IOWA BANKERS ASSOCIATION

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June 22, 2011

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

Re: Docket No. R-1417
RIN No. 7100-AD 75

Ms. Johnson and Board:

Iowa Bankers Association (IBA) is a trade association representing over 350 banks and savings and loan associations operating in the state of Iowa. Our membership is predominantly comprised of banks and savings associations deemed to be "small" for purposes of the Community Reinvestment Act (CRA) with a handful of "intermediate small" and large banks. Our member banks offer a variety of in-house portfolio residential mortgage loan products including adjustable rate mortgage loans, balloon loans and fixed rate loans. Some of our members also originate long term fixed rate and ARM loans that are sold to secondary investors. The in-house portfolio mortgage products offered by our members meet the unique needs of rural Iowa where housing prices are much lower. They are not high risk and are not abusively priced.

We appreciate the opportunity to comment on the Board's proposed rule to implement Sections 1411, 1412 and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) of 2010. These sections amend the Truth-in-Lending Act (TILA), prohibiting creditors from making mortgage loans without regard to the consumer's repayment ability. The proposed changes are meant to prohibit creditors from making mortgage loans unless there is 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. It is assumed by the IBA that with the DFA transfer date of July 21, 2011 – this ultimate final rule will be issued by the Consumer Financial Protection Bureau (CFPB).

Effects of the New Ability to Pay Legislation

The IBA believes these proposed regulations will result in a fundamental shift in mortgage lending as they will set the minimum underwriting standards that all future mortgage loans must adhere to. These rules also apply broadly to all closed-end residential real estate loans – whether or not they are primarily owner-occupied dwellings. These proposals therefore will have a profound impact on mortgage lending by modifying the legal responsibilities between lenders, and fundamentally impacting the types of mortgage lending done in Iowa by community banks – **particularly balloon mortgage lending**.

Ability to Repay vs. "Qualified Mortgage"

The proposal contains a general "ability to repay" requirement where loans would meet these new rules by meeting eight underwriting factors verifying the consumer's income, assets and obligations. In addition, the proposal sets up an alternative structure giving special protections for a "qualified mortgage" (QM) that is either a safe harbor or rebuttable presumption of compliance for the lender – depending on which option is selected by the Board/CFPB in the proposal. The IBA believes that given the new penalty provisions under the law, a majority of IBA members will seek to operate only within the qualified mortgage (QM) segment, and will avoid entirely making loans outside of any "safe harbor." Some of the reasons this new QM standard will comprise the bulk of all mortgage lending include:

- Secondary markets will demand "safe harbor" status for purposes of quality assurance, risk avoidance and guaranty of compliance.
- Heightened risk of scrutiny from regulators: In the same way HOEPA (high cost) loans generate more intense scrutiny from regulators in terms of fair lending and other analysis, the presence of non-QM mortgages will create greater risks of scrutiny and investigation from regulators. Once finalized, regulators will surely assess and regulate upon the increased legal risks that emanate from non-QM loans as posing greater "safety and soundness" hazards (because of new liability for damages in recoupment of foreclosure on the grounds the creditor violated the ability to repay requirement).
- A "QM" standard will stratify the market and create a structure of QM and non-QM loans. Non-QM loans would likely become a new category of "subprime" loans, with adjustments in risk assessments and/or investor requirements requiring that these loans will be priced accordingly.

The proposal sets forth two different alternatives for legal protections for loans made under the QM category. Under the first approach, a creditor making a mortgage loan that satisfies certain specific conditions meeting the qualified mortgage provisions would be entitled to "safe harbor" protections with regard to the repayment ability determination requirements. Under the second proposed approach, a creditor making a qualified mortgage loan and satisfying the conditions specified in the first alternative plus additional underwriting elements, would be entitled to "rebuttable presumption" of compliance with the repayment ability determination requirements.

The Board is asking for comments on these two alternatives because the DFA is not clear as to whether a QM is eligible for a safe harbor or a rebuttable presumption. For the following reasons, the IBA believes that the final rule must offer a safe harbor provision with the full protections that it would offer creditors:

- A safe harbor is needed both for lender and investor confidence – so lenders can have some level of certainty that their loan cannot be retroactively challenged. The only way to ensure predictable originations under the QM standard is to provide a safe harbor for these loans.
- A "presumption" is only an assumption made in the law that may stand unless challenged, so therefore it is only good until it is contested and shown to a judge or jury to be wrong. A presumption therefore offers no real legal protections to lenders, as by definition the consumer will have the right (under the proposed repayment provisions) to initiate the dispute to challenge a loan's repayment ability. In such a system, conferring a "presumption" to the defendant creditor offers no real legal protection that the creditor already does not have. Such a "presumption" standard that is less than a safe harbor will make residential real estate lending much riskier and will certainly be factored into the pricing of the credit markets for IBA members.

The IBA agrees in the preamble that the "drawback of treating a 'qualified mortgage' as providing a presumption of compliance is that it provides little legal certainty for the creditor, and thus little incentive to make a 'qualified mortgage,' which limits loan fees and features." This is a correct and accurate statement—a mere rebuttable presumption provides no added certainties to lenders, and would not therefore achieve the statutory objective of providing lenders the confidence and legal assurances they require. It is therefore crucial that the Consumer Financial Protection Bureau grant lenders the meaningful protections that a legal "safe harbor" would confer.

The Definition of a "Balloon Payment Qualified Mortgage" is Completely Unworkable for Iowa Banks
It should first be noted that there is a provision in the "general" ability to repay proposal for creditors to possibly make "prime balloon loans as long as the loan is not an HPML, and the ability to repay test is measured using the maximum payment scheduled for the first five years (which would include a balloon payment itself only if due

within the initial five years)." Because of the expanded damage and liability provisions under the DFA (lengthened statute of limitations, recoupment or setoff provisions in foreclosure, etc), most Iowa banks will likely NOT rely on this standard as having adequate protection from liability for the origination of balloon mortgages.

