GEORGETOWN UNIVERSITY LAW CENTER

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**Written Testimony of**

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Committee on Financial Services

"Preserving Consumer Choice and Financial Independence"

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**Witness Background Statement**

**Adam J. Levitin** is a Professor of Law at the Georgetown University Law Center, in Washington, D.C., where he teaches courses in financial regulation, structured finance, contracts, bankruptcy, and commercial law.

Professor Levitin has previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School, as the Robert Zinman Scholar in Residence at the American Bankruptcy Institute, and as Special Counsel to the Congressional Oversight Panel supervising the Troubled Asset Relief Program (TARP). Professor Levitin currently serves on Consumer Financial Protection Bureau's Consumer Advisory Board.

Before joining the Georgetown faculty, Professor Levitin practiced in the Business Finance & Restructuring Department of Weil, Gotshal & Manges, LLP in New York, and served as law clerk to the Honorable Jane R. Roth on the United States Court of Appeals for the Third Circuit.

Professor Levitin holds a J.D. from Harvard Law School, an M.Phil and an A.M. from Columbia University, and an A.B. from Harvard College. In 2013 he was awarded the American Law Institute's Young Scholar's Medal.

Professor Levitin has not received any federal grants or any compensation in connection with his testimony, and he is not testifying on behalf of any organization. The views expressed in his testimony are solely his own.

Mr. Chairman Hensarling, Ranking Member Waters, Members of the Committee:

Good morning. Thank you for inviting me to testify at this hearing. My name is Adam Levitin. I am a Professor of Law at the Georgetown University, where I teach courses in consumer finance, among other topics. I also serve on the Consumer Financial Protection Bureau's statutory Consumer Advisory Board. I am here today solely as an academic who studies consumer finance and am not testifying on behalf of the CFPB or its Consumer Advisory Board.

Community banks are ailing, but their problems are not because of the CFPB. The central problem for community banks is that size matters in consumer finance. Community banks lack the economies of scale necessary to compete in mortgages and credit cards. The CFPB has actually put a friendly thumb on the regulatory scale to ease regulatory burdens for community banks, but no amount of regulatory relief will offset the structural problem faced by community banks. Indeed, some of the regulatory relief that has been proposed would actually help megabanks more than community banks.

If Congress is truly interested in helping community banks, then tinkering with about the minutiae of CFPB regulations is not the right course of action. Instead, the best way to help community banks would be to pass legislation breaking up the megabanks. Until and unless the megabanks are broken up, there is every reason to expect that community banks will continue to disappear at their historical rate of nearly 300 per year.

## I. COMMUNITY BANKS ARE AILING, BUT NOT BECAUSE OF THE CFPB

This hearing is focused on the concerns of community financial institutions about the current regulatory environment. As a starting point, we should all be on the same page regarding what is a "community financial institution," or "community bank." The definition of community banks is a depository with less than $10 billion in assets.[1] By this measure, almost all depositories in the United States are considered community banks. Of the 6,509 depositories in the United States only 109 have over $10 billion assets, so there are 6,400 community banks in the United States.

