CONFERENCE OF STATE BANK SUPERVISORS

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Research, Markets & Regulations Division
Bureau of Consumer Financial Protection
1500 Pennsylvania Avenue NW
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Washington, DC 20006

To Whom It May Concern,

The Conference of State Bank Supervisors (CSBS) appreciates the opportunity to comment on the Bureau of Consumer Financial Protection's (CFPB's) Streamlining Inherited Regulations project, Docket No. CFPB—2011-0039. CSBS strongly recommends the CFPB utilize this opportunity to recognize the inherently aligned interests between consumers and banks that keep consumer loans in portfolio. Additionally, the CFPB should take this opportunity to create a tiered consumer regulatory framework that recognizes the differences between institutions of different sizes. These separate but related approaches to regulation can be informed by directly asking industry for the specific instances of consumer regulation that should be subject to exemptions or modifications for portfolio lending and a new tiered approach to regulation.

CSBS outlines the need to recognize the aligned interests of portfolio lenders and borrowers as well as the importance of a tiered regulatory structure in the body of this letter. CSBS also has detailed answers to the questions outlined in the federal register notice in the attached Appendix. The Appendix also includes additional areas the States have identified as in need of enhancement.

RECOGNIZING INHERENT CONSUMER PROTECTIONS IN PORTFOLIO LENDING

Community banks often originate consumer lending products and retain the assets in portfolio. As a result of this business model, community banks and consumers have inherently aligned interests. Recognizing this relationship, consumer financial regulations should be modified if the lending product is held by the bank in portfolio and subject to oversight from regulators. As a matter of policy, modifying regulations that are an inherent necessity of the underwriting process is the purest form of streamlining.

An eminent example of a regulation that should not be applied to a loan retained in a bank's portfolio is escrow requirements for higher-price jumbo mortgages. Banks that retain a higher-price jumbo mortgage in their portfolio have a vested interest in the borrower paying taxes, insurance, and other required periodic payments. These factors become a component of the underwriting decision and are discussed with borrowers to determine the best way to extend a loan.

Where banks have made the informed decision that an escrow account is not necessary for a loan being kept in portfolio, mandatory escrow requirements impose a cost that disincentivizes the bank from making the loan. This does not make sense. Banks that hold a mortgage in portfolio must determine whether the borrower will meet third party obligations and will work with the borrower accordingly. Where regulatory requirements mandate an escrow account, banks will be wary to incur the added

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costs for a service they have already determined unnecessary for the borrower. This results in decreased credit availability and incentivizes the sale of assets on the secondary market, thereby limiting the role community banks play as credit counselor and financial educator.

Fundamentally, CSBS believes escrow considerations and all other factors absorbed into the underwriting process should be subject to a modified consumer compliance regulatory structure. Modifying the regulatory structure for loans that do not fit the securitization model ensures credit is available in communities that require individually tailored loans.

STREAMLINING REGULATIONS FOR COMMUNITY BANKING BUSINESS STRUCTURES

The consumer regulatory structure is currently designed for financial institutions of all sizes. The same consumer regulations that apply to institutions with over $1 trillion in assets apply to those with $10 million in assets. In practice, this leads to overly burdensome regulations on community banks and ineffective regulations for large banks. As a result, local accountability and consumer protection considerations are skewed to fit a national consumer protection structure that cannot practicably be applied to community banks that operate drastically different business models from their large national counterparts.

The approximately 6900 banks with less than $1 billion in assets provide flexible financial solutions to meet the needs of their local communities.[1] Accordingly, they often have to satisfy regulations outside of their expertise to accommodate their customers' needs. Wherever possible, these institutions should have consumer compliance requirements that fit the size and business lines of the bank while still ensuring the proper level of consumer protection. In designing regulations and guidance, a streamlined approach focused on core consumer protection requirements should provide community banks with a way forward to provide their communities with products that might otherwise be unavailable.

Community banks are required to satisfy regulatory requirements specifically designed to address issues absent from many community bank product lines and services. As a matter of practicality, these issues can be eliminated through the use of a tiered consumer regulatory structure that is mindful of community bank business practices.

