Testimony of

G. Gary Berner

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

United States House of Representatives

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Chairman Frank, Ranking Member Bachus, and members of the Committee, my name is G. Gary Berner. I am Executive Vice President of First Niagara Bank, Lockport, New York. First Niagara Bank is a federally chartered savings bank, with approximately $9.6 billion in assets. We hold $2 billion in single family residential loans and service approximately $616 million in residential single family loans for investors. I am pleased to be here today on behalf of the American Bankers Association (ABA). ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.9 trillion in assets and employ over 2 million men and women.

We appreciate the opportunity to testify on H.R. 1728, which aims to improve mortgage lending standards. I wish to make it clear from the outset that the First Niagara Bank is one of many banks that never varied from traditional, portfolio lender underwriting standards. Our $2 billion residential loan portfolio is strong, with quarter-end delinquency rate of less than one percent and first quarter charge-offs running at an annualized pace of less than one basis point. We also have a "High Satisfactory" lending rating for Community Reinvestment Act (CRA) purposes, and our FA/VA portfolio is in excess of $50 million.

The fallout of the mortgage markets has been very troubling to the banking industry – an industry filled with institutions that have existed for decades, and in the case of my bank, for over 125 years. It has been primarily the actions of loosely-regulated non-bank lenders, and their sometimes fly-by-night operations, that have caused tremendous damage for consumers and for the lending industry, including banks like mine. Many of the non-bank firms have already gone out of business, while others have begun restructuring their businesses. As bankers, we intend to be in our communities for the next 100 years and beyond. Therefore, we know that we must be part of the solution, and we are very pleased to work with you, Mr. Chairman, and with the members of this Committee, on finding ways to bring mortgage lending practices back into balance.

Indeed, we are already a major part of the solution. At First Niagara Bank over the last six months, we have done 27 repayment plans or modifications and have had only three defaults. I have just returned from the ABA's industry meetings on housing and mortgage finance, and almost all banks there reported having similar success with workouts and modifications.

This should not be surprising. As you well know, the vast majority of banks in this country never made a toxic, subprime loan. Rather, we have followed underwriting practices that serve both our customers and our bank. Unlike many state licensed, unsupervised mortgage originators, most banks in this country have served our respective communities for decades. Since we retain loans in our portfolio as well as use the secondary market, we have a vested interest in lending to people who have a well-documented ability to pay us back.

Any regulation or legislation should promote a return to universal and conservative underwriting practices like those maintained at most banks. Conservative practices must be codified and promoted for ***all*** lenders at the same time. At a minimum, legislation must ensure that the prudently managed, federally-regulated banks are not subject to greater burdens than their less regulated, non-bank competitors. Additionally, care must be taken to ensure that the outcome of any legislation does not restrict housing credit. Such unintended consequences will prolong the recession and limit the potential for a strong recovery.

In July of last year, the Federal Reserve issued amendments to Regulation Z that addressed many issues that led to the housing price bubble and the ensuing overextension of credit. These are important and major changes, which in most aspects reflect the sound underwriting principles that have formed the foundation of traditional bank mortgage lending. The new regulations address the use of exotic or nontraditional mortgages; the loosening of underwriting standards, especially among non-depository financial institutions; and the increase of mortgage product complexity. The amendments to Regulation Z fundamentally change the protections offered to consumers, and the changes are forcing many banks and non-bank originators to rework their mortgage lending operations, even those that have never made a problem loan.

Among other things, the recent regulatory changes define a new category of loan based on its Annual Percentage Rate (APR) as a "higher-priced mortgage loan." The standards are so stringent that this category will include some loans that previously were classified as prime. That definition and pricing will certainly force many lenders to stop making loans that carry the stigma of "higher cost" label. The extent of the Regulation Z changes are sufficiently far reaching that our members report an expectation that it will curtail their ability to serve many creditworthy borrowers that may have less-than-perfect credit.

In considering any new legislation, it is critical to recognize the significant changes that are already underway in the mortgage industry that will provide much greater protections to consumers. Further changes, including some proposed in H.R. 1728, have the potential to impair economic recovery further and should be considered carefully.

