CONFERENCE OF STATE BANK SUPERVISORS

December 1, 2017

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

The Conference of State Bank Supervisors (CSBS)[1] would like to voice its support for efforts to meaningfully and thoughtfully provide regulatory relief for community banks, strengthen consumer protections, and tailor regulations based on a bank's business model and risk profile in the recently introduced Economic Growth, Regulatory Relief, and Consumer Protection Act of 2017 (S. 2155). More broadly, state regulators appreciate the Committee's efforts to identify areas of bipartisan support, particularly for smaller institutions and consumers, throughout the 115th Congress.

This letter highlights provisions of S. 2155 of particular interest to CSBS, and expounds on the following recommendations state regulators hope you will consider:

- Capital simplification for community banks should not constrain regulators' ability to address safety and soundness issues through the supervisory process, and federal banking agencies should consult with state regulators when evaluating a state-chartered bank's risk profile for purposes of the "qualifying community bank" definition in Section 201.
- As part of amending the SAFE Mortgage Licensing Act (SAFE Act) to facilitate job mobility for mortgage loan originators, Congress should also amend the SAFE Act's purposes section and liability provisions to appropriately:
    - Reflect the evolution of the SAFE Act and Nationwide Mortgage Licensing System (NMLS), and
    - Protect state regulators from good faith errors made when executing their duties in managing licensees through NMLS.

[1] CSBS is the nationwide organization of banking regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. State banking regulators supervise nearly 4,500 state chartered depository institutions, most of which are community banks. Additionally, most state banking departments regulate a variety of non-bank financial services providers, including mortgage lenders. For more than a century, CSBS has given state supervisors a national forum to coordinate supervision of their regulated entities and to develop regulatory policy.

CSBS Comments and Recommended Changes

CSBS offers the following comments and recommendations to certain provisions of S. 2155.

Section 201. Capital simplification for qualifying community banks.

State regulators have long called on both the federal financial regulatory agencies and Congress, including in recent testimony before the Senate Banking, Housing, and Urban Affairs Committee, to simplify the capital regime for community banks.[2] State regulators strongly support sufficient, high quality capital requirements at community banks. However, the costs and burden associated with Basel III's complexity disproportionately impact smaller institutions, and potentially inhibit community banks from serving the credit needs of their customers.

Section 201 permits a "qualifying community bank" to comply with a "community bank leverage ratio" in lieu of current risk-based and leverage capital requirements. CSBS is still evaluating the proposed "community bank leverage ratio." Nevertheless, state regulators would like to share initial observations and recommendations in the hopes of making this provision better achieve its twin goals of simplifying community banks' capital framework and promoting their safe and sound operation.

1. The importance of well-managed institutions and regulators' discretion

While state regulators believe banks should have strong levels of high quality capital, capital in and of itself is not a panacea for all of an institution's risks. Indeed, state regulators have witnessed institutions with high levels of capital burn through that capital quickly because of poor management and poor asset quality. For example, no level or type of capital, be it risk-based or leverage, can fully mitigate threats posed by a subpar management team and board of directors pursuing risky assets and imprudent business strategies. Therefore, state and federal regulators must retain the discretion to impose additional capital requirements on their regulated entities, including "qualifying community banks," in the event they discover unsafe and unsound practices during the supervisory process.

CSBS has questions related to Sections 201(c)(1)(C) and 201(c)(2) and their effect on each other. It appears Section 201(c)(1)(C) is meant to exempt "qualifying community banks" from "other capital or leverage requirements" (e.g., the capital conservation buffer[3]), and that 201(c)(2) is designed to allow regulators to require additional capital to address weaknesses discovered at a "qualifying community bank." However, state regulators are concerned that Section 201(c)(1)(C) may be sufficiently vague to unintentionally incorporate supervisory actions a state

