American Bankers Association
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Ms. Monica Jackson
Office of the Executive Secretary
Consumer Financial Protection Bureau
1700 G Street N.W.
Washington, D.C. 20552

Re: **Docket No. CFPB–2015–0004; RIN 3170–AA43**
Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)

The American Bankers Association ("ABA")[1] is pleased to comment on the Consumer Financial Protection Bureau's ("the Bureau" or "CFPB") proposed amendments to the Ability to Repay rules contained in Regulation Z (the "ATR" or "the Rules"). Under this proposal, the Bureau is advancing definitional changes to the Rules to facilitate mortgage lending by small creditors, particularly in rural and underserved areas. The proposal aims to increase the number of financial institutions able to access special regulatory provisions that incentivize community bank lending in rural and underserved areas, and assist small creditors in meeting compliance requirements under the new rules.

ABA commends the Bureau's attention to important implementation matters pertaining to the ATR rule. Overall, ABA members applaud the Bureau for its ongoing efforts to assist the industry in its compliance efforts, and for providing more clarity to the difficult requirements that arise from the ongoing legal reforms.

ABA also commends the Bureau's recognition in these proposals that small creditors play an important role in providing mortgage credit to certain communities. Community banks have always prided themselves on being flexible to meet the unique circumstances of their customers. This proposed rule recognizes that hometown banks rely on relationship lending models that naturally incorporate ability-to-repay principles. ABA is encouraged by the Bureau's recognition that the smaller size and single-community lending by these institutions afford them a keen understanding of the economic and other circumstances of their local customers and communities. ABA also agrees with the statement that the proposals advanced herein involve "a recognition that small creditors lack economies of scale necessary to offset the cost of certain regulatory requirements." These are very important statements for our small members, particularly within the very difficult ongoing environment of new and evolving rules, oral advisories and ever-changing expectations of regulators.

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 ½ trillion in deposits, and extend $8 trillion in loans.

With regard to the issues raised in this proposed rulemaking, the ABA offers that—

- ABA applauds the extension of the "small creditor" loan limit to 2,000 transactions per year, as this number is more inclusive of the full range and diversity of community bank lending across all jurisdictions. ABA supports the decision to exclude from such loan limit those loans held in portfolio by the creditor and its affiliates. These provisions, as proposed, are consistent with the overall objectives of promoting credit accessibility.

- CFPB should consider revising the asset limits under for the "small creditor" exemption from $2 billion in assets to $10 billion.

- For purposes of defining "rural areas," ABA supports the concept of using the urban-rural classification adopted by the Census Bureau. There are technical difficulties, however, in using the proposed geographical classifications, and ABA urges that the Bureau develop and release an official tool to track "rural area" designations as part of this rulemaking.

- The existing two-year transition period for balloon-payment qualified mortgages must be extended to last, at minimum, until the Bureau develops an official "rural area" tracking tool.

- The "grace period" to allow otherwise eligible creditors that exceed either the origination limit or the asset limit in the preceding calendar year should be extended to 6 months.

- ABA requests that the Bureau explicitly articulate the proper interplay between discriminatory lending and ability-to-repay requirements generally.

Following are ABA's detailed comments on the specific elements of this proposal.

<u>Expanded Definitions of "Small Creditor"</u>

Under the proposal, the loan origination limit to qualify for the rule's "small-creditor" status would be raised from 500 first-lien mortgage loans per year, to 2,000 per year. This exemption would amend Section 1026.35(b)(2)(iii)(B), which limits eligibility for the rule's special provisions and exemptions to creditors that, together with their affiliates, in the preceding calendar year originated 500 or fewer covered transactions secured by a first lien. The proposal would not amend the asset limits under section 1026.35(b)(2)(iii)(C), requiring that such creditors have less than $2 billion in assets to qualify for the exemption.

