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INDEPENDENT REGULATORY REVIEW COMMISSION

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August 20, 2007

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DEPARTMENT OF BANKING
LEGAL SECTION

The Honorable Steven Kaplan
Secretary
Department of Banking
17 N. Second Street, Suite 1300
Harrisburg, PA 17101-2290

RE: Comment Letter on Proposed Regulations – Chapter 46

Dear Steve:

We are grateful for the opportunity to comment upon the Department of Banking's ("DOB" or the "Department") proposed new Regulations governing certain conduct by licensees and other persons subject to the Secondary Mortgage Loan Act, 7 P.S. §§ 6601, *et seq.* (the SMLA") or the Mortgage Bankers and Brokers and Consumer Equity Protection Act , 63 P.S. §§ 456.101 *et. seq.* (the "MBBCPA") (hereinafter "Chapter 46" or the "proposed regulations"), which is proposed to be Codified as Chapter 46 of the DOB's Regulations. As community-based lenders who are in the financial services business for the "long run," we have an interest in seeing that truly abusive lending practices are curtailed throughout the Commonwealth, and that credit, particularly home financing, is made available to all who qualify.

We acknowledge and commend the dedicated efforts of the Department of Banking for its leadership and initiative in seeking to crack down on abusive lending practices. Our Executive Committee appreciated the opportunity to meet with you and was most impressed by your sincerity, knowledge of the Department, challenges confronting the marketplace and the dialogue we know you are interested in having as we move forward on issues of common interest. We look forward to working with you and your staff and the legislative committees on the proposed regulation, as well as the proposed legislative package of bills.

Prior to discussing the regulation and our position and concerns, we believe it is important to share with you PACB's history and the essence of community banking. PACB is the oldest financial services association in the nation dating back to 1877, and currently represents over 175 community banks across this Commonwealth -- PACB is proud to be the voice of community banking in Pennsylvania. Our member banks serve as the epicenter of community activity, providing key financial services to citizens and funding community-based businesses and programs. Community bankers are dedicated to serving their communities and take great pride in the positive impact we contribute by reinvesting in the community through residential mortgages, small business loans and agricultural and student loans. Community banking is about relationships and trust with our customers which in some cases dates back decades. Many of our institutions are celebrating their 75th, 100th, and 125th anniversaries. Prior to any federal or state regulations and mandates, community banks were doing community reinvestment as their principal stock in trade. That continues to be the case today.

Our members live by the motto, **Pennsylvania FIRST,** for we truly are the Financial Institutions Reinvesting in the State. This is not mere rhetoric but the very reason our members exist. Our combined assets of over $90 billion are almost entirely reinvested in the Commonwealth and its citizens. Collectively we have been serving Pennsylvania's communities for over 23,000 years with the majority of our members in existence for over 100 years. Our members, however, struggle with government over-regulation and paperwork burdens that continue to mount and distract us and detract from our service to our communities. Community banks are continually told that they are not part of the problem -- and this has been mentioned a number of times by Departmental staff in the context of the regulation -- but the solutions put in place always seem to mandate more paperwork more restrictions and a greater compliance burden for community banking and our small staff.

A number of years ago, the Chairman of Columbia County Farmers National Bank, Paul Reichart, and I met with Congressman Paul Kanjorski (D-Luzerne). As you know, Congressman Kanjorski is now the second ranking member of the House Financial Services Committee and a Chairman of a key subcommittee. During that meeting, Paul and I put before the Congressman all the paperwork a small community bank had to file to meet the requirements of the federal Community Reinvestment Act (CRA) and the conference room table was overwhelmed with paper. This vividly demonstrated for the Congressman what our members struggled with on a daily basis. The Congressman left that meeting as a champion for a streamlined approach to CRA compliance for community banks. Today community banks under $1 billion have this streamlined examination and we are grateful to Congressman Kanjorski and others for their vigorous advocacy for this important concept.

