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CREATING A HOUSING FINANCE SYSTEM BUILT TO LAST: ENSURING ACCESS FOR COMMUNITY INSTITUTIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON
SECURITIES, INSURANCE, AND INVESTMENT

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING COMMUNITY BANKS AND CREDIT UNIONS IN THE CURRENT HOUSING MARKET, INCLUDING THE KEY CHALLENGES AND OPPORTUNITIES FACING THESE INSTITUTIONS SEEKING ACCESS TO THE SECONDARY MARKET

JULY 23, 2013

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.fdsys.gov/

U.S. GOVERNMENT PRINTING OFFICE

82–781 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
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Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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CREATING A HOUSING FINANCE SYSTEM BUILT TO LAST: ENSURING ACCESS FOR COMMUNITY INSTITUTIONS

TUESDAY, JULY 23, 2013

U.S. SENATE,
SUBCOMMITTEE ON SECURITIES, INSURANCE, AND INVESTMENT,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Subcommittee met at 3 p.m., in room SD–538, Dirksen Senate Office Building, Hon. Jon Tester, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIRMAN JON TESTER

Chairman TESTER. I call to order this hearing of the Securities, Insurance, and Investment Subcommittee titled "Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions". I look forward to hearing from our witnesses this afternoon about the important role of community-based institutions in the housing market as well as challenges and opportunities facing these institutions as they access the secondary market.

They will also discuss the relationships between community institutions and Fannie Mae and Freddie Mac and the Federal Home Loan Banks.

The witnesses on our second panel will highlight the elements of the current system of housing finance that are most critical in ensuring equal access to the secondary market for community-based institutions, including the role of the Government backstop.

I want to start by saying how pleased I am that we are finally at a point where we are having a real, honest discussion about what the future of housing finance should look like. From my conversations with the folks on the Banking Committee, there is consensus that the status quo is not acceptable and that now is the time to act to create a housing finance system built to last and to withstand the next crisis.

Now is the time for us to get to work in addressing the unfinished businesses following the financial crisis, and if done correctly, this could be a major driver to our recovering economy.

I am glad that we are getting into more specifics about what the future housing finance system should look like. In May, this Subcommittee examined how to best bring private capital back to mortgage markets while limiting taxpayer risk and facilitating a stable and liquid mortgage market.

Today we are exploring an issue that is very near and dear to my heart as well as that of Senator Johanns: how to best ensure that community-based institutions have access to the secondary market.

As we both know, community-based institutions play a critical role in our housing market, providing a lifeline of credit for many American homeowners, particularly those in rural America. These institutions do an excellent job of knowing and serving their customers with their unique brand of relationship-based lending. And when it comes to mortgage lending, these institutions have always underwritten quality mortgages without exotic features and have been willing to serve their communities, some that would not be served if not for these institutions.

So as we look to the future and we consider what our system of housing finance looks like, we must ensure that these institutions can continue to access the secondary market and that these institutions are not crowded out of the market or forced to access it through their larger competitors. The last thing that I want to see is any further consolidation in mortgage markets.

Our housing finance system must also allow these institutions to securitize the mortgages that they underwrite, manage related risk, and meet the needs and desires of their customers. It must do this while preserving the 30-year fixed-rate mortgage in a way that small financial institutions can continue to offer this critical product.

The stakes are high, and the consequences of community-based institutions being pushed out of the mortgage market would be devastating, particularly for rural America. That simply is not an option, so I am pleased that we have some great witnesses here today that will help us drill down in the role of community-based institutions in the housing market, that will help shed some light on the key issues that we should be focusing on as we consider the future of housing finance reform. I have worked with many of these folks in drafting legislation along with Senators Johanns, Corker, Warner, and other Members of the Subcommittee that both restructures the housing finance system and retains important protections in ensuring access to the secondary market for community-based institutions.

Our legislation creates a mutual exclusively for small originators to enable them to enjoy the economies of scale of their bigger competitors and enables the Federal Home Loan Banks to help their members securitize mortgages. These are critical provisions that will help small financial institutions remain a part of the game when it comes to providing choice and competition in the mortgage origination marketplace.

I look forward to working with the Chair of the full Banking Committee and all of my colleagues in developing legislation that provides equal access to the secondary market for community-based institutions, and with that I will now turn it over to Senator Johanns for his opening statement.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Chairman Tester, let me just start out and say thank you for calling this important hearing today and for the

great work that you and your staff have put into making this hearing possible. I also want to say thank you to all the witnesses that are here today.

Let me, if I might, also offer a special word of thanks to Senators Corker and Warner for really jump-starting this Senate debate on the critically important topic of reforming a system that I regard as unsustainable.

As we all know, a group of eight Senators on this Committee, four of them from either side of the aisle, recently introduced a bill to responsibly transition out of the Fannie/Freddie model and into a model where private investors stand in front of the taxpayers but liquidity and affordability are preserved.

The pieces of that bill in which Senator Tester and I took the most interest were the provisions included to ensure small and medium-sized lenders have equal and fair access to the secondary mortgage market.

In every small town across Nebraska, a community bank or credit union truly is the lifeblood of that local economy. It is essential that these institutions can offer their customers fixed-rate mortgages at affordable prices. While many small institutions do, in fact, originate loans and hold them on their balance sheet, today's volatile interest rate environment can make that a risky proposition. Access to the secondary market is a necessary tool to mitigate that risk, and we have to figure out a way to maintain it.

To that end, I look forward to hearing from our witnesses about what exactly community-based lender need to see in a reformed housing finance system to ensure it is fair and workable for them.

Finally, I hope today we can begin the discussion here in the Banking Committee about the bipartisan Senate bill, what folks like and, quite honestly, what they do not, and how it can help the types of lenders found across Nebraska and Montana and other States compete and thrive in the future.

With that, let me again say, Mr. Chairman, thank you for calling this hearing. I look forward to hearing the witnesses.

Chairman TESTER. Thank you, Senator Johanns.

Would anybody else like to open with a statement?

[No response.]

Chairman TESTER. OK. I would like to welcome our first panel, a panel of one. Thank you for being here and for your willingness to testify today.

Ms. Sandra Thompson serves as the Deputy Director of the Division of Housing Mission and Goals at the Federal Housing Finance Agency. She oversees the FHFA's housing and regulatory policies, financial analysis, and policy research. Before joining the FHFA in March, Sandra spent 23 years with the FDIC, where she held various leadership positions, including Director of the Division of Risk Management Supervision. She has a wealth of experience and is a strong advocate for community-based institutions.

I want to welcome you, Ms. Thompson, and you will have 5 minutes for your oral statement, but please know that you complete written statement will be a part of the record. Please proceed.

STATEMENT OF SANDRA THOMPSON, DEPUTY DIRECTOR, DIVISION OF HOUSING MISSION AND GOALS, FEDERAL HOUSING FINANCE AGENCY

Ms. THOMPSON. Chairman Tester, Ranking Member Johanns, and Members of the Committee, thank you for the opportunity to discuss the important role that community-based institutions play in the Nation's housing finance system.

I am the Deputy Director for Housing Mission and Goals for the Federal Housing Finance Agency. We regulate Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks, which, combined, support over $5 trillion in mortgages.

For the past 5 years, we have also served as conservator for Fannie Mae and Freddie Mac. We take this responsibility very seriously and work hard to ensure that the enterprises operate in a safe and sound manner.

Before joining FHFA in March of this year, I spent 23 years with the FDIC, where I most recently served as the Director of Risk Management Supervision. At the FDIC, I spent a lot of time participating in outreach efforts that were specifically targeted to understanding the vital role that community banks play.

In a similar manner, FHFA is committed to undertaking outreach efforts with small and rural lenders to help better understand their access to and interaction with the secondary mortgage markets.

Despite the fact that community-based lenders account for a very small percent of the residential mortgage market, they do play a vital role in serving rural and underserved communities. They are a stabilizing force in their local markets and generally engage in responsible lending. Community-based lenders have a long history of making sound mortgage loans and for the most part did not originate the abusive and predatory loans that contributed to the financial crisis. More important, these lenders are committed to the people and places where they lend money.

Community institutions are particularly important in smaller and rural areas where many loans have nonstandard characteristics. For example, self-employed and seasonally employed borrowers often do not have the income documentation required to sell to large lenders. So the community lender often keeps these loans in their portfolio. But many community lenders can only make loans if they can sell them in the secondary market. The private label securitizers and correspondent banks have virtually abandoned the business.

Community lenders' primary access to the secondary market is through Fannie Mae, Freddie Mac, Ginnie Mae, and the Home Loan Banks. FHFA has taken steps to ensure that community-based lenders have equal access to the secondary market. Last fall, we increased guarantee fees for MBS swap transactions relative to cash window transactions. Now, this is important because large lenders primarily use the swap execution, and many small lenders use the cash window to sell loans. The increase in guarantee fees leveled the playing field between large and small lenders.

FHFA has also made the enterprises' development of the Common Securitization Platform a key component in building a new infrastructure for the secondary mortgage market. This framework

will connect capital markets investors to homeowners and is being developed with the potential to be used by all issuers, large and small, Government and private sector. My written testimony goes into detail and covers three main points: one, that community-based institutions play an important role in providing housing credit; two, that the FHFA has taken meaningful steps to ensure that community-based lenders have equal access to the secondary market; and, three, that community-based institutions must have the ability to fully participate in any future housing finance system. There should not be a significant difference in how large and small lenders are treated when securitizing residential mortgage loans. We stand ready to work with this Committee to see this goal reached.

Thank you, and I am pleased to answer any questions you might have.

Chairman TESTER. Well, thank you, Ms. Thompson, for your testimony.

I am going to go a little bit out of the order that we normally do because I know Senator Kirk has a commitment. Senator Kirk, you have the floor.

Senator KIRK. I would just say, Mr. Chairman, thank you very much for doing this hearing. I would say under the current old system we can safely say that housing finance was not broken, it was fixed. I am sure the Senator from Massachusetts can back me up on the future bank that we will someday found together——

Senator WARREN. That is right. That is our bank.

Senator KIRK. ——based on the HSBC model that we have talked about so many times.

Chairman TESTER. Thank you, Senator Kirk.

I think we will put 5 minutes on the clock and go down the road here.

Ms. Thompson, you have a unique perspective in your current role given your experience with the FDIC and your understanding of community-based institutions. It is critically important that these institutions remain in the business of mortgage lending, because I know that without them many areas of my State absolutely will not be served, as your testimony indicated.

Your testimony highlighted your work to encourage Fannie to—or Freddie to back away from the proposed low activity fee. But looking to the future, how do we ensure that the standards, requirements, and pricing for small institutions seeking access to the enterprises are risk based and are not cost prohibitive or have the effect of pushing small institutions out of the marketplace.

Ms. THOMPSON. Thank you, Senator. I totally agree. I think the important thing for us to do is to look at the characteristics of the loan and take that into consideration as opposed to having a volume based or dollar cutoff. When you have a dollar cutoff for eligibility, that automatically implies that bigger is better, and we know that that is not true. It also implies that larger is less risky, so any risk-based characteristics we can incorporate into how we define eligibility are critical as we move forward.

Chairman TESTER. OK. So what will you do to ensure that?

Ms. THOMPSON. Well, certainly with regard to our role as supervisor and regulator of the enterprises, ensuring that they have poli-

cies in place to evaluate potential counterparties based on a risk-based assessment as opposed to a hard-dollar threshold, because, again, when you have such a blunt number cutoff, it just makes it very difficult for smaller and perhaps less risky institutions to participate in the seller servicer model. And, again, I do believe that size is good, but bigger does not necessarily mean better.

Chairman TESTER. OK. In your testimony, you noted that the cash window volume at Fannie tripled from 2007 to 2012 and doubled at Freddie over the same time period. What is the reason for this?

Ms. THOMPSON. Well, actually I went back and looked at the flow for both MBS swap transactions and cash window transactions before the crisis and currently. And it was interesting because, before the crisis, the volume was almost—it was de minimis on a good day. But I think that there is an openness and receptivity to the entrance of small market participants, and that has been evidenced at both Fannie and Freddie as more and more people get back into the market. As the market recovers and as housing prices increase, I think there are more opportunities for persons to engage in the seller servicing business with Fannie and Freddie.

And as my testimony indicates, for smaller lenders, they have to go to the cash window because many of them do not have the volume to sell and issue mortgage-backed securities. So they have to sell one loan at a time, so it really makes a difference to have this mechanism available. And I would encourage that, in any future housing finance system, small lenders be able to sell either multiple or single loans to whatever entity is created.

Chairman TESTER. OK. Drawing on your experience at the FDIC in risk management, how important is access to Fannie and Freddie for community-based institutions when it comes to providing their customers with a 30-year fixed-rate mortgage?

Ms. THOMPSON. Well, I think, again, there are two different discussions to be had on that topic. Based on my experience at the FDIC, it is hard for institutions to do the asset/liability management with a longer-term product. But for affordability's sake, many people opt to have that product so that they can have an affordable mortgage product.

But I think I do not necessarily have a view on products. What I do care about, as a former bank regulator, is making sure that borrowers have the ability to repay mortgages and that they understand the loans that they get and that they are sustainable over time. And I think sound lending, which is certainly the hallmark of community banks, especially in the residential mortgage space, is as good as it gets.

Chairman TESTER. One of us will take this up with the next panel, but from your perspective, would the institutions that we are talking about, the community-based institutions, be able to provide a 30-year fixed-rate mortgage if there was not the Government backstop?

Ms. THOMPSON. Well, again, I think many community banks have to sell their mortgages under any circumstance so that they can have liquidity to originate more mortgages. Again, I am just not in a position to opine on products.

Chairman TESTER. OK. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

It strikes me that the secondary market is not only an important financing avenue but also a vital risk mitigation tool for institutions of all sizes. It shifts both credit and interest rate risk to investors willing to take that on.

If Congress reforms the system in such a manner that community-based institutions do not have a workable access, what sort of risks would be posed to those institutions? What happens in that kind of system? Do you have higher mortgage rates? Do you have less access to credit? Would you expect both to occur? Fill in the blanks there, if you would.

Ms. THOMPSON. Senator, I think the words you used were "workable access," and I think having access to the secondary market is critical, again, for community lenders, and whether they have it directly or through an aggregation process, the ability to originate and some absolutely have to sell. So I would think that in whatever future state would being developed by the Congress, that they would take those matters into consideration as we move forward, because, again, the secondary market is just absolutely critical, and access to that market is critical for the community lenders.

Senator JOHANNS. Chairman Tester has referenced this, and I think it is a very valid point that maybe you can offer some more testimony on, and that is, if we do not get this right and your community banks, your community lenders are not a part of the future going forward, then access to those services disappears in parts of our State. I mean, literally it is gone. Is that a correct observation?

Ms. THOMPSON. I think that is accurate. When you look at the banking system, I know there are almost 7,000 insured depository institutions, and of those 7,000, there are 117, give or take a few, that have assets over $10 billion. By number, community banks, and most of them, about 4,200, have assets of $250 million or less. So throughout the country by number, community banks are important. Dollar size and asset size, of course, the reverse is true. So 10 percent of the institutions hold 90 percent of the assets. But I do not think that the larger institutions particularly have an interest in this space that the community banks serve. And based on the experience I had at FHFA now and prior to that at FDIC, community banks are more than just a bank. Community institutions are a big part of those communities, and but for them—they do more than lending. They provide lots of services to the communities they serve. And many of them do not serve just one community. They serve multiple, and sometimes across State.

So I would hope that whatever policies the Congress decides to come up with, I think that certainly access for rural and community institutions is critical. It is in the public interest.

Senator JOHANNS. In your testimony you made mention of FHFA's work to encourage consistent customer access as well as to work to discourage Freddie Mac from imposing a so-called low-activity fee. To what extent should we ensure that equal pricing across lenders of all sizes such as the prohibition on volume discounts, like we have in our Senate proposal? It seems to me that Wells Fargo should get the same price for selling a qualified mortgage to the guarantor as First National of Omaha. That is what it

seems to me should be the case. Are there positives and negatives to the approach we are taking?