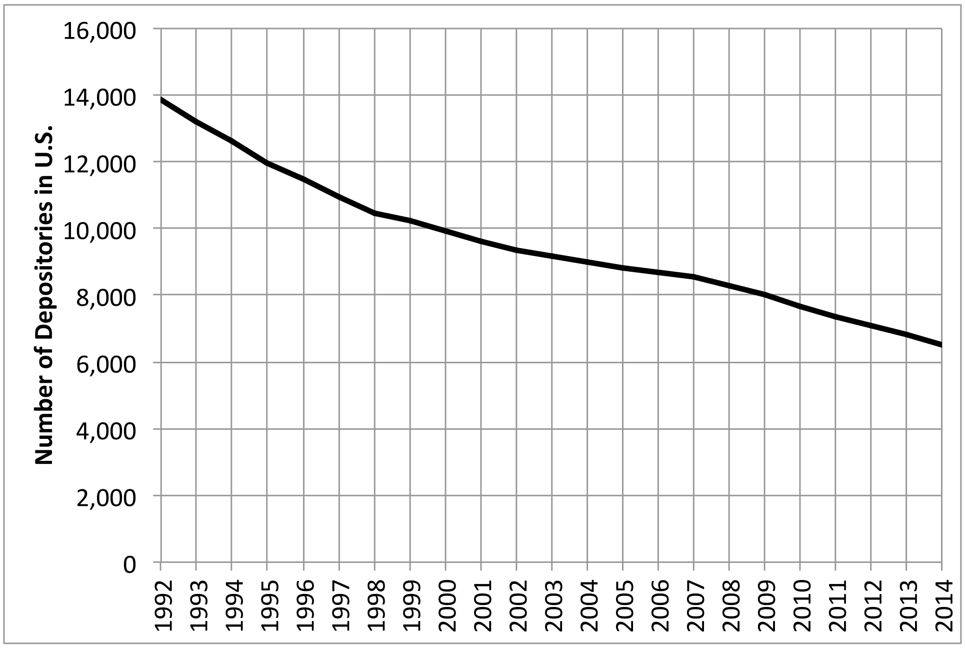
Community banks play an important role in the American financial system: they are key sources of credit in small business and commercial real estate lending, they tend to pride themselves on more personalized customer service and products, and they are often deeply engaged with the civic fabric of their communities. The health of community banks is also important for preserving choices for consumers in the financial products market place.

There is no question that community banks are ailing. The number of community banks in the United States has fallen nearly in half over the last decade. As Figure 1 (below) shows, this is the continuation of a long-term trend. In 1992 there were nearly 14,000 depositories in the United States, virtually all of which were community banks. Many small financial institutions failed during the savings and loan crisis, and the removal of interstate branch banking restrictions in 1994 encouraged bank mergers and the emergence of megabanks. Community banks continue to fail, be gobbled up by

[1] While $10 billion in assets is the commonly used threshold, it is unreasonably high and includes

larger banks, or more rarely grow out of being community banks.[2] For the past twenty-two years nearly 300 community banks have disappeared annually.

**Figure 1. Number of Depositories in United States, 1992-2014[3]**




None of the problems of community banks has anything to do with the CFPB or the post-financial crisis consumer financial protection reforms. Community banks' problems are structural and long-standing; they pre-dated the CFPB's existence (much less the key CFPB regulations, which only became effective in January 2014) by decades. There is zero evidence that the CFPB's regulations have been harming community banks. The CFPB and post-financial crisis reforms have actually given community banks a leg up by putting a friendly thumb on the regulatory scale.

Indeed, the overall banking industry's profits were down 7.3% in the fourth quarter of 2014 compared to the previous year. These poor results were driven by large banks. In contrast, ***community banks' profits were up 27.7% in the fourth quarter of 2014 compared to the previous year*.**[4] Larger banks bounced back from the financial crisis faster than community banks because of the bailout assistance they received,[5] but *community banks appear to be flourishing under the new CFPB regulations* even accounting for additional compliance costs and adjustments to regulations.

[2] While community banks' share of total banking system assets is shrinking, their total size is actually growing. This is consistent with a more optimistic view that community banks are reasonably healthy, but that large banks continue to enjoy economies of scale and too-big-to-fail benefits.

[3] FDIC Statistics on Depository Institutions (year end figures). The slope of the line has a coefficient of -295, with a $r^2$ of over 95%.

[4] FDIC Quarterly Banking Profile: Fourth Quarter 2014, *at* https://www.fdic.gov/bank/analytical/quarterly/2015_vol9_1/FDIC_4Q2014_v9n1.pdf (executive summary).

[5] *See* Victoria McGrane, *Annual Bank Profit Falls for the First Time in Five Years*, WALL ST. J. Feb. 24, 2015, *at* http://www.wsj.com/articles/u-s-banking-industry-profit-in-2014-falls-for-first-time-in-five-years-1424790315 (quoting FDIC Chairman Martin Gruenberg).