For example, community banks are required to provide annual privacy notices to their customers regardless of whether they share consumer information with third parties. A tiered approach to consumer regulation could fix this problem by exempting banks under a specified asset level from reporting privacy notices with an exception for those banks providing information to third parties. Under such an approach, the tiered structure provides a rebuttable presumption that community banks do not engage in information sharing, thereby eliminating a regulatory requirement with no consequences to consumers.

As an additional example, Regulation B, at 12 CFR 1002.7(d)(2) allows creditors to require the signature of persons to credit instruments to the extent it is reasonably believed necessary by the creditor under State law. The Official Staff Interpretation states, "[a] creditor's reasonable belief as to what instruments need to be signed by a person other than the applicant should be supported by a thorough review of pertinent statutory and decisional law or an opinion of the state attorney general." This statement poses an unreasonable and grossly impractical requirement on small community banks and

[1] Source: FDIC, as of Q1 2011.

other small creditors with respect to their processes in determining the appropriate signatures to require on credit documents. In effect, it requires a creditor to be able to point to a legal opinion or an opinion of the state attorney general as the authority for requiring the signature of a spouse or third party in many loan transactions. Most states do not have attorney general's opinions addressing this issue.

Community banks have a fundamental interest in making sure they can repossess property securing a loan and individuals with joint ownership of property securing a loan have a fundamental interest in the property. Accordingly, community banks should not be required to obtain a costly legal opinion analyzing this issue if the joint owner makes a fully informed decision to sign the credit instrument. With an exemption for smaller institutions, examiners can then be trusted to exercise judgment to determine whether the bank is properly requiring qualified applicants' spouses or other third parties to sign a credit instrument.

Identifying Regulations Internalized by Products in Portfolio and/or Appropriate for a Tiered Structure

To determine which rules are poorly designed for institutions that portfolio their consumer financial products and which rules can be modified under a tiered compliance structure, CSBS recommends commencing a project that includes requests for information from industry and a series of public roundtables with industry and consumer groups. The purpose of the requests for information and public roundtables should be to define the answers to the following questions:

1. What regulations are internalized in the underwriting process for products retained in portfolio?
2. What regulations should not be applicable to community banks because they are designed for different business structures?
3. What regulations are beneficial to both consumers and lenders?

Building a new regulatory framework for consumer financial laws will require elaborative discussion of these types of questions. CSBS would be glad to discuss the answers submitted to these questions and any additional questions the CFPB may ask.

Conclusion

With the CFPB's expertise, regulations can be fashioned to address the risk originally targeted in the consumer financial protection laws inherited by the Bureau. Streamlining regulations in a manner addressing the business lines of financial institutions will better serve communities across the country that rely on local banks to provide their credit needs and pave the way for a compliance framework that applies the purpose of national consumer protection laws to local markets.

Sincerely,

John Ryan
President & CEO

APPENDIX

CSBS RESPONSE TO SPECIFIC ILLUSTRATIONS OF POTENTIAL STREAMLINING OPPORTUNITIES

CSBS would like to take the opportunity to provide the States' perspective on the specific questions contained in the Federal Register notice. In addition, CSBS will provide additional insight into the regulations in question to inform the CFPB of related issues, gaps in regulation, and opportunities to alleviate regulatory burden.

Coverage/Scope of Regulation B (Equal Credit Opportunity)

Examiner Flexibility in Determining Discriminatory Preference

As a matter of priority, CSBS implores the CFPB to address inconsistencies in discriminatory preference findings. Regulation B, at 12 CFR 1002.4(b), prohibits creditors from making oral or written statements discouraging on a discriminatory basis a reasonable person from making an application. The Official Staff Interpretations to Regulation B, at Paragraph 4(b)1.ii. prohibit the use of words, symbols, models or other forms of communication that suggest a discriminatory preference or exclusion in violation of the ECOA. The States have encountered situations where a bank did not have any discriminatory preferences or policies or any intent to do the same, but due to an unintentional error, or a strained interpretation crafted by a federal examiner, a violation of this provision was deemed to have occurred.