Ms. THOMPSON. Well, I think that certainly transparency is important, and fair pricing certainly ought to be a standard, and there ought not be benefits versus one over the other. But I would say that a risk-based approach that looks to the characteristics of the loan is probably fair for all lenders, because if you look at, let us say, LTV, FICO, DTI, and there are no disparities, you can price based on risk. And I think a risk-based approach versus, again, a blunt dollar amount or a volume really is more appropriate.

Senator JOHANNS. OK. Thank you, Mr. Chairman.

Chairman TESTER. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. You know, I have been looking forward to this hearing because I think there are two principles at stake here. The first is we need housing finance reform. It has been 5 years since the crash and long past the time we need to make these reforms. But the second is we need to do it right. We are only likely to get one bite at this apple, and doing it right here means making sure that our small financial institutions, our community banks, our credit unions, still can thrive and be in an atmosphere where they can do that.

So I am very grateful to you for having the hearing here today, and what I would like to ask about follows up on what Senator Johanns had started with just a minute ago, and that is, as I understand it, Fannie and Freddie buy loans from lenders, pursuant to the terms of the individual contracts, as you identified. But depending on the lender and the transaction, the contracts can either be one-off or they can be master agreements that cover a lot of loans. And Fannie and Freddie currently keep the prices in terms of these individual agreements secret, but we do know from their past disclosures that the agreements tend to favor the largest financial institutions.

So what this means, in other words, is that Fannie and Freddie have charged our community banks and our credit unions more than they have charged the big banks for what might otherwise be exactly the same product.

So I think that transparency is powerfully important in any housing finance reform, but I am curious about how FHFA could make immediate improvements by requiring Fannie and Freddie to disclose all of their agreements with the individual lenders—that is, past, present, and future.

So do you have any thoughts on Fannie and Freddie's basis for not making the terms public and whether the FHFA should require Fannie and Freddie to disclose this information publicly?

Ms. THOMPSON. Well, Senator, I had not thought about the agreements per se. I was looking at pricing, and we did take a look at G-fees last year, and when we report to Congress annually, we do an annual G-fee report. One of the things that we do is we break the lenders or sellers to Fannie into three different categories: 1 to 5, 6 to 100, and 100 and below. And the larger ones are in the 1 to 5 category, and the smaller ones are in the latter category of 100 and below. And one of the steps——

Senator WARREN. And 100 and below referring to?

Ms. THOMPSON. 100 and—the top five lenders in terms of volume.

Senator WARREN. That is right, total volume that the lender does.

Ms. THOMPSON. Total volume of the lender. And so one of the things that we did last year in September when we increased G-fees was we, again—and I mentioned this in the testimony—we did raise the G-fees for the swap, the larger transactions relative to those participants in the smaller transactions. So when you look at the smaller, which is the 100 and below, and then the larger, when we raised the G-fees, there certainly is now an equal playing field. And I think the principles ought to apply.

One of the things that we are working on is trying to provide some uniform data standards, because right now there is a standard for Fannie, there is a standard for Freddie. And to the extent that we have a single data standard that we can have uniform reporting, uniform disclosures, those are the things that help drive the price down, when there is one set of standards that everyone knows, that people are aware of, it just makes it clear for all mortgage participants to work toward that end.

Senator WARREN. So, Ms. Thompson, I completely agree with you about the importance of standardized reporting so that you can make comparisons so the markets become transparent and we can tell. And I want to ask you a question about that in just a second, but I want to make sure I have kind of dug in on this question about what Fannie and Freddie do now.

I appreciate the point you make about changing the fees, but as I understand it, Fannie and Freddie still do not disclose what they are charging. And so my question is whether or not this is something FHFA could think about. As we heard toward reform, you know, it is like a lot of things. You kind of smooth it in if you start making changes now, and Fannie and Freddie were required by FHFA to make full disclosure of how they have priced in the past, how they are pricing now, how they continue to price in the future, whether or not that might be a helpful way both to understand how this market operates now and to make certain going forward that this market is a level playing field for our community banks and credit unions.

Ms. THOMPSON. I think we could take that into consideration.

Senator WARREN. That would be enormously helpful. Thank you. And we will get back someday to the question about how to make sure that we get uniform reporting, but count me as a big supporter on this, and we will have a good conversation about data tagging and keeping the information going forward. Thank you, Ms. Thompson.

Chairman TESTER. Senator, we may well have a second round. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. I want to thank you and the Ranking Member for your interest not only in GSE reform but also in particular paying a lot of attention to how to fix the smaller institutions. And I know in your two States in particular, but all of ours, it is a very important issue, so thank you.

I will make note that of the eight people who have been here on the dais, seven of the eight have actually supported and introduced

and affected in big ways a bill that would transition us, to use Senator Warren's—you know, as things are smoothed out, transition us into a better place. And I want to thank everybody who has been involved in that effort.

I do want to point out that one of the attributes of preconservatorship, going back to, again, more questions that Senator Warren asked, Fannie and Freddie were giving volume discounts, and so the big guys were getting bigger and the small guys that many of us represent were at a disadvantage. Would you agree that if there is going to be an explicit guarantee—and there is today. You know, because of what has happened, there is, in fact, an explicit guarantee. But going forward, would you agree that if there is a Government explicit guarantee that everybody ought to be charged the same price for that guarantee?

Ms. THOMPSON. I absolutely think that that is something that I would have to take back to my agency to consider. It sounds perfectly reasonable, and, again, there are so many complexities, it is just hard to give you a good answer.

Senator CORKER. Well, the bill that many of us have worked on does that. Let me ask you this question: In the event there was not a Government backstop of some kind—and I think, you know, most people on this Committee have come to the conclusion that some type of backstop is a reasonable place to be. But without a backstop, what would happen with the smaller institutions as far as wouldn't the larger institutions more and more dominate the market if there were not some kind of Government backstop?

Ms. THOMPSON. It is likely that if the—the smaller institutions would have to pay more because they would have to go through an intermediary, an aggregator to get direct access to selling their loans. But it is just hard to say what would happen with or without a Government backstop.

Senator CORKER. But it would make sense, I think, if you did not have that element of reinsurance, that over time the larger entities would have the ability to deal with the secondary market in a way that the smaller institutions would not. Is that correct?

Ms. THOMPSON. Correct, Senator.

Senator CORKER. I love leading you as a witness. I appreciate that.

[Laughter.]

Senator CORKER. Let me ask you another question in a nonleading way. Do you agree that having a situation where there is a Government backstop implied but that you have CEOs of entities that really are not focused on that particular aspect, which has to do with the taxpayers, but instead is focused on shareholders, that that is an untenable place for us as a Nation to be?

Ms. THOMPSON. Senator Corker, that is way above my pay grade, and I would defer to not answer that.

Senator CORKER. OK. Well, as an editorial comment, I will say then that I think what—actually, I think what most people on this Committee have come to the conclusion of, that model of having private shareholder gain and taxpayer losses where, in essence, the shareholders' interests are well served in good times but the public's interests are not well served during bad times is a model that we need to move beyond. There may be differing ways of get-

ting there, but I think just in looking at the body language, I think most people think that is not a good place to be. And it looks like you might want to answer now.

Ms. THOMPSON. Well, Senator, I did want to highlight that we are engaged in some credit risk-sharing transactions, and one of the things that Director DeMarco has done is establish a scorecard for the enterprises. And part of that scorecard, they have been asked to participate in multiple types of credit risk-sharing transactions so that we can bring private sector money back into the securitization market. And I do think that risk sharing is important, and I did want to raise that to your attention.

Senator CORKER. And I think that, you know, as I mentioned, seven of the eight people who have been here today, and hopefully more, really believe that it is important to have that risk sharing up front. And I want to thank you and actual the FHFA for leading—giving us a bread trail, if you will, toward that end. I know that you all are building toward an end where there is that private sector risk, which a bill that many of us have worked on together takes us to, and we thank you because we really believe we are working in the same direction and think that is very productive and helps create this smoothing effect that Senator Warren just talked about.

Ms. THOMPSON. Senator, we did want to take the opportunity to thank you for introducing the legislation. We are just glad that the policy makers have moved forward and introduced legislation. So we just wanted to say thank you.

Senator CORKER. Thank you very much.

Chairman TESTER. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. I appreciate that you and the Ranking Member both support this new legislation, holding this hearing. I would have preferred the opportunity to go in front of my friend Senator Corker since he asked all the questions I had, but I will find a way to——

[Laughter.]

Senator WARNER. ——come back around to them in a different way.

Chairman TESTER. Senator Heitkamp has some different questions if you would like me to move.

[Laughter.]

Senator WARNER. And I know I may be just going back over ground that has already been tilled, but I just cannot imagine—there is another proposal being put forward in the House that would remove any Government backstop, that would take out any private sector role, and I just do not see—can you envision a system in which that takes place? And, Senator Johanns, First Mutual of Omaha, what was your institution you——

Senator JOHANNS. First National.

Senator WARNER. How would First National in Omaha in that system ever be able to compete with Wells Fargo or JPMorgan? Can you envision a system where they would be on an equal footing, Wells Fargo and JPMorgan?

Ms. THOMPSON. Senator, I am envisioning the Congress working to enact legislation that I am happy to implement, and——

Senator WARREN. No, but you are an expert in the field. I would just think that you would have to have some sense whether, you know, First National of Omaha is ever going to have in a private sector-only system the ability to have equal access to a secondary market that a loan that was originated out of Wells or JPMorgan—I do not mean to be—just you have got a lot of experience. Is there a way to get there with that possibility?

Ms. THOMPSON. It is difficult to imagine. I have never worked in an environment where there was not that. But, again, I am just not certain, and I think that making sure that the Omaha or Nebraska institution has access to the secondary market, however they can, is done in a fair, transparent, and least costly—I would be concerned about cost, I guess, more than anything.

Senator WARNER. Right. And I guess one of the things that—you know, and you were kind enough to reference the legislation that some of us have worked a long time on. One of the ways, just to—I am sure most of the folks in the audience realize this—that we tried to ensure that access for community-based institutions, credit unions, and others was, you know, to—because we wanted a more competitive system of issuers, was to take some of those intellectual assets and other assets that are within Fannie and Freddie and create a co-op that would make sure that it had as its priority making sure that community banks and credit unions had that fair access and that pricing equality. As a matter of fact, as the legislation states, we even guarantee that pricing equality. As a matter of fact, as the legislation states, we even guarantee that pricing equality. I think one of the comments you made—and I think we all agree with this—pricing equality based upon access to a secondary market, obviously if there are loans of different quality, that has to be dealt with.

Ms. THOMPSON. That is correct, sir.

Senator WARNER. But I do think that the approach that this group is taking, you know, guarantees that access because if there is—again, one of the lessons that we have seen from the crisis is that when stuff hits the fan, sometimes it is these smaller institutions that stay in the communities, that stay through good times and bad, and that we have seen, again, from some of the data that you have, a relatively dramatic increase in the market share that these smaller institutions have had postcrisis versus precrisis. Correct?

Ms. THOMPSON. That is exactly correct, Senator.

Senator WARNER. And I would argue that is, again, a good thing in terms of keeping the value of these institutions.

I guess I want to just raise one other thing that Senator Warren raised. I agree that we need more transparency and that, again, a piece of this legislation that is bouncing around up here actually moves forward with what FHFA has been doing in terms of trying to create this Common Securitization Platform around reps and warranties, around documentation, that would allow transparency and really make sure this is a utility function. And I would echo, subject to being, you know, explained otherwise, why Senator Warren's comments would not be kind of right on, at least in that transition, why we should not have more of that transparency sooner than later, although again we envision that Common Securitization

Platform being an essential utility component of this new reform we have.

I do not want to lead you as well, but since you are welcoming this legislation, is it safe for me to infer that you do not think the status quo or recapitalizing Fannie and Freddie is the appropriate role?

Ms. THOMPSON. Well, not to provide my personal opinion, I just think that housing finance needs to be reformed. I am happy to see legislation that moves in the right direction. Fannie and Freddie, again, the model was broken. And to the extent that——

Senator WARNER. So a long-term conservatorship for Fannie and Freddie is not a valid option.

Ms. THOMPSON. Five years is a really long time for a conservatorship, and longer than that is quite unimaginable.

Senator WARNER. Thank you, Mr. Chairman. Thank you, ma'am.

Chairman TESTER. Senator Heller.

Senator HELLER. Thank you, Mr. Chairman and Ranking Member. I appreciate the opportunity to crash your Subcommittee. I know you do not see me enough, so I thought I would stop by. But this is an important issue, and you and I have had an opportunity, Mr. Chairman, in your office to talk about banking and the problems with community banking that we have in some of our more rural States and our more rural areas within our States.

I would argue that the economic downturn probably had more to do with housing, at least in our communities, than any other issue. I know gasoline prices played a big role in that also, but ultimately it was the crash of the housing market.

In Nevada—and I know some of my colleagues have heard this before, but over 50 percent of the homes in Las Vegas today are underwater. We have over 400,000 homes in Nevada that have received foreclosure notices. And, you know, to make matters worse, we have probably lost half of our community banks in the last 5 years, probably half of those banks—I mean, obviously making it very difficult for the economy to bounce back.

We had a report last week on unemployment, and it actually jumped half a point in Nevada last week, although I do see and most people are noticing that there is some recovery that is occurring in my home State.

So putting all those issues together, you can imagine the concern and the reason why I am here to have this discussion with this panel, because I believe the panel that is here today are, frankly, the individuals that are going to help solve this problem in the future.

So my question, since you are the expert, is: Have you had an opportunity to take a look at the Corker-Warner bill? Do you have any insight or opinions on it?

Senator WARNER. Corker-Warner-Heller bill?

[Laughter.]

Ms. THOMPSON. Senator, again, we are very happy that the legislation has been introduced. We have formed a working group to take a closer look at it, and we have not come to any determinations. But we are happy to, when we are done, provide any technical advice you would like on certain aspects of the bill.

Senator HELLER. OK. You made comments earlier in your discussions with others on the panel about the importance of the secondary market, and I agree with you 100 percent. I think there is a role for the secondary market. I think there is a role for Government to play in that to make sure that there is some level of certainty and liquidity out there so that these home loans can be made. And I think you have answered this question. We keep asking you the same question over and over again, but we are trying to get to the bottom of whether or not you believe that Freddie and Fannie need to be reformed.

Ms. THOMPSON. I think housing finance needs to be reformed. I think there needs to be a level playing field for anyone who wants to issue, whether you are large or small. I do think it is important, again, for special attention to be paid to the smaller institutions because of the public interest that they serve in communities across this country. I just think that is critical. So whatever legislation is introduced and enacted, I do believe that that is a crucial part to the long-term recovery of our Nation.

Senator HELLER. If after 5 years we do nothing, what would the consequences of that be?

Ms. THOMPSON. It would be very—it is hard to imagine. Certainly I am hoping that that will not be the case, that whatever legislation the Congress agrees upon will be enacted and we will be well along the way of implementing housing reform legislation. I just hope that that is not the case.

Senator HELLER. Do you believe that this lack of housing reform or as slow as we have moved here in Congress had—do you believe that that has slowed our economic recovery?

Ms. THOMPSON. I believe that this is the last piece that needs to be addressed. Again, I worked for—spent the last 23 years at the FDIC and just came out of a banking crisis, and certainly housing was a big part of that. I just believe that once we get this done, we will be well along our way to a recovered Nation.

Senator HELLER. Do you believe by not doing any reforms to Fannie and Freddie that we would be susceptible to another housing market crash?

Ms. THOMPSON. Fannie and Freddie just absolutely have to be reformed. That model was broken, and they had to borrow $185 million from the taxpayers, and it is just untenable. They are not capitalized entities, and this is a big part of our housing future, and we need to fix it.