Unfortunately, many community bankers—and their trade associations—are unwilling to face the fact that community bank faces a serious structural challenge; it is far easier to blame the regulator because there is little that community banks can themselves do about their structural problem. Yet focusing on tweaks to the details of CFPB regulations as somehow the solution for community banks is like worrying about electrolysis while ignoring a malignant tumor.

## II. SIZE MATTERS IN CONSUMER FINANCE

There is a simple structural reason why community banks are ailing: *size matters in consumer finance*. Consumer finance is a huge business built on lots of small transactions. As such it often have significant economies of scale. For example, a bank that offers consumer financial products will typically need to have a call center to handle communications with consumers. Much of the investment in the call center—the technology, the overhead and to some degree the labor costs—do not vary based on the volume of calls. Thus, there are inherent economies of scale for institutions doing business on a larger scale.

Community banks are, by definition, unable to leverage economies of scale the way megabanks do. Consider the two of the largest consumer finance markets: credit cards and residential mortgages, where community banks do poorly, and how they contrast with community banks' strength in commercial mortgages, small business lending, and deposit accounts.

The credit card business is all about economies of scale: mass marketing solicitation and intensive data mining and computer security.[6] Small banks just can't compete in this market. Not surprisingly, many small banks (and credit unions) don't even offer credit cards, and about 10 banks have 90% of the credit card market.[7]

Residential mortgages tell a similar story. Mortgage lending is a bad fit for small institutions for four reasons. First, mortgages, like credit cards, are increasingly technology-driven, both on underwriting and servicing. The servicing industry is all about economies of scale (and that's part of its problem). Second, mortgages are large loans, meaning a $100 million in mortgages is a less diversified portfolio simply in terms of number of borrowers than $100 million in credit card receivables. Second, most mortgages are long-term fixed-rate obligations. Small banks cannot handle the interest rate risk of holding large fixed-rate mortgage portfolios, and do not want their capital so tied up, so they sell the mortgages to aggregators, who eventually securitize them via Fannie Mae, Freddie Mac or Ginnie Mae executions. Securitization, however, creates a third problem for small banks. When mortgages are sold into the secondary market, they are sold with representations and warranties from the originators. Simply by virtue of their size, small banks raise more significant counterparty risk on representations and warranties than large banks.

[6] Adam J. Levitin, *Interchange Regulation: Implications for Credit* Unions, Filene Research Institute, Research Brief #224 (Nov. 2010) at 39-40; Adam J. Levitin, *The Credit C.A.R.D. Act: Opportunities and Challenges for Credit Unions*, Filene Research Institute, Research Brief #202 (Nov. 2009) at 6, 11.

[7] NILSON REPORT # 1058 (Feb. 2015).

In contrast, community banks are able to compete the commercial real estate (CRE) mortgage market, but it's because most of the factors that make them uncompetitive in the residential market are not at play. CRE loans are much larger and more unique than residential loans, so there are not economies of scale in underwriting and servicing. CRE loans are shorter-term (rarely over 10 years) and more frequently adjustable rate or at least have yield-maintenance clauses to protect lenders from rate risk. Moreover, most CRE mortgages are not securitized,[8] so the counterparty representation and warranty risk does not exist. And for CRE lending, local knowledge might matter more for underwriting; a community banker is more likely to know the business climate of the community than the personal situation of an individual borrower.

This same story holds true for small-business lending. The economies of scale do not exist because the loans are more heterogeneous. The loans have shorter terms tan residential mortgage (and more often have adjustable rates), so there is less interest rate risk, and securitization is much rarer because it is harder to securitize heterogeneous products. And again, local knowledge might matter for underwriting.

Deposits accounts (and debit cards) have certain operations and technology economies of scale, particularly with the growth of on-line/mobile banking, but these disadvantages for community banks are counterbalanced by locational factors: many consumers still value having a nearby brick-and-mortar bank branch. Not surprisingly, many more community banks offer debit cards than credit cards.[9]

There is really no way to avoid the fact that size matters in consumer finance. Federal statutes and regulations already attempt to put a friendly finger on the scale to help community banks (as detailed below), but even if these regulatory subsidies were expanded, it would not make a material difference to the community banking industry.