The Board, realizing that balloon mortgage lending has been a mainstay product of community banks, is exercising authority under the DFA to propose an exception to the definition of a QM for a balloon-payment loan (BPQM) made by a creditor that meets the criteria set forth in the DFA. This exemption is an accommodation to community banks making short-term balloon loans as a hedge against interest rate risk. To qualify for this new classification, the creditor must meet four criteria:

- The creditor operates in predominately rural or underserved areas;
- The creditor extended BPQM under a certain number or loans or dollar amount (depending on the alternative chosen);
- The creditor must not sell any balloon loans in the portfolio; and
- The creditor must fall under an asset size threshold set annually by the Board, which for calendar year 2011 would be $2 billion.

The IBA wishes to focus comments on the parameter above relating to a requirement in the preceding calendar year the creditor must have extended more than 50% of its covered BPQM in one or more counties designated as "rural or underserved."

The goal of this proposed classification was to provide a mechanism for community banks in Iowa to continue to be able to offer these mortgages, which has been a staple product line in Iowa for decades – and provide a low cost alternative for Iowa consumers in areas where home prices are much lower than national averages. However, the manner in which the definition of "rural" is crafted will eliminate most Iowa banks from being able to offer this product to their customers. First, the definition of "rural" is extremely complicated and difficult to understand. Under the proposal, which is similar to the recent Board proposal for escrow disclosures under TILA, a county is "rural" during a calendar year if it is not in a metropolitan statistical area or a micropolitan statistical area, as those terms are defined by the U.S. Office of Management and Budget, and it is not adjacent to any metropolitan area or micropolitan area; <u>or</u> it is adjacent to a metropolitan area with fewer than one million residents or adjacent to a micropolitan area, <u>and</u> it contains no town with 2500 or more residents. Most smaller IBA member banks do not have full time compliance staff or in-house legal counsel to review, analyze, and determine whether or not they meet this definition. As a result, these IBA members who have safely offered this low cost alternative to their customers for years will be forced to either offer more compliance intensive ARMs or force customers (who may have wanted their loan held locally) to choose a product sold servicing released into the secondary market.

Second and more importantly, applying the proposed definition of "rural" will result in very few counties in Iowa actually meeting the definition of "rural." Iowa consists of 99 counties; 20 of which have been designated as MSAs with an additional 15 designated as micropolitan areas. After applying the definition of "rural" only 16 counties meet the definition of rural because the remaining 48 counties either lie adjacent to an MSA or lie adjacent to a micropolitan and have at least one community with a population in excess of 2500. The entire state of Iowa has a total population of just over three million per the 2010 census (3,046,355) with the largest city's population at 203,433 (Des Moines). It would seem Congress' intent for regulatory relief was broader than reaching less than 20% of a state that has 55% (1,692,048) of its entire population in 20 MSAs. ***After an analysis on our membership approximately 44 of our 350 members would purportedly meet this definition***. That is 12% of our members is what is already considered to be a rural state – when about 80% of our members currently offer this product. Many of our smaller community bank members (who unfortunately are chartered in a micropolitan or adjacent to a micropolitan county), do not have the compliance expertise to conduct ARM lending, which will result in these smaller banks turning customers away who want their mortgage loan held and serviced by their local Iowa bank.

Finally, the Federal Reserve changes to the Regulation Z finalized in October of 2009 implementing restrictions for "higher priced mortgage loans" (See section 12 CFR 226.35) has effectively made owner-occupied residential balloon loans of less than seven years stay under the margin requirements of 150 basis points over the "Average Prime Offer Rate." Since these changes have effectively acted as a "ceiling" for these loans to be originated at or below these margins, there is little need for an overly restrictive "rural or underserved" definition that will further restrict credit in the rural housing markets.

In the interest of providing regulatory relief in a meaningful way, and to those creditors truly operating with limited resources serving a limited number of consumers, we would respectfully suggest the Board and the CFPB consider revising and simplifying its definition of a "rural" county for qualification of a BPQM to a county that is not in a metropolitan statistical area, as defined by the U.S. Office of Management and Budget.

Points and Fees Test

The DFA legislation requires the special legal protections contained in the qualified mortgage classification be afforded only in transactions where total "points and fees" do not exceed 3 percent of the total loan amount. This condition is significant, as it strictly demarcates which transactions may qualify for QM treatment. As described above, since the IBA believes the market will be concentrated within the QM category, the ability to qualify for QM treatment will largely determine which lenders participate in the market and what products are offered to consumers. In short, the formula for "points and fees"—its threshold level and how it is defined—will determine market entry and lender participation, and will therefore profoundly shape pricing and loan availability.

The IBA believes that the proposed points and fees test is extremely rigid and limiting and will, if finalized in its current form, greatly constrain the ability of banks to enter the mortgage market. The definitions that apply to "points and fees" and "total loan amount" would be the same definitions that apply to HOEPA loans. This formula is extremely complex and contains definitional contortions that make it difficult to ascertain its precise application.

Thank you for allowing the IBA to submit these comments on these proposed changes to the TILA pursuant to the Dodd Frank Act. We cannot understate the potential impact of these changes for our members and our customers in Iowa, and we encourage the Board and ultimately the CFPB to consider changes proposed by the IBA as outlined above.

If you have questions about these comments, please contact the undersigned at 515-286-4211 or via e-mail, rhartwig@iowabankers.com. Thank you for your time and consideration.

Sincerely,

Robert L. Hartwig
Legal Counsel