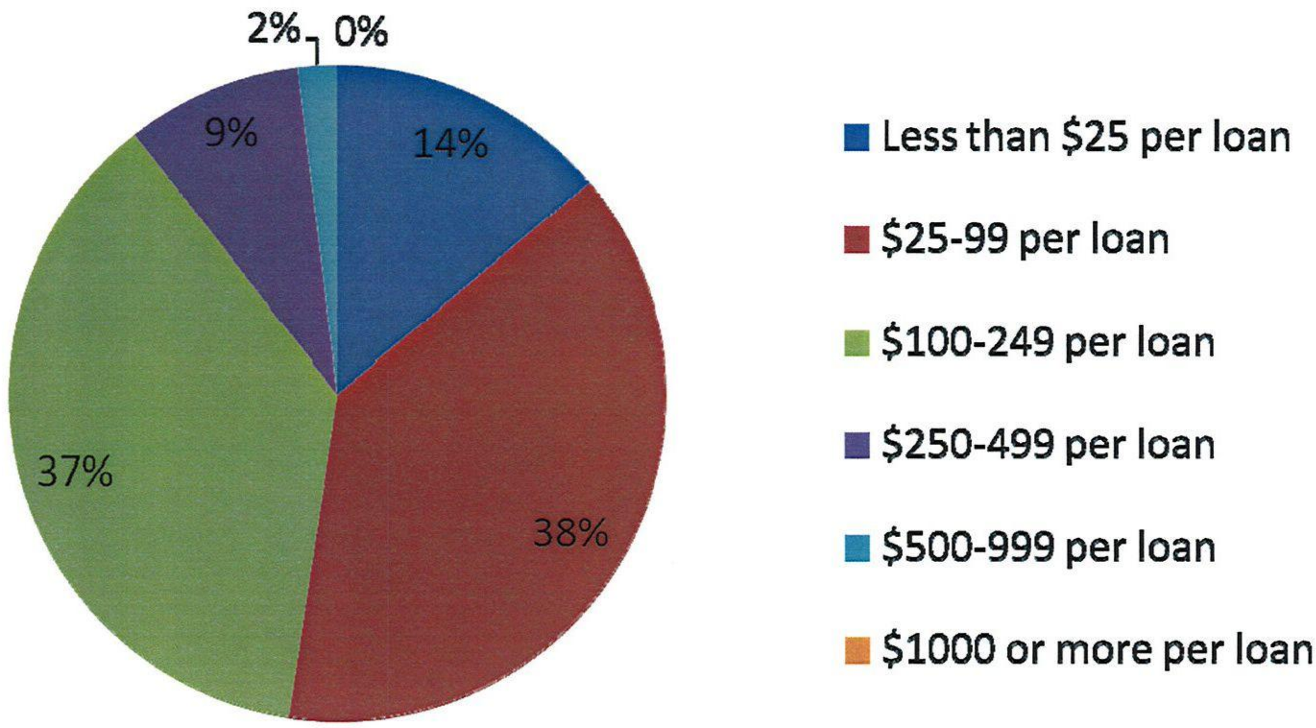
Percentages among 27% of respondents that already offer escrow accounts.

What is the ongoing annual cost of maintaining an escrow account per loan originated?

Your estimate should include staff time, systems resources, account maintenance and any other recurring expenses.