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[2] United States. Cong. Senate. Committee on Banking, Housing & Urban Affairs. *Hearing on Fostering Economic Growth: Regulator Perspective. June 22, 2017.* 115th Cong. 1st sess. (statement of Charles G. Cooper, Commissioner, Texas Department of Banking). See: https://www.banking.senate.gov/public/_cache/files/6810bad0-2b53-4997-b7b9-7b041e2a8783/59F1FEABF48A0982910107339D9A7ADC.cooper-testimony-6-22-17.pdf

[3] 12 CFR § 324.11.

or federal regulator may take, or it may create legal uncertainty stemming from a regulator's attempt to require a "qualifying community bank" to hold additional capital for safety and soundness purposes. CSBS suggests narrowing Section 201(c)(1)(C) and/or explicitly stating that the "other capital or leverage requirements" do not include additional capital a regulator may require a "qualifying community bank" to hold based on weaknesses found at the institution.

CSBS also proposes that Section 201(c)(2) be amended to explicitly include state regulators, which would effectively mirror similar statutory language in the Federal Deposit Insurance Act[4] aimed at not limiting federal banking agencies' or state regulators' authorities:

(2) EXISTING AUTHORITIES.—Nothing in paragraph (1) shall limit the authority of the appropriate Federal banking agencies or State supervisory authority as in effect on the date of enactment of this Act.

> *2. Federal banking agencies must consult state regulators when evaluating a state-chartered bank's risk profile.*

While a "qualifying community bank" is defined as a depository institution or depository institution holding company with total consolidated assets of less than $10 billion, the federal banking agencies have the authority to disqualify an institution based on its risk profile.

CSBS believes state regulators' consultation and recommendation on a state-chartered institution's risk profile is paramount for making Section 203 work as envisioned. As the chartering authority responsible for supervising more than 78 percent of the nation's banks,[5] states should provide the federal banking agencies input when there is a question about whether a state-chartered bank does or does not meet the requirements of the "qualifying community bank" definition. While the factors outlined in Sec. 201(a)(3)(B) are generally helpful measures in assessing a bank's risk profile, state regulators know that unique cases and circumstances impacting a bank's riskiness will inevitably arise. To that end, CSBS recommends the following change to Sec. 201(a)(3)(B):

(B) RISK PROFILE.—The appropriate Federal banking agencies may determine that a depository institution or depository institution holding company (or a class of depository institutions or depository institution holding companies) described in subparagraph (A) is not a qualifying community bank based on the depository institution's or depository institution holding company's risk profile, which shall be based on consideration of—

> *(i) off-balance sheet exposures;*
> *(ii) trading assets and liabilities;*
> *(iii) total notional derivatives exposures;*

[4] 12 USC §1831a(i).
[5] Bank Data & Statistics, as of 9/30/17. FDIC. Available at: https://www.fdic.gov/bank/statistical/

(iv) in the case of a State bank, the consultation and recommendation of the institution's State bank supervisor; and
~~*(iv)*~~ *(v) such other factors as the appropriate Federal banking agencies determine appropriate.*

Section 106. Eliminating barriers to jobs for loan originators.

CSBS understands and appreciates the importance of supporting job mobility, and state regulators have been engaged, over the past several years, in an extensive dialogue with the mortgage industry on this issue. CSBS worked closely with industry and Congressional stakeholders to draft language that ensures state regulators continue to have the ability to protect consumers and the marketplace, while facilitating loan originators' job mobility.

Section 106 includes most, but not all, of the provisions state regulators developed. Like all current state-licensed mortgage loan originators (MLO) and federal MLO registrants, state regulators will manage this new class of transitional loan originators through the Nationwide Mortgage Licensing System (NMLS). By mandating states provide transitional MLO authority, Section 106 effectively requires state regulators to expand the functionality and operability of NMLS to manage this new class of transitional MLOs. State regulators are confident that an expanded NMLS can properly manage these individuals based on the success of managing state-licensed MLOs, MLO registrants, and an increasing number of non-mortgage, state-licensed financial services providers. In fact, Congress has helped state regulators facilitate the expansion of NMLS to license other non-mortgage, state-licensed financial services providers through targeted amendments of the SAFE Act.[6]