Senator HELLER. Ms. Thompson, thank you for your testimony.

Again, Mr. Chairman, thank you for allowing me to come in and ask a few questions.

Chairman TESTER. You are welcome anytime.

Senator Heitkamp.

Senator HEITKAMP. Thank you so much, Mr. Chairman and Ranking Member. This is critically important, and I always think it is interesting to follow Senator Heller because North Dakota's situation could not be more different from the situation in Nevada, where they are seeing houses underwater, excess capacity in the market. In North Dakota, we think we need to build about 33 percent more units by 2025. But I want to bring the subject back because, at the very heart of it, every person here who is rep-

resenting a different situation is telling you that it is absolutely critical that we maintain a role for independent community banks and credit unions, and that when we are all wringing our hands in despair over too big to fail, we are setting policies in Washington, DC, that are consolidating more and more assets into the larger banks and diminishing the capacity of the smaller community banks to participate in the marketplace, and that has to end.

Now, I know you are frustrated with all of us because we are trying to get you on board here, and we really do——

[Laughter.]

Senator HEITKAMP. We really do appreciate your advice. But I would emphasize to you we need your leadership, and it is not leadership to come and not, you know, kind of say we will help you in any way you can. You are the experts. We represent a lot of different folks, a lot of different constituencies. We need the expertise that you bring and that the other panels bring. But we also need your leadership, and we need you to be weighing in on the important policy questions.

And so, you know, I hope that as you explore the Corker-Warner-Heller-Tester-Heitkamp—you know, we could go on and on, but those are the ones who are here—bill, that as we have said many times, we think we have done a pretty good job, but nothing is perfect, and we need leadership from the administration.

But I want to turn to a topic that is maybe unique and different in my State, and that is, appraisals. You know, I recently had an opportunity to get an appraisal in Washington, DC, and shock upon shock, it only took a week. And if I were going to do that in North Dakota right now, it would be 6 to 10 months—or 6 to 10 weeks. We cannot move forward, in part because of the impediments and because of the requirements.

I also would tell you that I am from a small town of 90 people, grew up in a little small town of 90 people. If somebody wanted to sell a house, good luck finding comparable sales within a 10-mile radius. There is too much one-size-fits-all in the housing market, and that is even more discouraging, not just for the industry but for the homeowners as they are trying to transition out and build opportunities.

Do you think that would be appropriate to take a look at areas like Senator Tester and Senator Heller and I represent where, you know, you could not see another person for miles and miles, take a look at those kinds of areas and look at some different standards as it relates to quality of mortgages?

Ms. THOMPSON. I absolutely agree with you, Senator. In fact, a couple of institutions have raised the issue of appraisals that describe just exactly what you are talking about. The next home may be 10 miles away——

Senator HEITKAMP. That is typical.

Ms. THOMPSON. ——so it is very difficult to find a comparable appraisal value. And so we have been engaging with both Fannie Mae and Freddie Mac about their seller servicer guide and the standards, and in particular highlighting here is the policy, but here is how it applies to rural and small communities, and here is how it applies to you. And we do believe that certainly the policies you make in Washington, it is not one-size-fits-all, and it is not bigger

is better. And you have to take a risk-based and specific targeted approach to address the issues that are relevant to the city you are in, the two you live in, or the issue that you are facing. And I certainly could not agree with you more about appraisals.

Senator HEITKAMP. Thank you.

Chairman TESTER. Well, thank you, Ms. Thompson. We appreciate you being here very, very much, and we will stay in touch.

We will now proceed to the second panel, and while the witnesses are setting up, I am going to read a brief bio on each of them.

First of all, we have Jack A. Hartings who serves as vice chairman of the Independent Community Bankers of America and is the president and CEO of The Peoples Bank in Coldwater, Ohio. He previously served as State director for ICBA and as chairman of ICBA's Policy Development Committee. Mr. Hartings also serves as a member of the Consumer Financial Protection Bureau Community Bank Advisory Council. Welcome, Mr. Hartings.

We have Mr. Bill Hampel, who is the senior vice president of research and chief economist for the research and policy analysis at the Credit Union National Association. Mr. Hampel writes economic analysis columns that appear in several credit union publications. Prior to joining CUNA, he taught economics at several universities, including the University of Montana and Iowa State University. Welcome, Mr. Hampel.

We have Mr. Andrew Jetter, the president and CEO of the Federal Home Loan Bank of Topeka. He joined the FHLB Topeka in 1987 as an attorney and served as general counsel and senior vice president through his tenure with the bank. Before joining FHLB Topeka, Mr. Jetter was engaged in private practice in law and served as a full-time instructor in the areas of finance and management at the University of Nebraska at Omaha. Welcome.

And last, certainly not least, Michael Middleton is the chairman and CEO of the Community Bank of Tri-County. Mr. Middleton joined the bank is 1973 and was promoted to president and chief executive officer in 1979. He is also chairman of the Board of Directors of the Maryland Bankers Association and is former chairman of the Board of Directors of the Federal Home Loan Bank of Atlanta. Welcome, Mr. Middleton.

Each of you, as with the previous panel, will have 5 minutes, and your entire written statement will be put in the official record. You can start, Mr. Hartings.

STATEMENT OF JACK A. HARTINGS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE PEOPLES BANK COMPANY, COLDWATER, OHIO, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. HARTINGS. Thank you. Chairman Tester, Ranking Member Johanns, Members of the Subcommittee, I am Jack Hartings, president and CEO of The Peoples Bank Company and vice chairman of the Independent Community Bankers of America. The Peoples Bank Company is a $400 million asset bank in Coldwater, Ohio, and I am pleased to represent community bankers and ICBA's nearly 5,000 members.

Any broad-based recovery of the housing market must involve community bank mortgage lending. Community banks represent approximately 20 percent of the mortgage market, but more importantly, this lending is often concentrated in the rural areas and small towns not effectively served by large banks. For many borrowers in these areas, a community bank loan is the only option.

The Peoples Bank Company serves a community of approximately 5,000 people and has been in business for over 100 years. Our bank survived the Great Depression and numerous recessions—as have many other ICBA member banks—by practicing conservative, commonsense lending.

Today I would like to talk to you about my bank's mortgage lending and the importance of the secondary market. Mortgage lending is about 80 percent of my business. The Peoples Bank Company is the number one mortgage lender in my county, Mercer County. About half of the mortgage loans my banks makes are sold, mostly to Freddie Mac, with a smaller portion sold to the Federal Home Loan Bank of Cincinnati. The secondary market allows us to meet customers' demands for fixed-rate mortgages without retaining the interest rate risk these loans carry.

Selling into the secondary market frees up our balance sheet to make more residential mortgage loans as well as small business loans, which play a vital role in our community.

ICBA developed a comprehensive set of secondary market reform principles.

First, community banks must have equal and direct access. We must have the ability to sell loans individually for cash under the same terms and pricing available to the larger lender.

Second, customer data cannot be used to cross-sell financial products. We must be able to preserve customers' relationships after transferring the loans.

Third, originators must have the option to retain servicing rights at a reasonable cost. Servicing is critical to the relationship lending business model vital to community banks.

Finally, private capital must protect taxpayers. Securities issued by secondary market entities must be backed by private capital and third-party guarantors. Government catastrophic loss protection, which is critical during periods of market stress, must be fully priced into the guarantee fee and the loan level price.

Without these principles, there could be further consolidation of the mortgage market, which would limit borrower choice, disadvantage communities, and put our financial system at risk of another collapse.

ICBA is pleased to see the robust debate emerging on housing finance reform. Many of these ideas and proposals provide promising features but also warrant additional consideration and reworking.

ICBA welcomes the deliberation of the future of housing finance and the important role of community banks such as mine in the mortgage market. ICBA is grateful to Senators Warner, Corker, Tester, and Johanns for introducing S.1217 and to Senators Hagan, Moran, Heller, and Heitkamp for their cosponsorship.

ICBA sincerely appreciates the opportunity to provide input into this bill. We are encouraged by the inclusion of certain provisions

to accommodate ICBA's concern, and I note four of those in particular:

First, the mutual securitization company would secure access to the secondary market for community banks and other small originators and would allow them to sell loans for cash and to retain their servicing.

Second, the Federal Home Loan Banks would also be allowed to issue securities, creating another access point for community banks.

Third, limiting issuers to no more than 15 percent of the outstanding guaranteed securities would reduce concentration in the securitization market by large banks or Wall Street firms.

Last, the FMIC guarantee, well insulated by private capital, would insure the securitization market continues to function even in times of market stress.

We look forward to continuing to work with the other cosponsors and the Chairman and the Ranking Member to further strengthen this bill and to ensure it serves the needs of community bank customers.

I want to thank you again for holding this hearing and for the opportunity to testify, and I look forward to your questions.

Chairman TESTER. Well, thank you, Mr. Hartings, for your testimony, and just for the record—and you did not know this—but other than the nine you listed, we can also add Senator Manchin as an original cosponsor. With that, thank you for your testimony.

Mr. Hampel, you may proceed.

STATEMENT OF BILL HAMPEL, SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, CREDIT UNION NATIONAL ASSOCIATION

Mr. HAMPEL. Thank you. Chairman Tester, Ranking Member Johanns, Members of the Subcommittee, thank you for the opportunity to testify at today's hearing. I am Bill Hampel, chief economist for the Credit Union National Association, which represents the Nation's almost 7,000 credit unions and their 97 million members.

CUNA appreciates the attention this Subcommittee is focusing on housing finance reform. Credit unions need fair and equal access to a secondary market for lenders of all sizes, one that will ensure affordable mortgage products for our members. My written testimony describes in detail the current state of mortgage lending by credit unions; the importance of the 30-year fixed-rate mortgage; the need for some form of Government guarantee so long as there are adequate taxpayer protections; and, finally, it offers some comments on S.1217.

Credit unions have been actively engaged in mortgage lending since the 1970s. Our origination volumes rose sharply in the recent financial crisis as credit unions remained able to lend while major parts of the secondary market collapsed. Last year, credit unions originated $123 billion of first mortgage loans, representing 6.5 percent of the market, and over 80 percent of those loans were fixed-rate loans. Credit unions are now significant players in residential real estate finance.

Credit unions originate mortgage loans both for their own portfolios and for sale to the secondary market. The decision to hold or

sell a loan depends primarily on the management of interest rate risk as opposed to the desire to offload excessive credit risk. Interest rate risk considerations can vary through time. Up until 2008, credit unions sold only a third of their new loans. Since then, as long-term interest rates have plummeted, credit unions have found it prudent to sell more of their new loans so as to not repeat the savings and loan debacle of the 1980s. In the first quarter of this year, they sold almost 60 percent of their originations.

At current low interest rates, mortgages are much more appropriately financed by investors with a long-term horizon such as life insurance companies and pension funds than by depository institutions.

The fact that many loans will be held on credit unions' books makes them prudent lenders. Even at the depths of the recent financial crisis, losses on credit union-held first mortgages remained remarkably low, peaking at less than one-half of 1 percent of loans outstanding. At commercial banks, similar calculated losses peaked at almost four times that amount, and loss rates at other lenders were undoubtedly even higher.

The fact that interest rate risk management often requires selling a significant portion of loans means that a robust and accessible secondary market is vital to credit unions.

We fully appreciate the need to reform the current system of housing finance. We are concerned, however, that the reform does not hinder the ability of credit unions to meet their members' housing finance needs in a member-friendly, cooperative way. Because of this concern, we have a few principles that we feel strongly the new system must accommodate.

First, there must be fair access to the secondary market for lenders of all sizes.

Second, the entities providing secondary market services must be subject to rigorous regulatory and supervisory oversight to ensure safety and soundness and equal access.

Third, the new system must ensure that, even in troubled economic times, mortgage loans will continue to be made available to qualified borrowers.

Fourth, the new housing finance system should emphasize reasonable consumer education and counseling.

Fifth, the new system should include consumer access to mortgage loans with predictable, affordable payments for qualified borrowers. This has traditionally been provided through the 30-year fixed-rate mortgage.

Sixth, the new housing system should apply reasonable conforming loan size limits that adequately take into consideration variations in local real estate costs.

Seventh, the important role of Government support for affordable housing should be a function separate from the responsibilities of the secondary market entities. The requirements for a program to stimulate the supply of credit to lower-income borrowers are not the same as those for the more general mortgage market.

Eighth, most market participants define "servicing" as the process whereby monthly payments from borrowers are routed to investors and how delinquencies are handled. While credit unions understand the importance of those functions, they view loan servicing

more as an opportunity to continue to provide excellent service to their members after the loan has been made. Credit unions are also concerned about the continued confidentiality of their members' data. Therefore, it is critical that credit unions are able to continue to perform servicing for their members in the future.

And, last, the transition from the current system to any new housing finance system must be reasonable and orderly.

As we continue to study S.1217, we are encouraged that it largely addresses our principles. CUNA especially appreciates the leadership of Senators Corker and Warner and the rest of the sponsors of the bill to ensure that credit unions and other small community lenders will continue to have access to the secondary market. Through the creation of the Mortgage Insurance Fund, the bill goes to great lengths to protect the taxpayer while providing a necessary ultimate Government backstop.

In summary, CUNA believes that S.1217 is a positive step toward creating a sustainable and affordable housing market. Thank you again for allowing me to testify today on behalf of America's credit unions, and I look forward to your questions.

Chairman TESTER. Thank you, Mr. Hampel.

Mr. Jetter.

STATEMENT OF ANDREW J. JETTER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL HOME LOAN BANK OF TOPEKA, ON BEHALF OF THE COUNCIL OF FEDERAL HOME LOAN BANKS

Mr. JETTER. Good afternoon, Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee. My name is Andrew Jetter, and I am the President and CEO of the Federal Home Loan Bank of Topeka. I appreciate the opportunity to speak to you today on behalf of the Council of Federal Home Loan Banks.

Congress created the Federal Home Loan Banks in 1932 to support America's housing finance system by providing liquidity to thrift institutions and insurance companies. Since that time, Congress has expanded the mission of the banks to include support for affordable housing, community development, and other forms of community lending, and opened membership to commercial banks, credit unions, and community development financial institutions. Although Congress has expanded our mission, our core structure remains unchanged: 12 independent cooperatives, each with our own capital, membership, boards of directors, and management.

During the Nation's financial crisis, the Federal Home Loan Banks were a critical source of funding for U.S. financial institutions. The Banks expanded their lending to members of every asset size and in every part of the country, with loans to members, what we call "advances," increasing from $650 billion in 2007 to over $1 trillion in 2008. And, importantly, the Federal Home Loan Banks took no taxpayer dollars.

The Federal Home Loan Banks are financially strong and stable. 2012 net income was $2.6 billion, and the banks ended the year with over $10 billion in retained earnings. Each bank is now allocating 20 percent of its net income to a special restricted retained earnings account.

The Council welcomes the opportunity to share our views on housing finance reform. We commend you for your extensive efforts in working to achieve a sustainable housing finance system that also protects the taxpayer.

As you consider the future role of the Federal Home Loan Banks, you have appropriately recognized that the Federal Home Loan Banks are very important to community financial institutions. These smaller institutions often have limited options and depend on the products and services provided by the Federal Home Loan Banks.

Community financial institutions are significant players in housing finance. Their core strength is their deep knowledge of local markets and their personal relationship with customers. In smaller communities and in rural markets, community financial institutions are often the sole source of mortgage credit.

Community financial institutions originate a significant amount of mortgage loans. In the first quarter of 2013, banks and thrifts with less than $10 billion in assets originated $55 billion in residential mortgages. They also held on balance sheet approximately $500 billion in mortgage loans and $300 billion in mortgage-backed securities.

Mr. Chairman, community financial institutions are dealing with enormous challenges and uncertainty. We are currently conducting a survey of our members to understand how we can better assist their housing finance activities. Some of the initial feedback is disturbing, as many of these institutions are questioning their ability to continue as housing lenders. Much of the concern relates to the new rules around qualified mortgages and the capital requirements under the new Basel III rules. While some progress has been made, more needs to be done.