## III. COMMUNITY BANKS ALREADY RECEIVE SIGNIFICANT REGULATORY RELIEF

Community banks already receive significant relief from consumer finance regulation. As an initial matter, it is important to recognize that absent regulatory intervention community banks would not exist in the first place.

The existence of community banks in the United States is a legacy of historic interstate branch banking restrictions, which were repealed in 1994. The United States has nearly 6,000 depository institutions. Only around 100 of those institutions have more than $10 billion in assets, which is the cut-off typically used for defining “community” banks. In other words, virtually all US depositories are community banks, and most of those depositories have under $1 billion in assets. No other country in the world has as many depositories as the United States by a couple of orders of magnitude. What we are

[8] CRE securitization deals with properties in only about 60 major urban markets. The rest is all balance sheet lending. Adam J. Levitin & Susan M. Wachter, *The Commercial Real Estate Bubble*, 3 HARV. BUS. L. REV. 83, 93 (2013).

[9] Adam J. Levitin, *Interchange Regulation: Implications for Credit* Unions, Filene Research Institute, Research Brief #224 (Nov. 2010) at 18-19.

witnessing now in the consolidation of the banking industry is the mean reversion one would expect absent restrictions on interstate branch banking.

Even today, regulation helps support the community banking industry. Absent FDIC insurance, depositors would never use small institutions instead of large ones. And merger approval requirements and entry restrictions help protect the community banking business.

The Dodd-Frank Act codifies special solicitude for community banks through several provisions:

- Community banks are exempt from the Durbin Interchange Amendment's debit card fee regulation.[10] This gives community banks a significant competitive advantage over megabanks.
- All financial institutions with less than $10 billion in assets are exempt from examination and enforcement actions by the CFPB.[11] There are only 111 financial institutions that are subject to CFPB examination and enforcement. Instead, smaller banks and credit unions are examined and subject to enforcement by their regular prudential regulators. This means that community banks have to deal with fewer examinations and are not subject to the scrutiny of a dedicated consumer protection agency. To date, I am unaware of a single enforcement action brought against a community bank under the Consumer Financial Protection Act. Instead, all enforcement actions have been against megabanks and non-banks.
- In addition to the regular notice and comment requirements of the Administrative Procedures Act, the CFPB is required to go through a special rulemaking process under the Small Business Regulatory Enforcement Fairness Act when it promulgates rules that will affect small businesses, including community banks.[12] The SBREFA process lets small businesses comment on proposed rules when they are in an early stage, before the "train has left the station."

The CFPB has also codified special provisions for community banks in its regulatory implementations of the Dodd-Frank Act, even though it is not required to do so. The CFPB has built in numerous exceptions for smaller financial institutions to its rule:

- Small creditors (with less than $2 billion in assets) can make mortgage loans at APRs 200 basis points (2%) higher than larger creditors and still qualify for the absolute safe harbor to the Ability to Repay Rule.[13]
- Small creditors (with less than $2 billion in assets) that originate less than 500 mortgage loans per year can qualify for the absolute safe harbor to the Ability to

[10] 15 U.S.C. § 1693o-2(a)(6).
[11] 12 U.S.C. §§ 5515, 5516(d).
[12] 5 U.S.C. §§ 603(d), 609(d)(2).
[13] 12 C.F.R. § 1026.43(b)(4), (e)(5).

