July 31st, 2017

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, DC 20552

Re: Request for Information Regarding Ability-to-Repay/Qualified Mortgage Rule Assessment

Dear Director Cordray,

The Conference of State Bank Supervisors ("CSBS" or "state regulators") is the nationwide organization of state regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, and facilitates state implementation of policy through training, educational programs, and production of examiner tools and job aids. Each member state banking agency that CSBS represents has an in-depth, comprehensive understanding of the local economy and the firms that service that economy. In fact, states are the chartering authority and primary regulator for 78% of the nation's banks, a figure that represents 4,572 institutions with over $5.3T in assets. State agencies are also the primary regulators of over 20,000 non-depository financial services providers, including: residential mortgage lenders and servicers, money service businesses and money transmitters, debt collectors, consumer and small dollar loan lenders, and emerging and established financial technology companies.

Like many federal regulatory standards, the Ability to Repay (ATR) and Qualified Mortgage (QM) Rule under the Truth in Lending Act (Regulation Z)[1], has had effects on institutions that, because of their proximity to the local community, rely on more flexible underwriting and determination of ability to repay. State regulators continue to support the principles that drive the QM/ATR rule, but have several recommendations to better tailor the rule commensurate to the community bank business model. State regulator observations of the effects of the QM/ATR Rule and proposed solutions will be detailed below.

The QM/ATR Rule Does Not Fit Community Bank Business Model

One of the most distinct characteristics of the community bank business model is a reliance on social capital, or relationship lending. In fact, smaller banks simply process information about customers differently, and do not rely on highly standardized products to complete transactions, unlike larger institutions.[2] Because community banks are often located in rural communities and have a smaller customer base, expanded qualitative data is taken into consideration throughout the lending process.[3]

[1] *See* 1026.32(c), 1026.43(e)(2)
[2] *See* here. Per research from Marsh and Norman's paper Reforming Community Banks (2013), the community bank model is often described as "relationship banking," while larger banks maintain "transactional banking."
[3] *Id*

As of the first quarter of 2017, 879 FDIC-defined community banks held residential mortgage loans as more than 30% of total assets. These banks represent a very local cohort - 50.98% of community residential mortgage lenders had fewer than four offices, and 69.23% had a banking presence in only one state. Community banks are also rurally located, as 46.94% of community banks with a mortgage lending specialization operate in communities that are outside of large metropolitan statistical areas (MSAs). Community institutions that are defined as being mortgage lending specialists have experienced decline in both number and market influence.

Figure 1 shows that since 2010, 1,173 community banks have left the residential mortgage lending space, or extensively restricted those business lines. Although this decline tracks closely with general community bank consolidation, acquisition and merger trends[4], community banks with a mortgage specialization have exited the market at a faster rate than banks with commercial and industrial, agricultural and multi-specialty lending business lines.[5] This presents great concern to state regulators, as community banks are often the only source of credit in rural communities.

