INDEPENDENT COMMUNITY BANKERS of AMERICA®

April 16, 2015

Legislation Needed to Restore Community Bank Mortgage Credit

On behalf of the more than 6,000 community banks represented by ICBA, thank you for convening today's hearing on "Regulatory Burdens to Obtaining Mortgage Credit." New mortgage rules, including rules that have not yet become effective, are restricting community bankers' ability to extend mortgage credit. Both anecdotal and empirical data clearly illustrate the impact. ICBA is pleased to take this opportunity to submit the following statement for the record, which substantiates our concerns and outlines recommended legislative solutions contained in our Plan for Prosperity.

Customer Impact: Compelling Anecdotal Evidence

As the only national trade association that exclusively represents community banks, ICBA hears from hundreds of community bankers from across the country about their real world experience in implementing a multitude of complex new mortgage rules. Cited below are testimonials from bankers across the country. In many cases, creditworthy, long-term customers were turned away because new mortgage rules deny community bankers the flexibility and the discretion to serve them. These testimonials are representative of what ICBA hears from community bankers.

- A community banker from upstate New York, reports the hardest mortgage to make now is to a self-employed small business owner. An entrepreneur's greatest source of capital is usually the equity in their home. However, the self-employed often have difficulty complying with the income documentation requirements under the Consumer Financial Protection Bureau's (CFPB's) ability-to-repay rule, despite having excellent credit. The New York community banker had to decline a $30,000 first mortgage application from a 20-year customer because he couldn't satisfy rigid income documentation requirements. This community banker would have liked to support a local business owner by making a loan he believed to safe and sound.
- Low dollar loans are typical in many parts of the country for purchase or refinance of residential properties. However, the fees on these loans, though low in absolute terms, often exceed the QM fee caps. The bank's cost to make a low dollar loan is the same as its cost to make a higher balance loan. A community banker from Ohio offers this example: a $75,000 loan with an 80 percent loan-to-value ratio and a cash-out feature. The lender might wish to serve this customer by holding the loan in portfolio as a QM loan, but the closing fee for a loan in this dollar range is capped at $3,000, which is less than the lender's cost of underwriting and processing the loan. As a result, a creditworthy borrower would be unable to receive the loan from his local bank because the banker has little flexibility. Ironically, the

lender could transfer the loan to Fannie Mae or Freddie Mac, which would confer automatic QM status, but their fees would exceed $4,000, in addition to the originator's fee. In this example, QM, far from protecting the customer, would cause him to pay significantly more or be denied access to the loan altogether.

- A community banker in Texas recently had to decline a mortgage for a realtor with 30 years of experience in his field because, having relocated, he did not have enough paystubs from his new employer. This happens time and again with teachers, doctors, pharmacists, and other professionals who relocate to new towns. A creditworthy borrower shouldn't have to rent, and possibly be forced into a 12-month lease, because they don't have enough paystubs to qualify for a mortgage. Community bankers need more flexibility to work with relocated customers.
- While CFPB rules provide special accommodations for "rural lenders," banks that serve both rural and non-rural markets, as defined by the Census Bureau, are effective denied "rural lender" status, which requires that they lend "predominantly" in rural areas. As a matter of demographics and arithmetic, such lenders generate most of their mortgage volume and higher loan balances in their suburban, exurban, or urban markets. They fail the CFPB's rigidly-defined "rural lender" test, even under the agency's proposed expansion of the "rural" definition. It doesn't matter that such a bank may be the only lender serving its rural markets. Beginning in 2016, only a "rural lender" can obtain QM status for balloon loans, a staple of rural lending that protects the lender from interest rate risk on loans that are not eligible for transfer to the secondary market. The vast majority of community banks will not assume the heightened legal liability of non-QM lending. In addition, "non-rural" community banks are deterred from mortgage lending because they cannot provide costly escrow services. ICBA believes that this problem is best solved by elimination of the "predominantly" rural limitation and any references to "rural" in the Truth in Lending Act.
- A New Mexico community banker reports limited availability of mortgage credit in his community is keeping would-be homeowners in the rental market and has driven up rental costs significantly. In his community, an average renter now pays $800 to $900 a month, though he or she could purchase a more appealing home for $80,000 with a monthly mortgage payment of $400. This banker believes the disparity between rents and mortgage payments is directly attributable to the overly stringent underwriting required by new mortgage rules.

These are not isolated anecdotes. They are well supported by a number of empirical studies.