We mention this example because as we discussed in our meeting with you, we believe it's time for Pennsylvania to adopt a similar concept in public policy. Community banks are special and unique and Pennsylvania ought to recognize in state law/regulations a concept similar to the small bank streamlined approach for CRA. If community banks are not part of the problem -- in this case abusive lending practices and predatory lending -- which we definitely are not, then we believe the Department of Banking should carve out a complete exemption in the proposed regulation for community banks and our subsidiaries and affiliates, and this same exemption should be considered for the legislative package relevant to House

Bill 1079 and House Bill 1080. As previously mentioned, we are already heavily regulated by the federal and state governments and hold ourselves to the highest possible standard of community trust. Again, the marketplace has been our consistent judge and many of our institutions have survived depressions, recessions, wars, booms, downturns and other cyclical events, remaining the bedrocks of their communities.

At this point, we will provide a more specific commentary on the proposed regulations keeping in mind our fundamental request that the Department and General Assembly consider an exemption for community banking and our subsidiaries and affiliates.

We are concerned based upon our members' commitments to the community, that Chapter 46, as currently proposed, may have a seriously deleterious effect upon the availability of credit to Pennsylvania residents, and/or increase the cost which may be passed on to consumers. We are opposed to some portions of the proposed regulations, seek modification of others and support some parts of the proposal. In support of our position, we offer the following analysis and suggested amendments.

A. Applicability to PACB Membership

The proposed regulations, if adopted, would apply only to "licensees" which is defined to mean licensees under either the SMLA or the MBBCPA. However, the regulation indicates that it would apply to "partially exempt" entities under the MBBCPA.

We believe the DOB is in agreement with our understanding that federally chartered banks and savings institutions (i.e. National Banks and "FSB's") and their subsidiaries, as a matter of federal law, are wholly exempt from the licensing provisions of both the SMLA and the MBBCPA. State chartered depository institutions and their affiliates and subsidiaries are also exempt from licensing under the MBBCPA, but affiliates and subsidiaries of state-chartered institutions are subject to certain reporting requirements and are considered "partially exempt" by the Department. Under the SMLL, state chartered banks, savings institutions and private banks having their principal office located in the Commonwealth are exempt from the licensing requirement.

We seek confirmation of our view that, under existing law and based upon the language in the proposed Reg, the licensing provisions of either the SMLA or the MBBCPA (and hence the new Reg.) apply directly or partially to:

any non-subsidiary affiliate of a national bank or federal savings institution,
any subsidiary or affiliate of a state-chartered bank, savings institution, savings bank or credit union

Accordingly, while the proposed regulations would not apply to deposit-taking members of PACB, if state-chartered members have any subsidiaries or affiliates, or federally-chartered members have non-subsidiary affiliates engaged in offering consumer mortgage loans; the proposed regulations would apply to those entities. **Again, we urge the Department and General Assembly to remove any doubt about applicability and exempt community banks and their subsidiaries and affiliates.**

B. Commentary Regarding Proposed Regulations

1. Generally.

As the Department is aware, in order to efficiently offer the consuming public competitively priced products, compliance with the consumer protection laws must be reasonably ascertainable. Lenders and other financial services providers seek rules and regulations that are objective, reasonably definitive and fair to all parties to a transaction. Regulations which impose subjective standards which are difficult to pin down create uncertainty as to what loan terms or disclosures comply or fail to comply with the law. Most industry members, certainly our membership, desire to comply with all aspects of applicable federal and state laws and regulations. But compliance is difficult or impossible if the rules are so vague and overbroad that reasonable minds may disagree as to what they mean. As drafted, the proposed regulations would apply very subjective standards to the conduct of lending, and would leave lenders without the tools to determine whether a particular loan does or does not violate the law. We will explain in detail, below. Additionally, some of the proposed regulations are largely unnecessary in that they proscribe conduct which is already illegal, such as falsifying data in a loan application. Our membership also objects generally to the overall tenor of the proposed regulations because it substitutes governmental judgment for that of the private lender in determining appropriate underwriting standards. Except in the most extreme circumstances, we believe the government's attempts to substitute government judgment for the underwriting process will lead to a severe decrease in the availability of loan products and an unwarranted limitation of choices available to consumers.