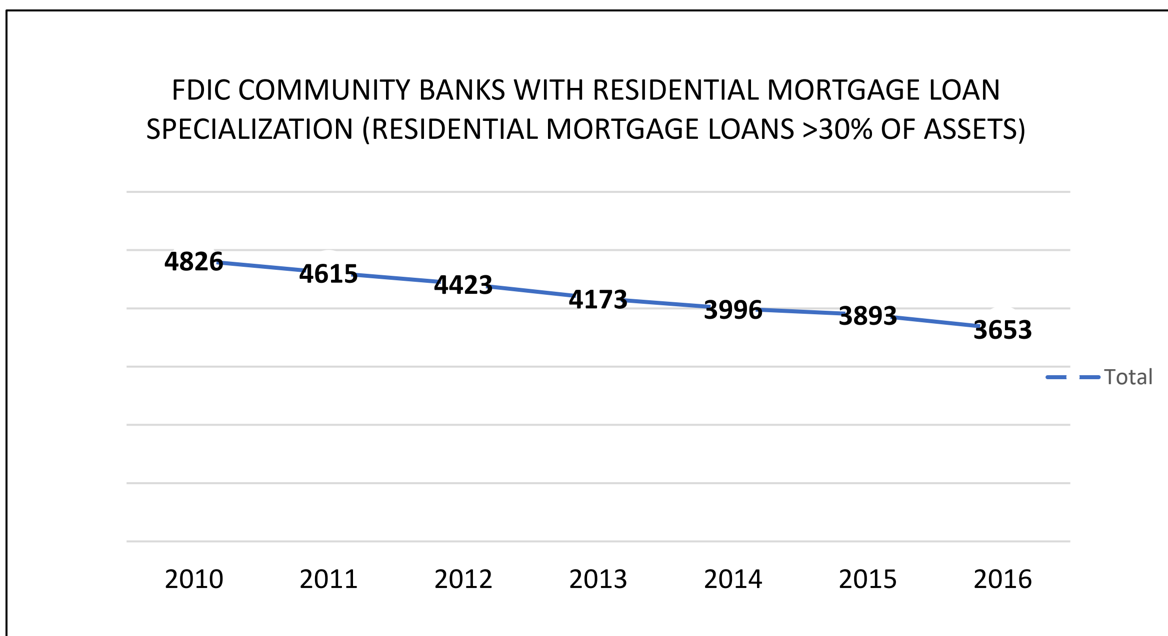

Figure 1 Source: FDIC Community Bank Reference Data

Access to qualitative data often makes it difficult for smaller and less complex institutions to originate mortgage loans that fit the Qualified Mortgage standard, simply because their markets require more flexible underwriting. This is demonstrated by community banks' tendency to hold loans in portfolio, and assume the credit risk of the loan. Unlike larger institutions that focus on standardized mortgage lending and routinely sell loans into the secondary market, community banks are much more likely to

[4] 1,715 community banks have disappeared since 2010, with 54 exiting the market in 2017 alone. *See* FDIC Quarterly Financial Data as of 3/31/2017.

[5] Since 2010, there has been a loss of only 37 community banks with an agricultural lending specialization, 228 with a C&I lending specialization, and 885 with specialties in multiple business lines. Multi-specialty lenders are defined as having retail loans as greater than 40% of assets, or having commercial loans as more than 40% of assets. *See* FDIC Community Banking Reference Data Notes here.

originate loans and hold them in portfolio. *Figure 2* illustrates that banks under one billion dollars in assets tend to hold only a small fraction of loans and leases for sale as part of the consolidated bank's mortgage banking activities.[6]

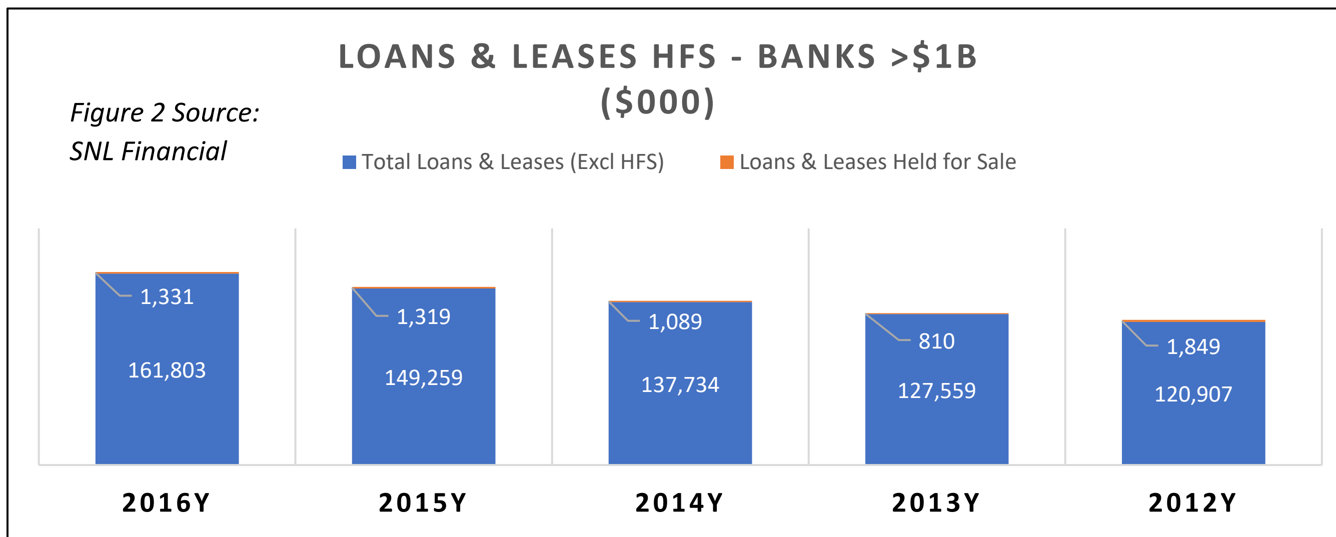

Figure 2 Source: SNL Financial

Every year, as part of ongoing research conducted by CSBS through the *Community Banking in the 21st Century Research and Policy Conference*, a national survey is deployed to community bankers across the country. As of July of this year, *The National Survey of Community Banks* has received 480 responses from community bankers all over the country. *Figure 3* clearly illustrates that community insitutions continue to hold loans in portfolio, and that the majority of respondents originate non-QM loans and hold them in portfolio.