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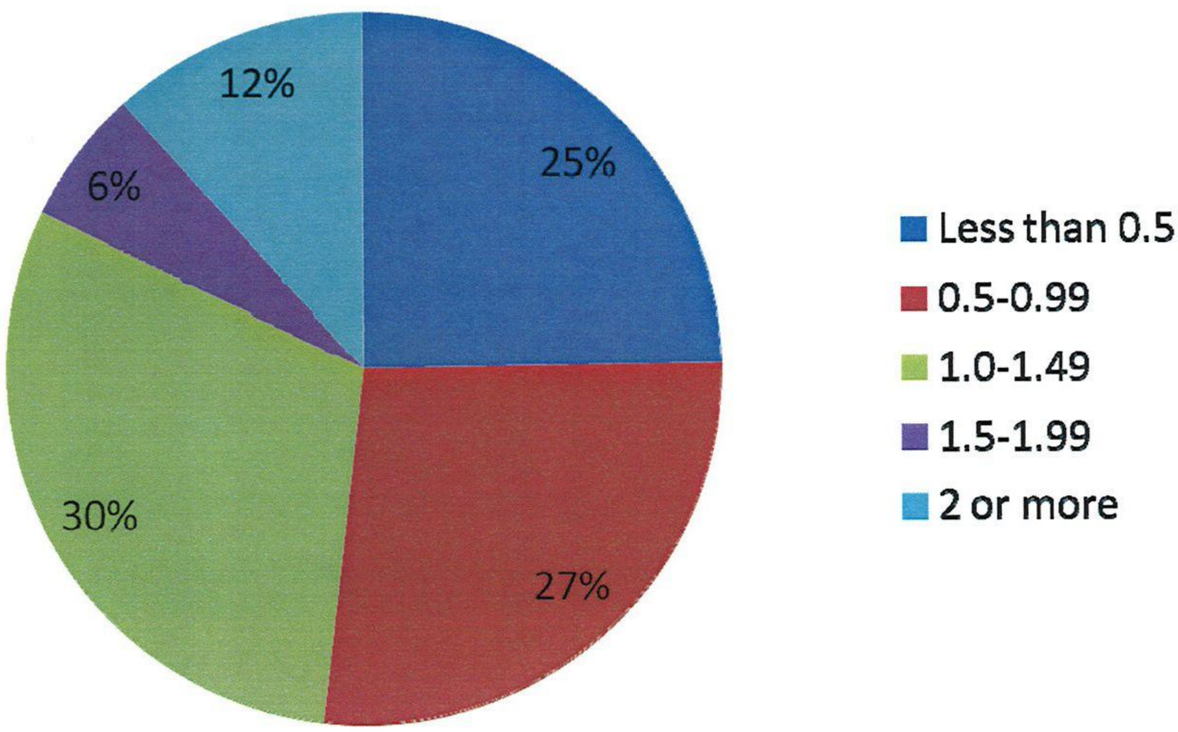
Percentages among 27% of respondents that already offer escrow accounts.

How many full-time equivalent employees are required by your bank in order to maintain escrow accounts?



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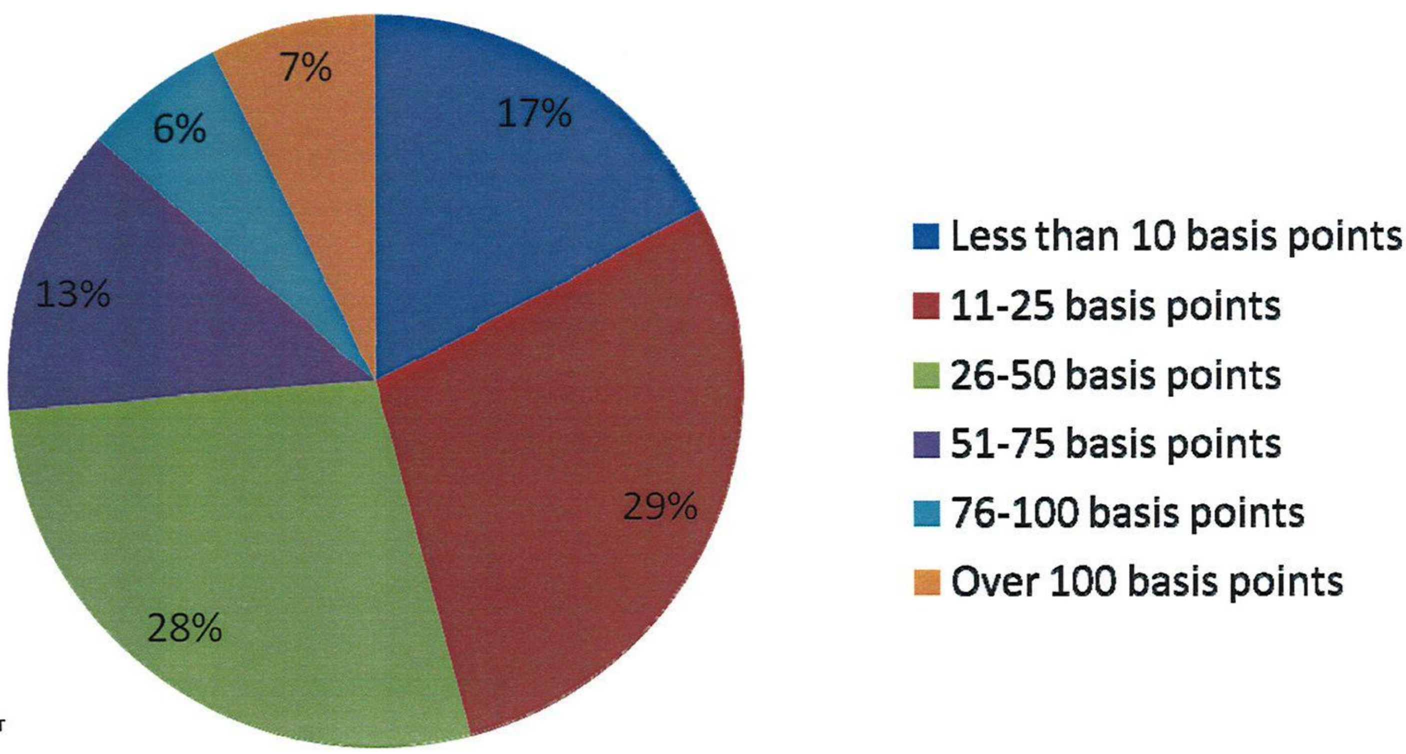
Percentages among 27% of respondents that already offer escrow accounts.