- ABA appreciates the extension of the loan limit to 2,000 transactions, and believes this higher limit is important for the size and type of institutions that particularly require relief. In this sense, ABA understands that the Dodd-Frank statute explicitly requires that the Bureau establish, with some flexibility, annual loan origination limits. Our internal analysis suggests that the Bureau approximates a good target through the proposed 2,000-transaction limit. From informal polling of our smaller community bank members, we understand that 1,000 loan originations per year is a common amount at banks of asset sizes below $1 billion. Many may originate more. Thus, the existing 500-loan origination limit is unnecessarily restricting at this asset size, and unless this test is expanded, as per the proposal, many community banks will ration credit in order to remain in the special QM categories.

- ABA supports the Bureau's proposal to exclude from the 2,000 loan limit those loans held in portfolio by the creditor and its affiliates. This exclusion is consistent with the rule's overall goals of ensuring safe lending while promoting credit accessibility. The success and livelihood of community banks are dependent upon repayment of their portfolio customers. Community banks carefully underwrite these loans based on knowledge of their communities and standards that meet local customer needs. The sound lending practices of hometown banks is demonstrated by their persistently low default and foreclosure rates, even through the recent mortgage crisis.

- ABA strongly recommends that the Bureau consider revising the asset limits under section 1026.35(b)(2)(iii)(C), that currently require creditors to have less than $2 billion in assets to qualify for the small creditor exemption. This expansion in asset threshold is especially important if the Bureau decides to finalize the proposed provision where the asset threshold includes the assets of the creditor's mortgage-originating affiliates. ABA has advised in past comments that in order to have a less restrictive impact on credit availability for borrowers served by community banks, the QM's small creditor limits should be expanded to cover a broader and more meaningful representation of smaller portfolio lenders. ABA believes that sizes of up to $10 billion in assets should be used as the applicable benchmark. The Bureau has advanced only minor reasons to exclude banks up to $10 billion in size from the small creditor QM exemption. As we've pointed out in previous comments, our surveys reveal that the more binding control in the two-pronged condition set forth in this provision (the asset test and the loan-per-year test) is, in fact, the loan-per-year component. Provided that the rule retains the loans-per-year prong of the test, increasing the asset test would still preserve the "transaction quantity" safeguard that appears to be the Bureau's objective. This change would, however, empower more small institutions to provide needed capital in their communities.

Expanded Definitions of "Rural"

The special provisions that apply to small creditors under these rules would require that the creditor operate predominantly in rural or underserved areas (i.e., the creditor must extend more than 50 percent of its total first-lien covered transactions secured by properties located in rural or underserved areas). The current proposal would expand the definition of "rural" to include census blocks that are not in an urban area as defined by the Census Bureau. Specifically, the proposal expands the definition of rural to include either: (1) a county that meets the current definition of rural county, or (2) a census block that is not in an urban area as defined by the U.S. Census Bureau.

- ABA welcomes these proposed amendments as an improvement and simplification of the methodology to define urban vs. rural areas. As a threshold matter, among the various possible approaches that could be used to identify such areas, ABA generally supports the use of the urban-rural classification adopted by the Census Bureau. The Census classifications appear to be the most suitable for the purposes and objectives of these regulations.

- There are, however, difficulties in the application of the Census Bureau classifications to mortgage lending by community banks. As described by the Bureau in the preamble, the urban-rural classification completed by the Census Bureau is done at the level of the census block, which is the smallest geographic area for which the Census Bureau collects and tabulates decennial census data. Census blocks are smaller than counties—while there are about 3,000 counties in the United States, there are approximately 11 million census blocks.

  ABA agrees that this methodology provides much more granularity than county-based metrics, but unfortunately, the Census methodology is significantly different from approaches typically employed by community banks to analyze and manage mortgage finance. When planning and evaluating mortgage lending activities (or housing patterns in general), lenders typically focus on county classifications, or alternatively, on regions defined as "metropolitan areas" (MAs). "Counties" are generally established by states as administrative or political subdivisions. MAs, defined by the Office of Management and Budget, are officially established by considering population "centers" and concentrations of population. Census tracts, on the other hand, are defined with local input, as they are intended to represent "neighborhoods" (i.e., designed to be homogeneous with respect to certain characteristics, economic status, and/or living conditions). In short, the geographical classifications being proposed here are not similar to the geographical classifications in use today, and it will take considerable effort to create systems to recognize census block classification for purposes of compliance.