2. Specific Comments and Suggestions.

The definition of "application" incorporates the federal definition set forth in RESPA,[1] but miscites to Title 24 of the United States Code. We are reasonably certain this should be the Code of Federal Regulations because Title 24 of the Code relates to health care. The correct cite is: Title 12 of the United States Code or ,24 C.F.R. § 3500.2(b).

As proposed, section 46.2(b) and (c) require a yet another written disclosure to the borrower of certain loan terms. However, the only items not already required to be disclosed to the borrower under the federal Truth-in-Lending Act are: (1) whether or not an escrow account for taxes is required; and (2) whether the licensee has the ability to directly lock in the loan. We are not sure

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[1] The federal Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601 *et seq.*

what "directly" means. It is our understanding that, under the MBBCPA, loan brokers are prohibited from issuing their own "lock-in" agreement, but may pass through a lender's lock-in agreement or statement. We do not believe that disclosing to the borrower that the licensee has the "ability" to obtain a locked rate, without more, conveys any additional meaningful information to the borrower.

Subsection 46.2(e) requires a licensee to take into account certain factors as to the borrower's ability to make the payments on the loan, but provides little specific guidance on what procedures will suffice. This section proposes highly subjective standards which directly invade the territory of lender underwriting and credit decisions. Except for high-rate loans we object to the requirement that licensees verify and document the borrower's income and fixed expenses (which are undefined). Several other states which have enacted some rules along these lines have focused on the borrower's monthly debt obligations as disclosed in the applicant's credit report, rather than something as unclear as "fixed expenses." Query does that include gasoline for the car, groceries, tuition payments, etc. The regulation does not explain how far a licensee must go in investigating these things. We recommend eliminating this reg, or at a minimum that the reg be changed to allow the licensee to rely on the debt obligations identified in the borrower's credit report, and provide for a safe harbor if the borrower's income exceeds a certain level,[2] or if the monthly debt payments to gross monthly income ratio is below a certain percentage. The regulation should only apply to high rate loans. The regulation is not necessary for conventional borrowers.

The proposed regulations incorporate by reference the "Guidance on Nontraditional Mortgage Product Risks" issued by the Department and requires that "great weight and due consideration" be given that document. The guidelines were issued as guidelines, not absolute requirements. The Department's language would lead to the view that a licensee had better have a good reason for deviating from the Guidelines, otherwise he or she could be held to have violated this regulation because the guidelines were not given sufficient "weight" and "consideration." We are concerned this is an attempt to regulate the underwriting standards and loan terms without actually establishing specific standards by regulation. We oppose this method because it turns the Guidelines into regulations without exposing them to the procedural scrutiny involved in the promulgation of formal regulations. Regulations have the force of law, that is why there is a proposal period, allowed comments and other due process. The Guidelines should remain guidelines.

Subsection 46.2(f) sets forth a laundry list of prohibitions which either describe conduct which is already illegal, or use terms which are ill-defined or not defined at all, thus creating uncertainty. We offer the following specifics. (the text of the proposed reg is in bold)

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[2] The United States Department of Labor statistics establishing median family incomes for standard metropolitan statistical areas has been used by some states as a benchmark for a "safe harbor" in this regard.

A licensee may not:

(1) Advise or imply to an applicant that the applicant's income is not relevant to the loan transaction.

We are unclear as to what type of conduct the Department means by the word "imply." Moreover, the use of the word "relevant" renders this section difficult to understand and comply with. An acceptable alternative would read:

> "A licensee may not advise an applicant whether the applicant can afford a particular loan product unless the licensee has reviewed the applicant's income and the total payments under the applicant's monthly debt obligations which would be required if the new loan is made."