We are proud that the Federal Home Loan Banks have a long history of supporting the housing finance activities of community financial institutions. For portfolio lenders, we offer a variety of products that help them hedge the risk of a long-term fixed-rate mortgage portfolio. We offer long-term fixed-rate advances, advances that amortize similar to a mortgage, and advances that are prepayable to match the prepayment option in mortgages. We provide technical assistance to help members quantify and manage the interest rate risk from a portfolio of fixed-rate loans.

We also support their secondary market needs through our mortgage programs. These programs combine the credit expertise of a local lender with the funding and hedging advantages of the Federal Home Loan Banks. Most of the members participating in our mortgage programs have less than $1 billion in assets. Many of the Federal Home Loan Banks offer MPF Xtra. Through MPF Xtra, mortgage loans are aggregated through the Banks and sold to Fannie Mae. This program allows small members to sell loans at prices competitive with larger institutions.

We are very pleased that S.1217 recognizes the importance of maintaining a role for institutions of all sizes in the housing finance system of the future. We believe providing reliable access for small and midsized lenders to the secondary market is very important.

We appreciate that the bill provides different options for the Federal Home Loan Banks to serve their members in the future. Along with our members, we are open to exploring opportunities to expand our support of community lenders in housing finance.

At the same time, we recognize the paramount importance of maintaining and protecting our continuing role as a reliable source of liquidity for our members.

Chairman Tester, Ranking Member Johanns, thank you for the opportunity to appear before you today.

Chairman TESTER. Thank you for being here, Mr. Jetter. Thank you for your testimony.

Mr. Middleton.

STATEMENT OF MICHAEL MIDDLETON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, COMMUNITY BANK OF TRI–COUNTY, WALDORF, MARYLAND, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. MIDDLETON. Chairman Tester, Ranking Member Johanns, my name is Michael Middleton. I am the chairman and CEO of the Community Bank of Tri-County in Waldorf, Maryland. We serve all of southern Maryland and the northern neck of Virginia with 11 branches and assets just under $1 billion. I greatly appreciate the opportunity to represent the ABA's views on the future of the secondary mortgage market.

The ABA commends Senators Corker, Warner, Manchin, Tester, Johanns, Hagan, Heitkamp, Heller, Kirk, and Moran on sponsoring Senate bill 1217. We believe it prudently addresses the Federal Government's role in the mortgage market and resolves the longstanding conservatorship issues of Fannie Mae and Freddie Mac.

This bipartisan legislation is a first positive step in what is certain to be a long, long process in creating a sustainable, rational, and limited role for the Federal Government in supporting and regulating a healthy mortgage market. It properly realigns a significant portion of the residential mortgage process so that it is conducted by the private sector. Under the implementation, it should serve as a model for the other Government mortgage aggregators.

Now, as you are fully aware, the mortgage market touches the lives of nearly every American, and, therefore, it is imperative that reform be done without inflicting further harm on the already fragile housing market and, most importantly, does not inadvertently harm creditworthy Americans who wish to own their home.

The bill follows principles that have long been advocated by the ABA. It provides a set of incentives to strengthen Government's involvement and to an appropriate and sustainable level, while establishing the structure for a liquid private market.

The legislation creates the Federal Mortgage Insurance Corporation, or FMIC, which will serve as the public guarantor of eligible mortgages, as well as the regulator of the issuers, aggregators, and credit enhancers.

This approach addresses a number of key concerns with the Government's role in the housing finance markets.

First, in the area of mortgage finance, the primary goal of any Government-sponsored enterprise is to create stability and liquidity

to the market participants. Its role is to facilitate the ability of the primary mortgage market to provide credit for qualified borrowers.

Your proposed legislation achieves the goal by limiting the scope of the FMIC guarantees a narrow set of well underwritten loans as well as proper regulation of the market participants. Second, by limiting the FMIC's scope, the bill creates an environment for a strong and healthy private market to take over the role of the GSEs. And by moving these activities to the private sector and ensuring private entities take the first loss position against guaranteed debt, the bill substantially reduces taxpayer liability. It better addresses the mandate of the Dodd-Frank Act for a lender to have skin in the game in a manner that is certainly much more achievable for the community banking sector.

In order to accomplish its goal of a more limited Government role while ensuring that the mortgage markets continue to function properly, a number of outstanding issues need to be addressed. These include clearly refining the capitalization requirements for those entities that are taking up the role of securitization of the GSEs.

Also, the Committee should consider its proposed role as the regulator of the Federal Home Loan Banks, yet keeping a securitized subsidiary under its purview ensures that the Federal Home Loan Bank System remains committed to its mission.

There are other areas where the bill can do more, particularly in the role of Government and multifamily housing market. We would also note to fully protect the taxpayers from additional losses like those suffered by Fannie and Freddie, the Farm Credit System, which continues to follow the model of privatized gains and public losses, should be included in this solution. Without similar reforms to the Farm Credit System, it is only a matter of time until the taxpayers again are put at risk.

In conclusion, due to the importance of the mortgage market to our economy and our families across the country, any reform must be deliberate. It must carefully address the many concerns and interests of a wide range of participants and require pragmatic negotiation, compromise, and cooperation.

There is much more work to be done. This bill is a very well-considered and well-constructed formula on which to begin the process, and thank you very much for allowing me to testify, and I am happy to answer any questions.

Chairman TESTER. Well, thank you for your testimony, Mr. Middleton, and thank you all for being here today and for your testimony.

I think we will just start with 7 minutes on the clock, please, and I will just go down the line on these questions.

Would you or the institutions that you represent be able to offer a 30-year fixed-rate mortgage without a Government backstop?

Mr. HARTINGS. The 30-year fixed-rate mortgage is certainly the most popular product that we—portfolio that we originate today. So I think it would be very difficult to operate without a credible 30-year mortgage product. Now, does it need a Government backstop? It certainly needs something. You have to ask the buyers of that security more than the seller. I am selling it into Freddie. You have

to ask the folks that are actually buying that security. Would they buy that security without a Government backstop?

Chairman TESTER. Do you think they would?

Mr. HARTINGS. I think it would be difficult. I think the Government backstop does give it a credible standard, which is what, if you want to buy a security, you want to know a credible standard there. So I think it is very important.

Chairman TESTER. Mr. Hampel.

Mr. HAMPEL. We would, but very few. We could only make enough fixed-rate loans that we could hold on our books, and so once we had a sufficient portion of those, we would have to sell them to someone else. And in that context, some form of a Government backstop is guaranteed—is necessary.

You know, some have said that evidence from the jumbo market suggests that a Government backstop is really not necessary because we have nonfederally backed up jumbo mortgages that existed up until the crisis. Of course, the crisis did exist, and they dried up.

And, also, the primary risk with a jumbo mortgage is that of prepayment, not of credit risk. What investors do not like about jumbo mortgages is that they pay off too fast.

For a regular mortgage made to a regular person, you know, a middle-income—lower-, moderate-, or upper-middle-income person in the U.S., what is now conforming size, those are the sorts of loans that, if they are for 30-year fixed-rate, they are likely to stay on someone's books for a long, long time. They, therefore, need some sort of credit enhancement for an investor to be willing to buy that sort of security, especially today. The loans being taken out now and for the next few years are very likely to be staying on someone's books for a very long time because of refinancing opportunities at lower rates just are not going to be around anymore.

So we could make a little bit of them, but nowhere near the amount that our members would want.

Chairman TESTER. OK. Mr Jetter.

Mr. JETTER. Well, I think that our opinion probably would not be too much different. Obviously the Home Loan Banks themselves are not making these mortgages.

Chairman TESTER. Right.

Mr. JETTER. And we have some programs through which our members originate 30-year mortgages——

Chairman TESTER. Correct.

Mr. JETTER. ——that we would take. But clearly, you know, at all times and at what rates, I think those are real issues, that there may be some 30-year mortgages made, but clearly it would not be as appealing in the secondary market as what you see today with a Government backstop.

Chairman TESTER. Mr. Middleton.

Mr. MIDDLETON. 30-year fixed-rate mortgages, at our bank we stratify them. Our affordable housing product usually has several layers, structured layers of nonprofits, and we portfolio those. The fixed-rate jumbos, we price them for quality and duration. Conforming, we usually sell into the secondary market because it is an interest rate risk measure.

So we use sort of a broad spectrum, and we look at each one, but our affordable housing products we like to keep on our books at the bank.

Chairman TESTER. OK. Let us go down the line of affordability and price, and I will start with you, Mr. Middleton, and we will go the other direction. If there was not a guarantee, if there was not that Government backstop, what would you anticipate would happen with both the pricing and the availability of a 30-year fixed-rate?

Mr. MIDDLETON. I think it would disrupt the market. I think there are certain sectors that do require a Government backstop at certain levels. I think the private sector has to come in quickly if the Government discontinues any type of backstop. I think the market pricing will change significantly because you are going to price to risk. And I think it is going to be harmful to so many middle Americans who need housing. And so I think there is a role for it, a needed role for it.

Chairman TESTER. Mr. Jetter.

Mr. JETTER. Well, again, we are not in the direct business of originating, but our opinion would be similar, that in terms of pricing it would assume the market would not be able to absorb nearly what it does now, and the price would be higher than what it is today.

Chairman TESTER. Mr. Hampel.

Mr. HAMPEL. We definitely think the price would go up, and it would likely go up more than the amount of an increase in the price necessary to fully fund a private backstop ahead of the Government backstop, so that the system envisioned in the Corker-Warner bill actually is the best of both worlds. It has a Government backstop, but it requires the private sector to pay for that up front.

Chairman TESTER. Good. Mr. Hartings.

Mr. HARTINGS. Yes, I think no doubt pricing goes up, but I am probably a little bit more concerned with access because banks like myself proposal are not going to take that interest rate risk. Do I get out of that market? Who is going to fill in that market in my rural area? And that is probably my bigger concern about the loss of that.

Chairman TESTER. OK. So let us talk about that just for a second, Mr. Hartings. If you are not able to offer a 30-year fixed-rate note because either you are priced out of the market or you just decide it is just not worth it, there are too many hassles, in a fully privatized market, and you are not able to offer the 30-year fixed, what does that do to your customers? Not only what does it do to your banks and what does it do the customers that your banks service?

Mr. HARTINGS. It would somewhat destroy my business model. You know, I mentioned in my testimony we are an 80-percent mortgage lender, and half of that today goes to the secondary market. And that is not unlike a lot of community banks out there. That business model would—you would have to really re-evaluate: What else can I do? What other risks should I be taking out there? And it is probably not good risk. So I think it would be very difficult.

The question, Senator, would be: Is that 30-year mortgage available somewhere else? You know, if that is available at a larger institution, I think you are going to see a lot of folks pack up shop, I mean, because we have to have that access.

The bad news about that is we are packing it up in these rural areas and these underserved areas and these areas that really the bigger institutions probably do not want to be there today.

Chairman TESTER. OK. I am out of time, so I will go over to Senator Johanns.

Senator CORKER. Mr. Chairman, if I could, I have a preset meeting. I know all—no, I am not going to ask any questions. I just want to again thank the two of you for your leadership on this issue, for focusing in particular on how it affects the smaller institutions, and having witnesses in that are knowledgeable and deal with this on a daily basis. I think all too often we do not really talk enough with the people who are out on the front lines taking care of these kinds of activities. And, again, I want to thank you, and I hope that this leads to something that is very constructive.

Chairman TESTER. Well, thank you.

Senator JOHANNS. Mr. Chairman, thank you.

Just a quick follow-up on the Chairman's question, because as each of you were going around, one of the things that occurred to me about the 30-year mortgage and the clientele that you are talking about is, you know, I remember when I bought my first house. I probably would have loved to have paid it off in 15 years but, quite honestly, did not have the economic ability to do it. I was thrilled to get a 30-year mortgage, absolutely ecstatic about it.

It just causes me to think that if we are not doing the right thing for the 30-year mortgage, the people who are hurting would be that first-time home buyer, that person that maybe is stretching their income to get into that house. It is truly the entry-level home buyer. Is that observation correct, Mr. Hartings?

Mr. HARTINGS. I would say your observation is right on. I never really thought about it, but, you know, we make 30-year mortgages, we make 15-year mortgages, we make some 5-year adjustables. But if you really look at the folks that are the catalyst, the mortgage market, that first-time home buyer, they are in that 30-year mortgage. They are stretching themselves absolutely as far as they can go because that is what you have to do to buy the first home. So I think that would really hurt that part of the market.

Senator JOHANNS. Anyone else have any thoughts on that?

Mr. HAMPEL. Absolutely, Senator. The first-time home buyer, you know, it sounds risky to ask the borrower to stretch themselves to the limit, but if they do it reasonably in a normal market, it is actually a very good thing for them because they are freezing in their housing costs for several years. But we could not—the 15-year mortgage is a really good product for a person closer to retirement who is trying to reduce their debt. It just does not work for a first-time home buyer.

Mr. MIDDLETON. If I may, Senator, it is not only the first-time home buyer; it is the second-time home buyer, because of the bubble, the inflation of the value of the house, this will come down to a more normalized level so that you do not get this huge flip-up. So it is the second generation or the second-time home buyer that

also would struggle significantly to put down the 20 percent downpayment.

And, again, I know Jack's bank, our bank are many, many decades old. We have the second and third generation of our customers that they say, you know, go to our community bank and handle them. This is not an anomaly. This is routine business all day for us. We have about 25 percent of our portfolio in residential mortgages.

Senator JOHANNS. OK, great.

Mr. Jetter, one of the things that has intrigued me about what you folks do is your mortgage purchase program, which I think has really worked well. If you could just take a minute and offer an observation about how that program would work and maybe interface with the legislation that we are talking about today. Is this a fit?

Mr. JETTER. Well, I think it is. I think one of the things that—yes, one of the things that you want to do in reforming, I guess, the mortgage finance system is to have a variety of avenues through which mortgages work, and we think that the mortgage programs at the Home Loan Banks have been very successful and one of our keys as we work with you and the legislation is being able to continue those programs. They seem to be especially appealing to our small community financial institutions who find to a certain degree it is just much easier to work with us in those programs than some of the secondary market channels they might look at.

In addition, they are rewarded directly for taking skin in the game, if you will, by being compensated for the credit performance of those mortgages, and then it allows us to hold those, again, the aggregate volume of that is probably not going to be a lot larger than what it is today because it is a balance sheet portfolio item for the Home Loan Banks. But for our small community banks, it is very appealing, and we have many, many of our members that are participating in it. And I do not see anything in the legislation in terms of creating the secondary market access that you are talking about with the help of the Federal Home Loan Banks and other routes that would necessarily be inconsistent at all with the mortgage programs.

Senator JOHANNS. One of the things I looked at when I first looked at this proposed legislation was how does it fare compared to what we have today. What we have today is Fannie and Freddie, and I guess we know the problems there, because we saw them firsthand. When the market collapsed, taxpayers became responsible, in effect, for a massive amount of debt.

We are talking about the backstop today, but it occurs to me that if this would have been in place a few years ago when the market collapsed, we would have had a firewall in front of the taxpayers that in all likelihood would have been sufficient to avoid exposure for them.

I was just curious as to whether any of you had looked at that aspect of the bill in terms of its merits versus the current system. Anybody want to take a swipe at that?

Mr. MIDDLETON. If I may, Senator, the current system was gamed by the GSEs, unfortunately. The system that you are proposing should have the precautions and the structure that would

eliminate the ability to game the system. And I think you are correct in your observation. It would be an entirely different world had we not gone the path we went.

Mr. HAMPEL. Senator, I think the current system has several design flaws which were exposed by the crisis. They were not actually designed. They just evolved and turned out that way. And now with the benefit of 20/20 hindsight, this proposal addresses all those design flaws, and so it would, I think, dramatically reduced the probability of something like this happening again.