  In light of these difficulties, ABA community bank members report that it will be challenging to ascertain the precise number of covered transactions originated in any previous year, as there are no automated tools or solutions that count and track all "covered" transactions across various bank products. The calculation of whether a creditor extends more than 50 percent of its total first-lien covered transactions secured by properties located in rural or underserved areas will necessarily be subject to a "manual count." There will be difficulties in identifying the classification the Census tracts where the consumer's property is located because this task will require a "naked eye" comparison of physical maps. Institutions will be required to use county maps, then subdivide these into the separately designated tract classifications and then ascertain the quantity of lending from that composite. Without viable tools to identify and cross-check Census tract locations, it will be difficult to aggregate loans from diverse qualifying census tracts to come to a final, or "total" amount. In short, institutions will be forced to assemble "manual workarounds" which do not contribute to regulatory relief, but instead, exacerbate compliance risk.

- In the proposed rule's preamble, the Bureau offers a viable solution to the difficulties posed herein. On page 7785, CFPB states an intention to create safe harbor provisions related to the rural or underserved definition for certain automated tools that "may be provided on the Bureau's Web site to allow creditors to determine whether properties are located in rural or underserved areas," or may be "provided on the Census Bureau's Web site to assess whether a particular property is located in an urban area according to the Census Bureau's definition."

  ABA is in full support both of these options. Community banks of the size affected by this rulemaking would greatly benefit from a system that, as described in the preamble, allows creditors "to enter property addresses, both individually and in batches, on the Bureau's public Web site to determine whether the properties are located in a rural or underserved area for the relevant calendar years." We urge that the Bureau advance with this plan, as it would provide a very reliable solution to a very difficult compliance hurdle.

  More pointedly, our members report that the task of identifying and tracking rural or underserved areas for purposes of this provision will be so difficult, and the risks associated with a breach are so severe, that they will delay changing their systems to accommodate the expanded definitions until the Bureau provides a tracking tool of the type set described above. Banks also observe that if they construct a "rural area" tracking system prior to the Bureau's release of an official tool, they will be forced to come back to reconstruct or alter their systems to incorporate whatever device the Bureau provides. There is a strong disincentive, therefore, to spend resources to build a bank compliance system that will have to be altered in the mid- or near-term. In short, we urge that the Bureau advance expeditiously in developing an official automated tool that will identify rural areas and support a safe harbor under the law.

  ABA also asks that the Bureau move with the back-up alternative that any pertinent tool provided by the *Census Bureau* could be relied on as a safe harbor for purposes of these regulations. Specifically, ABA supports proposed §1026.35(b)(2)(iv)(C)(3), which provides that a property shall be deemed to be in an area that is ''rural'' or ''underserved'' in a particular calendar year if the property is not designated as located in an urban area by the Census Bureau by any automated address search tool that the Census Bureau provides on its public Web site for that purpose.

- As a final and important point, ABA believes that the Bureau must extend the existing special two-year transition period during which small creditors that do not operate predominantly in rural or underserved areas can offer balloon-payment qualified mortgages if they hold the loans in portfolio. (§ 1026.43(e)(6)) Although the Bureau is recommending that such transition period be extended to last until April 2016, ABA urges that this date be extended much further out, and that, at the very minimum, it must last until banks can access an official automated tool to identify rural areas. As per the discussions immediately above, if the law is changed to impose a rural limitation for small creditor balloons, many small institutions will be incapable of ensuring compliance with the definitions, and will very likely curtail or eliminate that type of financing. This would be a harmful result in any community, and it can be avoided by making the transition period continuous until the automated mapping tools are developed and released to the public. The Bureau would then issue a formal *Federal Register* announcement of the transition period's sunset.