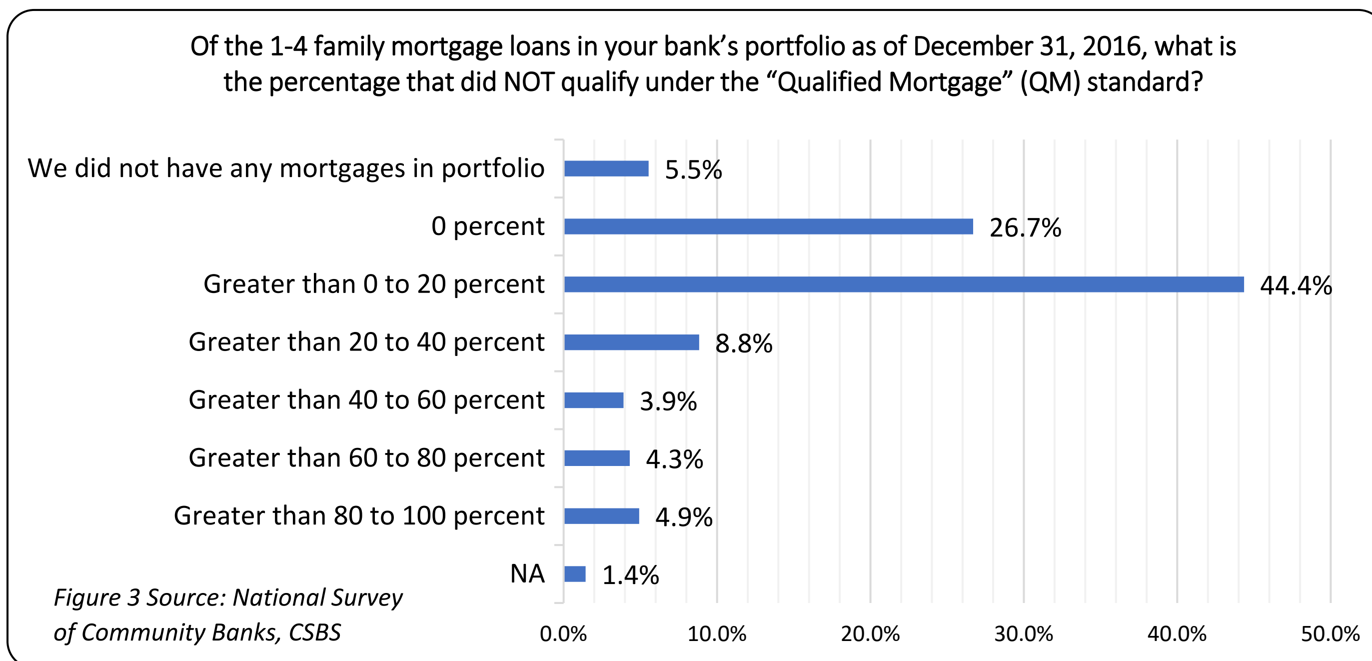

Figure 3 Source: National Survey of Community Banks, CSBS

[6] As per the FFIEC 031 041 Call Report instructions, banks are required to report, under Schedule RC-C Part I, all loans and leases held for sale as part of the consolidated bank's mortgage banking activities. *See* here.

QM Safe Harbor for Mortgage Loans Held in Portfolio

The Qualified Mortgage standard exposes community banks to uncertain legal liabilities if their originated mortgages do not meet the QM standard, regardless of whether loans are held in portfolio. In the case of non-QM, the presumption is that the lender failed to appropriately consider the borrower's ability to repay, regardless of whether credit risk is assumed by holding mortgage loans in portfolio. This distinction can cause legal uncertainty for community banks that do not operate within a "credit box," instead lending to the needs of consumers within their market. State regulators recommend that lenders that retain mortgages in portfolio be subject to more flexible underwriting standards, as they are fully incentivized to ensure the borrower can meet the monthly obligations of a mortgage.

Specifically, state regulators recommend granting QM status to all loans held in portfolio by community banks. This approach reflects the alignment of interest between the bank and the borrower, tailoring regulatory requirements to the relationship-based nature of community bank mortgage lending. Granting safe-harbor status to loans held in portfolio aligns the interests of the lender and the borrower, and allows community banks to continue using a model that has proven to be resilient and efficient.

Expand the Small Creditor Definition under Regulation Z

Further, many state regulators have observed that the two-billion-dollar threshold to be eligible for small creditor status under Regulation Z does not capture all community banks that engage in portfolio lending.[7] Because the community bank business model is distinct and not necessarily linked to asset size, state regulators recommend that the CFPB utilize a definition that is primarily activities-based. The FDIC community bank research definition, introduced in 2012,[8] defines community banks by an indexed asset threshold and certain activities. By that definition, there are 412 community banks that are over two-billion in asset size. State regulators recommend that the Small Creditor definition should not rely on a two-billion-dollar threshold for eligibility, as it creates artificial barriers for smaller and less complex banks.

Conclusion

In closing, state regulators will continue to observe the effect of the ATR/QM rule on community banks, and we appreciate the opportunity to provide this perspective. Community banking organizations are vital to the economic health of local markets, and regulation should be tailored to the size and complexity of the institution. Although macro approaches to issues that affect the entire banking market are necessary, they simply cannot function if they do not take smaller and less-complex banks, which comprise most our country's institutions, into account.

Sincerely,

John W. Ryan
President and CEO

[7] 12 CFR Part 1026, *see* here.
[8] *See* here.

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