Surveys & Data Analysis Confirm Anecdotal Accounts

In ICBA's 2014 Community Bank Lending Survey, which surveyed over 500 community banks nationwide, 73 percent of survey respondents cited the regulatory burden of new rules and requirements as the most significant barrier to making more residential mortgage loans, more than any other factor including lack of borrower demand, competition from bank and non-bank lenders, or lack of qualified borrowers.[1] A significant percentage of survey respondents, 15 percent, are considering an exit or have already exited this line of business. These results are consistent with a survey conducted by the Independent Bankers Association of Texas (IBAT), just before the ability-to-repay rules became effective in 2014, 13 percent of respondents said they would stop making mortgage loans in response to the new regulatory landscape, and 53 percent of respondents said they would limit the types of mortgages they offer.[2]

For many community banks, mortgage lending is a side product rather than a core component of their business. For example, they may offer mortgage credit that strengthens their relationships with small business customers, originating 50 or fewer mortgages a year. It is these banks that are most likely to exit the mortgage business altogether in response to higher regulatory costs. Though they offer relatively few mortgages, their mortgage lending may be important to their local real estate market and critical to their relationship banking model. In the IBAT survey, 30 percent of respondents said that if they stopped or curtailed their mortgage activity, there were no other banks in their area to fill the void.

In a survey conducted by the Conference of State Bank Supervisors (CSBS), before the QM rule became effective, "15 percent of active mortgage lenders noted 80 percent or more of their 1-to-4 family mortgage loans would not meet QM requirements." The most frequently cited reasons for non-compliance were the DTI cap and the bar on balloon payment loans made by "non-rural" lenders.[3] At the same time, according to ICBA's 2014 Community Bank Lending Survey, only 25 percent of respondents are actively providing non-QM loans. These results indicate a significant unmet demand for non-QM loans. QM has effectively shrunk the credit box, stranding borrowers without access to credit. In the ICBA survey a majority of respondents, 57 percent, reported tighter underwriting in residential mortgage lending and 44 percent reported decreases in originations.

[1] ICBA 2014 Community Bank Lending Survey
[2] "Texas Community Bank Response to CFPB Mortgage Rules." Compiled by the Independent Bankers Association of Texas. 2014.
[3] "Community Banking in the 21sth Century: Opportunities, Challenges and Perspectives." Federal Reserve System & Conference of State Bank Supervisors. September 2014.

Industry Consolidation, Driven By Regulatory Costs, Will Harm Borrowers

This statement has emphasized the direct impact of regulatory burden on borrowers, where new rules prohibit or make infeasible the offering of certain products and services. However, the lender impact of escalating compliance costs will also affect borrowers. Many community banks report compliance costs have grown from approximately five percent of overhead ten years ago to 15 to 20 percent today. This increase in regulatory burden has likely contributed to the decrease of 1,342 community banks in the United States since 2010. The number of banks with assets below $100 million shrunk by 32 percent, while the number of banks with assets between $100 million and $1 billion fell by 11 percent.[4] Banks need more scale to accommodate higher regulatory costs.

Unfortunately for borrowers, consolidation will result in fewer and more commodified product choices and higher costs. The impact will be particularly severe in rural areas that depend on community banks to provide customized financial products. If consolidation continues apace, certain rural areas may be left without access to mortgage credit at all.

Legislative Solutions Are Needed

The good news is that there are readily available legislative solutions to this pending crisis. Working with community bankers from across the nation, ICBA developed its Plan for Prosperity, a platform of legislative recommendations designed to provide meaningful relief for community banks and allow them to thrive by doing what they do best – serving customers and growing their communities. Each provision of the Plan was crafted to preserve and strengthen consumer protections and safety and soundness. I encourage the members of this Committee to review the Plan, which is attached to this statement.

Key provisions of the Plan for Prosperity are designed to keep community banks in the business of mortgage lending and to give them more flexibility in extending credit. Plan provisions include:

- "Qualified mortgage" status under the CFPB's ability-to-repay rules for any mortgage originated and held in portfolio for at least three years by a lender with less than $10 billion in assets.
- An exemption from any escrow requirements any first lien mortgage held in portfolio by a lender with less than $10 billion in assets.

