Testimony of
R. Michael S. Menzies, Sr.
President and CEO, Easton Bank and Trust Company

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on

"H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009"

April 23, 2009
Washington, DC

Chairman Frank, Ranking Member Bachus, Members of the Committee, my name is Michael Menzies, and I am the President and CEO of Easton Bank and Trust Company, Easton, MD, and the Chairman of the Independent Community Bankers of America[1]. Easton Bank is a state-chartered community bank with $150 million in assets. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on "H.R. 1728, the Mortgage Reform and Anti-Predatory Lending Act of 2009."

Introduction

Community banks are strong, commonsense lenders that largely did not engage in the practices that led to the current crisis. As a result of this commonsense approach to banking, the community banking industry, in general, is well-capitalized and has fewer problem assets than other segments of the financial services industry.

That is not to suggest community banks are unaffected by the recent financial collapse. Indeed, the squeeze on interbank lending has raised liquidity issues in some areas, the collapse in the value of the preferred stock of government-sponsored enterprises Fannie Mae and Freddie Mac under the Treasury/Federal Housing Finance Agency conservatorship has affected the bottom lines of some community banks, and the general decline in the economy has caused many consumers to tighten their belts and reduce their demand for credit. And, many bank examiners are overreacting, sending a message that contradicts recommendations from Washington to banks that they maintain and increase lending. That is why it is essential that the government continue its efforts to stabilize the financial sector.

And, just as important, Congress, regulators and the financial services industry working together must put in place strong measures to prevent a reoccurrence of the current crisis. Imprudent and predatory lending practices in the subprime mortgage market instigated the current financial crisis. It is appropriate that Congress consider legislation to improve regulation of residential mortgage lending. Community banks are truly invested in long-term relationships with their customers and their communities. Community banks put consumers into mortgages they can repay. We do not want our customers to default because it

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $1 trillion in assets, $800 billion in deposits, and more than $700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

is not only bad for the bank and the customer, it also has a negative impact on the community. If all mortgage lenders had used the common-sense lending practices of community banks, we would not be here today to discuss mortgage reform legislation.

Principles for Mortgage Reform

While we have concerns with some of the approaches to reform taken in, H.R. 1728, which we discuss later in the testimony, we commend Chairman Frank and Representatives Watt and Miller for initiating the process of achieving needed reform and for their work on comprehensive mortgage reform legislation. Before addressing the specific provisions of H.R. 1728, we would like to set forth some principles that we believe should be observed in reforming mortgage regulation.

- Maintain Community Banks' Role

Community banks continue to play an important role in our mortgage finance system. Community bank mortgage originations have remained steady throughout 2008. We estimate community banks have originated approximately 800,000 mortgage loans for an aggregate principal amount of approximately $125 billion for 2008. Reform should not inadvertently diminish the ability of community banks to participate in the mortgage finance market.

- Concentrate on Problem Lenders

Congress and the regulators should concentrate their efforts on those parts of the market that overextended and overheated mortgage lending, particularly the less regulated mortgage brokers and non-bank mortgage lenders, and should avoid unnecessary additional regulation of community banks that did not engage in the abusive subprime lending practices at the heart of the current crisis.

- Maintain Flexibility for Homebuyers

Policymakers should also avoid hindering the flexibility community banks use to meet consumers' needs at different stages in their lives and in changing interest rate and lending environments. A flexible, yet sensible, mortgage finance system serves the best interest of consumers in the long run.

Summary of Comments and Recommendations

<u>New Standards under TILA</u>

- Community banks base their credit decisions on a customer's documented ability to pay, and they do not engage in robbing their customers of equity in pursuit of fees. Nevertheless, the new lending standards as articulated in the bill, along with the cause of action to enforce the new standards, raise concerns for community banks.
- H.R. 1728 creates more litigation risk than the bill adopted by the House in the last Congress, H.R. 3915, by providing no clear presumption of compliance for any mortgage product. We suggest that the legislation

provide more certainty by adopting a clear presumption of compliance for mortgages meeting interest rate caps.

- Moreover, whether it is a clear presumption of compliance or the rebuttable presumption provided in H.R. 1728, the presumption should apply to a broader range of safe mortgage products that are beneficial to consumers, not just 30-year fixed rate mortgages.

- Without a more certain safe harbor covering a broader range of safe mortgage products, the legislation would instill in the mortgage finance system a rigidity that prevents lenders from responding to changing lending environments and local markets.

Anti Steering Provisions

- It is appropriate for Congress to consider legislation to prevent a mortgage originator from steering a consumer to a subprime product, when the consumer qualifies for a prime loan, or promoting a mortgage product with predatory characteristics. Unless the regulation of non-bank originators – the main perpetrators of this practice - is significantly strengthened, new mortgage origination regulations will not be focused on the part of the industry where regulation is most needed.

