MID-SIZE BANK COALITION OF AMERICA

ASSOCIATED BANK
BANK OF HAWAII
BOK FINANCIAL
CITY NATIONAL BANK
COMMERCE BANCSHARES, INC.
EAST WEST BANK
FIRSTBANK HOLDING COMPANY
FIRST HAWAIIAN BANK
FIRST HORIZON NATIONAL CORPORATION
FIRSTMERIT CORPORATION
FROST NATIONAL BANK
FULTON FINANCIAL CORPORATION
HANCOCK BANK
IBERIA BANK
MB FINANCIAL
OLD NATIONAL
ONE WEST BANK
PEOPLE'S UNITED BANK
RAYMOND JAMES BANK
SILICON VALLEY BANK
SUSQUEHANNA BANK
TCF FINANCIAL CORPORATION
THE PRIVATE BANK
TRUSTMARK CORPORATION
UMB FINANCIAL CORPORATION
UMPQUA BANK
VALLEY NATIONAL BANK
WEBSTER BANK

July 9, 2012

Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Re: Truth in Lending (Regulation Z), Notice of Proposed Rulemaking
RIN 3170-AA17

Ladies and Gentlemen:

On behalf of the Midsize Bank Coalition of America ("MBCA"), I am writing to provide the MBCA's comments on the above-referenced notice of proposed rulemaking ("Proposal") published by the Consumer Financial Protection Bureau ("Bureau") on June 5, 2012.[1]

By way of background, the MBCA is a non-partisan financial and economic policy organization comprising the CEOs of mid-size banks doing business in the United States. Founded in 2010, the MBCA, now with 28 members, was formed for the purpose of providing the perspectives of mid-size banks on financial regulatory reform to regulators and legislators. As a group, the MBCA banks do business through more than 3,800 branches in 41 states, Washington D.C. and three U.S. territories. The MBCA's members' combined assets exceed $450 billion (ranging in size from $7 to $30 billion) and, together, its members employ approximately 77,000 people. Member institutions hold nearly $336 billion in deposits and total loans of more than $260 billion.

I. Background

The Proposal reopens the comment period on proposed rules published by the Board of Governors of the Federal Reserve System ("Board") on May 11, 2011, that are intended to implement amendments to the Truth in Lending Act

[1] *Truth in Lending (Regulation Z)*, 77 FR 33120 (Jun. 5, 2012).

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("TILA") made by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[2] As amended by the Dodd-Frank Act, TILA now requires that a creditor, before making a residential mortgage loan, make a reasonable and good faith determination that a consumer has a reasonable ability to repay the loan.[3] TILA also establishes the following four options for compliance with this requirement:

- Originate a covered transaction under a general ability-to-repay standard;
- Refinance a "non-standard mortgage" into a "standard mortgage";
- Originate a balloon-payment qualified mortgage, which provides a presumption of compliance with the rule; or
- Originate a "qualified mortgage," which provides a presumption of compliance.[4]

As noted above, when a loan meets the definition of a "qualified mortgage," a creditor or assignee will enjoy a presumption that the loan meets the ability to repay requirements.[5] The Board's prior release included proposed rules to clarify and expand the definition of a "qualified mortgage," and to implement the statute's safe harbor for qualified mortgages.

In the present release, the Bureau seeks comments on certain mortgage loan data that it received from the Federal Housing Finance Agency ("FHFA") and the extent to which such data may be used to define circumstances where a lender may be presumed to have complied with the ability-to-repay requirements.[6] The Bureau also seeks estimates and other data as to potential litigation costs and risks associated with claims alleging violations of ability-to-repay requirements for both qualified and non-qualified mortgages.[7]

The proposed rules are some of the most important to be implemented under the Dodd-Frank Act. As other commenters have noted, all residential mortgage lending in the United States will have to conform to the standards of

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[2] *Regulation Z; Truth in Lending*, 76 FR 27390 (May 11, 2011). The original comment period ended on July 22, 2011. As of July 21, 2011, the Dodd-Frank Act transferred the Board's rulemaking authority for TILA to the Bureau, and the Bureau assumed responsibility for finalizing the proposed rule.

[3] TILA Section 129C(a)(1).

[4] TILA Section 129C(a), (b).

[5] TILA Section 129C(b).

[6] 77 FR at 33121.

[7] *Id.* at 33124-25.

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the final rules.[8] We believe almost all residential mortgage lending will have to conform to the qualified mortgage standard in particular, because it is the only one that provides for legal certainty under a statute that otherwise imposes the potential for significant liability on lenders and third-party assignees in the secondary mortgage markets. Therefore, if qualified mortgages are not properly defined and given adequate protection, mortgage lenders could reduce their lending activities or raise home loan rates to compensate for increased legal risk. At the same time, investors in the secondary mortgage markets may reduce the prices they are willing to pay for mortgage-related investments. The combination of these trends may shrink available funding for home mortgage loans, which would retard the recovery of the secondary mortgage markets and economic recovery in general.