Addition of "Grace Period"

The Bureau is proposing a "grace period" which would allow otherwise eligible creditors that exceed either the origination limit or the asset limit in the preceding calendar year to continue to operate as a small creditors with respect to applications received prior to April 1 of the current calendar year—with the benefit of the special provisions and exemptions—as if it had not exceeded the limits in the preceding year. This proposed 3-month grace period will be available to creditors that exceeded the respective limits in the preceding calendar year but had not exceeded them in the calendar year prior to the preceding calendar year.

- ABA thanks the Bureau for a grace period that intends to ensure continuity and stability in bank lending operations. ABA believes that the "grace period" approach set forth in this proposal is of great value and can work if properly fashioned.

- ABA recommends that the grace period be extended to 5 months, in order to facilitate the tracking and compliance obligations inherent in this rule. The additional time we request should not be read as an opportunistic design to allow banks with additional time to make more loans when they reach their lending limits. ABA's request for a 5-month period is connected to all the tracking difficulties that are discussed above. In short, the function of tracking precise origination thresholds will be very difficult for community banks, and this function will be particularly challenging within a 3-month deadline period. The addition of two additional months will greatly assist smaller banks in meeting their compliance obligations.

  We note that there is precedent for a longer grace period in the mortgage servicing rules. *See* 12 CFR 1026.41(e)(4)((iii). Under that provision, small servicers are evaluated based on the number of mortgage loans serviced as of January 1st for the remainder of the calendar year. A servicer that crosses the threshold will have a full 6 months after crossing the threshold, or until the following January 1, whichever is later, to comply with any requirements for which a servicer is no longer exempt as a small servicer. We urge that a similar approach be adopted here.

Fair Lending Concerns

Community banks have expressed very serious concerns regarding the interplay of these proposals and the fair lending laws. As the Bureau recognizes, anytime numerical thresholds, limits or triggers are imposed upon lending institutions—whether set by law or guidelines—there is a high probability of going astray of disparate impact requirements. The potential conflicts of these proposals with fair lending laws will arise under various scenarios—

- Where banks adopt a policy of capping loans in certain areas/tracts so as not to exceed the numerical limits that guarantee "small creditor" or "rural" status.

- Where banks, at a particular point in the year, decide to alter their lending to limit credit activities in certain areas/tracts in order to avoid exceeding the numerical limits that guarantee "small creditor" or "rural" status.

- Where banks, from one month to the next, decide to alter their pricing or product mix in specific areas/tracts because they no longer qualify for the "small creditor" or "rural" status.

In each instance, there is a danger that protected classes will be disproportionately affected by actions of the bank for purposes of complying with the safe harbors established under law.

For purposes of safety and soundness, in order to achieve appropriate and orderly oversight of lending practices, in order to guard the reputational risk of the entire industry, and in order to ensure adequate levels of funding to all populations, ABA requests that the Bureau explicitly articulate the proper interplay between discriminatory lending and ability-to-repay requirements generally. Specifically, as it pertains to these proposed provisions, the Bureau must, at minimum, articulate guidance on the three bulleted scenarios set forth above. In each scenario mentioned, we ask that the Bureau assure that attempts by banks to manage lending activity in order to stay within the thresholds of the special provisions afforded to "small creditors" and creditors operating predominantly in "rural" areas will not subject such creditors to negative disparate impact repercussions.

As we have done in past comments, we urge that these crucial clarifications be issued as part of any final rule issued by the Bureau. Banks face unprecedented challenges and scrutiny over their fair lending policies and risk management programs. Without doubt, fair lending has become a top enforcement priority of the current Administration and the current Bureau leadership. Ignoring the disparate effects of this regulation or overlooking the need to issue authoritative guidance will only heighten industry confusion and cause significant disincentives in an already complex regulatory landscape.