Based on these new regulatory requirements and your estimated escrow costs, by how many basis points would your loans increase if you had to provide escrow accounts for higher-priced mortgage loans?



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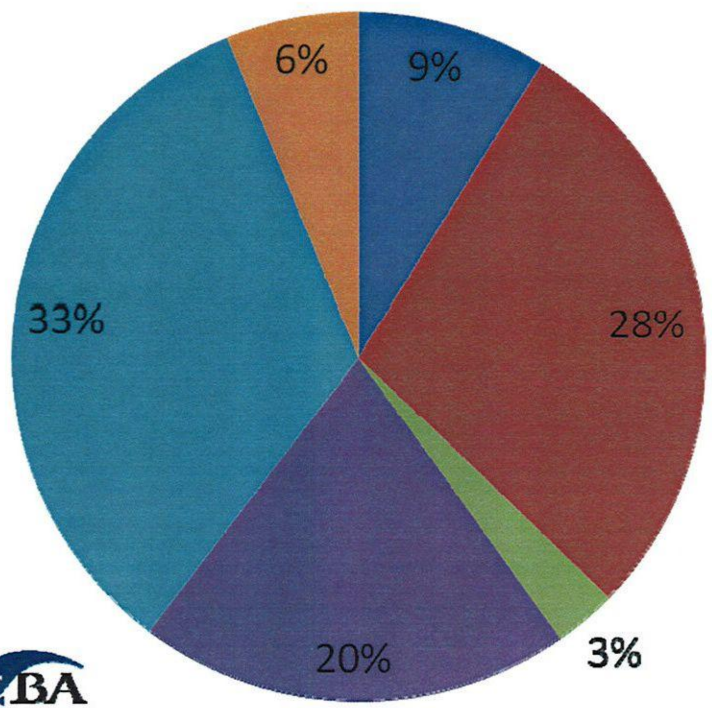
If your bank was required to establish escrow accounts in order to originate mortgages that are "higher-priced mortgage loans" under the Fed's definition, what impact would this have on your bank's mortgage lending?



- We would implement the escrow system, continue lending at current volumes and maintain our current rate and fee levels.
- We would implement the escrow system and continue lending at current volumes passing increased costs on to consumers through increased rates and fees.
- We would implement the escrow system and reduce our lending volume.
- We would implement the escrow system, reduce our lending volumes and pass increased costs on to consumers through increased rates and fees.
- We would stop making the types of mortgages that would trigger the escrow requirements.
- Other