To address this issue, the following reasonable limitation should be added to 12 CFR 1002.4(b) and its accompanying Official Staff Interpretation: *"In such instances, if the creditor does not in fact have a discriminatory preference or policy and any suggestion or implication to that effect was unintentional, the creditor shall not be found to have violated this section. If the creditor does not realize a monetary benefit, there is a presumption that a discriminatory practice has not occurred."* The flexibility in this approach allows for examiners to fully vet issues before finding a discriminatory practice. Further, a presumption of compliance based on monetary gain frames the issue for preference, yet allows examiners to go beyond the basics when they suspect discriminatory activity.

For example, banks have been cited for Regulation B violations due to the cost difference for credit reports between joint unmarried applicants and married applicants. This cost difference is due to the credit bureaus' cost structures, not a bank discriminating against marital status. In these cases, banks are required to refund the fee difference in a third-party's pricing structure. Under the proposed interpretation, the fact that the bank does not realize a monetary benefit frames the issue, and examiners can presume there is no discriminatory practice. Examiners could then approach the issue without being pushed towards a strict finding of a discriminatory practice and would give examiners discretion to examine for third-party management issues that might be a greater concern.

States have found highly inconsistent application of this section of Regulation B by federal regulators. As a result, many community banks are subject to further proceedings despite a lack of actual discriminatory preference. In the interest of justice, examiners should have a sound basis to determine an institution has discriminatory preference before subjecting institutions to the daunting repercussions of an ECOA violation.

Relaxed Notice & Timing Requirements

CSBS notes the Equal Credit Opportunity Act is an important law to ensure credit is available to all. To that end, as part of a tiered approach to consumer financial regulation, CSBS recommends the CFPB relax the notice and timing requirements for lenders originating fewer than 25 loans or 5 loans secured

by real property. The principles behind Regulation B should be engrained in the policies, procedures, and lending implementation of all financial institutions. However, there should be flexibility for those smaller institutions requiring more time to properly comply with the requirements. The recommended loan volume, 25, should be used to mirror the Regulation Z exemptions for non-mortgage loans.

Tribe

Lastly, in 12 CFR 1002.8(b)(2) of Regulation B, the word "tribe" should be added to the examples in the parenthetical part of the paragraph which lists persons sharing one or more common characteristics. In the States, from time to time, banks would like to offer special purpose credit programs benefitting certain Native American tribes.

Consistent and Sufficient Definitions

Application

As CSBS has previously noted in a letter to the CFPB, there should be a uniform definition for "application." This definition should be broad so the CFPB can then use modifiers throughout its regulations to fit the purpose of the underlying law. For example, the Truth in Lending Act relies upon "application" for disclosure requirements, whereas the SAFE Act uses "application" for determining who requires licensure or registration. If there is a standardized definition of application, modifiers can then be used to specify where in the application process the regulation is triggered. In this example, Truth in Lending requirements should be triggered upon a "completed application," whereas a SAFE requirements should be triggered upon "taking any component of an application." Taking an application is purposely broad under SAFE to ensure the proper parties are licensed or registered, which places application in a different realm from its consequences for disclosure under Truth in Lending. This example can be extended to all other regulatory references to "application," including a flexible definition for HMDA purposes.

The need for a single definition of application with appropriate modifiers is underscored by the Regulation B and C "approved," "denied," or "withdrawn" issue. The same definition of application should apply throughout the regulations, and then can be described through modifiers like "approved," "denied," or "withdrawn," each of which should have a simple guide for institutions to know what those modifiers mean. From a regulatory standpoint, examiners will be able to recognize if an institution deviates from the clarified meaning of modifiers like "approved." If there are holes in this approach, the resulting practices would almost certainly be unfair, deceptive, or abusive.

CSBS also notes "application" could be the key to regulating so-called "loan modification experts." The States have witnessed a plethora of "loan modification experts" charging upfront fees for modification help that is either never supplied or falls well short of being useful. These "modification experts" escape licensing requirements by operating under the premise that their "modification" work is not refinancing, therefore the applicable regulations are not triggered. These actors couple themselves with attorneys to attempt to invoke regulatory exemptions as well as attorney-client privilege, and often cannot qualify for mortgage licensure because of felony convictions. A broad definition of application that simply includes the negotiation of terms for credit could be used to combat this practice.

Regularly Engaged

Regulation Z and other federal regulations require institutions "regularly engaged" in a certain practice to abide by particular regulations. Defining the term "regularly engaged" in the same manner for all the regulations under the CFPB would provide greater consistency. In clarifying "regularly engaged," the

burden should be placed on the creditor to show they are not regularly engaged versus the regulator having to prove one is regularly engaged.

