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March 12, 2010

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Bernanke:

On behalf of the members of the American Bankers Association¹, I am writing to emphasize our concerns regarding certain provisions of the Federal Reserve's final rules amending the Home Ownership and Equity Protection Act portions to Regulation Z that become effective April 1, 2010. In a letter dated November 4, 2009, and in discussions with Board staff, we have expressed these and other general concerns. This letter highlights a specific problem about to become effective, and offers recommendations and supporting data for the Board's consideration.

The final Truth in Lending rules issued in July 2008 (73 FR 44522) provide that, beginning on April 1, 2010, creditors making loans in the "higher-priced mortgage loan" category (HPML) will be required to establish escrow accounts for tax and insurance payments during the first 12 months of the loans, with the option that the bank may offer the customer an opt-out from escrow requirements, thereafter. ABA has noted before, and we stress again, that the burdens associated with these escrow requirements are substantial for some banks, and will force many institutions to curtail mortgage lending. We believe that the reduction of credit options will affect many markets, and will be particularly severe in small and rural communities.

As background, it should be understood that many banks do not currently have escrow capabilities. These institutions are generally rural banks and smaller community banks that lend for their own portfolio. In most instances, these banks do not have staff knowledgeable and experienced in handling escrow services, and costs associated with setting up escrow capabilities can pose a severe and burdensome expense. This point is well-illustrated by data from ABA's *2009 Compensation Survey*, which is based on a sample of 407 banks, of which 104 were between \$100 and \$300 million in asset size. Of the banks in the \$100-\$300

¹ The American Bankers Association brings together banks of all sizes and charters into one association. 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 trillion in assets and employ over 2 million men and women.

million asset range, only 10% indicated that they employed an escrow clerk. The average reported base salary of an escrow clerk was \$29K annually. Significantly, no banks under \$100 million in asset size reported employing escrow clerks.

We can conclude, therefore, that banks of less than \$300 million in asset size rarely maintain escrow capabilities, and any mandates to add escrow employees would impose approximately \$36K in base salary and fringe benefit expenses. Such a cost would add a minimum of \$700 in cost for each HPML transaction for an institution making 50 such loans a year, and \$1,400 per loan for institutions making 25 HPML transactions per year. This is a prohibitive expense for the limited number of HPML originated by such institutions. Nor can these smaller banks rely on outsourcing as a cost-effective solution to the new regulatory requirements. Rural banks and smaller portfolio lenders generally do not originate sufficient volumes of HPML mortgage loans to attract vendors to provide escrow services in a cost-effective manner. In short, such banks are consistently reporting that they will simply stop making HPML loans rather than bear such extraordinary additional costs. The greatest impact is expected on two classes of mortgage loans: balloon payment mortgages offered in rural areas where balloon notes are common practice for agricultural loans, and for manufactured home loans.

ABA believes that there are effective ways to avoid this needless reduction in credit availability, while still retaining the consumer protection objectives of the final rules. We suggest that the Board consider establishing a limited exemption from mandatory escrow for those institutions originating fewer mortgages than a *de minimis* threshold. We propose that the *de minimis* exemption be available to lenders that make 50 or fewer such HPML loans in a given year. Moreover, this exemption could be made applicable only to lenders that hold HPML transactions in portfolio, which would ensure that the lender retains all risks associated with underwriting the transaction. The *de minimus* threshold exemption would ensure continuation of reasonably priced credit that would not otherwise be available. Further, the loans would be provided by institutions that are closely supervised and that retain 100% of loan risks, so that the interests of the institutions are closely aligned with the consumer regarding successful loan performance.

A further protective option which could be adopted either separately from, or in addition to, the recommendation above, is to establish a signed waiver provision. Under this option, a waiver would have to follow a precise text to be fashioned by the Federal Reserve Board, and would clearly and explicitly inform the consumer about the potential risks and obligations of advancing without establishing an escrow account in connection with the mortgage loan. The waiver would require an affirmative signature by the consumer, which could be done at the initial TILA disclosure phase, and/or at closing.

ABA believes that these recommendations are a very effective means of eliminating the potential of consumer abuse. Together, the suggestions we outline meet the standards applicable to addressing unfair or deceptive activity that is in any way likely to cause “substantial injury to consumers which is not reasonably avoidable by consumers themselves.” Under the ABA recommendations above, the law would ensure that there is a fully informed consumer that would have the affirmative

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obligation to specifically assent in writing to a loan option that carries independent indicia of safety. In all measures, the Board would meet the minimum standards applicable to protecting against unfair and deceptive trade practices.

To conclude, we urge that the Board adopt reasonable measures to avoid the unintended consequences being brought about by the new HPML escrow requirements. These new provisions, which are scheduled to become generally effective in April, present *bona fide* hardships for certain banks, and could constrict credit for many communities. Moreover, our recommendations are limited and targeted, and would not disturb the structure, operation and safeguards of the existing rule. We ask that you consider our recommendations as an effective solution to avoid this unintended harm.

Sincerely,

A handwritten signature in black ink that reads "Robert R. Davis". The signature is written in a cursive, flowing style.

Robert R. Davis

Attachment: November 4, 2009 letter