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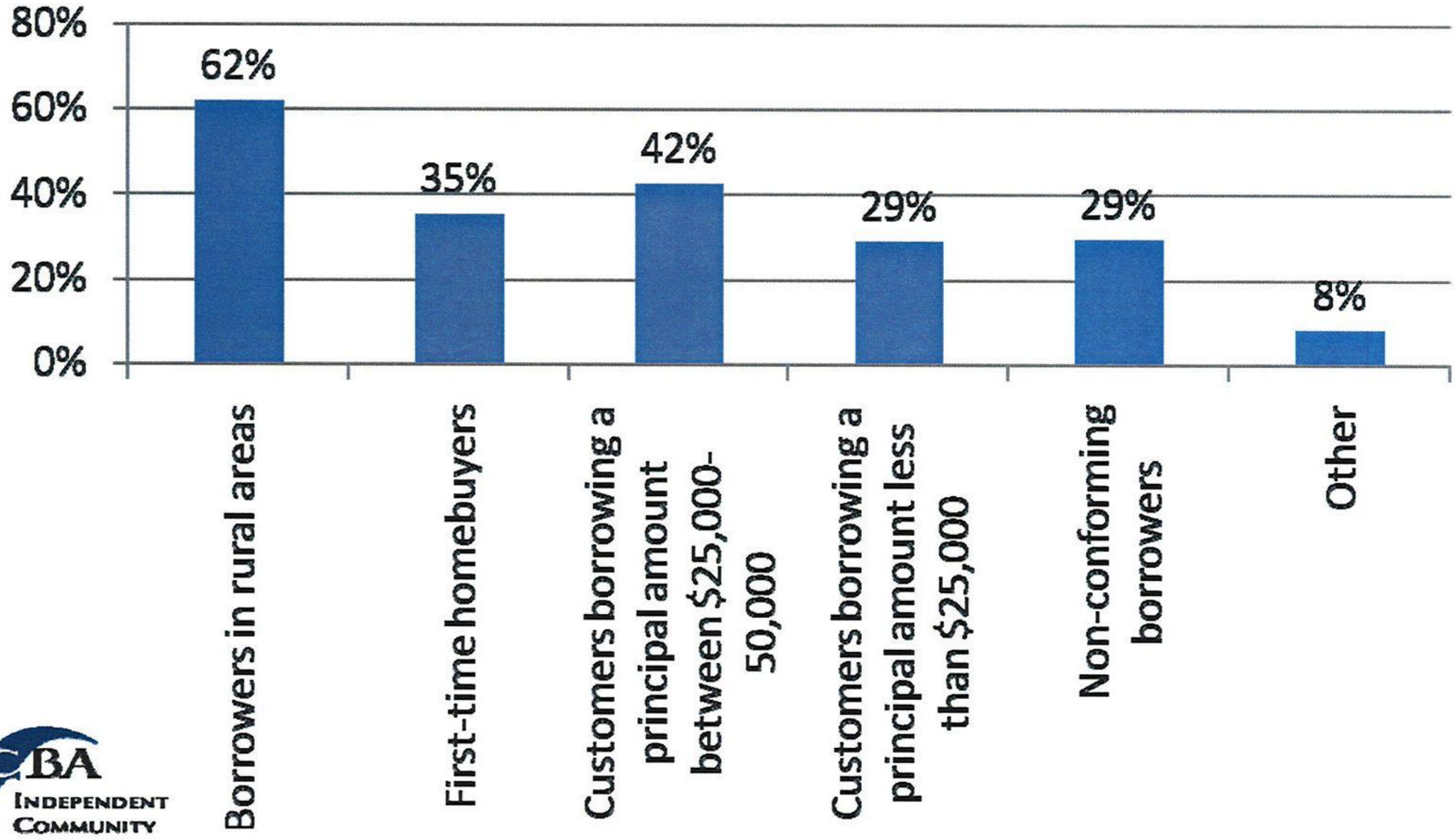
If your bank stopped making mortgages due to these new requirements, which of your customers would be most impacted?

[Respondents could select more than one answer]



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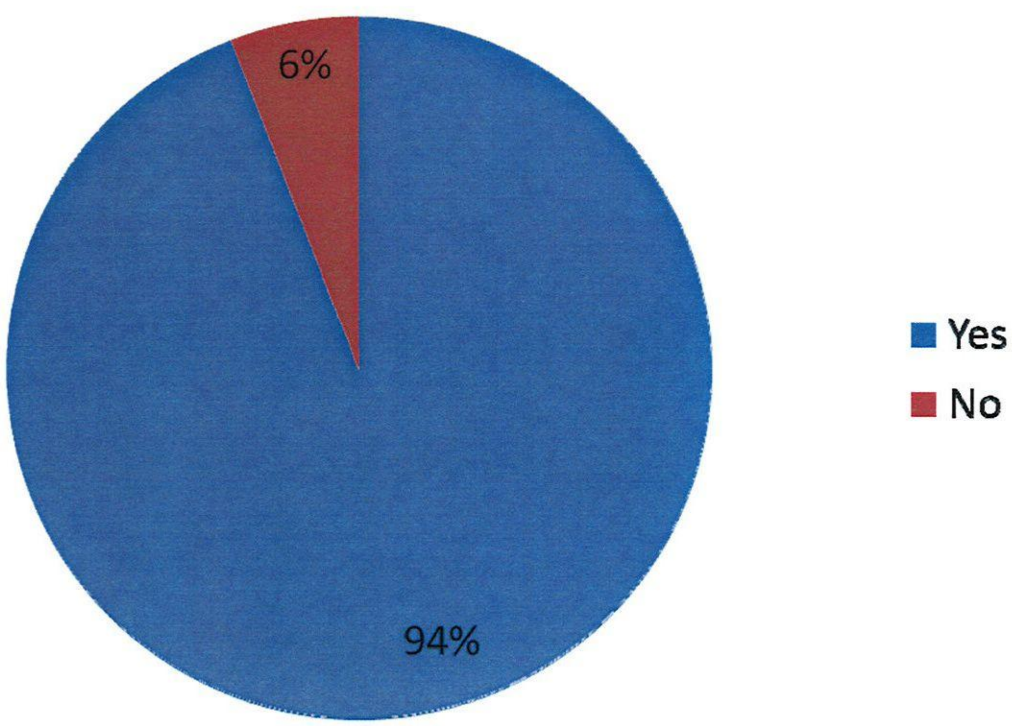
Should loans that are originated and held in portfolio by the bank until maturity, or until repaid, be exempt from the escrow requirements for higher-priced mortgage loans?



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