Repay Rule for the loans they retain on portfolio even if those loans have debt-to-income ratios above 43%.[14] If these loans are held in portfolio for three years, they retain their safe harbor even if subsequently sold to another small creditor. [15]

- Small creditors (with less than $2 billion in assets) that operate predominantly in rural and underserved areas are exempt from the requirement of maintaining escrow accounts for high-cost mortgages.[16]
- Small creditors (with less than $2 billion in assets) in rural and underserved areas are exempt from the prohibition on high-cost balloon loans.[17]
- Small creditors in rural and underserved areas may until 2016 make balloon mortgages that qualify for the safe harbor from the ability-to-repay rule.[18]
- Implementation of balloon payment limitations is delayed for two-years (until 2016) for all small creditors (with less than $2 billion in assets) irrespective of whether they operate predominantly in rural or underserved areas.[19]
- Loans made against rural properties are not subject to the same rules regarding appraisals for high-cost mortgage loans.[20]
- Small mortgage servicers are exempted from the Truth in Lending Act requirement of periodic statements.[21]
- Small servicers are exempted from most of the Real Estate Settlement Procedures Act loss mitigation requirements (other than prohibition on commencing foreclosure until 120 days delinquency)
- Entities that handle 100 or fewer remittances per year are exempt from the Remittance Rulemaking under Regulation E under the Electronic Fund Transfers Act.[22]

CFPB has also proposed rules that would expand the definition of "rural" creditor and as well as increase the small creditor debt-to-income exemption from 500 loan originations to 2,000 loans sold annually (and unlimited originations).[23]

Beyond this, the CFPB has voluntarily taken actions to ensure that the voices of small institutions are heard in the regulatory process:

- The CFPB has voluntarily created a Community Bank Advisory Board and a Credit Union Advisory Board, in addition to its statutorily required Consumer Advisory Board.
- The CFPB has included representatives of small financial institutions on its Consumer Advisory Board, which is currently chaired by the chairman of rural community development credit union.

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[14] 12 C.F.R. § 1026.43(e)(5)(i); 1026.35(b)(2)(iii)(B)-(C).
[15] 12 C.F.R. § 1026.43(e)(5)(ii)(A).
[16] 12 C.F.R. § 1026.35(b)(2)(iii).
[17] 12 C.F.R. § 1026.43(e)(6).
[18] 12 C.F.R. § 1026.43(f)(1)(vi).
[19] 12 C.F.R. § 1026.43(e)(6).
[20] 12 C.F.R. § 1026.35(b)(4)(vii)(H)
[21] 12 C.F.R. § 1026.41(e)(4).
[22] 12 C.F.R. § 1005.30(f)(2).
[23] 80 FED. REG. 7769 (Feb. 11, 2015).

All of this is to say that the CFPB has shown particular solicitude for small financial institutions, attempting to balance their particular concerns and cost structures with the need for uniform consumer protection laws.

## IV. COMMENTS ON SPECIFIC LEGISLATIVE PROPOSALS

In this section, I provide some comments on specific legislative proposals affecting consumer finance regulation. Not all of these proposals have been introduced as bills yet in the current Congress, but as their introduction is anticipated, I will comment on them here.

### *(1) Making All Residential Mortgages Loans Held in Portfolio Qualified Mortgages*

One proposal (not yet introduced this Congress, but introduced in the last Congress as the Portfolio Lending and Mortgage Access Act, H.R. 2673) is to make all residential mortgages held in portfolio "qualified mortgages" (QM) and thus exempt from the Dodd-Frank Act's Ability to Repay Rule.

This proposal is unwise. It is based on an assumption that lenders will not make ill-advised loans if they have to retain the credit risk. This assumption ignores the substantial amount of evidence of principal-agent conflicts within financial institutions in which the incentives of loan officers do not align with those of the institution. A loan officer has shorter term incentives based on increasing lending volume, while the institution has incentives based on longer-term loan performance. These principal-agent concerns are not merely hypothetical: Countrywide, Wachovia, and Washington Mutual all kept a significant volume of the loans they originated on their portfolios with disastrous results. Many of these loans had low-or-no documentation, high loan-to-value ratios, and were not fully amortized. The resulting foreclosures harmed both borrowers and the banks. Although the originate-to-distribute lending model was a major contributor to the financial crisis, it is not the only way to tank a bank, and portfolio lending does not ensure good lending.