Senator JOHANNS. Go ahead.

Mr. HARTINGS. Senator, if I could just say, you know, I think you are right, hindsight—I am not going to sit here and tell you that Fannie and Freddie are not broke. But I really think it is the disconnect of that mortgage process. One of the reasons community banks survive through this and still have sold Fannie and Freddie good product, we originate and service the loans we bring on their books, and really that is probably our best quality portfolio, even through all of this problem.

So I think if you are going to look at hindsight, you have to look at that disconnect and say: When did it get disconnected? And how do you keep that connection together?

Senator JOHANNS. Thank you, Mr. Chairman.

Chairman TESTER. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

As we consider the reform of mortgage finance, we have to think about the role that the Federal home loan banks will play. The FHLBs increase liquidity in the system. They are often used by the small financial institutions, as you have pointed out, those who have limited access to capital markets. And while the FHLBs do not require taxpayer dollars, as you rightly point out, and they do not have an explicit Government guarantee, they have a line of credit with the U.S. Treasury and are widely considered to have an implicit guarantee.

So last month, I wrote to FHFA Director DeMarco asking about a multi-billion-dollar line of credit with Sallie Mae, a Fortune 500 company and the biggest private student lender in the country and this line of credit they have with the FHLB. And right now Fannie Mae is paying the FHLB one-quarter of 1 percent interest and then turning around and making student loans at a rate of 25 times or more higher.

Now, I understand that many people understand that the FHLB's implicit guarantee and the extraordinarily cheap access to capital that results helps support mortgages and helps support community projects, but I do not think many people know that it is helping support the country's biggest private student loan outfit, Sallie Mae.

So my question is, Mr. Jetter, do you have any thoughts on why the FHLBs are in the business of providing loans to Sallie Mae instead of focusing on local institutions that need access to that capital?

Mr. JETTER. Senator, I understood you might be asking a question on this, and so I have taken a look at it a little. Clearly the institution you reference is not a member of my bank, and so I do not have any independent or personal knowledge of their activities.

I do know that we do accept Government-guaranteed student loans as collateral, that in the past or in the financial crisis there were severe issues in terms of liquidity in that market, and Congress encouraged the banks—I think there was a House bill that went through, a sense of the Congress bill, as well as a number of Senators that encouraged the Home Loan Banks to look very hard at accepting guaranteed student loans as collateral in order to provide more liquidity to the system. And then our regulator worked with us to encourage us to accept Government-guaranteed student loans as collateral.

And in terms of our collateral practices, we have members both large and small, we have insurance companies, credit unions, banks, and thrifts. We adopt collateral rules in terms of what we will apply to the lending that goes on there really across the board. We do not——

Senator WARREN. Mr. Jetter, let me just stop you there to make sure that I am understanding this. I actually looked at your Web site, and the Web site for the FHLB says, and I will quote: "The purpose of the Federal Home Loan Banks is to be a strong and reliable source of funds for local lenders to finance housing, jobs, and economic growth."

Now, Sallie Mae is a Fortune 500 company worth billions of dollars. It is not a local business. It is not in the business of doing real estate loans, helping people buy homes. It is not in a local community. And so I am trying to understand how it is that Sallie Mae has been able to access capital from the Federal Home Loan Bank Boards at one-quarter of 1 percent.

Mr. JETTER. Well, as I explained, we have—our membership rules are defined by Congress as to who is eligible to become a member of the system. And we make our advances available based on collateral rules that are the same for all the members. So we do not distinguish to pick a particular member and say we do not believe that that is acceptable for you because of the institution you are, but we would think it is acceptable for another institution. We actually have a mandate to treat all our members fairly and equally without prejudice.

Senator WARREN. So actually let me ask you about that on treating everybody fairly and equally. Are the community banks and credit unions borrowing for one-quarter of 1 percent?

Mr. JETTER. It depends on what—they may be borrowing for substantially less, depending on what—it has to do with the term and type of advance that they are looking at. But short-term rates, if that is what you are looking at, are much less than that for most of our members. So I am not sure—as I said, I am not familiar with the type of credit that that institution has. I cannot—but I would assume, generally speaking for our bank, that those rates would be available to all our members or would be very comparable.

Senator WARREN. Maybe I should ask this the other way. Mr. Hampel, I thought your testimony was very interesting about the Federal home loan banks and the importance they play in providing capital to small institutions. So let me ask it the other way. Is there anything you think we should do or think about going forward to make sure that the Federal home loan banks really are focused on lending to community institutions?

Mr. HAMPEL. Well, I am familiar with any changes in the charter of the home loan banks during the crisis. You know, if Congress made changes in whom the Federal home loans banks were supposed to serve during the financial crisis, I suspect the Federal home loan banks would have to meet those needs.

What credit unions use the Federal home loan bank for is not such short-term borrowing, because we have plenty of short-term funds from our members; we use it to hedge long-term interest rate risk. So we will borrow longer term. We would love to pay a quarter of a percent, but, of course, we are going for a longer term. We borrow for a much longer term in order to use those funds to make long-term loans, put long-term loans on our books. And there are limits to the extent we can do that because of capital requirements that credit unions face.

Senator WARREN. I understand. And, Mr. Hartings, would you like to add anything?

Mr. HARTINGS. Yes, I think the Federal Home Loan Bank of Cincinnati, who we deal with, does an excellent job with her MPP program. We really do not use a lot of the borrowing from that, so I am not really probably here to tell you rates to help you out with that, Senator.

Senator WARREN. OK. Fair enough. I just think that as we think about mortgage finance reform and the role of the Federal home loan banks, I am very impressed by what you say on your Web site. But we really want to think about whether or not the Federal home loan banks and the implicit Government guarantee that backs that up and permits it to have money at such a low rate is focused on our community banks and credit unions and on helping people buy homes and not in other areas. So thank you, Mr. Jetter.

Thank you, Mr. Chairman.

Chairman TESTER. Senator Heitkamp.

Senator HEITKAMP. Just a quick comment, and not to belabor this point, but I do want to kind of go on record saying we need to be careful with one-size-fits-all, because the bank that the Bank of North Dakota deals with, because of their relationship, has been able to offer some very interesting and low-cost student products. And so we have a great opportunity in North Dakota to partner up, and the Bank of North Dakota has been extraordinarily grateful, and I think the students in North Dakota have been grateful for that relationship.

So I do not know about the Sallie Mae issues, but I do know that we need to be careful because the charter of the Bank of North Dakota is very similar to yours, which is economic development and community development, and we think that includes some development of education needs of students and have always interpreted the charter of the bank that way.

I want to get back to maybe the first question that Senator Tester asked, which is, without an explicit Federal guarantee, will we have a 30-year mortgage market? And, you know, some of you were a little clearer than others. Some of you dodged pretty good in the response. But I think it is so important that your organizations think long and hard about this and you think, instead of, you know, kind of looking at what is going to give you the maximum amount of positioning as we move forward with this, take a look

at what that really means, because I think when we went and negotiated this bill and I came in on the tail end of it, I am convinced that, without that, we will price the 30-year mortgage away from affordability for first-time and second-time and maybe even third-time homeowners. At a time when we have increasing homeowner costs in this country, a bigger and bigger percentage of our income is being used to pay for our housing.

And, you know, I am a big believer that no matter what happens, if we saw something like this again, even though there is not an explicit, there would be an implicit. And so we need to be proactive in that direction.

And so I really encourage you—I do not mean to sound too preachy here, but I really encourage you to send a clear message about what it is that your institutions need, both your private institutions that you represent today and the organizations that you represent today. Because without a clear message, that could, in fact, result in a product that will not accomplish what you know needs to be accomplished for your institutions but also for the American people.

So, with that said, my question is actually for you, Mr. Jetter. You mentioned the regulatory environment for small community banks and a lot of our smaller institutions, and you said some has been done. This is an issue that I think every person on this Committee has raised one time or the other with the regulators. And they keep assuring us they are fixing the problem, that all is well, it is coming, do not worry, we are not going to regulate the small community banks out of the market.

Now, you did mention that you were not convinced that the regulatory help is coming, and you said you have some suggestions on other things that could be done. And I am curious about what you think those other things are that could be done and should be done right now by the regulators that are not being considered.

Mr. JETTER. Well, let me say first of all that I am sure the other folks on this panel are probably better suited to actually address the specifics of that. What I am really communicating is what my members are telling me in terms of the business and what we are getting back in terms of the survey results that we conducted. In talking to them, I know that in some of the new rules that came out on Basel there were some adjustments, but I guess my impression—then I will let these other folks address it, if that is all right with you. My impression is that it is just amazing the compliance, additional compliance burden that is falling. And it is particularly falling on a group that probably follows pretty prudent lending on their own if there were no rules. It is interesting when we go out and try to talk to a member institution about thinking about participating in the MPF program where they would credit-enhance their mortgages, and you ask them, you know, "What risk are you taking and what kind of losses have you had?" And for small community banks, the routine answer is, "Well, we have never had a loss because we make prudent loans that people are going to pay back, and we work with them if they have problems." And so it is quite a bit different.

But I would defer to the others on the panel who probably have a better understanding of specifics.

Senator HEITKAMP. Just not to belabor the point, but obviously you did do a survey, and if there were specifics within that survey that you would like to share with me or the Committee, I know that we would be interested in seeing those.

Mr. JETTER. We would be happy to get those to you.

Senator HEITKAMP. Thank you. Mr. Hampel.

Mr. HAMPEL. Senator, first of all, to your first question, the 30-year fixed-rate mortgage, as we know it, would absolutely not exist with some form of a Government guarantee.

Senator HEITKAMP. Thank you.

Mr. HAMPEL. A few people would be able to get it from a few very large institutions that would survive in the market, but to normal people it just would not be available. And that is the first thing.

The second thing, you have said several times one size fits all. That is the problem with the new regulations that have come out of the crisis of the last few years. Because some players in the market, not represented at this table, did not behave very well, Congress felt the need to create some sort of basic rules, default rules, that if everyone follows those, they know everything will be OK. The trouble is what we do as small institutions closer to our members, closer to their customers, we are able to make loans on the basis of not having to fit all of the—the QM rule is a perfect example of requiring a one-size-fits-all solution, and the problem is it excludes an awful lot of qualified borrowers simply because it has sort of default lines everywhere and a much more complicated loan decision than a small local lender is able to deal with.

Senator HEITKAMP. And what happens to relationship banking?

Mr. HAMPEL. It goes away. It is mandated——

Senator HEITKAMP. It is no longer a relationship.

Mr. HAMPEL. Right. It is a checklist.

Senator HEITKAMP. Formula.

Mr. MIDDLETON. Senator, if I can opine on that, I appreciate the question. I think we can turn your question around. What impact will it have on a 30-year mortgage? It would definitely ensure its viability. Is that clear?

Senator HEITKAMP. The current——

Mr. MIDDLETON. A backstop or the FMIC I think, in my opinion, would ensure the viability of the 30-year product.

With respect to the regulatory issue—I know Jack and I talk about this often—it is the number one concern. We have not the regulations yet. We are in a Catch-22 on CRA now. We will be put into that position by the QM, and the non-QMs. We have not seen how we will handle non-QRMs because basically that is our portfolio. It is the second generation, dividing up a farm of 30 acres apiece. It does not fit. It is the pieces that—that is our portfolio. Well underwritten, always performed, no losses.

So we have not seen the impact. You start connecting all the dots, and you will see just how long this line is, and it is all coming at us at once.

As a billion-dollar bank, we are extremely efficient in compliance. We work very hard for that. But we are sort of in awe at what appears to be approaching us, and we are constantly saying, "How can our business models survive with this overwhelming tsunami of regulatory process?"

Mr. HARTINGS. Just a few comments. You know, as a banker, we always say it is pile-on regulation. I like to point to one, but it is this big pile of regulations that is kind of burying us right now. But we have been talking about QM, and a good example of QM is portfolio lending.

I am asked the question once in a while: Will you make a non-QM loan? Well, right now I am making them all the time. But when QM goes into place, I may not after that.

So these are customers—and I am one of those banks that have very low losses. My delinquency is well below the national average. But yet still I am a major lender in my field.

So that is the regulation I do not want to see burden community banks because it hurts customers. At the end of the day, you know, why are we so good at what we do? Because I do not have to look at my regulator. I just have to look at my neighbor and probably my brother-in-law, and they are the folks that we lend to in our area. And I cannot do anything with them because they all know where I live. You know, and so we take care of ourselves. Just keep that in mind.

Senator HEITKAMP. Thank you.

Chairman TESTER. We have got a vote here very shortly, but I do have a couple questions, if I might. And these are for everybody but Mr. Jetter, OK?

[Laughter.]

Chairman TESTER. There are some proposals out there that would—and I am sure you are all familiar with the single securitization platform that FHFA is working on. There are some proposals out there to outsource that single securitization platform to private entities. What would the impact of that be?

Mr. HARTINGS. I think the devil is always in the details, Senator, so I am not sure until that gets maybe progressed a little longer to really comment from the banking side on what the impact may be.

Chairman TESTER. Let me flesh it out a little more for you, then. Assuming that they do outsource it, I would assume that you are not going to be a bank that has access to be able to buy that securitization platform.

Mr. HARTINGS. That would be a real fair assumption.

Chairman TESTER. So it goes to one of the big guys. What is the impact going to be?

Mr. HARTINGS. Again, it looks at maybe taking another piece of our business model and destroying it. And how do we continue to operate if we have less and less of that business model there?

Chairman TESTER. Mr. Hampel.

Mr. HAMPEL. That would raise major concerns about fair and equal access to that securitization platform, probably insurmountable, but major concerns.

Chairman TESTER. OK. Mr. Middleton.

Mr. MIDDLETON. It would take a rather large platform to do what you are saying.

Chairman TESTER. That is correct.

Mr. MIDDLETON. So we think it would be greatly out of the reach of most community banks or regional banks. I think what you want to avoid is a monopoly duopoly. So that would be my position.

Chairman TESTER. OK. So in all fairness, Mr. Jetter, this next question is for you. In a housing finance system without Fannie and Freddie or any Government backstop, what would the impact be of a proposal that allowed the Federal home loan banks to aggregate, as you do now, but not securitize mortgages on behalf of your members?

Mr. JETTER. So we could aggregate, but ultimately we would have to find a buyer of those securities, who then would be issuing them on their own. I guess in the example that you said, I imagine that would be the large institutions would be who we would need to deal with. But ultimately, you know, on what terms it is difficult to anticipate.

Chairman TESTER. Would you anticipate it would increase interest rates?

Mr. JETTER. If there was not a Government backstop, I am assuming that that would increase interest rates. It is hard to understand how it would not.

Chairman TESTER. OK. All right. First of all, I want to thank you all for your testimony and thank you for your patience in answering the questions. There are a bunch more questions to ask of you guys simply because you are the folks that really hit it where the rubber hits the road.

I do want to go back to something that Senator Heitkamp said, and I think most of the people behind you understand this, and I think you do, too. And, that is, you need to be very, very clear as we move forward so you are not aced out of this system. There are those that want to do more consolidation in banking, and I think this is one good way to try to get more consolidation banking.

By the way, I am not one of those. I think we need more competition in the marketplace, and we need more guys out there on the ground creating more competition to move it forward.

So I would just say stay in touch, make sure the message is clear, because, quite frankly, I think coming from a State like Montana, as I said in my opening, if you guys are not able to do business, it has some pretty major impacts in my neck of the woods.

So I just want to thank you once again for your testimony. I think the hearing has underscored the importance of ensuring that community-based institutions have access to that secondary market, and it has given us some food for thought as we move forward with housing finance reform in this Committee.

The hearing record will remain open for 7 days for any additional comments or any questions that might be submitted for the record.

Once again, thank you for your time, and this hearing is adjourned.

[Whereupon, at 4:49 p.m., the hearing was adjourned.]