This effect could be exacerbated by other regulatory initiatives that will have a significant effect on home mortgage lending. Most significantly, the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation are seeking comment on three proposed rulemakings that would revise and replace current capital rules for banking entities consistent with agreements reached by the Basel Committee on Banking Supervision ("Basel III Rulemakings"). Among other things, the Basel III Rulemakings would require banking entities to retain greater amounts of capital, both in general and against portfolio loans that are deemed to be of higher risk.[9]

In addition, the Securities and Exchange Commission, FHFA, the Department of Housing and Urban Development and bank regulators have proposed rules to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1943, as added by Section 941 of the Dodd-Frank Act.[10] The proposed rules would generally require securitizers of asset-backed securities to retain credit risk in assets collateralizing asset-back securities. However, they would also create an exemption from the risk retention requirements where asset-backed securities are collateralized solely by "qualified residential mortgages," as defined in the proposal.[11]

These rulemakings could have a cumulative effect on the availability of capital for home mortgage lending and the market for home mortgage investments. Therefore, we urge the Bureau to take into consideration the actions to be implemented by other financial regulators, and to carefully consider how all of the final rules combined will affect the recovery of the U.S.

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[8] *See e.g.,* Comments of the American Bankers Association (Jul. 22, 2011).

[9] *See generally, Agencies Seek Comment on Regulatory Capital Rules and Finalize Market Risk Rule," Joint Release (Jun. 12, 2012 (available at http://www.fdic.gov/news/news/press/2012/pr12068.html)).*

[10] *Credit Risk Retention*, 76 FR 24090 (Apr. 29, 2011).

[11] 76 FR at 24090, 24096.

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housing market, the real estate market in general, the markets for mortgage-related securities, and the overall U.S. economy. We urge the Bureau to adopt rules that articulate a broad safe harbor for qualified mortgage lending.

Indeed, the structure of the revised statute requires implementation of a safe harbor. TILA Section 129C differentiates "qualified" mortgages from those that are to be examined under the general ability-to-repay standard.[12] A mere rebuttable presumption for qualified mortgages would not give effect to the distinction, because dispute resolution would then require the same degree of factual, evidentiary analysis for both qualified and non-qualified mortgages. In any event, Congress had twin goals in amending TILA. On one hand, it wished to protect consumers from unfair lending practices by promoting the use of standard, easily understood loan terms and disclosures. On the other, it sought to promote access to home mortgage loans and rehabilitate the home lending market. A safe harbor would serve both purposes by ensuring that the terms of loans are fair and properly disclosed, while encouraging qualified mortgage lending.

II. Analysis of FHFA Data and DTI Ratios

In this light, we are concerned with respect to certain aspects of the Bureau's treatment of the FHFA data discussed in the Proposal. According to the release, the Bureau has "received a sample drawn from the FHFA's Historical Loan Performance (HLP) dataset" including a "one percent random sample of all mortgage loans in the HLP dataset from 1997 through 2011."[13] The HLP dataset contains data as to all mortgage loans purchased or guaranteed by Fannie Mae and Freddie Mac (the "Government Sponsored Entities," or "GSEs"). However, it does not include loans retained in bank portfolios or loans backing private-label mortgage-backed securities bought by the GSEs"[14]

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[12] TILA Section 129C(b)(2).

[13] 77 FR at 33121.

[14] *Id*.

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As to all such single-family mortgages, the dataset includes:

- Product type;
- Payment-to-income ("PTI") ratios at origination;
- Debt-to-income ("DTI") ratios at origination;
- Initial loan-to-value ("LTV") ratios based on the purchase price or appraised property value and the first-lien balance;
- Credit score(s) for the borrower(s); and
- Other unspecified information.

Yet, the Bureau's release concentrates its attention solely on one aspect of this data: DTI ratios. In particular, the release presents data as to the volume of loans and loan performance by origination year and DTI ratios.[15] The release describes the Bureau's intent to use the data "to tabulate volumes and performance of loans with varying characteristics and to perform other statistical analyses that may assist the Bureau in defining loans with characteristics that make it appropriate to presume that the lender complied with the ability-to-pay requirements … ."[16]

At the outset, we note that the sampling of the dataset described in the release suffers from several inadequacies. First, the data relates only to mortgages purchased or guaranteed by the GSEs. Many such mortgages would have been generated by lenders following an originate-to-distribute model, especially during the years 2001- 2007 when the real estate bubble was growing. Thus, these loans are likely to be marked by less stringent underwriting standards and the "stacking" of risks described in the Board's initial proposal.[17] On the other hand, the data discussed in the release do not include mortgages that banks retained in their portfolios. Members of MBCA generally follow an originate-to-retain business model. We have found that portfolio mortgages generally have better performance records than those generated under an originate-to-distribute business model. Consequently, the data described in the release, which does not include bank-retained loan data, is likely to be skewed to reflect higher default rates than the overall market.[18]

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[15] 77 FR at 33121.