Additionally, portfolio lending can be predatory. A portfolio lender can lend at high interest rates to borrowers and aggressively pursue defaults with the aim of taking ownership of the borrower's property and capturing the borrower's equity. Indeed, given that the QM rulemaking keys off of "creditors" rather than "insured depositories" and "insured credit unions," it includes not just banks and credit unions, but also non-bank "hard money" lenders that have traditionally been among the most predatory lenders. Allowing these hard money lenders to evade QM through a portfolio exemption would be to invite abusive lending.

Therefore, I would urge that to the extent that a safe harbor from the Ability to Repay rule is considered for portfolio loans, it include a minimum down payment requirement of at least 20% in order to create an equity cushion to protect lending institutions as well as a requirement that the income or assets supporting the underwriting decision be fully documented.

### *(2) Raising the HOEPA APR Trigger for Manufactured Housing Loans*

The Preserving Access to Manufactured Housing Act of 2015, H.R. 650, would raise the APR and points-and fees triggers for the application of the Home Ownership and Equity Protection Act (HOEPA) for manufactured housing loans. H.R. 650 would also exempt manufactured housing retailers from the HOEPA definition of "mortgage originators".

H.R. 650 would not expand access to *sustainable* credit; it would instead encourage predatory lending. Under H.R. 650, HOEPA protections would not kick in for manufactured housing loans in the current lending environment unless interest rates were around 14%. In contrast, the going-rate for a traditional real estate mortgage loan is around 4%. Likewise, under H.R. 650, a manufactured home borrower could pay almost $3,500 in documentation and other junk fees on a $75,000 loan. Again, this is a license for abusive lending practices. Similarly, exempting manufactured housing retailers from the definition of "mortgage originators" would mean that manufactured housing borrower would not be protected from steering and other conflicts of interest

HOEPA provides an important set of protections against predatory lending by requiring additional disclosures, regulatory reporting, and private rights of action. There is no principled reason for changing the HOEPA caps solely for manufactured housing. H.R. 650 would be a license for predatory lending aimed at the generally lower-income population that lives in manufactured housing.

***(3) Removing Affiliated Title Fees from Counting Toward the QM Fee Cap***

H.R. 685, the Mortgage Choice Act of 2015, would exempt title insurance fees from inclusion in the both HOEPA points-and-fees trigger and from the points-and-fees cap on Qualified Mortgages (QM). H.R. 685 is an ill-advised proposal that would harm consumers by subjecting them to fee gouging and restrict access to credit.

Title insurance is a broken market. Borrowers are responsible for paying for title insurance, but title insurance pricing is basically negotiated between the lender and the title insurance company; the pricing and sales system is completely opaque, making it impossible for borrowers to shop for better prices on title insurance. As a result, competition does not drive down title insurance prices. Instead, title insurance premiums often reflect a significant mark-up over actual risk: the title insurance industry pays out less than 7¢ in claims for every $1 of premiums paid.[24] Most of the premiums are compensation for the sales agent, rather than set aside to provide coverage for losses. The result is that borrowers significantly overpay for title insurance, and this can easily add $1,000 to the upfront costs of a mortgage.

The inclusion of title insurance in the HOEPA and QM point-and-fee caps serves to limit title insurance pricing from even greater excesses. To the extent that the Committee is concerned about ensuring greater availability of credit to consumers, exempting title insurance from the HOEPA and QM point-and-fee caps is a terrible idea,

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[24] American Land Title Association, *2013 Year-End Title Insurance Industry Financial Statement*, *at* http://www.alta.org/industry/13-04/Form9_Industry.pdf. *See also* GAO, *Title Insurance: Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers*, GAO-07-041 (April 2007), at 42.

as it virtually guarantees that consumers will be gouged with increased title insurance costs, which will make homeownership more expensive.