In my statement, I would like to focus on these three points:

- The changes required in recent regulation constitute major reforms to the mortgage industry;
- The recent regulatory reforms reflect the sound underwriting principles that have formed the foundation of traditional bank mortgage lending; and
- H.R. 1728 should be amended to better recognize the conservative tendencies of banks and the protections afforded by supervisory processes, and provide safe harbors for bank products that fill important market needs; further, it should not overly restrict quality credit being made available to creditworthy borrowers.

I will discuss each of these in turn.

I. The changes required in recent regulations constitute major reforms to the mortgage industry

In recent changes to Regulation Z, the Federal Reserve emphasized the need for more prudent and traditional underwriting. ABA supports changes including regulations to strengthen the integrity of appraisals and prohibit deceptive advertising. ABA also supports requirements that mortgage lenders properly consider a borrower's ability to repay the mortgage, whether it is a fixed or adjustable rate loan. Some of the elements of these new rules codify the underwriting practices of many of our members. The use of these practices throughout the mortgage industry will help to ensure that future lending is done in a prudent and safe manner.

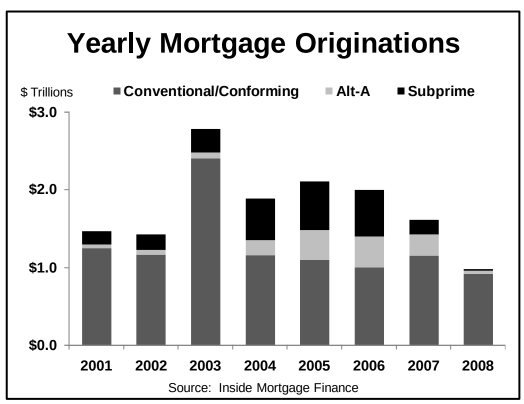
The standards set by the Federal Reserve in its amendments to Regulation Z are stringent. We believe that the subprime excesses would not have occurred had these regulations been in place and enforced earlier. Had the secondary market provided for some degree of "skin in the game" for all market participants, there would also have been far less abuse and fewer bad loans made.

The Federal Reserve's expansion of Regulation Z come with teeth – including limits on terms and conditions for credit and the possibility of expensive individual actions and penalties as well as class action litigation – all of which will have an impact on lending, and reducing available credit for less creditworthy borrowers. The changes also address subprime lending by establishing a new category of "higher-priced" loans. However, the definition is based on a relatively low APR threshold. As a result, this new category is likely to include many prime loans in certain markets, depending on market conditions. This will further dampen credit availability to some creditworthy borrowers.

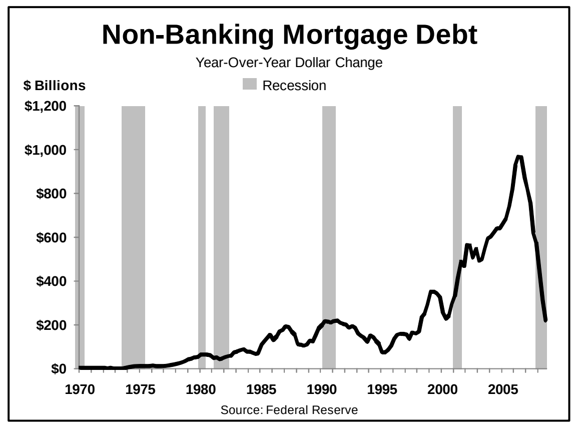
The challenge will be to apply the rules in a targeted manner that prevents recurrence of the subprime problem without unnecessarily restricting credit. ABA has embraced the Federal Reserve's approach, and we will continue to work with the Federal Reserve and other regulators to help ensure that only the intended results are achieved. Congress may choose to go beyond these changes, but we feel it is important to understand the cumulative effect of the recent regulatory changes and changes in the marketplace before enacting further restrictions.

II. Recent reforms reflect the sound underwriting principles that have formed the foundation of traditional bank mortgage lending

The return to traditional underwriting is already visible. This chart shows a comparison of traditional, Alt-A, and subprime loan originations. The trend away from subprime and Alt-A products is clear, and we can expect that numbers for 2009 will continue this trend.