Given this proposed expansion of NMLS and Congress's support for NMLS as a platform licensing a broad range of state-licensed financial services providers, CSBS believes that the SAFE Act's purposes section[7] and liability provisions[8] should also be amended to:

1. Reflect the evolution of the SAFE Act and NMLS by amending 12 USC § 5101.
2. Protect state regulators from good faith errors made when executing their duties in managing licensees through NMLS, including state-licensed MLOs, federal MLO registrants, transitional MLOs, or other licensees by amending 12 USC § 5112.

State regulators propose 12 USC § 5101 and 12 USC § 5112 be amended to read as follows:

§ 5101. Purposes and methods for establishing a mortgage licensing system and registry
In order to increase uniformity, reduce regulatory burden, enhance consumer protection, and reduce fraud, the States, through the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, are hereby encouraged to establish a

[6] Pub. L. 114-94 §§ 88001-88002; Pub. L. 114-113 § 703.
[7] 12 USC § 5101.
[8] 12 USC § 5112.

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Nationwide Mortgage Licensing System and Registry for the residential mortgage industry and other financial service providers that accomplishes all of the following objectives:

(1) Provides uniform license applications and reporting requirements for State-licensed loan originators.
(2) Provides a comprehensive licensing and supervisory database.
(3) Aggregates and improves the flow of information to and between regulators.
(4) Provides increased accountability and tracking of loan originators.
(5) Streamlines the licensing process and reduces the regulatory burden.
(6) Enhances consumer protections and supports anti-fraud measures.
(7) Provides consumers with easily accessible information, offered at no charge, utilizing electronic media, including the Internet, regarding the employment history of, and publicly adjudicated disciplinary and enforcement actions against, loan originators.
(8) Establishes a means by which residential mortgage loan originators would, to the greatest extent possible, be required to act in the best interests of the consumer.
(9) Facilitates responsible behavior in the subprime mortgage market place and provides comprehensive training and examination requirements related to subprime mortgage lending.
(10) Facilitates the collection and disbursement of consumer complaints on behalf of State and Federal ~~mortgage~~ regulators.

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§5112. Liability provisions
The Bureau, any State official or agency, or any organization serving as the administrator of the Nationwide Mortgage Licensing System and Registry or a system established by the Director under section 5108 of this title, or any officer or employee of any such entity, shall not be subject to any civil action or proceeding for monetary damages by reason of the good faith action or omission of any officer or employee of any such entity, while acting within the scope of office or employment, relating to the collection, furnishing, or dissemination of information concerning persons who ~~are loan originators or are applying for licensing or registration as loan originators~~ have applied, are applying, and/or are currently licensed or registered through the Nationwide Mortgage Licensing System and Registry, including but not limited to loan originators.

Section 107. Protecting access to manufactured homes.

State regulators recognize the importance of manufactured housing as an important source of housing in many communities. Consumers deserve access to a wide variety of housing options, including manufactured housing. Since the enactment of the SAFE Act, CSBS and state banking departments have worked with the manufactured housing industry to provide guidance and, where appropriate, flexibility with regard to how the licensing requirements of the SAFE Act may apply to industry employees. In addition to language contained in the federal rule

commentary,[9] several states have added language to their statutes to clarify the fact that manufactured home retailers and their employees are not subject to licensing when performing only clerical and support duties in connection with the sale of a manufactured home and when no compensation is received from a lender for the performance of such activities.[10]

However, state regulators believe approaches that alter the Truth in Lending Act's or the SAFE Act's definitions of "mortgage loan originator" will not further Congress's and state regulators' shared goal of protecting consumers or maintaining comprehensive, nationwide MLO licensing and registration standards. CSBS recognizes that Section 107 does not alter the SAFE Act's MLO definition, and it encourages Congress not to accept any amendments to S. 2155 that do so.

CSBS Supported Provisions

In addition to the comments and recommended changes previously mentioned, CSBS supports the following provisions of S. 2155.

