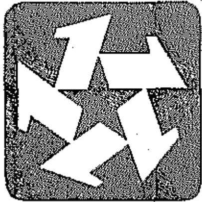

Member FDIC
www.fsbcentral.com

July 12, 2011

Via electronic submission

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

Re: Comment on Proposal – Regulation Z – Truth-in-Lending [R-1417]

Dear Ms. Johnson:

First State Bank appreciates the opportunity to comment on the Federal Reserve Board's proposed amendments to Regulation Z relating to an ability to repay standard for consumer mortgage loans.

First State Bank (FSB) is a locally owned, community bank with branches in Scottsbluff and Gering, Nebraska and Colorado Springs, Colorado. One of the primary ways that FSB serves its customers is by offering personal mortgage loans that are competitively priced and conveniently provided to the individuals in our communities. The bulk of FSB's consumer mortgage loans are originated in our Nebraska trade area, which includes the counties of Scotts Bluff, Sioux, Banner and Morrill in the sparsely populated western part of the state.

Originating a Qualified Mortgage Should Be a Safe Harbor

The Dodd-Frank Act creates expanded remedies for violations of Section 129C of the Truth-in-Lending Act. Specifically, a consumer can recover "special" statutory damages in addition to actual damages, the statute of limitations is extended to three years, and a consumer can assert a violation of the statute as a defense to foreclosure. This defense has no time limit. Because of this increased exposure to liability, FSB believes that a qualified mortgage should operate as a safe harbor to provide creditors with some degree of legal certainty. A qualified mortgage cannot include risky features such as negative amortization, interest-only payments or balloon payments and the amount of points and fees is limited. Consumers will be protected from these risks and from large fees if creditors originate qualified mortgages. In exchange, creditors should be provided with a reduced risk of liability and an incentive to make qualified mortgages.

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The alternative to the safe harbor approach is a presumption of compliance (Alternative Two). This approach is basically the equivalent of the general ability to repay standard and thus does not offer a meaningful alternative. In addition, Alternative Two requires a creditor to consider more factors in making its underwriting decision. FSB believes this approach is counter-intuitive. It invites a creditor to exercise more discretion when making a credit decision, and then leaves the creditor's decision wide open to challenge.

Defining a "Qualified Mortgage"

Under the proposed rules, a "qualified mortgage" is a loan for which, among other things, the creditor considers an applicant's monthly debt-to-income ratio or residual income. The Board does not propose a quantitative standard for the debt-to-income ratio or residual income. The Board solicits comment on this approach. FSB agrees that the Board should not impose a numerical standard or limitation. Underwriting a loan involves weighing a variety of factors. Often, compensating factors can mitigate a high debt-to-income ratio or low residual income. FSB believes that creditors should be allowed to exercise discretion and weigh risks. Specific numerical limits could restrict credit availability for our customers.

The Proposed Definition of a "Rural" Area Is Too Narrow

One of the ways that a creditor can comply with the ability to repay requirement is by originating a balloon payment qualified mortgage. This exception applies only to creditors that operate in a predominantly rural or underserved area. We believe that, as proposed, this exception is narrower than required by the Dodd-Frank Act. If the definition remains limited, it will restrict our ability to serve our customers.

As noted above, FSB originates a large number of our consumer home loans in Scotts Bluff County. We would not be allowed to originate balloon payment qualified mortgages under the proposed rules because Scottsbluff is a micropolitan statistical area. The proposal states that the exception was "evidently meant to accommodate community banks that originate balloon loans to hedge against interest rate risk." Many of our customers are financially conservative and do not want an adjustable rate mortgage. By making shorter-term, fixed-rate balloon loans we are able to serve our customer's needs and protect the bank against interest rate risk. If community banks in our area are unable to make balloon loans due to the limited definition of "rural" and our big bank competitors are excluded from that market as well, there will be no local entity available to serve our customers.

FSB believes that the definition of a "rural" area should be based on population density as determined by the United States Census Bureau. If a threshold of 75 persons per square mile were used, the vast majority of Nebraska counties would qualify as "rural" areas. Only the metropolitan centers in Sarpy, Lancaster, Hamilton, Douglas and Dakota Counties would be considered urban. We believe population density offers a more accurate and practical definition of a "rural" area.

Total Annual Residential Mortgage Loan Originations for Qualified Creditors

In order to qualify for the balloon payment qualified mortgage exception, a creditor must have total annual residential mortgage loan originations that do not exceed a limit set by the Board. The proposal seeks comment on (1) whether total annual originations should be measured by number of loans or by aggregate dollar volume; and (2) the appropriate threshold under either measure.

FSB believes that the threshold should be based on originations as measured by the number of loans originated. We feel this would allow us to focus on serving more customers rather than looking simply at the dollar amount borrowed. During the last five years, FSB averaged 153 consumer mortgage loan originations per year. This includes loans sold to secondary market investors. FSB consider itself a typical community bank. A reasonable threshold based on our relatively small volume would be 250 originations per year.