The principal rationale for these provisions, and the reason they can be safely enacted, is they apply <u>only</u> to loans originated and held in portfolio by community banks. As relationship lenders, community bankers are in the business of knowing their borrowers and assessing their ability to repay a loan. What's more, when a community bank holds a loan in portfolio it holds <u>100 percent</u> of the

[4] Parsons, Richard J. "Bank Think," The American Banker (February 16, 2015).

credit risk and has an overriding incentive to ensure the loan is well underwritten and affordable to the borrower. In a typical community bank portfolio, even a small number of defaults can put a bank at risk. Community bank portfolio lenders ensure they understand the borrower's financial condition and structure the loan accordingly. If the borrower has trouble making payments due to job loss or other unforeseen circumstances, a community bank portfolio lender will work with the borrower to restructure the loan and keep the borrower in their home. Community bank portfolio lenders will protect their collateral by ensuring borrowers remain current on tax and insurance payments. For this reason, the escrow requirement, which must be outsourced at a relatively high cost by community banks with a low volume of mortgages, is an unnecessary burden when a loan is held in portfolio.

ICBA is pleased these important portfolio QM and escrow provisions are included in the **Community Lending Enhancement and Regulatory Relief Act of 2015 (the "CLEAR Act", S. 812)**, introduced by Senators Jerry Moran and Jon Tester. S. 812 also includes a third provision: relief from the SOX 404(b) internal control assessment mandate for community banks with less than $1 billion in assets. ICBA urges the members of this Committee to cosponsor S. 812 and we urge its provisions be included in any regulatory relief measure emerging from this Committee.

Thank you again for convening today's hearing and for the opportunity to submit this statement. ICBA looks forward to working with this Committee to craft legislation to restore the flow of mortgage credit.

ATTACHMENTS

- ICBA Plan for Prosperity. January 2015

INDEPENDENT COMMUNITY BANKERS of AMERICA

One Mission. Community Banks.®

Plan for Prosperity

A Pro-Growth Agenda to Reduce the Onerous Regulatory Burden on Community Banks and Empower Local Communities
2015

Plan for Prosperity: An Agenda to Reduce the Onerous Regulatory Burden on Community Banks and Empower Local Communities

America's 6,500 community banks are vital to the prosperity of the U.S. economy, particularly in smaller towns and rural communities. Providing more than half of all small business loans under $1 million, as well as customized mortgage and consumer loans suited to the unique characteristics of their local communities, community banks serve a vital role in ensuring the economic recovery is robust and broad based, reaching communities of all sizes and in every region of the country.

In order to reach their full potential as catalysts for entrepreneurship, economic growth, and job creation, community banks must be able to attract capital in a highly competitive environment. An end to the exponential growth of onerous regulatory mandates is critical to this objective. Regulation is suffocating nearly every aspect of community banking and changing the very nature of the industry away from community investment and community building to paperwork, compliance, and examination. A fundamentally new approach is needed: Regulation must be calibrated to the size, lower-risk profile, and traditional business model of community banks.

ICBA's Plan for Prosperity provides targeted regulatory relief that will allow community banks to thrive by doing what they do best – serving and growing their communities. By reducing unsustainable regulatory burden, the Plan will ensure that scarce capital and labor resources are used productively, not sunk into unnecessary compliance costs, allowing community banks to better focus on lending and investing that will directly improve the quality of life in our communities. Each provision of the Plan was selected with input from community bankers nationwide and crafted to preserve and strengthen consumer protections and safety and soundness.

The Plan is a set of detailed legislative priorities positioned for advancement in Congress. A subset of these priorities is specifically dedicated to strengthening community bank viability by creating new options for capital raising and capital preservation. A number of regulatory relief measures would be tiered, with different thresholds for Consumer Financial Protection Bureau rules (generally $10 billion and under) and safety and soundness regulation (generally $50 billion and under). The recommended thresholds are based on existing levels and statutory provisions, which may vary by provision.

ICBA is committed to advancing and enacting the provisions of the Plan with all due vigilance and the aggressive use of every resource at our disposal. The Plan is a flexible, living document that can be adapted to a rapidly changing regulatory and legislative environment to maximize its influence and likelihood of enactment. Provisions are described below.

ACCESS TO CAPITAL: CREATING NEW OPTIONS FOR THE CREATION AND PRESERVATION OF COMMUNITY BANK CAPITAL

ICBA is proposing a set of options to strengthen community bank viability by enhancing access to capital.

Basel III Amendments: Restoring the Original Intent of the Rule. Basel III was originally intended to apply only to large, internationally active banks. ICBA proposes the following amendments for banks with assets of $50 billion or less.