General Comments

Although ABA believes that the regulatory fine-tuning offered in these comments are useful, small community banks express that the foremost difficulty in coping with the new ATR requirements is the inherent complexity of the regulations. Even where the Bureau acts to allow special lending windows under the difficult QM requirements, there is a general skepticism by community banks in offering tailored loan programs because the law is so uncertain and the liabilities so severe. In this sense, ABA believes that these regulations must continue to undergo upgrades to ensure that they are more accessible, comprehensible, and most importantly, accommodating to useful financing approaches that can assist community institutions in meeting their communities' credit needs.

By large margins, our community bank members report that the most poignant impact of the ATR regulations is the curtailing of balloon payment loans. Other issues remain. As an illustration of comments from those banks that are attempting to tailor products and serve the credit needs of their home towns, we offer the following typical testimonials, from different institutions—

- Our bank has a long history of doing balloon loans and our delinquency and charge-off rates have historically been very low. It is important to note that rural and underserved markets are <u>not</u> the only areas that present challenges, as we see many applicants that do not qualify for the conforming Fannie/Freddie loan and could be helped by alternative products. The issues could involve minimum credit score requirements, marketability of the collateral, or other variables. Our portfolio products allow for much more flexibility, which offers the increased availability of credit, but also compels us to price based on elevated risk and necessity to manage interest rate risks in our portfolio. We have been able to be more creative with this product in ways that conforming financing cannot. We also offer the Fannie/Freddie product and sell these loans in the secondary market. In situations where our customer could not qualify for GSE loans, we have been able to get them in the home due to having our balloon mortgage available.

- Many of our specialty products are balloons and test as HPML. As a result, we are required to escrow. Numerous customers have requested that they do not desire to escrow. We believe there should be other criteria to allow the consumer to have a choice when escrowing. Fannie/Freddie loans have an LTV requirement of 80% or less and escrows can be waived. Some consideration should be given to create more flexibility so the consumer can have more options.

- We rely on the Small Creditor QM and want this exemption to be continued. It must be brought to the policymakers' attention that, in our communities, there is a real stigma associated with ARM loans. Our customers generally do not want ARMs, as they view them as more risky and less predictable. I would ask regulators conduct consumer research to see how ARM loans are viewed by the public.

- In our bank, loans take much longer to close—all at the detriment to the customer. Very specialized staff is now needed to work on mortgages, and therefore, fewer staffers in the bank know how to do mortgage loans. This is, again, a detriment to the customer in cases of staff limitation or increased demand. The higher fees for software and employee time, both being on the rise, are passed on to customers, all of which result in ever higher fees to consumers.

- Our bank wants to do things the right way, and with full respect of the rules. Our reputation and survival depend on it. Regulatory fear and cost are, however, creating immense burden using limited staffing. The centralization of document preparation is a "must," in our view, to avoid incorrect preparation. The result in always lost revenue. Increasing expenses lead to increased costs to consumers, reduction in availability of mortgage loans, and community banks have to make difficult decisions on whether to continue lend.

- We are a small rural bank. We understand that Dodd-Frank was supposed to have saved each consumer $600-$800 in costs. Our costs actually increased from $450 to $700 per loan. We spend way too much time trying to maintain compliance with constant changes and therefore may choose to discontinue offering residential real estate loans as we do not have a loan software package. Purchasing such a package would not be cost effective for the 20 loans we average per year.

- We are a small town bank and we have always offered a 10 year fixed rate balloon loan. It appears that we will not be able to keep this product after 1/1/2016. Our ARM loans are good options, but we are fearful we will lose loans to the larger banks and credit unions in this and in surrounding towns.

- We are considering making ARM loans, but feel that we will lose market/customers as ARM loans are not popular.

Conclusion

ABA commends the Bureau's efforts to respond to industry needs as community banks strive to fully comply with these difficult mortgage reforms. We look forward to working with the Bureau to further improve upon these regulations and refine the disclosure forms in terms of consumer understanding.

Thank you for the opportunity to comment.

If you have any questions, please contact Rod Alba at ralba@aba.com.
Sincerely,

Rodrigo J. Alba