[16] *Id*.

[17] 76 FR at 27392.

[18] Moreover, the date range of the data subjects it to some uncertainty. As noted above, the U.S. real estate market developed a bubble beginning in 2001, as reflected in Table 1 of the Proposal, which shows a dramatic increase in the volume of mortgage lending from 2000 to 2001. 77 FR at 33122. The data for loans extended from 2001 to 2007 are therefore likely to reflect inflated real estate values as well as mortgages that are subject to weaknesses that were common in that

Footnote continued on next page

Second, we note that the Proposal is focused almost exclusively on the use of DTI as a predictor of default. Yet, the data from FHFA include much other information that the release does not detail, and which would be useful for commenters. For example, the FHFA data apparently includes "initial loan-to-value (LTV) ratios based on the purchase price or appraised property value and the first-lien balance," as well as "credit score(s) for the borrower(s)."[19] Along with DTI ratios, credit scores and LTV ratios are critical factors for banks to consider when evaluating the risk of default. If the Bureau is considering formulating the definition of a "qualified mortgage" by reference to DTI ratios, it must also consider how LTV ratios and the borrower's credit history should enter the equation.[20] Unfortunately, we are not able to provide comments on the FHFA data in this regard, because the Bureau's release does not include the complete data. Surely, the Bureau could have released this data to help enlighten the discussion.[21] In any event, without the context that this information would provide, it is not possible to analyze the DTI data's overall utility as a predictor of default rates or as a factor in the determination as to what constitutes a qualified mortgage.

Finally, while DTI can be a useful measure, MBCA members all use other metrics together with DTI, such as LTV ratios and credit scores, to determine the credit risks associated with a mortgage loan. For example, it is the experience of the members of the MBCA that high DTI ratios do not produce appreciably higher default rates if they are combined with high credit scores, a sustained record of consistently earned income, high cash reserves, and/or low LTV ratios. Furthermore, although DTI is useful at the time of origination as a measure of whether the borrower can afford the loan, as time goes on, other factors may take precedence over DTI in predicting default rates, such as loss of employment and other unexpected events. We believe the Bureau should not focus on DTI to the exclusion of these other important factors in defining a qualified mortgage.

III. The Potential Costs of Litigation

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era, such as overstatement of borrower income. Thus, the only years in the database that may serve as an effective reference point are 1997-2000.

[19] 77 FR at 33121.

[20] Indeed, the joint agency proposed rulemaking on credit risk retention of asset-backed securities makes clear that factors such as LTV and credit scores play an important role in predicting default for purposes of defining "qualified residential mortgage." *Credit Risk Retention*, 76 FR at 24119.

[21] While the Bureau noted that some of the FHFA data is confidential (77 FR at 33121 n. 2), we believe the Bureau should be able to release aggregate data on LTV ratios and credit scores, just as it has released the DTI information.

The Proposal seeks "comment and data on estimates of litigation costs and liability risks associated with claims alleging a violation of ability-to-repay requirements for a mortgage loan that is not a 'qualified mortgage,' in addition to costs and risks that might apply to a 'qualified mortgage.'"[22] There is no doubt that a rebuttable presumption for qualified mortgages will increase the risk of litigation. Assuming that is the case, there are numerous factors that would affect the cost of such litigation, such as attorneys' rates in different jurisdictions, standards of proof and the relative speed of different court dockets. Litigation costs are notoriously unpredictable, and mid-sized and smaller banks do not have the staff or resources to quantify or predict such likely expenses. Nonetheless, a broad and effective safe harbor for qualified mortgages would suggest lower legal expenses, because it would reduce the need for fact-intensive resolutions through litigation. With a safe harbor, banks will not have to assess litigation costs or factor those costs into their lending rates and fees, and will be able to focus on ensuring that consumers are provided with safe and affordable products.

IV. Conclusion

The MBCA supports the Bureau's efforts to improve its assessment of data related to the qualified mortgage definition. However, in order for the members of the MBCA to provide more meaningful commentary on the Bureau's efforts, the Bureau would need to disclose additional data predictive of default, including LTV ratios and credit scores, and expand the data to include mortgages retained by banks in their portfolios. Additionally, the MBCA urges the Bureau to coordinate its efforts with other financial regulators, and to carefully consider how all of the final rules combined will affect the recovery of the U.S. housing market, the real estate market in general, the markets for mortgage-related securities, and the overall U.S. economy. We appreciate the opportunity to express our concerns and suggestions and look forward to discussing these matters with you in the future.

Yours Truly,

[22] *Id.* at 33124.

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