- *Exemption from the capital conservation buffer.* The new buffer provisions impose dividend restrictions that have a chilling effect on potential investors. This is particularly true for Subchapter S banks whose investors rely on dividends to pay their pro-rata share of the bank's tax. Exempting community banks from the capital conservation buffer would make it easier for them to raise capital.
- *Full capital recognition of allowance for credit losses.* Provide that the allowance for credit losses is included in tier 1 capital up to 1.25 percent of risk weighted assets with the remaining amount reported in tier 2 capital. This change would reverse the punitive treatment of the allowance under Basel III. The allowance should be captured in the regulatory capital framework since it is the first line of defense in protecting against unforeseen future credit losses.
- *Amend risk weighting to promote economic development.* Provide 100 percent risk weighting for acquisition, development, and construction loans. Under Basel III, these loans are classified as high volatility commercial real estate loans and risk weighted at 150 percent. ICBA's proposed change would treat these loans the same as other commercial real estate loans and would be consistent with Basel I.

Additional Capital for Small Bank Holding Companies: Modernizing the Federal Reserve's Policy Statement. Require the Federal Reserve to revise the Small Bank Holding Company Policy Statement – a set of capital guidelines that have the force of law. The Policy Statement, which makes it easier for small bank and thrift holding companies to raise additional capital by issuing debt, would be revised to increase the qualifying asset threshold from $1 billion to $5 billion. Qualifying bank and thrift holding companies must not have significant outstanding debt or be engaged in nonbanking activities that involve significant leverage.

Relief from Securities and Exchange Commission Rules. ICBA recommends the following changes to SEC rules which would allow community banks to commit more resources to their communities without putting investors at risk:

- Provide an exemption from internal control attestation requirements for community banks with assets of less than $1 billion. The current exemption applies to any company with market capitalization of $75 million or less. Because community bank internal control systems are monitored continually by bank examiners, they should not have to sustain the unnecessary annual expense of paying an outside audit firm for attestation work. This provision will substantially lower the regulatory burden and expense for small, publicly traded community banks without creating more risk for investors.

- Due to an oversight in the 2012 JOBS Act, thrift holding companies do not have statutory authority to take advantage of the increased shareholder threshold below which a bank or bank holding company may deregister with the SEC. Congress should correct this oversight by allowing thrift holding companies to use the new 1,200 shareholder deregistration threshold as well as the new 2,000 shareholder registration threshold.
- Regulation D should be reformed so that anyone with a net worth of more than $1 million, including the value of their primary residence, would qualify as an “accredited investor.” The number of non-accredited investors that could purchase stock under a private offering should be increased from 35 to 70.

TARGETED REGULATORY RELIEF

Supporting a Robust Housing Market: Mortgage Reform for Community Banks. Provide community banks relief from certain mortgage regulations, especially for loans held in portfolio. When a community bank holds a loan in portfolio, it has a direct stake in the loan’s performance and every incentive to ensure it is properly underwritten, affordable and responsibly serviced. Relief would include:

- Providing “qualified mortgage” safe harbor status for loans originated and held in portfolio by banks with less than $10 billion in assets, including balloon mortgages.
- Exempting banks with assets below $10 billion from escrow requirements for loans held in portfolio.
- An exemption from the higher risk mortgage appraisal requirements for loans of $250,000 or less provided they are held in portfolio by the originator for a period of at least three years.
- New information reporting requirements under the Home Mortgage Disclosure Act should not apply to community banks.

Strengthening Accountability in Bank Exams: A Workable Appeals Process. The trend toward oppressive, micromanaged regulatory exams is a concern to community bankers nationwide. An independent body would be created to receive, investigate, and resolve material complaints from banks in a timely and confidential manner. The goal is to hold examiners accountable and to prevent retribution against banks that file complaints.

Reforming Bank Oversight and Examination to Better Target Risk. ICBA makes the following recommendations to allow bank examiners to better target their resources at true sources of systemic risk:

- A two-year exam cycle for well-rated community banks with up to $2 billion in assets would allow examiners to better target their limited resources toward banks that pose systemic risk. It would also provide needed relief to bank management for whom exams are a significant distraction from serving their customers and communities.
- Banks with assets of $50 billion or less should be exempt from stress test requirements.
- Community banks should be allowed to file a short form call report in the first and third quarters of each year. The current, long form call report would be filed in the second and fourth quarters. The quarterly call report now comprises some 80 pages supported by almost 700 pages of instructions. It represents a growing burden on community banks without being an effective supervisory tool.

Redundant Privacy Notices: Eliminate Annual Requirement. Eliminate the requirement that financial institutions mail annual privacy notices even when no change in policy has occurred. Financial institutions would still be required to notify their customers by mail when they change their privacy policies, but when no change in policy has occurred, the annual notice provides no useful information to customers and is a needless expense.