[Prepared statements and additional material supplied for the record follow:]

PREPARED STATEMENT OF SANDRA THOMPSON

DEPUTY DIRECTOR, DIVISION OF HOUSING MISSION AND GOALS, FEDERAL HOUSING FINANCE AGENCY

JULY 23, 2013

Chairman Tester, Ranking Member Johanns, and Members of the Committee, my name is Sandra Thompson and I am the Deputy Director for Housing Mission and Goals for the Federal Housing Finance Agency (FHFA). Thank you for the opportunity to appear before you today to discuss the important role that community-based financial institutions play in the Nation's housing finance system.

As you know, FHFA regulates Fannie Mae, Freddie Mac (the Enterprises), and the 12 Federal Home Loan Banks. Combined, these institutions support over $5.5 trillion in mortgage assets nationwide. FHFA has also served as the conservator for Fannie Mae and Freddie Mac for close to 5 years now. We take this responsibility very seriously and have focused on our statutory mandate to ensure the Enterprises operate in a safe and sound manner while preserving and conserving their assets.

Before joining FHFA in March, 2013, I spent 23 years with the Federal Deposit Insurance Corporation (FDIC), most recently as Director of the Division of Risk Management Supervision. In this capacity, I was responsible for all aspects of FDIC's risk management examination activities for approximately 4,500 FDIC-supervised institutions nationwide, overseeing a distributed workforce of employees deployed in six regional offices and 84 field offices across the country.

At the FDIC, I was involved in several outreach efforts designed to understand the vital role that community bankers play not only in their local communities, but also in the overall economy. Engaging in regional roundtable discussions and other forums, provided valuable insight from community bankers, their trade organizations and State banking commissioners about the challenges and opportunities they encounter in the banking industry.

In a similar manner, FHFA is committed to undertaking outreach efforts to better understand the activities of community-based financial institutions in the housing finance industry. As discussed later in my testimony, we are meeting with community bankers, credit unions, mortgage bankers and trade associations to help us better understand their access to and interaction with the secondary mortgage markets. Since joining FHFA I have participated in one meeting so far, and what is clear is—without access to liquidity, many community-based lenders could not be active in the primary market.

In my testimony today, I would like to make the following points:

- Community-based financial institutions play an important role in the provision of housing credit;
- During conservatorship, FHFA has taken meaningful steps to ensure community-based lenders have equal access to the secondary market; and
- It is vital to ensure that community-based institutions have the ability to fully participate in the housing finance system of the future.

The Role of Community-Based Lenders

Community-based lenders play an important role in the provision of housing credit. In addition to broadly supporting the financial services needs of their customer base, this role is particularly important for certain areas of the country, for certain types of borrowers, and for certain types of mortgage products.

There is no generally accepted definition of "small lender" or "community bank" within the industry or between the Enterprises. Federal bank regulators generally define them as institutions with under $1 billion in assets, while employing various exceptions to this definition. The Enterprises generally define community-based lenders as lenders originating less than $1 billion of mortgages per year regardless of the institution's total asset size.

Despite the fact that community-based lenders account for a small percent of the residential mortgage lending market, they have a vital role in serving rural and underserved markets nationally. Most importantly, community-based lenders are committed to the people and the places where they lend money. They are a stabilizing force in their local markets and generally engage in responsible lending. Community-based lenders have a long history of making sound mortgage loans, choosing not to originate the kinds of abusive and predatory loans that contributed to the housing and financial crisis. This type of responsible lending helps local economies thrive.

Community-based lenders are particularly important in smaller and rural communities where lending can be challenging. Standard documentation that aggregators or large lenders require from mortgage originators before accepting loans for

securitization may be more difficult to produce in smaller and rural communities. For example, appraisals for collateral located in rural areas and documentation for self-employed and seasonally employed borrowers may not be acceptable to a larger lender and therefore may not be acceptable for secondary market participation, resulting in many small lenders retaining loans in their portfolios. Having lenders active and involved in smaller markets can be the difference in local borrowers having access to single family home financing.

For many community-based lenders, participation in the primary mortgage market is predicated on their ability to access the secondary market. This requires an established relationship with a secondary market participant. Historically, these lenders have maintained relationships with Fannie Mae and Freddie Mac, the Federal Home Loan Banks, Government National Mortgage Association (GNMA or "Ginnie Mae"), private label securitizers, and correspondent banks.

Since the financial crisis, private label securitizers have been almost entirely absent from the single family market, while a number of correspondent banks have either curtailed or abandoned that business. Today, a large number of community-based lenders continue to depend on relationships with Fannie Mae, Freddie Mac and/or the Federal Home Loan Banks for access to the secondary mortgage market. They also interact with Ginnie Mae when originating FHA and VA loans.

Also, some community-based lenders that are members of a Federal Home Loan Bank are opting to sell their loans directly through the Federal Home Loan Bank System's Acquired Member Asset program. In some cases, the Federal Home Loan Bank buys loans outright for its portfolio, but increasingly the Federal Home Loan Bank acts as an aggregator for small lenders, buying loans from members and then selling them to Fannie Mae.

The Chicago Federal Home Loan Bank sponsors and administers the Mortgage "MPF Xtra" program, where whole loans are aggregated directly from members and sold to Fannie Mae for securitization. The "MPF Xtra" program is the largest seller using cash execution at Fannie Mae, delivering over $6.9billion in residential mortgage whole loans during 2012. Members of seven different Federal Home Loan Banks, including Chicago, utilize this cash execution in the secondary market.

Fannie Mae and Freddie Mac offer mortgage originators two options for delivering loans for securitization. Mortgage originators may either sell loans for cash through Freddie Mac's "cash window" or Fannie Mae's "whole loan conduit" or they may exchange loans for mortgage-backed securities in an MBS swap transaction. In this testimony we use the term cash window to refer to both Enterprises' mechanisms for delivering loans for cash. Through the cash window, the Enterprises purchase loans that meet their standards directly from lenders, packaging them into securities and selling the securities to the market. The cash window is a mechanism designed to enhance the liquidity of the lender.

Smaller lenders who do not have the scale to participate in the guarantor business generally use the cash window, although lenders of all sizes sell loans through this path. Fannie Mae and Freddie Mac each have an existing selling and/or servicing customer relationship with over 1,000 community-based lenders. Some institutions have relationships with both Enterprises.

Across all entities conducting business with the Enterprises—including banks, credit unions and mortgage bankers—cash window volumes at Fannie Mae tripled from 2007 to 2012 and doubled at Freddie Mac over the same period. In 2012, over 2,200 customers sold $286 billion in loans for cash (one loan at a time or in bulk) representing 25 percent of Fannie Mae's purchase volumes and 19 percent of Freddie Mac's purchase volumes.

Over the past 5 years, the total volume of loans delivered to the Enterprises by community-based lenders has increased substantially. For example, in 2007, only 3.6 percent of loans delivered to Freddie Mac came from outside the top 100 lenders. In 2012, this increased to 15.1 percent of all loans at Freddie Mac, more than a fourfold increase. From 2007 to 2012, the number of community-based lenders at both Enterprises increased by 18 percent.

During Conservatorship, FHFA Has Taken Meaningful Steps to Level the Playing Field

FHFA has undertaken initiatives that maintain and help ensure community-based lenders have equal access to the secondary market. Last fall, FHFA mandated an increase in guarantee fees for mortgage-backed security (MBS) swap transactions relative to those charged for cash window transactions. Since large lenders tend to engage in swap transactions and small lenders tend to engage in cash transactions, the intended effect of these changes was to level the playing field between small and large lenders. This action followed price adjustments earlier in the conservatorships that had already significantly reduced the substantial pricing advantages large cus-

tomers of the Enterprises historically used. Data provided to FHFA by both Enterprises indicates this objective has been achieved.

FHFA has also directed both Enterprises to align and streamline their servicing standards, and has encouraged consistent customer access and management through standard eligibility and counterparty requirements. In this regard, FHFA has discouraged the implementation of new minimum customer annual activity thresholds for selling, servicing, and utilizing the Enterprises' automated underwriting systems. Freddie Mac's proposed "low activity" fee of $7,500 would have created a significant financial burden on smaller community-based lenders and discouraged their ability to obtain liquidity in the secondary mortgage market. With FHFA encouragement, the fee was changed and now there is only a minimal fee for community-based lenders who have not delivered a loan within the past 3 years. This fee allows small lenders to maintain their approved seller status, which is important because it keeps the option open to make future sales to the Enterprise.

It Is Vital To Ensure That Community-Based Lenders Can Participate in the Future Housing Finance System

FHFA believes it is critical to include community-based lenders as we take steps to prepare the foundation for a new housing finance system. There should not be a significant difference in how large and small lenders are treated when securitizing residential mortgage loans. We are developing and executing alignment activities between the Enterprises, by establishing common data standards and uniform legal and contractual documents. Standardization of both data requirements and contractual language necessary for securitization will go a long way toward leveling the playing field between large and small securitizers.

In 2010, FHFA directed the Enterprises to initiate, develop and deploy a Uniform Mortgage Data Program (UMDP). This effort is designed to capture consistent and accurate mortgage data, improve loan quality, and enhance risk management capabilities.

A solid foundation of data standards is crucial to the future of housing finance and will allow lenders of all sizes to participate in the marketplace on equal footing. Developing an industry standard makes it far easier and cheaper for all lenders, including community-based ones, to acquire the necessary technology from a third-party vendor and apply it within their institution.

A component of UMDP that is currently underway is the Uniform Mortgage Servicing Data (UMSD) project. UMSD will expand and standardize the servicing dataset used for managing performing and nonperforming loans and for disclosure reporting. FHFA and the Enterprises are working with the industry to define the complete UMSD dataset requirements at this time; full build-out and industry adoption is expected to take several years. FHFA and the Enterprises are working with the Mortgage Industry Standards Maintenance Organization (MISMO) to ensure that UMSD data points are accurately defined and specified for industry adoption. We are also working with other Agencies and the Enterprises to standardize origination data collected through the new Consumer Financial Protection Bureau (CFPB) Closing Disclosure Form, which integrates parts of the HUD-1 and the final Truth in Lending forms. The Enterprises are also working to expand and reorganize the data collected on the Uniform Residential Loan Application (URLA).

FHFA has also made the Enterprises' development of the technical and functional capabilities of the Common Securitization Platform (CSP) a key component of the strategic goal to build a new infrastructure for the secondary mortgage market. The Common Securitization Platform is the technological means for packaging mortgages into a variety of security structures. It also provides the operational support to process and track the payments from borrowers to investors. Initially, the platform will be the infrastructure the Enterprises use for data validation, issuance, disclosure, master servicing, and bond administration for their securities. This framework will connect capital markets investors to homeowners and is being developed with the potential to be used by other issuers in the future in a housing finance system with or without a Government guarantee. It is also vitally important that all lenders, large and small, have access to the Common Securitization Platform.

Recently, FHFA in conjunction with the American Bankers Association (ABA), hosted a meeting with community bankers with operations in towns with populations as low as 11,000 from seven States. These bankers have relationships with their Federal Home Loan Bank, and with either Fannie Mae or Freddie Mac. The discussion centered on the role these banks play in serving primarily rural, small, and potentially underserved communities. The asset size of these institutions ranged from $233 million to $508 million. In 2012, they originated between $35 million to $166 million in residential mortgage loans.

This was the first event in a larger outreach effort FHFA is undertaking to engage community-based lenders. We plan to meet with more groups of community-based financial institutions over the next month, leveraging the expertise of their respective industry trade groups, including the Independent Community Bankers Association (ICBA), the National Association of Federal Credit Unions (NAFCU), Credit Union National Association (CUNA), the Mortgage Bankers Association (MBA), and multiple State Bankers Associations. The meeting with the ICBA member banks will be held in Chicago on August 12th. Similar to the initial meeting with the ABA members, we intend to raise and address the following:

- How to maintain and maximize community-based lender relationships with Fannie Mae, Freddie Mac, and the Federal Home Loan Banks;
- How to ensure community-based lenders are on equal footing with larger competitors; and,
- The challenges and opportunities community-based lenders face, particularly in either rural or underserved areas.

After we have met with community-based lenders, we will review their feedback and consider changes to Enterprise processes and policies that would address issues of concern and provide benefit to smaller institutions.

The Federal Home Loan Banks may also have an opportunity to expand their role. This is especially important as the aggregation role for nonjumbo mortgage loans provided by the private label securitization model has largely evaporated. As Acting Director DeMarco recently commented at the 2013 Federal Home Loan Banks Directors Conference, there is opportunity for the Federal Home Loan Bank system to expand upon the limited loan aggregation role they are playing today with the Mortgage Partnership Finance (MPF) programs. With the existing cooperative structure, the Federal Home Loan Banks could offer liquidity with securities markets levels of execution, aggregating nonhomogenous mortgage loans from members that would be funded with capital from global sources. As we consider a future secondary market with a reduced Government guarantor role, providing members with aggregation services to access various types of secondary market execution might become an important opportunity for the Federal Home Loan Banks.

Conclusion

As we move closer to reforming our Nation's housing finance system, it is important to ensure that community-based lenders are able to fully participate in the new system. In many respects, this means ensuring equal access to the secondary mortgage market, since for many community-based lenders the ability to be active in the primary market is based on an ability to access the secondary market. As conservator, FHFA has taken several steps to level the playing field for community-based lenders. We believe ensuring their participation in the future system is in the public interest and we stand ready to work with this Committee to see this goal reached. Thank you, and I am pleased to answer any questions you may have.

PREPARED STATEMENT OF JACK A. HARTINGS

PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE PEOPLES BANK COMPANY, COLDWATER, OHIO, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA

JULY 23, 2013

Chairman Tester, Ranking Member Johanns, Members of the Subcommittee, I am Jack Hartings, President and CEO of The Peoples Bank Company and Vice Chairman of the Independent Community Bankers of America. The Peoples Bank Company is a $400 million asset bank in Coldwater, Ohio. I am pleased to represent community bankers and ICBA's nearly 5,000 members at this important hearing on "Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions". We are grateful for your recognition of the critical importance of preserving community bank access in any reforms to the housing finance system. It is essential to borrowers and the broader economy that the details of any reform are done right. We sincerely appreciate the opportunity we've been given to work with members of this Committee to craft housing finance reform legislation. We look forward to providing ongoing input on the impact of reform on community banks and their customers.

Community Banks and the Mortgage Market

Community bank mortgage lending is vital to the strength and breadth of the housing market recovery. Community banks represent approximately 20 percent of the mortgage market, but more importantly, our mortgage lending is often concentrated in the rural areas and small towns of this country, which are not effectively served by large banks. For many rural and small town borrowers, a community bank loan is the only mortgage option.

A vibrant community banking sector makes mortgage markets everywhere more competitive, and fosters competitive interest rates and fees, better customer service, and more product choice. The housing market is best served by a large and geographically dispersed number of lenders. Five years after the financial crisis, an already concentrated mortgage market has become yet more dangerously concentrated. We must promote beneficial competition and avoid further consolidation and concentration of the mortgage lending industry.

The Peoples Bank Company has been in business for 108 years. We survived the Great Depression and numerous recessions before and since—as have many other ICBA member banks—by practicing conservative, commonsense lending. We make sure loans are affordable for our customers and they have the ability to repay. Loans are underwritten based on sound practices using our personal knowledge of borrowers and their circumstances.

Fair Access to the Secondary Market

Secondary market sales are a significant line of business for many community banks. According to a recent survey, nearly 30 percent of community bank respondents sell half or more of the mortgages they originate into the secondary market.[1] When community banks sell their well-underwritten loans into the secondary market, they help to stabilize and support that market. Community bank loans sold to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks (the GSEs) are underwritten as though they were to be held in the bank's portfolio.