2. Recommend or imply that an applicant default on any existing contract or financial obligation.

Here again "imply" does not seem to fit and seems intended to cover the situation where no express recommendation or advice was given, but somehow an impression was made. We are not at all sure what problem this particular prohibition is intended to address because the last thing a loan originator wants is his or her applicant to suddenly default on his or her current mortgage loan or other financial obligations. Default always has a negative impact on the ability of the originator to obtain the new loan. We feel this is an attempted solution to a problem that does not exist.

3. Advise or induce an applicant to refinance an existing loan or otherwise enter into a new financial obligation without performing the ability to repay analysis required by section (e).

See our discussion of subsection (e), above.

4. If an applicant qualifies for a loan offered by the licensee, offer to the applicant a covered loan without advising the applicant that the applicant qualifies for a loan other than a covered loan.

A "covered loan" is a high rate loan under the federal Home Ownership and Equity Protection Act of 1994 ("HOEPA") - sometimes referred to as a "Section 32" loan. Pennsylvania adopted the federal definition when it enacted the "Consumer Equity Protection Act" portion of the MBBCPA. This reg has language problems, but does not unduly impinge on the underwriting of a loan. This provision would be clearer if it read as follows:

> "make or arrange a covered loan for an applicant if the applicant qualifies for a non-covered loan having a lower cost that is available through the licensee, unless the licensee

first advises the applicant of that qualification."

5. Advise or imply that an applicant should ignore any required disclosures or suggest that a document or the execution of any document is unimportant or of no consequence.

Some of the documents and disclosures in a mortgage transaction are more important than others. This regulation, if enacted, would arguably prohibit the licensee from focusing the borrower on the more important documents. We think what the Department is trying to accomplish with this provision can be better stated as follows:

"misrepresent to the borrower the significance or importance of any loan document or disclosure made in connection with the application or the loan."

6. Direct, encourage, permit or otherwise be involved with the improper execution of any document, including:

(i) Requesting or allowing an applicant to sign documents that contain blank spaces where material information regarding the loan transaction is required.

(ii) Permitting the execution of documents where signatures are required to be witnessed without the witnesses being physically present.

(iii) Permitting someone other than the required signatory to execute a document unless otherwise authorized by law.

The three specific prohibitions in roman (i) through (iii) are acceptable because they prohibit specific examples of bad lending practices. However, the general prohibition against "improper" execution of documents is too vague and should be eliminated. "Improper" is simply not an objective standard with which a licensee can comply/ Who decides when a certain execution of a document is "improper" and when?

7. Knowingly submit or permit or encourage an applicant or third party to submit, false or misleading information, or information that the licensee reasonably should know is false or misleading, to any party to a loan transaction.

No problem with this language.

8. Improperly influence, or attempt to improperly influence:

(i) An appraiser by committing any act or omission that is intended to:

(A) Compromise the independent judgment of an appraiser.
(B) Ensure that an appraisal matches a requested or target value.

(ii) Any other entity related to the mortgage loan business, such as notaries, title companies, real estate agents, builders and sellers of properties.

The term "improperly influence" implies that some degree of influence may be proper. As such it may have the opposite effect than that desired. The reg gives no clue as to what conduct could be considered "improper." Query whether simply telling the appraiser the purchase price of the home or the amount of the loan requested by the borrower constitutes an attempt to improperly influence the appraiser. The reg is even less specific with regard to "improperly influencing" mortgage professionals. It is unclear what actual conduct the Department seeks to prohibit here.

9. Obtain insurance required for a loan for an applicant at loan consummation without providing the applicant with the opportunity to secure or provide evidence of their own insurance.

This provision would be acceptable if it were expressly limited to property hazard (homeowners) insurance. It does not make sense for private mortgage insurance, title insurance or optional credit life/disability insurance.