***(4) Creating a Process for Banks to Petition to be Given a Rural Exemption by CFPB***

H.R. 1259, the Helping Expand Lending Practices in Rural Communities Act, would create a process for individual lenders to petition the CFPB for designation as rural lenders. Rural lender designation exempts a lender from the requirement to establish escrow accounts for high-cost mortgages.[25] To qualify, a lender must make over half of its loans in rural or underserved areas, make less than 500 loans per year and have assets of less than $2 billion.[26] The CFPB currently defines "rural" as counties that are not in a metropolitan statistical area or a micropolitan statistical areas adjacent to a metropolitan statistical area, as defined by the Office of Management and Budget.[27]

It is not clear that such an individualized petition process is necessary, at least at this point. The CFPB has proposed an amendment to its regulatory definition of "rural" that would expand its definition of rural lenders to include all census blocks in that are not in urban areas as defined by the Census Bureau.[28] The proposed rule-making would also adjust the lookback period for evaluating rural lender status from three years to one year to more accurately reflect lenders' current operations, as well extend a grace harbor for applications received in the first three months of the following year in the result that a lender's status changes. The CFPB estimates that the proposed rulemaking will increase the number of lenders with rural status from around 2,400 to 4,100 (most of these creditors are already exempt from QM as small creditors.)[29] The CFPB believes that most of these creditors, however, already provide escrow accounts because they originate higher-cost loans, so the benefit of rural designation will have little effect on these institutions.[30]

Additionally, an implementation of H.R. 1259 would likely require the CFPB to further amend its definition of "rural." Such further amendment would add to regulatory uncertainty for the thousands of financial institutions while potentially benefitting only a few.

Given that the CFPB is already amending its process of designating rural lenders, it makes sense to allow the CFPB to finalize its rulemaking and to see its impact on rural lenders before attempting legislative fine-tuning of the regulatory process and creating more regulatory uncertainty for lenders.

***(5) Amendments to CFPB Advisory Board Structure***

Other proposals focus on changes to the CFPB's Advisory Board structure, such as mandating a Small Business Advisory Board for the CFPB or subjecting the CFPB to

[25] 12 C.F.R. § 1026.35(b)(2)(iii).
[26] 12 C.F.R. § 1026.35(b)(2)(iii).
[27] 12 C.F.R. § 1026.35(b)(2)(iv)(A).
[28] 80 FED. REG. 7769 (Feb. 11, 2015).
[29] 80 FED. REG. 7769, 7788 (Feb. 11, 2015).
[30] 80 FED. REG. 7769, 7791 (Feb. 11, 2015).

the Federal Advisory Committee Act. Such proposals have little to commend them other than as political harassment of the CFPB.

The CFPB has a statutory Consumer Advisory Board, of which I am a member. (I emphasize that my testimony here is solely in my individual capacity as an academic who studies consumer finance.) The CFPB has also voluntarily created a Community Bank Advisory Board and a Credit Union Advisory Board. It also is required to vet all major rulemakings with small business panels assembled by the Small Business Administration as part of the SBREFA rulemaking process.[31] Only two other federal agencies are subject to this requirement. Additionally, the CFPB has created an Office of Financial Institutions to be a point of contact with regulated institutions. The consumer finance industry—including small entities—do not lack for points of access to engage the CFPB. Therefore, it is not clear why an additional "Small Business Advisory Board" is needed.

As far as subjecting the CFPB's existing advisory boards to FACA, the CFPB is currently exempt from FACA by virtue of being a bureau within the Federal Reserve Board, which is entirely exempt from FACA. The Federal Reserve Board had a Consumer Advisory Board for years without there being concerns that FACA should apply to its meetings. It is hard to see why concerns would suddenly arise with the creation of the CFPB as a bureau within the Federal Reserve Board.

As it stands, however, even though it is not legally subject to FACA, the CFPB already ensures that it currently complies with FACA. CFPB advisory board meetings are conducted in public and include opportunities for public comment. The documents made available to the advisory board are made available to the public, as are transcripts and minutes of the meetings. Therefore, it is not clear why it is necessary to specifically legislate that CFPB advisory boards are subject to FACA.