Retention of Balloon-Payment Loans in Portfolio

To qualify for the balloon payment qualified mortgage exception, a creditor must retain the balloon loans in portfolio. FSB routinely keeps the balloon payment consumer mortgage loans it originates in portfolio. The Board has proposed two alternative versions of this requirement. Alternative One provides that a creditor must not sell any balloon payment loan on or after the effective date of the final rule. Alternative Two limits the period during which the creditor must not have sold any balloon payment loan to the preceding and current calendar years. FSB agrees that Alternative One does not represent a practical solution. As the proposal notes, "once a creditor sold even one balloon-payment loan after the effective date, it would become permanently ineligible for the exception." FSB believes that Alternative Two represents a more realistic requirement that would be based on the creditor's recent originations.

The Board asks whether, under either alternative, it should recognize some *de minimis* number of transfers that could be made without losing eligibility for the exception. The proposal suggests two per calendar year as a *de minimis* amount. FSB agrees with this approach.

Refinancing Non-Standard Mortgages

The Dodd-Frank Act provides for an exception to the ability to repay standard if a creditor refinances a non-standard mortgage into a standard mortgage. As proposed, this exception applies only if the consumer applies for the standard mortgage before the non-standard mortgage is recast. FSB believes this requirement is too restrictive. The underlying goal is to help consumers who have gotten themselves into loans with risky features to refinance those loans into a more stable product. Often, consumers are unaware of the features that lead to payment shock until it is too late. We believe that consumers should be allowed to apply for the standard loan after the non-standard loan

has recast. The Board should exercise its legal authority to make adjustments to the Truth-in-Lending Act to permit streamlined refinancings even after a loan is recast.

The definition of a "non-standard mortgage" includes (1) an adjustable-rate mortgage with an introductory fixed interest rate for a period of one year or longer, (2) an interest-only loan and (3) a negative amortization loan. These loan types feature terms that can lead to payment shock during the life of the loan or put the borrower in a worse financial position than when the loan was originated. The proposal seeks comment on whether balloon payment loans should be added to the definition of non-standard mortgages.

FSB believes that balloon payment loans should not be included in the definition because consumers are generally well aware of the balloon payment feature in a loan. We clearly explain this provision to our customers. During the life of a balloon payment loan, the borrower often makes regular payments that reduce the principal balance. FSB believes that balloon payment loans do not make it more likely that a consumer will default, when compared to loans currently within the definition of a "non-standard" mortgage.

In order to qualify for the exception for refinancing non-standard mortgages, a creditor must consider whether the standard mortgage will prevent a "likely default" by the consumer. The proposal seeks comment on whether additional guidance is needed to define the term "likely default." This is a highly subjective term. FSB asks the Board to provide a definition and guidance as to what circumstances constitute "likely default."

Definition of Points and Fees

The Dodd-Frank Act defines a "qualified mortgage" to include a limitation on points and fees charged by the creditor. Generally, points and fees may not exceed 3% of the total loan amount. The proposed definition of "points and fees" would include all compensation paid directly or indirectly by a consumer or creditor to a mortgage originator. A loan originator's base salary would be excluded from the definition of points and fees, however, any bonus tied to the number or amount of covered transactions originated would be included.

FSB's commission program is similar to the program described in the third example in the proposed commentary. Our loan originators do not receive any bonus until their loan volume reaches a threshold amount. Originators are then paid a bonus on the loan volume that exceeds that threshold. FSB would be required to include some bonuses paid to our loan originators in points and fees, and exclude others. We would have to introduce a tracking system to monitor the dollar volume of loans originated by each loan officer on a daily basis. This increases our regulatory burden. Secondly, the bonus would affect the points and fees limitation for some customers but would not affect it for others. How does this serve the customer? The loan amount granted to the first customer per month contributes to the total volume in the same way that the eleventh customer's loan amount does. However, the bonus only affects the points and fees limitation for one of these customers.

The new Regulation Z rules restricting loan originator compensation prohibit payments to loan originators that are based on the loan's interest rate or terms. Creditors are allowed to pay loan originators compensation based on a fixed percentage of the loan amount. FSB feels that the proposed regulation should be consistent with these provisions. If the bonus complies with the loan originator compensation rules, we feel that it should not be included in the definition of "points and fees."

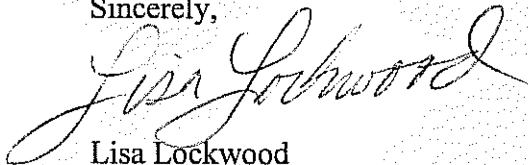
Limits on Points and Fees

The Board proposes two alternatives for the limits on points and fees for qualified mortgages. The Board seeks comment on these two alternatives. FSB believes that the limits outlined in Alternative Two are too complex and would unduly increase our regulatory compliance burden. We need simple, bright-line rules. The limits are already difficult to understand because the creditor determines the tier that the loan falls into based on the face amount of the loan, but applies the allowable points and fees percentage to the "total loan amount" which is often a different value.

Our staff now finds it exceedingly difficult to understand and retain all of the rules regulating consumer mortgage lending. Although the limits in Alternative One may create some anomalies, these straightforward limits would at least be easier to understand and explain. FSB believes that simplifying the limitations would enhance lender compliance with this requirement.

Again, thank you for the opportunity to comment on the proposed regulations.

Sincerely,



Lisa Lockwood
Vice President