INDEPENDENT BANKERS ASSOCIATION OF TEXAS

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April 29, 2011

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

Re: Docket No. R-1406 – Notice of Proposed Rulemaking 7100-AD65 (76 Fed. Reg. 11598 (March 2, 2011))

Dear Ms. Johnson:

The Independent Bankers Association of Texas (IBAT), a trade association representing approximately 500 independent community banks domiciled in Texas, offers these comments on certain aspects of the proposed revisions to Regulation Z (Reg. Z) with respect to the escrow requirement for higher-priced mortgage loans (HPMLs). All members of IBAT make residential mortgage loans and are affected by these changes.

As we have said in previous letters to the Federal Reserve on the issue of HPMLs, 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 HPML amendments to Reg Z, even with the currently proposed revisions, though well-intentioned, will not repair the negative effects that the previously adopted HPML amendments to Reg. Z had on community bank mortgage lending in rural areas. If adopted as proposed, these changes to Reg. Z will not substantially reverse the scaled back lending at community banks or reestablish residential mortgage lending operations that were shut down.

While we appreciate Congress' and the Federal Reserve's attempt to reverse some of the residential lending contraction brought on by the HPML amendments to Reg. Z by providing certain additional exemptions in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), we continue to believe that the real answer is a complete exemption of in-portfolio mortgage loans for federally insured financial institutions. A requirement to establish escrow accounts is unnecessary because it is already in the best interest of lenders who hold loans in-portfolio to assure that their borrowers can afford the principal, interest, taxes, and insurance. There simply isn't a compelling public policy reason for requiring escrow accounts on these loans.

Despite our contention that an in-portfolio loan exemption is the best solution for our community bankers and the communities they serve, in an effort to offer a palatable compromise, in our October 22, 2010, letter to Governor Elizabeth Duke, we offered these four suggested solutions, in order of preference:

- Exempt in-portfolio mortgage loans.
- Exempt in-portfolio mortgages loans when the borrowers put down large down payments (e.g. 20%) or have significant equity in their principal dwellings (e.g. the resulting refinance or home equity loan would not exceed 80% loan-to-value).
- Exempt mortgage loans with APRs that are less than 2.5 percentage points above the APOR for first-lien loans and less than 4.5 percentage points above the APOR for second-lien loans.
- Establish a reasonable floor for the APOR that rises and falls based on an appropriate index for determining if a mortgage loan is a HPML. (When the APOR is at or below the floor, the lender would use the floor (rather than the APOR) as the rate for a comparable transaction and the 1.5 and 3.5 percentage point indices in 12 CFR §226.35(a) to determine whether a loan is a HPML.)

While we remain fervent in our contention that an exemption for in-portfolio loans at federally insured financial institutions will simply, fairly, and satisfactorily serve Congress' purpose to assure that borrowers can afford their residential loans, we acknowledge and appreciate that the Dodd-Frank Act provided certain exemptions to the requirements for escrow accounts for consumer credit transactions secured by a first lien on a consumer's principal dwelling. However, despite the fact that Congress statutorily crafted exemptions for only certain in-portfolio loans, we contend that Congress did not prohibit the Federal Reserve from exempting in-portfolio loans at federally insured financial institutions.

Congress' primary exemption applies to mortgage loans extended by creditors that operate predominately in rural and underserved areas, originate a limited number of mortgage loans, retain loans in-portfolio, and meet size thresholds and other criteria, consistent with the exemption in the Dodd-Frank Act, established by the Federal Reserve. However, the Federal Reserve's proposal is not consistent with Congress' exemption in the Dodd-Frank Act with respect to rural areas because it is more restrictive than Congress intended and narrower than necessary to achieve the purpose of the HPML provisions in the Truth in Lending Act.

The test for "rural" in proposed § 226.45(b)(2)(iv)(A) is based on the "urban influence codes" numbered 7, 10, 11, and 12. Under proposed § 226.45(b)(2)(iv)(A), a county would be "rural" during a calendar year if it is not in a metropolitan area or a micropolitan area and either (1) it is not adjacent to any metropolitan or micropolitan area; or (2) it is adjacent to a metropolitan area with fewer than one million residents or adjacent to a micropolitan area, and it contains no town with 2500 or more residents. According to the 2000 census, this test would result in about 274,000 Texas residents being considered as living in rural areas. Of course, in 2011, many fewer would be considered to live in rural areas because Texas residents have migrated toward urban areas.

We had a call recently regarding whether Spearman, Texas (population about 4,000) would be considered rural under the proposed rule. Spearman is in Hansford County (with an urban influence code number 9), and is adjacent to Moore County (with an urban influence code number 5) where Dumas, Texas, is located. With a population of about 14,000, Dumas is considered a micropolitan area. It is a 61 mile drive between Dumas and Spearman, but Hansford County shares a county line with Moore County. That apparently means that Spearman isn't in a rural area because it is in a county that contains a town with 2500 or more residents that is adjacent to a county that contains a micropolitan area. This result is evidence that the definition of rural is much too restrictive. If you've ever been to Dumas or Spearman, you would know that both are rural towns in rural areas.

