AMERICAN BANKER®
THE FINANCIAL SERVICES DAILY

Tuesday, April 16, 2013

Mortgage Lending at Risk Thanks to New Rules, Small Banks Say

By Victoria Finkle

WASHINGTON — Community bankers sounded more warnings about the Dodd-Frank reform law and proposed Basel III requirements on Tuesday, including how new rules will impact mortgage lending.

Several bank executives said many institutions will not make home loans unless they are part of an ultra-safe class of lending identified by the Consumer Financial Protection Bureau as "qualified mortgages."

Ken Burgess

"We have a concern that the box is becoming so small for people to fit into, and the risks are becoming so high to be outside that box from our standpoint that depending on how this all comes out, we'll have to make a decision about whether to stay in the mortgage lending business," said Ken Burgess, chairman of First Bancshares of Texas, in testimony before a House Financial Services subcommittee.

When the CFPB first released its QM rule in January, the industry breathed a sigh of relief, with many representatives saying it wasn't as tough as it could have been.

Yet bankers continue to fear heightened legal liability that may result from making loans outside of qualified mortgages.

"You're going to err on the side of caution, I would imagine. Instead of saying 'I'll take the risk on this,' you're going to pull back. What kind of consumer is the one that's going to be most hurt?" asked Rep. Shelley Moore Capito, the chairman of the House financial institutions subcommittee.

Preston Pinkett III, president and chief executive of City National Bank of New Jersey, responded that it "certainly becomes difficult to write many mortgages."

"It becomes more [like a] factory, as opposed to a customized consumer product. The challenge of all the regulations that dictate what the products look like is that they also dictate what the customer looks like, and that leads to less flexibility," said Pinkett. "The regulators could ask us to justify our products … in a way that is supportive of the customer, as opposed to telling us what the products should look like."

Rep. Patrick McHenry, R-N.C., asked if the banks had increased interest in lending outside of the QM standards in light of comments by CFPB Director Richard Cordray, in February in which he urged credit unions to do just that.

At issue is the legal protection afforded to QM loans. A prime QM loan has a safe harbor from litigation if a borrower defaults while other loans could be challenged under the CFPB's regulation requiring lenders to ensure borrowers have the ability to repay.

Most of the panelists at the hearing said they were still evaluating whether lending outside of QM was practicable, while Burgess said his bank had already concluded it would not offer such loans.

"In our mind, we make about 1000 loans or so a year, and to have that much unmeasured risk that we cannot evaluate for the ongoing life of the loan, that's just not something we think we can do," said Burgess.

The bankers also noted that tighter credit standards could make it more difficult to meet other goals, like those outlined in the Community Reinvestment Act, to lend to less creditworthy borrowers.

"There's a continual friction between safety and soundness regulation and then the need to make loans in underserved markets," said Charles Kim, executive vice president and chief financial officer at Commerce Bancshares, testifying on behalf of the Consumer Bankers Association. "In fact, the QM rule probably makes it harder to make loans in underserved markets. So if we comply with QM we make fewer loans there and they rap us on the knuckles for not making the loans there."

Lawmakers also pressed the bankers about the possible impacts of the proposed Basel III regulations, a longstanding concern for community banks. Panelists warned about the uncertainty of not knowing how regulators would decide to implement the international agreement, saying small institutions should be exempted from the requirements or face a simplified version of the capital and liquidity standards.

"The rule was written for the world's banks. It makes sense for those systemically important institutions and there needs to be some sort of level playing field. It wasn't written for us. It really doesn't work for us," said Kim. "Now the Federal Reserve in the way it interprets those rules maybe will make it easier for banks of various sizes to comply and may leave some things out, but we're not sure, there's no clarity."

The bankers warned again about the impacts on mortgage loans under Basel III, in particular due to proposed risk weighting standards.

"Our mortgage loans are probably the safest loans we have on our books. We've never foreclosed in 15 years on a mortgage loan. So we're now talking about significantly increasing the risk weighting on the safest part of our portfolio," said Burgess.

The panelists were also supportive of a longstanding bill, reintroduced in the Senate and House, to establish an independent appeals process for bank examinations. ▪