The vast majority of banks have long followed traditional, prudent underwriting models. By doing so, they have avoided troubled loans and prevented borrowers from getting into untenable financial situations. We agree with Chairman Frank when he said: "Reasonable regulation of mortgages by the bank and credit union regulators allowed [that] market to function in an efficient and constructive way, while mortgages made and sold in the unregulated sector led to the crisis."[1] It has been the actions of loosely-regulated non-bank lenders, with low market entrance hurdles and little or no stake in the subsequent performance of the loans that have caused much of the damage for consumers and for the industry. In fact, many bankers tried to warn consumers against subprime loans and deals that were too good to be true, only to watch those consumers succumb to the pitches of non-regulated originators. Now we are helping to clean up the mess that the less regulated industry has left behind. We are effectively addressing problem loans that are the result of economic recession and our own mistakes, and we are extending new credits wherever possible to creditworthy borrowers.



This conservative approach has led the market to turn back to banks as the lenders of choice. In fact, in some cases, banks are the only lenders available. In fact, banks increased lending during 2008. According to the Federal Reserve, commercial bank loan balances have grown from $6.8 trillion as of December 2007 when the recession began, to $7.2 trillion by the end of 2008. Although this number has decreased slightly to $7.1 trillion as of the end of the first quarter, lending is still above first quarter 2008 levels of $6.94 trillion. Almost all banks are reporting an increase in mortgage lending market share.

Even with this increase, banks are unlikely to make up for all the gaps created in the non-bank lending market. Non-bank funding has dominated credit markets, particularly over the last several years. The financial turmoil of the last 18 months has changed this balance. Suddenly, investors have become completely risk-averse, and much of the funding normally coming from the non-GSE secondary market ceased. As a result, banks were forced to find other sources of short-term funds to meet their loan obligations. Fortunately, the Federal Home Loan Banks were able to meet many of these needs. Without this source of funding, the severe lack of liquidity would have been magnified many times over.

Further complicating the current situation, bank regulators continue to caution banks about adding risk to their lending portfolios in this environment. Current economic conditions and declining home values have also contributed to a decline in both commercial and consumer demand for loans.

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[1] *Boston Globe*, September 14, 2007.

This means that loan volume will likely decline. The more conservative approach typical of banks and the regulator oversight that emphasizes prudent underwriting based on ability to repay is precisely what permitted the volume of non-bank originations to increase so dramatically. Homebuyers were anxious to tap home equity, speculative investors were eager to ride the rapidly-rising home values, and Wall Street firms had an insatiable hunger to sell high interest-rate securities backed by subprime loans.

In contrast, banks that stuck to traditional underwriting and lent within their own footprint have successfully avoided many of the problems of the current market situation.

III. H.R. 1728 should be amended to better recognize the conservative tendencies of banks and the protections afforded by supervisory processes, and provide safe harbors for bank products that fill important market needs; further, it should not overly restrict quality credit being made available to creditworthy borrowers

Given the magnitude of the problems in the mortgage market, we understand the impulse for Congress to act against abusive lending. ABA appreciates and supports the general thrust of the legislation to require ***all mortgage lenders*** to abide by the strict underwriting standards and other requirements adhered to by insured depository institutions. Gaps still exist. I note with concern that, despite the passage last year of the SAFE Mortgage Licensing Act, non-bank originators still have more than a year to comply with licensing requirements, and lack of supervision for this lending segment remains a concern. A recent article in the Washington Post headlined the fact that the FHA insured 9,200 loans that defaulted after making less than one payment. Much of this lending was done ***by non-bank originators over a period of just 14 months***. This reveals there are still gaps in the system.

At its core, H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act, seeks to eliminate these gaps. However, this legislation can be modified to ensure that the prudent, federally-regulated survivors are not subject to greater burdens than their less-regulated competitors. H.R. 1728 should enable banks to continue to lend in the same conservative fashion in which they have always lent, utilizing products that are usual and customary for particular needs in the mortgage market. As noted above, this lending is critical to guaranteeing the continued availability of credit in the mortgage market.

ABA is particularly concerned about the safe harbor provisions in the bill, which we believe are far too limited. We have been pleased to work with committee members and staff, and we suggest the following improvements:

1) ***The safe harbor should be expanded to include all types of fixed-rate mortgages.***

The safe harbor as envisioned in H.R. 1728 is currently limited to 30-year fixed-rate mortgages. However, there are fixed-rate mortgages in durations other than 30 years that meet specific financial needs. All fixed-rate, fully-amortizing loans of any duration made by insured depositories should be included in the safe harbor, including 30, 15, 20, 40 year loans and other fixed-rate loans. At First Niagara Bank, of the $1.6 billion of fixed-rate, fully-amortizing loans we currently hold in portfolio, a full 66 percent were originated with original terms of 10-25 years.