While community banks choose to hold many of their loans in portfolio, it is critical for them to have robust secondary market access in order to support lending demand with their balance sheets. For example, I have a portfolio of 867 loans with a balance of $81 million we originated and sold to Freddie Mac. Loan sales to Freddie Mac allow me to support the broad lending needs in my community, particularly with fixed-rate loans demanded by my customers. As a community bank, it is not feasible for me to use derivatives to offset the interest rate risk that comes with fixed-rate lending. Secondary market sales eliminate this risk. The ability to sell single loans for cash, not securities, is critical to my bank because I don't have the lending volume to aggregate loans before transferring them to Freddie Mac. In addition, I have the assurance that Freddie Mac won't appropriate data, from the loans sold, to solicit my customers with other banking products.

Even those community banks that hold nearly all of their loans in portfolio need to have the option of selling loans in order to meet customer demand for long-term fixed-rate loans. Meeting this customer demand is vital to retaining other lending opportunities and preserving the relationship banking model.

While many community banks remain well capitalized following the financial crisis, others are being forced by their regulators to raise new capital, even above minimum levels. With the private capital markets still largely frozen for small and midsized banks, some are being forced to contract their lending in order to raise their capital ratios. In this environment, the capital option provided by the secondary markets is especially important. Selling mortgage loans into the secondary market frees up capital for more residential mortgages or other types of lending, such as commercial and small business, which support economic growth in our communities.

Many community banks would like to sell more loans but for the challenge of identifying "comparable" sales, as required by Fannie Mae and Freddie Mac, in rural markets where properties have unique characteristics such as large plots of land. The nearest comparable may be 60 miles away.

In addition to selling mortgage loans to Freddie Mac, my bank participates in the Mortgage Purchase Program (MPP) through the Federal Home Loan Bank of Cincinnati. While our loan sales to the MPP—33 serviced loans with an outstanding balance of $4.4 million—are only a fraction of our sales to Freddie Mac, we're pleased to have this alternative secondary market access. The Federal Home Loan Banks (FHLBs) are a critical source of liquidity to support community bank mortgage lending. The FHLBs were particularly important during the financial crisis

[1] ICBA Mortgage Lending Survey. September 2012.

when they continued to provide advances to their members without disruption while other segments of the capital markets ceased to function. The FHLBs must remain a healthy, reliable source of funding.

Key Features of a Successful Secondary Market

The stakes involved in getting housing-finance market policies right have never been higher. Housing and household operations make up 20 percent of our economy and thousands of jobs are at stake.

With regard to the secondary market, if the terms are not right, the secondary market could be an impractical or unattractive option for community banks. Below are some of the key features community banks require in a first-rate secondary market.

Equal access. To be sustainable and robust, a secondary market must be impartial and provide equitable access and pricing to all lenders regardless of their size or lending volume. Without the appropriate structure, a secondary market entity will have a strong incentive to offer favorable terms to only the largest lenders. Such an outcome would drive further industry consolidation, increase systemic risk and disadvantage the millions of customers served by small lenders.

Financial strength and reliability. A secondary market must be financially strong and reliable enough to effectively serve mortgage originators and their customers even in challenging economic circumstances. Strong regulatory oversight is needed to ensure the secondary market operates in a safe and sound manner.

No appropriation of customer data for cross-selling of financial products. When a community bank sells a mortgage to a secondary market entity, it transfers proprietary consumer data that would be highly valuable for the purposes of cross-selling financial products. Without large advertising budgets to draw in new customers, community banks grow by deepening and extending their relationships with their current customer base. Secondary market entities must not be allowed to use or sell this data. Community banks must be able to preserve customer relationships and franchises after transferring loans.

Originators must have the option to retain servicing and servicing fees must be reasonable. Originators must have the option to retain servicing after the sale of a loan. In today's market, the large aggregators insist the lender release servicing rights along with the loan. Transfer of servicing entails transfer of data for cross-selling, the concern identified above. While servicing is a low-margin business, it is a crucial aspect of the relationship-lending business model, giving a community bank the opportunity to meet the additional banking needs of its customers.

Limited purpose and activities. The resources of any secondary market entities must be focused on supporting residential and multifamily housing. They must not be allowed to compete with originators at the retail level where they would enjoy an unfair advantage. The conflicting requirements of a public mission and private ownership must be eliminated.

Private capital must protect taxpayers. Securities issued by secondary market entities must be backed by private capital and third-party guarantors. Any Government catastrophic loss protection must be fully and explicitly priced into the guarantee fee and the loan level price. This guarantee would provide credit assurances to investors, sustaining robust liquidity even during periods of market stress.

The Future of the Secondary Markets

There is widespread agreement the secondary market must be reformed. An aggressive role for the Government in housing is no longer a viable option. The private sector should and will take the lead in supporting mortgage finance. ICBA welcomes this new reality as an appropriate response to the moral hazard and taxpayer liability of the old system. Community banks are prepared to adapt and thrive in this environment. But whatever replaces Fannie Mae and Freddie Mac must have features to allow community banks to continue to prosper as mortgage lenders and to serve their communities.

The worst outcome in GSE reform would be to allow a small number of megafirms to mimic the size and scale of Fannie and Freddie under the pretense of creating a private sector solution strong enough to assure the markets in all economic conditions. Moral hazard derives from the concentration of risk, and especially risk in the housing market because it occupies a central place in our economy. Any solution that promotes consolidation is only setting up the financial system for an even bigger collapse than the one we've just been through.

The GSEs must not be turned over to the firms that fueled the financial crisis with sloppy underwriting, abusive loan terms, and an endless stream of complex securitization products that disguised the true risk to investors while generating

enormous profits for the issuers. These firms must not be allowed to reclaim a central role in our financial system.

ICBA is pleased to see a robust debate emerging on housing finance reform. A number of serious proposals have been put forth to date—both from within Congress and from outside—all of which combine promising features with others that warrant additional consideration and reworking.

The Housing Finance Reform and Taxpayer Protection Act

ICBA is grateful to Senators Warner, Corker, Tester, and Johanns for introducing S.1217, the Housing Finance Reform and Taxpayer Protection Act, as well as Senators Hagan, Moran, Heller, and Heitkamp. ICBA sincerely appreciates the opportunity to provide input into this bill. We are encouraged by the inclusion of certain provisions to accommodate ICBA's concerns. In particular:

- The Mutual Securitization company would secure access to the secondary market for community banks and other small originators and would allow them to sell loans for cash and to retain servicing rights.
- The Federal Home Loans Banks would also be allowed to issue securities, creating another access point for community banks.
- Limiting issuers to no more than 15 percent of outstanding guaranteed securities would reduce concentration in the securitization market by large banks or Wall Street firms.
- The FMIC guarantee, well insulated by private capital, would insure the securitization market continues to function in times of market stress.

These provisions would help provide access for community banks to the secondary market without requiring them to take on the additional risk and cost of securitizing loans. We look forward to continuing to work with you and the other cosponsors and the Chairman and Ranking Member to further strengthen the bill and ensure it serves the needs of community bank customers.

Closing

Thank you again for the opportunity to testify today. Private entities must play a more robust role in the mortgage securitization market and taxpayers must be more effectively insulated from any market failures. That much is settled. But it is critically important the details of reform are done right to ensure community banks and lenders of all sizes are equally represented and communities and customers of all varieties are served.

PREPARED STATEMENT OF BILL HAMPEL

SENIOR VICE PRESIDENT AND CHIEF ECONOMIST, CREDIT UNION NATIONAL ASSOCIATION

JULY 23, 2013

Chairman Tester, Ranking Member Johanns, Members of the Subcommittee, thank you very much for the opportunity to testify at today's hearing entitled, "Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions". My name is Bill Hampel, Senior Vice President and Chief Economist at the Credit Union National Association (CUNA) headquartered in Madison, Wisconsin. CUNA is the largest credit union industry trade association representing America's State and federally chartered credit unions and their nearly 97 million members.

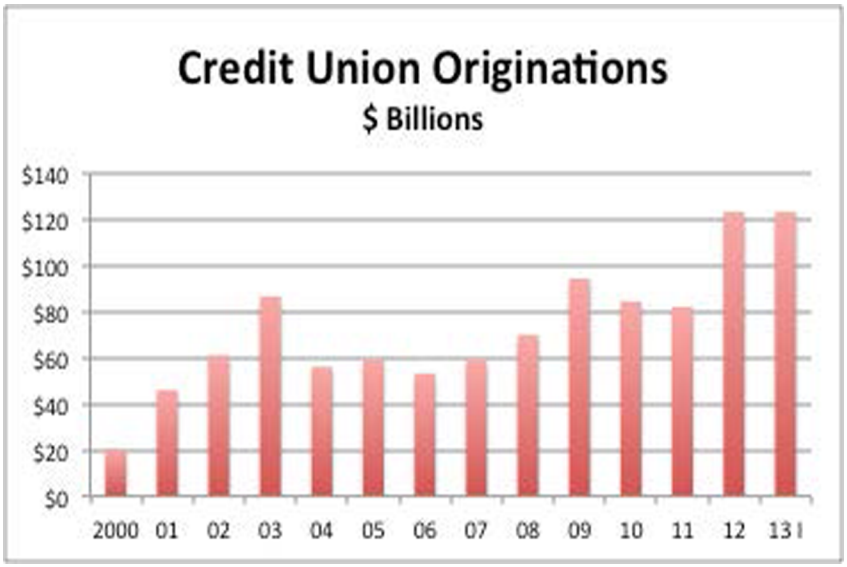
Overview of Credit Union Mortgage Lending

As member owned, not-for-profit financial cooperatives, credit unions strive to meet their member's financial services need, and offering home mortgages is an important part of meeting member demand. Some credit unions have made first mortgage loans since their inception, but most did not offer mortgage lending services until the 1970s. Credit unions now serve more than 96 million Americans, and first mortgage lending is an increasingly important component of credit union lending. First mortgages now account for 41 percent of the total loans held in portfolio, with the remaining 59 percent of a credit unions portfolio comprised of second mortgages [13 percent], consumer loans [39 percent], and small business loans [7 percent]. Just last year alone, credit unions originated $123 billion of first mortgages, representing 6.5 percent of the entire mortgage origination market. Credit unions are now significant players in residential real estate finance, and historically our market share has risen annually to reflect the growing demand of our members.

Currently, 4,300 credit unions (62 percent) offer first mortgages to their members. Because larger credit unions are more likely to offer mortgages than smaller ones, 88 million (92 percent) of all credit union members belong to a credit union that offers first mortgages. It is clear that consumers are choosing credit unions more and more to be their mortgage lenders, and as Congress considers housing finance reform, it is critical that credit unions have equitable and readily available access to a functioning, well-regulated secondary market and a system that will accommodate the member-demand for long-term fixed-rate mortgages products in order to ensure they can continue meeting their members' mortgage needs.

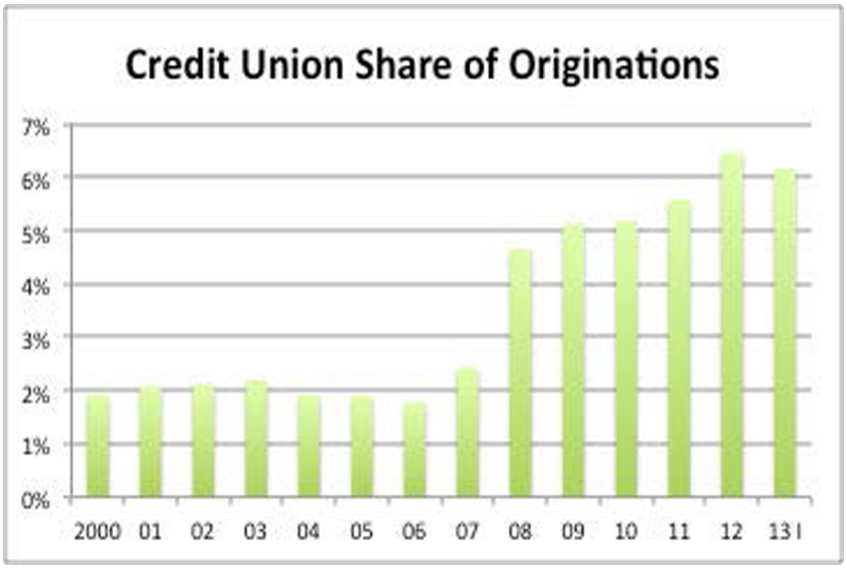
Historically, with fields of membership tied to larger employers, credit unions have a greater presence in urban areas than in rural districts. At the end of 2012, 1.1 percent of credit union members belonged to credit unions headquartered in rural districts. These credit unions originated $750 million of first mortgage loans in 2012, or 1.2 percent of the number of loans originated in 2012.

From 2000 to 2006, annual credit union originations of first mortgages averaged just under $55 billion. As the subprime mortgage crisis began to weaken the secondary market for mortgage loans in 2006 and 2007, credit union origination volume began to rise dramatically. Homebuyers increasingly turned to their credit unions as other sources of mortgage lending dried up. Credit unions were able to meet this demand because at the time they primarily funded loans from their own portfolios, and their conservative financial management as cooperatives meant they were less affected by the financial crisis than many other lenders. By 2009, credit union originations rose to $94 billion. New loan volume fell to just above $80 billion in 2010 and 2011 before rising to over $120 billion in 2012 and the first quarter of 2013, at an annual rate. This recent increase in volume is due to the desire on the part of many members to refinance their loans given very low interest rates.



2013: First Quarter, Annualized

Total first mortgage originations from all lenders peaked at $3.1 trillion in 2005 before plunging to only $1.5 trillion in 2008. Since then, originations have recovered to just over $1.9 trillion in 2012, at an annual rate of $2 trillion in the first quarter of 2013. Because credit union lending increased while the broader market was wracked by the financial crisis, the credit union share of mortgage lending sharply increased, from less than 2 percent in 2005 to almost 6 percent in 2008. Since then, as the broader mortgage market recovered, credit union lending continued to grow to the point that it accounted for over 6 percent of the market in 2012 and 2013.



Historically, credit unions have been largely portfolio lenders. From 2000 to 2008, credit unions sold only a third of first mortgage originations, ranging from a low of 26 percent in 2007 to a high of 43 percent in 2003. The decision of whether to hold or sell a loan depends primarily on asset liability-management issues, essentially the need to manage interest rate risk, but also at times, depends on the availability of liquidity in the credit union. Asset liability management hinges on such factors as the level of interest rates, the relative demand for fixed versus adjustable loans from members, the amount of fixed-rate loans and other longer-term assets already on a credit union's books, and the maturity of the credit unions funding sources. Managing credit risk is not the primary factor in secondary market decisions by credit unions.

As long-term interest rates plunged in 2009 and again in 2011, credit unions found it increasingly important to sell longer-term, fixed-rate mortgages to avoid locking in very low earning assets for the long term. As a result, the proportion of loans sold almost doubled, to an average of 52 percent from 2009 to 2012, and as much as 58 percent in the first quarter of 2013.

Servicing member loans is very important to credit unions, for a number of reasons. As member owned cooperatives, credit unions are driven by a desire to provide high quality member service. Many credit unions are reluctant to entrust the core function of serving members to others, unless they have a stake and a say in the entity doing the servicing. Credit unions are also concerned that third-party servicers might use the data they gather about credit union members to market competing products or services. As such, many credit unions service both the substantial portfolios of loans they hold on their own balance sheets, and the loans they have sold to the secondary market. Currently, in addition to the $248 billion of first mortgages that credit union hold in portfolio, they also service $145 billion of loans they have sold.

The credit quality of credit union first mortgages held up remarkably well during the recent financial crisis, especially when compared to the experience of other lenders. Prior to the Great Recession, annual net charge-off rates on residential mortgage loans at both banks and credit unions were negligible, less than 0.1 percent. However, as the recession took hold, losses mounted. At credit unions, the highest annual loss rate on residential mortgages was 0.4 percent. At commercial banks, the similarly calculated loss rate exceeded 1 percent of loans for 3 years, reaching as high as 1.58 percent in 2009.