Balanced Consumer Regulation: More Inclusive and Accountable CFPB Governance. The following changes would strength CFPB accountability, improve the quality of the agency's rulemaking, and make more effective use of its examination resources:

- Change the governance structure of the CFPB to a five-member commission rather than a single Director. Commissioners would be confirmed by the Senate to staggered five-year terms with no more than three commissioners affiliated with any one political party. This change will strengthen accountability and bring a diversity of views and professional backgrounds to decision-making at the CFPB.
- The Financial Stability Oversight Council's review of CFPB rules should be strengthened by changing the vote required to veto a rule from an unreasonably high two-thirds vote to a simple majority, excluding the CFPB Director.
- All banks with assets of $50 billion or less should be exempt from examination and enforcement by the CFPB; and CFPB backup (or "ride along") authority for compliance exams performed by a bank's primary regulator should be eliminated.

Eliminate Arbitrary "Disparate Impact" Fair Lending Suits. Amend the Equal Credit Opportunity Act and the Fair Housing Act to bar "disparate impact" causes of action. Lenders that uniformly apply neutral lending standards should not be subject to frivolous and abusive lawsuits based on statistical data alone. Disparate impact forces lenders to consider factors such as race and national origin in individual credit decisions, which are specifically precluded by law.

Ensuring the Viability of Mutual Banks: New Charter Option. The OCC should be allowed to charter mutual national banks to provide flexibility for institutions to choose the charter that best suits their needs and the communities they serve.

Rigorous and Quantitative Justification of New Rules: Cost-Benefit Analysis. Provide that financial regulatory agencies cannot issue notices of proposed rulemakings unless they first determine that quantified costs are less than benefits. The analysis must take into account the impact on the smallest banks which are disproportionately burdened by regulation because they lack the scale and the resources to absorb the associated compliance costs. In addition, the agencies would be required to identify and assess available alternatives including modifications to existing regulations. They would also be required to ensure that proposed regulations are consistent with existing regulations, written in plain English, and easy to interpret.

Cutting the Red Tape in Small Business Lending: Eliminate Burdensome Data Collection. Exclude banks with assets below $10 billion from new small business data collection requirements. This provision, which requires the reporting of information regarding every small business loan application, falls disproportionately upon community banks that lack scale and compliance resources.

Preserve Community Bank Mortgage Servicing. The provisions described below would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation, which is harmful to borrowers:

- Increase the "small servicer" exemption threshold to 20,000 loans (up from 5,000). To put this proposed threshold in perspective, the average number of loans serviced by the five largest servicers subject to the national mortgage settlement is 6.8 million. An exemption threshold of 20,000 would demarcate small servicers from both large and mid-sized servicers.
- For banks with assets of $50 billion or less, reverse the punitive Basel III capital treatment of mortgage servicing rights (MSRs) and allow 100 percent of MSRs to be included as common equity tier 1 capital.

Creating a Voice for Community Banks: Treasury Assistant Secretary for Community Banks. Economic and banking policies have too often been made without the benefit of community bank input. An approach that takes into account the diversity and breadth of the financial services sector would significantly improve policy making. Creating an Assistant Secretary for Community Banks within the U.S. Treasury Department would ensure that the more than 6,500 community banks across the country, including minority banks that lend in underserved markets, are given appropriate and balanced consideration in the policy making process.

Modernize Subchapter S Constraints. Subchapter S of the tax code should be updated to facilitate capital formation for community banks, particularly in light of higher capital requirements under the proposed Basel III capital standards. The limit on Subchapter S shareholders should be increased from 100 to 200; Subchapter S corporations should be allowed to issue preferred shares; and Subchapter S shares, both common and preferred, should be permitted to be held in individual retirement accounts (IRAs). These changes would better allow the nation's 2,200 Subchapter S banks to raise capital and increase the flow of credit.

Five-Year Loss Carryback Supports Lending During Economic Downturns. Banks with $15 billion or less in assets should be allowed to use a five-year net operating loss (NOL) carryback. The five-year NOL carryback is countercyclical and will support community bank capital and lending during economic downturns.

Risk Targeting the Volcker Rule. Exempt banks with assets of $50 billion or less from the Volcker Rule. The Volcker Rule should apply only to the largest, most systemically risky banks. Proposals to apply the rule to community banks carry unintended consequences that threaten to destabilize segments of the community banking industry.

The Independent Community Bankers of America®, the nation's voice for 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. For more information, visit www.icba.org.