Section 101. Minimum standards for residential mortgage loans.

CSBS strongly supports Section 101 as key to advancing state regulators' goal of ensuring the regulatory framework recognizes community banks' relationship-lending business model. This provision will encourage community banks to lend more to homeowners, align the interests of the bank and the borrower, and promote economic growth.

State regulators have long supported a flexible approach to underwriting for community banks that retain mortgages in portfolio. Lenders that hold loans on their books – retaining 100 percent of the risk of default – are fully incentivized to ensure the borrower can meet the monthly obligations of a mortgage. Furthermore, Section 101 includes important safeguards ensuring consumers are protected even when a mortgage is held in portfolio.

Section 103. Exemption from appraisals of real property located in rural areas.

State regulators are concerned that the current appraisal thresholds are outdated and unnecessarily impede credit availability, particularly in rural and underserved markets. The targeted fix proposed by Section 103 would help to alleviate some of the problems homebuyers and mortgage lenders face in rural areas. CSBS supports exempting properties under $400,000 in rural areas from appraisals when an appraiser cannot be found.

[9] SAFE Mortgage Licensing Act: Minimum Licensing Standards and Oversight Responsibilities (Final Rule). See: https://www.hud.gov/sites/documents/SAFERULE.PDF

[10] E.g., Arizona Rev Stat §6-991.01; Louisiana Rev Stat §6:1087.

Section 104. Home Mortgage Disclosure Act adjustment and study.

Section 104 would provide community banks relief from the increasingly complex Home Mortgage Disclosure Act (HMDA) reporting requirements. CSBS has consistently argued that the 25 closed-end mortgage loan reporting threshold is too low, calling on the Consumer Financial Protection Bureau (CFPB) to, at a minimum, exempt institutions originating fewer than 100 loans from HMDA reporting. State regulators believe the increased reporting burden on community banks is not worth the additional HMDA data received from these institutions.[11]

Section 202. Limited exception for reciprocal deposits.

State regulators support the reasonable and responsible changes proposed by Section 202 to reciprocal deposit funding. Community banks and local communities have benefitted from advances in reciprocal deposit networks, which allow institutions to maintain banking relationships with large depositors in their markets. CSBS believes these stable deposits should not be considered brokered deposits.

Section 203. Community bank relief.

State regulators generally support the Volcker rule's prohibitions on proprietary trading and owning or investing in hedge funds and private equity funds. However, state regulators have also been concerned about the rule's complexity and ways it may limit smaller institutions' ability to legitimately hedge risk. Section 203 provides a sensible approach to further shield traditional community banks from the Volcker rule.

Section 303. Immunity from suit for disclosure of financial exploitation of senior citizens.

Several states have been leaders in fighting the financial exploitation of seniors, providing immunity for financial service professionals to report abuse in good faith, imposing penalties for failing to report or making false reports of elder abuse, and combatting power of attorney abuse.[12] CSBS supports Section 303 for encouraging financial services employees to report any suspected exploitation by making them immune from any civil or administrative liability arising from such a report, provided they exercised due care and reported in good faith and are appropriately trained in identifying and reporting abuse.

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State regulators thank you for the opportunity to offer their support for the bipartisan community bank regulatory relief provisions in S. 2155, and to share their recommendations on

[11] CSBS Comment Letter on CFPB Proposed Amendments to Home Mortgage Disclosure (Regulation C). October 29, 2014. See: https://www.regulations.gov/document?D=CFPB-2014-0019-0182

[12] "Elder Abuse." Commission on Law and Aging. American Bar Association. See: https://www.americanbar.org/groups/law_aging/resources/elder_abuse.html#banksreporting

improving the legislation. We look forward to working with you on S. 2155 and throughout the rest of the 115th Congress on bipartisan proposals to promote economic growth.

Sincerely,

John Ryan
President and CEO

CC: Members of the Senate Banking, Housing, and Urban Affairs Committee