- Paying points to adjust the interest rate on a mortgage provides a tremendous benefit to consumers. The legislation should not restrict a consumers' ability to vary his or her interest rate by paying points. We suggest that the legislation clearly exempt this standard practice from the bill's originator compensation restrictions.

Risk Retention Requirement

- If the secondary market had required that all market participants have some skin in the game, the current crisis would not be as severe. We need to be careful, however, that we address the problems that created the subprime crisis without unnecessarily burdening mortgage credit.

Changes to HOEPA

- We are concerned the proposed trigger based on fees could capture some low-dollar prime mortgages. The concern is that fixed-cost items, like credit reports and appraisals, could put prime mortgages with small dollar principals above the threshold. We suggest the Federal Reserve be given discretion to exempt fixed-cost items from the definition of fees with respect to smaller loans.

New TILA Standards Applicable to All Residential Mortgages

H.R. 1728 would amend the Truth-In-Lending Act (TILA) to create two new standards applicable to all residential mortgages. The first would require the creditor to make a reasonable and good faith determination that the consumer, at the time the loan was made, had a reasonable ability to repay the loan, taxes and assessments. The determination would have to be made on verified, documented information. The second would require a creditor to make a reasonable good faith determination that a refinanced mortgage provides a net tangible benefit to the consumer. The legislation would leave to the Federal banking agencies the responsibility of defining "net tangible benefit," but would provide that no net tangible benefit is provided by a loan where the costs associated with the loan exceed the amount of any newly advanced principal without any other changes that are advantageous to the consumer.

The legislation would provide a new cause of action for rescission and costs against a lender, assignee and securitizer for violations of the new standards. Lenders would also be liable for attorneys' fees. A consumer would have three years from the date of consummation of a fixed-rate mortgage to bring an action. For an adjustable rate mortgage, the statute of limitations is the earlier of one year after the reset or six years from the date of consummation. A claim under the new provisions could be asserted as a defense to foreclosure during the statute of limitations period, and even after the statute of limitation period expired, a consumer could bring an action for damages, cost and attorneys' fees in defense of a foreclosure.

A lender, assignee or securitizer could avoid liability under the new provisions by providing a cure to the violation. The legislation would define cure for a violation of the ability to repay or net tangible benefit requirements as a modification or refinancing of the loan at no cost to the consumer on terms that would have satisfied the ability to repay and net tangible benefit requirements, plus additional costs of the borrower and a reasonable attorney's fee.

The legislation would permit a creditor and any assignee or securitizer of a residential mortgage loan to presume that the loan has met the ability to repay and net tangible benefit requirements if the loan is a "qualified mortgage." However, presumption is rebuttable.

The bill would define "qualified mortgage" as a mortgage:

1. that meets the bill's interest rate restrictions: any first lien residential mortgage must have a rate that does not exceed the "average prime offer rate" (to be published by the Federal Reserve) by 1.5 or more percentage points and any subordinate lien residential mortgage must have a rate that does not exceed 3.5 or more percentage points;
2. for which the income and financial resources of the consumer are verified and documented;

3. for which the underwriting is based on the fully-indexed rate, and takes into account all applicable taxes, insurance and assessments;
4. that does not cause the consumer's monthly debt to exceed a percentage of gross monthly income or other percentage of such income as may be prescribed;
5. for which the term of the loan is fixed for a period of not less than or more than 30 years.

New Cause of Action Raises Concerns

Most community banks are very conservative in their underwriting practices, and a consumer's documented ability to pay is a central part of underwriting their loan. Moreover, community banks do not engage in robbing their customers of home equity in the pursuit of fees on mortgages that do not benefit the customers. Nevertheless, the new lending standards articulated in the bill, along with the cause of action provided to enforce the new standards, raise concerns for community banks. We address these concerns in the sections that follow, along with suggestions to address these concerns in some cases.

The Safe Harbor Should Provide More Certainty and Cover a Broad Range of Safe Mortgage Products

H.R. 1728 creates more litigation risk than the bill adopted by the House in the last Congress, H.R. 3915, by providing no clear presumption of compliance for any mortgage product. As a result, every mortgage product, even the ones that meet the stringent standards of "qualified mortgage" under the bill, carries with it litigation risk that it does not have today. Moreover, because a consumer would always have a claim for damages as a defense to a foreclosure action, the litigation risk never goes away. While it is hard to say what the premium associated with the additional litigation risk would be, the risk would affect the pricing of all residential mortgages. We suggest that the legislation provide more certainty by adopting a clear presumption of compliance for mortgages meeting interest rate caps.