***(6) Delaying the Implementation of Basel III's Treatment of Mortgage Servicing Rights***

Another proposal for regulatory relief is to delay the regulatory implementation of the Basel III Bank Capital Accord's treatment of mortgage servicing rights (MSRs). MSRs have traditionally been an important asset class for depositories, as their value provides a countercyclical offset to mortgage origination activity, and MSR accounting is subject-enough to give depositories room to smooth their earnings.

Currently, banks are required to deduct 10% of the fair market value of their MSRs from their Tier 1 capital. Banks are also currently limited to having the total value of their intangible assets, including MSRs, as no more than 100% of their Tier 1 capital. Under Basel III, MSRs would be limited to 10% of a bank's common equity (a component of Tier 1 capital). Additionally, the combined balance of a bank's MSRs, deferred tax assets, and investments in unconsolidated financial institutions' common stock is capped at 15% of common equity, with the excess deducted from common

[31] 5 U.S.C. §§ 603(d), 609(d)(2).

equity.[32] Those MSRs would receive a 100% risk-weighting that will increase to a punitive 250% risk-weighting in 2018.[33] Any MSR values about 10% of common equity would be deducted from common equity, meaning that for every dollar of MSRs above 10% of common equity, the bank would need to raise an additional dollar of common equity to be in compliance with capital requirements.[34]

The Basel III changes make MSRs an unattractive asset for banks. Not surprisingly, banks have been selling off their MSRs to non-banks in anticipation of the Basel III implementation.

I am supportive of delaying the regulatory implementation of Basel III on MSRs because I believe that there is a major regulatory coordination problem regarding mortgage servicing. The mortgage servicing industry is in complete collapse as a result of the financial crisis. The industry was built to handle performing loans. The servicing of performing loans requires little discretion and can be highly automated, creating economies of scale. The servicing of defaulted loans is another matter, and mis-servicing has resulted in enormous litigation settlements, including Consent Orders with the Office of the Comptroller of the Currency, the $25 billion National Mortgage Settlement, a $8.5 billion settlement between Bank of America and the trustees for various securitization trusts. Many banks have been transferring their servicing to non-bank servicers, such as Ocwen and Nationstar and Seterus, but (not surprisingly) many of the problems that exist in bank servicing space also exist with non-bank servicers.

The servicing industry is badly in need of reform. Unfortunately there are several different regulatory changes of that have been occurring in an uncoordinated fashion. Bank regulators are changing capital requirements for MSRs, the CFPB has changed consumer protection regulations for servicing, the FHFA has been pressing Fannie Mae and Freddie Mac for improvements in their servicing guidelines, Ginnie Mae has been concerned about the counterparty risk presented by its servicers, and looming over everything is the uncertainty created by the unresolved question of housing finance reform. Until and unless housing finance reform is resolved, it is hard for anyone to predict what the lending and hence the servicing business model will look like going forward, and this discourages investment in servicing. Accordingly, I believe it is sensible to weight implementing further regulatory changes of servicing that do not implicate consumer protection until the housing finance reform issue is resolved.

## CONCLUSION

Community banks face a serious structural impediment to being able to compete in the consumer finance marketplace because they lack the size necessary to leverage economies of scale. The CFPB has repeatedly acted to ease regulatory burdens on community banks in an attempt to offset this structural disadvantage. While community banks continue to face serious problems with their business model, their profits were up

[32] 78 FED. REG. 62178 (Oct. 11, 2103).
[33] 78 FED. REG. 62181 (Oct. 11, 2013).
[34] 78 FED. REG. 62178 (Oct. 11, 2103).

nearly 28% in the last quarter of 2014 over the preceding year, which strongly indicates that they are not being subjected to stifling regulatory burdens.

Ultimately, if Congress wants to help community banks, the answer is not to tinker with the details of CFPB regulations. As noted above, the particular proposals that have been made are ill-advised on their own merits. Instead, if Congress cares about community banks it needs to take action to break up the too-big-to-fail banks that receive an implicit government guarantee and pose a serious threat to global financial stability. Until and unless Congress acts to break up the too-big-to-fail banks, community banks will never be able to compete on a level playing field.