Because the proposed rule would determine whether a county is a rural area during a calendar year, we could have counties that are not considered rural areas one year and then rural the next because of population changes in areas where the lender doesn't even make residential loans. Escrowing for taxes and insurance takes additional employees and expensive technology. A tiny bank in West Texas, with its declining population, that must spend the money and time to gear up to escrow so it can offer residential mortgages to its customers, only to have the area it serves change to be considered a rural, would be financially devastated. Additionally, borrowers will not understand why one year a lender requires escrow, but the next year they do not when seemingly nothing has changed. Because there is no compelling reason to require escrow accounts on in-portfolio loans, which the majority of these loans will be, this potential back and forth, based on factors unrelated to the lender, borrower, or relevant geographic area, would be an expensive exercise in futility.

We realize that the proposal is based on thoughtful work by the Federal Reserve, but it is evidence that a restrictive one-size-fits-all approach to determining whether an area is rural is impossible and unworkable. A different approach, and one that doesn't rely on the population of unrelated geographic areas, is needed. And what does IBAT contend is rural? With apologies to the late Supreme Court Justice Potter Stewart's comments on how he knew something was obscene, all we are really sure of is that we know a rural area when we see it. What Justice Stewart knew was that there are some things that you just know when you see, but they are difficult or impossible to define. We know that Dumas and Spearman are rural areas, but it is difficult to suggest a definition for rural that would include them both and fairly determine which areas are rural in the remainder of Texas and the entire United States.

This is why a simple exemption for in-portfolio loans is really what's needed. However, if the Federal Reserve is not inclined to grant that exemption, it can make sure that its rule fairly implements the rural area exemption in the Dodd-Frank Act by expanding the definition of rural area to include more in-portfolio loans.

We suggest that the Federal Reserve look to the Regulation L (Reg. L) definition of "*contiguous or adjacent cities, towns, or villages*" as the answer to the dilemma of how to fairly define rural area. Reg. L, at 7 C.F.R. §212.2(d), defines *contiguous or adjacent cities, towns, or villages* to mean "cities, towns, or villages whose borders touch each other or whose borders are within 10 road miles of each other at their closest points. The property line of an office located in an unincorporated city, town, or village is the boundary line of that city, town, or village for the purpose of this definition." We suggest that a creditor should be exempt from creating escrow accounts if that creditor made, during the preceding calendar year, more than 50% of its total first-lien, higher-priced mortgage loans 10 road miles or more from a Metropolitan Statistical Area at their closest points.

In Texas, this would mean that a creditor would be considered to operate predominately in rural areas if more than 50% of its total first lien, HPML loans were made 10 road miles or more from the Metropolitan Statistical Areas of Abilene, Amarillo, Austin-Round Rock-San Marcos, Beaumont-Port Arthur, Brownsville-Harlingen, College Station-Bryan, Corpus Christi, Dallas-Fort Worth-Arlington, El Paso, Houston-Sugar Land-Baytown, Killeen-Temple-Fort Hood, Laredo, Longview, Lubbock, McAllen-Edinburg-Mission, Midland, Odessa, San Angelo, San Antonio-New Braunfels, Sherman-Denison, Texarkana, Tyler, Victoria, Waco, and Wichita Falls. Few people outside of Texas could even name a Texas city that isn't on this list.

These areas represent about 22,228,152 residents out of the 25,373,947 residents in Texas. And with rural area being defined as anything 10 road miles or more from any of these areas, the number of residents who would be considered to be in rural areas would be fewer still. However, it would be a much larger and more relevant number than would come from the proposed definition. And if someone thinks that this definition would include areas of Texas that are not rural, I challenge them to put on their cowboy boots and meet me there. The areas 10 road miles outside of Texas Metropolitan Statistical Areas are rural.

Whether the Federal Reserve adopts our suggested definition of rural area or not, a broader definition than was proposed is much needed. Many lenders have been 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 proposed rule exempts very few borrowers from the HPML escrow requirement.

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 consumers want; not the loans Wall Street or the secondary market has told them they can have. These are not high-priced loans. They are prime loans at rates that are fair both to the lender and the borrower.

The final rules adopted in 2009 punished 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. Fortunately, Congress chose to give lenders in rural and underserved areas some relief from these rules. However, the narrowness of the proposed rules would deprive many deserving rural areas from experiencing this much needed relief.

We object to these rules as proposed and urge you to withdraw them and propose rules that exempt in-portfolio loans held at federally insured financial institutions. Alternatively, we request that the Federal Reserve more fairly define rural areas. Any newly proposed rules should be carefully tailored so that they apply only to nontraditional lending products and predatory lending practices. We know that it isn't the Federal Reserve's intent to inflict hardships on community banks and their customers; and, therefore, we sincerely hope that you'll agree that an exemption of in-portfolio loans at federally insured financial institutions or a broader definition of rural area is required, such as the one we suggested above. Or in the much preferred alternative, that in-portfolio mortgage loans would be exempted from the mandatory escrow requirements.

Thank you for the opportunity to comment and for your consideration of our comments. If you would like to discuss this issue, please do not hesitate to call.

Sincerely,

Christopher L. Williston, CAE
President and CEO