10. Charge an applicant a fee for any legally required notices or disclosures unless otherwise authorized by law.

Federal RESPA prohibits a separate charge for preparing disclosures required under TILA and RESPA. 12 U.S.C. § 2610. However, a non-specific charge for preparation of documents is generally permitted and is even excluded from the calculation of "FINANCE CHARGE" under the Truth-in-Lending Act.[3] The proposed reg extends that prohibition to all "legally required" notices or disclosures. It is ineffectual because the lender or broker may charge an unregulated fee for document preparation (at least in a first mortgage transaction). Thus, the proposal, while appearing to prohibit certain fees, is simply prohibiting the labeling of a fee as being for the purpose of defraying the cost of preparing specific disclosures. There will be no effect on the bottom line cost to the borrower. Moreover, we have not encountered lenders or brokers charging a fee which would violate this proposed provision. It appears to address a problem that does not exist.

11. Pay compensation to or receive compensation from, contract with, or employ any person engaged in the mortgage loan business who is not licensed or otherwise exempt from licensure.

[3] *See*, 12 C.F.R § 226.4(c)(7)(ii).

This provision would be acceptable if the Department will insert the words "whom the licensee knows or has reason to know" after the word "business."

12. Render legal advice to an applicant.

No problem with this provision.

Section 46.2(g) prohibits certain delays and failure to fund loans that have closed, although it takes into account loans subject to the three-day rescission period under TILA (which includes most refinances). The reg requires prompt funding of the loan after the rescission period expires, and prohibits extending the time for funding in order to "fix" underwriting stipulations.

Normally, loans are fully underwritten before closing. Generally speaking when a loan closes with unresolved underwriting issues, it is at the request or insistence of the borrower. Moreover, in a rescindable transaction, even if there is a material change in circumstances, such as for example, the borrower losing his or her job, this proposed provision would prohibit the lender from refusing to fund the transaction. It is incongruous that one portion of these proposed regulations is geared toward prohibiting a licensee from making or arranging a loan that a borrower cannot afford to pay, while this portion of the proposed regs eliminates any lender discretion to cancel the transaction if that issue becomes evident after the loan documents are signed but prior to funding.

An additional objection to this reg arises because TILA allows curative redisclosure if an error is made on the TILA cost disclosure form or the Notice to the Borrower of his or her right to cancel. If an error is disclosed, the rescission period is extended until the lender cures the error by properly disclosing. Those circumstances could extend the time for funding.

In light of the foregoing, we strongly oppose this part of the proposal as inconsistent with both federal law and other portions of these same proposed regulations.

Section 46.2(h) is acceptable. Borrowers should receive copies of all documents they sign. This is a typical requirement around the country.

Section 46.2(i) should be directed toward the holder or servicer of the loan, and not to the licensee that originated the loan. In today's active secondary market, loans very seldom remain in the servicing portfolio of the originating licensee. Accordingly, this proposed provision would place an impossible burden on the originator to locate the current servicer and obtain a payoff within 7 days. This simply cannot be done in most cases.

This concludes our general and specific observations on these proposed regulations. Again, we commend the Department for its initiative and leadership. We again respectfully urge the Department and General Assembly to consider an exemption for community banking and our affiliates and subsidiaries. We also would leave you with the notion that what is needed in the mortgage industry is not more rules and more disclosures but clearer, simpler rules that provide more meaningful information to consumer applicants at a time when that information is most helpful. This summer, the Federal Trade Commission ("FTC") issued a Report of a study they conducted titled Improving "Consumer Mortgage

Disclosures." The study collected empirical data on the ability of both prime and non-prime borrowers to understand the important aspects of their mortgage transactions given the existing required disclosures. The study found that such understanding was poor, across the board, and that simplified disclosure documents significantly improved consumer understanding of all the terms applicable to his or her loan. The Report is available on the FTC's website.

We believe the FTC's report vindicates the longstanding position taken by industry members that the only thing worse than too little disclosure is too much. We believe we have reached the point where the expanding multiplicity of rules and disclosure requirements serves to obscure rather than clarify the consumer's options for choice of product. It certainly makes compliance increasingly difficult for the industry.

Again, thank you for this opportunity to comment. We look forward to further dialogue with the Department and General Assembly on these important issues.

Sincerely,

Frank A. Pinto

Frank A. Pinto
President/CEO

CC: PACB Executive Committee
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