2) ***The safe harbor should be expanded to include adjustable rate mortgages.***

ABA's Real Estate Lending Survey shows that even after the housing economy collapsed and long-term interest rates reached historic lows, lenders were making a significant number of "garden variety" adjustable rate mortgages (ARMs). Given the remaining popularity of ARMs, even in a low interest rate environment, they should not be overly restricted. Interest rates will rise as the economy improves. And, in a rising interest rate environment and traditional steep yield curve, ARMs will be an increasingly necessary tool to help people finance home purchases.

3) ***The safe harbor should be irrebuttable for insured depository institutions making the safest loans.***

Because insured depositories have constant regulation and examination, the safe harbor for insured depositories making fully-amortizing and fully-documented fixed-rate mortgages should be irrebuttable.

4) ***A rebuttable safe harbor should be available for all lenders.***

There should be a rebuttable safe harbor for all lenders (not just insured depositories) which would include fully amortizing, fixed-rate loans of any duration, as well as ARMs which are not classified as "non-traditional" by the bank regulatory agencies or "higher-priced" loans under the Truth in Lending Act regulations.

These safe harbor changes would, in effect, create a two-tier safe harbor:

- **Tier one** would apply only to fully-amortizing, fixed-rate loans (of any duration) made by insured depository institutions. As in H.R. 1728, the loans would be required to be fully underwritten and fully documented and could not be higher-priced loans under the Truth in Lending Act (TILA) regulations. A full safe harbor is necessary for these loans because fully-amortizing fixed rate loans are among the least risky, most well-understood products in the marketplace, and insured depositories are the most regulated and examined participants in the marketplace. The combination of product stability and heavily regulated lenders should allow for certainty that these loans, made by these lenders are fully compliant with the duty of care requirement established by the bill.

- **Tier two** would include fully-documented and fully-underwritten loans with well-established and traditional characteristics. To be eligible to be in this tier, loans could not be deemed "non-traditional" loans under federal banking agency regulations or guidance and must not be higher-priced under TILA. ARMs would fall into this tier in addition to fixed-rate mortgages not originated by an insured depository institution. The rationale for the rebuttable safe harbor remains much the same as in H.R. 1728 in its current form; however, garden variety ARMs, which continue to account for a significant percentage of the mainstream mortgage lending market, would also be allowed. These loans provide borrowers with affordable loans which often are better suited to their borrowing needs than longer term loans.

ABA has the following further concerns with H.R. 1728:

- **Risk retention provision:** ABA supports the concept of prudential lending standards reinforced through risk exposure, but has concerns about the provisions in H.R. 1728. If implemented as currently drafted, it will have many repercussions across the industry, which would require the restructuring of much of the securitization market and likely would also require significant accounting changes. In addition, the provision could significantly curtail the availability of credit by requiring significant increases in capital requirements in the loan origination process, even when mortgages are ultimately held by non-leveraged investors.

  The provisions in the bill set out the barest of frameworks for risk retention. Much more detail and discussion is needed across the spectrum of participants in the industry. Originators, securitizers, and investors must be involved in setting the structure of a revised set of requirements.

- **Delegation of discretionary authority:** ABA is confused about the new delegation of discretionary authority to issue regulations about unfair and deceptive acts and practices, among other abusive lending topics. There are currently a number of statutes in which there is delegation of discretionary authority, including new FTC authority granted in the recent appropriations bills. Each delegation of authority is slightly different, including providing for different remedies. Given the specific acts and practices that H.R 1728 is designed to address, we suggest that this general language be deleted or synchronized with all of the similar authority contained in other laws to ensure a consistency of approach and results.
- **Liability provision:** Section 204, Liability should be clarified to clearly state that trustees are not included in the term assignee or securitizer. We would be pleased to provide a specific proposal to the Committee on how to better address issues involving trustees.

Conclusion

Significant changes are underway in the mortgage industry that will provide significant protections to consumers. Further dramatic changes have the potential to impair economic recovery further and should be considered carefully. ABA appreciates the opportunity to testify today and we stand ready to work with this Committee to improve legislation that would make the mortgage markets a safer place for all consumers.