Moreover, whether it is a clear presumption of compliance or the rebuttable presumption provided in H.R. 1728, the presumption should apply to a broader range of safe mortgage products that are beneficial to consumers, not just 30-year fixed rate mortgages. The underlying premise of H.R. 1728 is that only 30-year fixed rate mortgages are beneficial for consumers. Currently, there is a very favorable interest rate environment for 30-year fixed rate loans, but that will not always be the case. Adjustable rate mortgages have benefited millions of consumers in times when long-term interest rates were significantly higher than short-term rates.

Additionally, consumers in many rural areas and small towns need alternatives to 30-year fixed rate products. In those rural areas, the secondary market for 30-year fixed rate mortgages may be very weak or non-existent because the loans from these areas cannot meet secondary market requirements, such as collateral valuation requirements based on comparable properties or because the amount of the loans are relatively small. Often first-time homebuyers will need a parent's guarantee to qualify for a mortgage. Such loans do not meet secondary market standards. Community banks making loans to these consumers must hold the loans in portfolio. In order to make these loans in a safe and sound and economically feasible manner, the community bank has to fund the loans from short-term deposits. As a result, the community bank cannot offer a 30-year fixed rate product under these circumstances.

Without a more certain safe harbor covering a broader range of safe mortgage products, the legislation would instill in the mortgage finance system a rigidity that prevents lenders from responding to changing lending environments and local markets and to customer needs. We strongly urge the Committee to remove the 30-year fixed rate requirement from the "qualified mortgage" definition and to make other changes that preserve the choices enjoyed by consumers today, particularly rural consumers.

Anti-Steering Provisions

It is appropriate for Congress to consider legislation to prevent a mortgage originator from steering a consumer to a subprime product, when the consumer qualifies for a prime loan, or promoting a mortgage product with predatory characteristics. As a general matter, community banks do not steer customers to inappropriate predatory products. However, community banks are concerned that any new origination requirements will not be enforced evenly across the mortgage finance industry.

The regulatory regime for non-bank originators is not nearly as rigorous as the one that regulates banks. Non-bank originators are not subject to onsite compliance examinations. The new SAFE Act's licensing requirements for mortgage brokers are minimal and easily met. The predatory steering practices of non-bank originators were a principal cause of the subprime mortgage crisis. Unless the regulation of non-bank originators is significantly strengthened, new mortgage origination regulations will not be focused on the part of the industry where regulation is most needed. Instead, new requirements will add to the regulatory burden of community banks, which did not engage in these steering practices, without any significant benefit to consumers.

Section 103 of the legislation provides that the amount of direct and indirect compensation permitted to a mortgage originator may not vary based on the terms of the loan (other than the amount of the principal). Under the definition of mortgage originator, the term includes a bank originating a loan, both those held in portfolio or sold to the secondary market. We are concerned that Section 103's restriction on compensation would prevent a bank from offering a consumer the opportunity to lower the interest rate on their mortgage through the payment of points. Paying points to adjust the interest rate on a mortgage provides a tremendous benefit to consumers. The legislation should not restrict a consumer's ability to vary his or her interest rate by paying points. We suggest that the legislation clearly exempt this standard practice from these compensations restrictions.

Risk Retention Requirement

The bill would require the Federal banking agencies to jointly prescribe rules to require any creditor making a non-qualified mortgage to retain an economic interest in a material portion (at least five percent) of the credit risk for each such loan the creditor transfers, sells or conveys. If the secondary market had required that all market participants have some skin in the game, the current crisis would not be as severe. We need to be careful, however, that we address the problems that created the subprime crisis without unnecessarily burdening mortgage credit.

While the accounting treatment of the proposal is not entirely clear, it is clear that an originator will have to hold capital against its retained interest for the life of the loan. Over time, the retention requirement will limit an institution's capacity to originate loans. The impact would be greatest on banks that are heavy users of the secondary market for ARMs and other non-qualified mortgages.

Changes to HOEPA

The legislation would lower the triggers that define "high-cost mortgage" under Home Ownership Equity Protection Act (HOEPA). We are concerned the proposed trigger based on fees could capture some low-dollar prime mortgages. The concern is that fixed-cost items, like credit reports and appraisals, could put prime mortgages with small dollar principals above the threshold. We suggest the Federal Reserve be given discretion to exempt fixed-cost items from the definition of fees with respect to smaller loans.

Conclusion

Thank you for this opportunity to testify. We look forward to working with the Congress to create a regulatory regime that prevents abusive mortgages, while providing the mortgage finance industry flexibility to meet consumers' needs. I would be happy to answer the Committee's questions.