Annual Privacy Notices

In addition to utilizing a tiered regulatory structure for privacy notice requirements, CSBS recommends a study to determine the usefulness of privacy notices. A project similar to the Know Before You Owe project might narrow the privacy issues consumers find the most critical as well as the best manner in which to communicate those critical pieces of information. As part of such a project, CSBS suggests the CFPB determine how to address the failure of privacy notices to identify the nexus between the consumer and the financial institution in situations where the relationship was originally established between the consumer and a third party.

Regardless of the results of such a study, CSBS believes it would be logical to allow for financial institutions of any size to implement an opt-in program for online privacy posting in lieu of mailings. Many consumers will want to opt-out of receiving privacy statements in the mail, and a clearly disclosed opt-in program will provide this function and save institutions time and money. The program would have to carry minimum requirements to make sure the disclosures are delivered and received.

ATM Fee Disclosure

Technology has reached the point where electronic fee disclosure can be simple and efficient. CSBS recommends requiring all automated cash dispensing machines to disclose the fee on the first screen. A prominent "$X.XX Out of Network Withdrawal Fee" disclosure on the first screen will efficiently notify consumers of the cost to use the ATM prior to entering a PIN. No other fee disclosures should be required until the consumer is prompted to accept or decline the fee. In addition to simplifying the rules applicable to all entities that charge a fee for cash dispensing, this would stop frivolous class action law suits that have emerged where people scratch disclosure notices off of ATM machines and commence law suits.

Coverage/Scope of Regulation C (Home Mortgage Disclosure)

Generally

At the very least, the coverage and scope of Regulation C should be aligned with the Regulation Z exemptions for institutions that originate and refinance five or fewer mortgages in a year. Requiring HMDA reporting for institutions performing one origination or refinance is burdensome, particularly considering such services are performed simply as an accommodation for customers. To that end, CSBS applauds the CFPB for recognizing the fundamentals of customer relationships at small banks.

Additional Point on HMDA Error Rates and Corrective Actions

In addition to the specific Regulation C question, CSBS believes Regulation C and HMDA provide a pristine example of inconsistent applications of laws and regulations among the federal agencies. The error rates that trigger expanded reviews and in some cases civil money penalties and/or a requirement to review and re-file HMDA data are not set forth in the regulations and are left to the examination procedures of each individual agency. States consistently find the federal regulators vary on the corrective action for HMDA errors. CSBS believes a set of guidelines from the CFPB would streamline regulators' approach to examination. A uniform approach to the level of error rates that trigger specific regulatory actions would allow financial institutions to be examined consistently and remove some of the inevitable variability associated with examiner judgment. When making these guidelines, the CFPB

should consider a safe harbor or specified tolerance for examiners for low levels of errors in non-critical fields. These guidelines should not be a method for institutions to avoid proper HMDA reporting, but rather a means to ensure institutions and regulators follow the same guidelines in the more subjective areas of examination.

ADDITIONAL AREAS IN NEED OF ENHANCEMENT

Better Guidance Needed for RESPA and HMDA

The Real Estate Settlement Procedures Act (RESPA) and Home Mortgage Disclosure Act (HMDA) are crucially important regulations for lenders, yet there is no definitive source to clarify issues that may emerge under their highly complex regulations. HUD's FAQ's and RESPA Roundup were useful for the limited areas they touched, but were not a centralized source. Similarly, the FFIEC's *A Guide to HMDA Reporting: Getting it Right!* and various industry letters clarify specific issues, but do not provide the full body of information for a law that is among the top priorities in examinations. A combination of all current guidance into an "Official Staff Commentary" for each of these laws would streamline the application of the law across regulators and institutions.

Annual Percentage Rate (APR)

CSBS notes industry concerns regarding the burden of calculating APR and consumers' ability to utilize the information. CSBS believes the APR is an important disclosure in the origination process and should be preserved as a central regulatory requirement. To that end, CSBS supports all efforts to improve a consumer's ability to understand APR terms through the Know Before You Owe project. Where there is an opportunity to explain the importance of APR to a consumer, the opportunity should be taken.