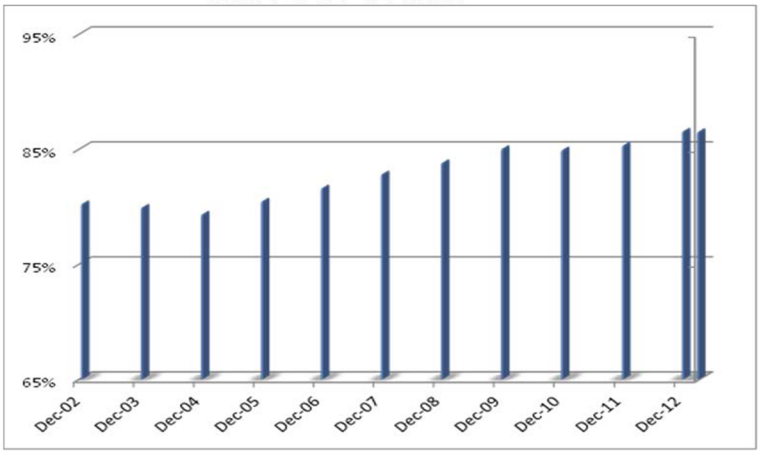
There are two reasons for this remarkable record at credit unions. First, as cooperatives, credit unions tend to be more risk-averse than stock-owned institutions. The incentives faced by credit union management (generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits) induce management to eschew higher-risk, higher-return strategies. As a result, credit union oper-

ations are less risky, and subject to less volatility over the business cycle. This largely explains why credit unions were able to increase lending as the financial crisis deepened.

Second, since the bulk of credit union lending is intended to be held in portfolio rather than sold to investors, credit unions tend to pay particular attention to such factors as a member's ability to repay a loan, proper documentation and due diligence, and collateral value before granting loans.

We believe that in addition to ensuring access to the secondary market for credit unions, it is also important that the housing finance system Congress puts in place accommodates the demand of credit union members and other consumers for long-term, fixed-rate mortgage products. The data suggest that credit union members overwhelmingly prefer fixed-rate mortgages. Over the past 10 years, our members have chosen a fixed-rate product over 80 percent of the time, compared to a variable rate mortgage (see graph below). Just in the first quarter of 2013, 86 percent of the mortgages issued by credit unions were fixed-rate products. Congress should acknowledge that the American homebuyer prefers a fixed-rate mortgages and do everything in its power to ensure this important mortgage product remains a valuable part of housing finance.

Percentage of Fixed Rate Mortgages Issued by Credit Unions Since 2002 - Present



Overview of CUNA Principles for Housing Finance Reform

As Congress studies and debates the issue of housing finance reform, we would like to share with this Committee our general principals with respect to the secondary market needs of credit unions:

1. There must be equal and unbiased access to the secondary market for lenders of all sizes. CUNA understands that the users—lenders and borrowers—of a reformed secondary market will be required to share in the cost of housing finance. However, these fees should not penalize smaller institutions due to lender volume.
2. A strong regulator must be created so that rigorous oversight of the market will ensure safety and soundness, standardization within the system and guarantee equal access.
3. The new system must provide for liquidity in all economic times and recognize that all qualified borrowers have the ability to obtain a mortgage.
4. The new housing finance system should emphasize consumer education and counseling as a means to safeguard consumers so they may receive appropriate mortgages.
5. Proper attention should be given to provide products that are predictable and affordable to all qualified borrowers. The 30-year fixed-rate mortgage has traditionally been the product that best fulfills this requirement.

6. Reasonable conforming loan size limits that adequately take into consideration variations in local real estate costs should be considered as a necessary component of any legislation.
7. Credit unions strongly believe in the ability to retain the servicing rights of their members mortgages when sold on the secondary market.
8. The transition from the current system to any new housing finance system must be reasonable and orderly.

The Secondary Mortgage Market Reform and Taxpayer Protection Act of 2013

Credit unions appreciate and applaud Senators Corker, Warner, Tester, Johanns, Heitkamp and Heller for introducing S.1217, the "Secondary Mortgage Market Reform and Taxpayer Protection Act of 2013". This bill is a right step towards reforming the housing finance system and pays special attention to smaller lenders, like credit unions, while protecting the American taxpayer.

At the heart of the legislation is the creation of the Federal Mortgage Insurance Corporation (FMIC) that will operate with a Federal charter. The FMIC is designed to foster liquidity and the availability of mortgage credit in the secondary mortgage market, while protecting the taxpayer from losses. The bill calls for the wind-down of Fannie Mae and Freddie Mac within 5 years, but allows for flexibility to protect markets from overacting if more time is needed to sell the Fannie and Freddie portfolios. CUNA understands there may be negative market reaction to the shuttering of the Government Sponsored Enterprises (GSE) and we appreciate that thought has been given to the ramifications for home mortgage finance if this process takes places in an expedited manner.

The management of the FMIC will be conducted by a Director who will be appointed for 5 years and chairperson to a five person Board of Directors with varying backgrounds in mortgage insurance markets, assets management, community-based financial institutions, and multifamily housing development. Creation of the independent board is a thoughtful approach to the management of the FMIC, but because of the unique structural nature of credit unions we urge that a seat on the FMIC be reserved for a representative of the credit union system.

Mortgage Insurance Fund and the Government Guarantee

The creation of a Mortgage Insurance Fund (MIF) with the intent to cover any losses incurred by mortgage securities traded and held in the secondary market, capitalized by premiums collected from issuers and investments held in portfolio is an acceptable approach that will protect taxpayers from losses in the event of a catastrophic economic event. CUNA appreciates that the MIF will have the "full faith and credit of the U.S. Government" and strict regulation by the FMIC, which will ensure overpricing of mortgages does not occur.

In addition to the MIF, the bill sets into place a full Government guarantee as the ultimate backstop and we appreciate that it would only be used "in unusual and exigent market conditions" no more than once in any given 3 year period. CUNA fully supports the inclusion of an explicit Government guarantee and the market stability that accompanies this provision.

Exclusion of the Qualified Residential Mortgage and Considerations of a Qualified Mortgage

Credit unions also welcome the inclusion of section 207 that would eliminate for credit unions and other lenders risk retention requirements that are to be implemented under Qualified Residential Mortgage (QRM) standards that are being developed by regulators. Allowing financial institutions to sell properly underwritten mortgages to the secondary market without the unnecessary burden of retaining a significant portion of the loan on a credit unions balance sheet is greatly appreciated.

We urge the committee to take a closer look at the Qualified Mortgage (QM) rule issued by the Consumer Financial Protection Bureau earlier this year as you consider housing finance reform. Historically, credit unions have been portfolio lenders, holding 60–75 percent of the mortgages they write on the books in most years prior to the financial crisis. The incentives of portfolio lenders are different from those that primarily sell into the secondary market, given that the lender bears the entire risk of default. Portfolio lenders have strong incentives to pay close attention to the borrower's ability to repay, and credit unions, given that their members are also their owners, have especially strong incentives to employ sound underwriting practices. There is a very real concern that credit unions will not be able to offer mortgages to their members who do not meet all of the QM standards, but nevertheless have the ability to repay a mortgage loan. Our prudential examiners may "encour-

age" credit unions to focus only on QMs as a way to limit a lender liability, furthermore, the secondary market may be unwilling to accept non-QM loans if viewed negatively by regulators. However, strict adherence to QM does not facilitate the kind of creative products that are possible through portfolio lending based on the individual circumstances of each member.

Simply put: credit unions have every incentive to evaluate a member's ability to repay because their members are also their owners. We encourage the Committee to work with the CFPB and prudential regulators to ensure lenders with a proven history of properly writing non-QM loans will retain the continued ability to serve the mortgage finance needs of all members who can afford an appropriately structured mortgage, whether it is QM or not.

Secondary Market Access

Section 215 would establish a "Mutual Securitization Company (MSC)" the purpose of which would be "to develop, securitize, sell, and meet the issuing needs of credit unions and community and midsize banks with respect to covered securities." CUNA strongly supports the creation of the MSC that will ensure credit union access to a well regulated secondary market in a manner that will safeguard fairness and market liquidity during every economic occurrence.

Credit unions do have concerns regarding the relatively low asset cap of $15 billion per institution. As the marketplace continues to force never ending changes to the size of community based financial institutions, thought must be given to the future appearance of these organizations. Credit unions have seen the largest influx of membership in our history, gaining over 2 million members in the past year. As more Americans embrace the benefits of becoming a credit union member, we fully expect the explosion in credit union membership growth to continue. As a direct result of such growth many credit unions over the next 10 to 15 years could be above the $15 billion asset cap. We urge the committee to consider higher caps so that more community based institutions can access the MSC. Increasing the eligibility size of credit unions and community banks will also ensure that the MSC is well capitalized, guaranteeing its future stability.

The bill would also increase the role of the Federal Home Loan Bank (FHLB) system in the securitization process of mortgages to the secondary market. CUNA encourages the increased usage of FHLBs and sees the entities as a positive force in housing finance. As we have previously noted for the sponsors of the legislation, only a small number of credit unions use the Federal Home Loan Banks, due in large part to FHLB requirements that hinder their access. For example, in order to join a FHLB, a portion of a credit union's qualifying assets must be in either mortgages or mortgage backed securities, which creates problems for smaller credit unions. Further, State chartered privately insured credit unions are not permitted to join a FHLB.

Conclusion

In conclusion, CUNA recognizes that reforming the secondary market to ensure a viable housing market is no easy task. We greatly appreciate the leadership this Committee has put forward in addressing the needs and concerns of our members so that the American dream of home ownership will not be disadvantaged by inflated costs and Government imposed limitations that could result in undue impediments that would hinder access to a safe and affordable secondary market.

PREPARED STATEMENT OF ANDREW J. JETTER

PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL HOME LOAN BANK OF TOPEKA, ON BEHALF OF THE COUNCIL OF FEDERAL HOME LOAN BANKS

JULY 23, 2013

Good Afternoon Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee. My name is Andrew Jetter and I am the President and CEO of the Federal Home Loan Bank of Topeka. I appreciate the opportunity to speak to you today on behalf of the Council of Federal Home Loan Banks (Council), a trade association representing all of the Federal Home Loan Banks (FHLBanks).

Federal Home Loan Bank System Overview

Initially, I would like to describe the FHLBanks and their critical role in providing cost-effective funding and other services to members to assist them in financing housing and community and economic development. Following that, I will address our understanding of the role of community financial institutions in providing

mortgage finance, the challenges they face, and how the FHLBanks currently assist them in that role.

The FHLBanks were created in 1932 to support America's housing finance system through their member thrift institutions and insurance companies. Since that time, Congress has expanded the mission of the FHLBanks to include support for affordable housing, community development, and other forms of community lending and has expanded eligibility for membership in the FHLBanks to commercial banks, credit unions, and community development financial institutions. Advances (fully secured loans to member institutions) represent the core of the FHLBanks' business. Members rely on the FHLBanks to provide competitive access to liquidity across all economic and credit cycles. This liquidity enhances the financial strength of local lenders so that they can meet the housing finance and other credit needs of their communities through a range of products and services.

During the Nation's financial crisis, when dislocations in the capital markets made funding from other sources difficult, the FHLBanks were a critical source of funding for U.S. financial institutions, preventing far greater losses and potential failures. The FHLBanks were able to increase their lending to members of every asset size and in every part of the country by $370 billion—from a total of $650 billion in the second quarter of 2007 to over $1 trillion in the third quarter of 2008. The FHLBanks were able to carry out this essential liquidity function for their members without requiring taxpayer assistance. The crucial role played by the FHLBanks was recognized in an extensive study prepared by the staff of the Federal Reserve Bank of New York. This study found that during the financial crisis the Federal Home Loan Bank System was "by far, the largest lender to U.S. depository institutions while most of the Federal Reserve's liquidity operations have been for the benefit of nondepository institutions or foreign financial institutions."[1] The backstop role played by the FHLBanks was also recognized by William Dudley, President of the Federal Reserve Bank of New York, who noted that when the interbank lending market dried up in 2007, depository institutions turned to the Federal Home Loan Bank System for needed liquidity.[2]

The FHLBank System's Unique Structure Has Enabled It to Successfully Fulfill Its Mission Since 1932

The FHLBanks have been able to successfully fulfill their mission as a result of several unique characteristics: their cooperative structure; a scalable, self-capitalizing, operating model; broad participation by a diverse membership; and dependable access to a deep, liquid market for FHLBank debt.

Cooperative Structure

The FHLBank System has a unique structure, comprised of twelve independent cooperatives and the Office of Finance that issues debt on behalf of those twelve regional FHLBanks. The FHLBanks are overseen by an independent regulator, the Federal Housing Finance Agency (FHFA), established by the Housing and Economic Recovery Act of 2008 (HERA Act of 2008). Each FHLBank is a separate and distinct corporate entity with its own stockholder—member institutions and its own board of directors. While the FHLBanks issue debt collectively and are jointly and severally liable for the repayment of those debt obligations, there is no single controlling entity with responsibility for or authority over the FHLBanks. Each FHLBank operates independently under the authority granted by Congress through the Federal Home Loan Bank Act, as amended, and in accordance with the regulations established by the FHFA.

Each FHLBank operates within a district originally established by the Federal Home Loan Bank Board, one of the predecessors to the FHFA. Each FHLBank's capital stock can only be purchased by its member institutions. Each member must purchase the FHLBank's capital stock in order to become a member, and must maintain capital stock holdings sufficient to support its business activity with the FHLBank in accordance with the individual FHLBank's capital plan.

Scalable, Self-Capitalizing, Operating Model

The FHLBank System is built to be scalable—advance levels ebb and flow with credit cycles to match member demand. Since the height of the crisis, advances have declined by more than half as weak asset growth and excess liquidity have reduced members' need for advances. The decline in advance levels, following their rapid expansion, demonstrates that the FHLBank model works as intended.

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[1] Federal Reserve Bank of New York, Staff Report No. 357 at pp. 28–29 (November, 2008).

[2] "May You Live in Interesting Times", Remarks of William Dudley, Executive Vice President of the Federal Reserve Bank of New York, October 17, 2007.

As cooperatives, FHLBanks are not subject to the growth imperative that often drives the decisions of publicly traded corporations. Demand for advances expands and contracts with economic and market conditions and the FHLBanks' capital stock outstanding appropriately adjusts to these changes. Although the specific requirements vary based on each FHLBank's capital plan, an institution must hold a certain level of capital stock to be a member. In addition, a member must maintain "activity-based" capital stock in proportion to the amount of advances it has outstanding.

During periods of credit expansion, the activity-based stock requirement automatically provides additional capital to support advances growth. For example, in the recent liquidity crisis, the signficiant increase in advances was accompanied by the purchase of additional capital stock to support those advances, thereby providing additional capital to the FHLBanks in direct proportion to the increase in assets. This allowed each FHLBank to meet the liquidity needs of its members while preserving the safety and soundness of the cooperative.

An FHLBank's capital stock cannot be issued to or held individually by members of an FHLBank's board of directors, its management, its employees, or the public, and is not publicly traded. There is no market for FHLBank capital stock other than among FHLBank members. The price of an FHLBank's capital stock cannot fluctuate, and all FHLBank capital stock must be purchased, repurchased, or transferred only at its par value. There are no stock options or other forms of stock-based compensation for FHLBank management, directors, or employees.

Broad Participation by a Diverse Membership

The membership of the FHLBank System consists of thrifts, commercial banks, credit unions, insurance companies, and community development financial institutions. At the end of first quarter of 2013, the FHLBanks had 7,604 members, composed of: 967 thrifts; 5,169 commercial banks; 1,185 credit unions; 268 insurance companies; and 15 community development financial institutions.

The composition of the FHLBank membership closely approximates the composition of the banking industry: 88 percent of members have less than $1 billion in assets compared with 91 percent of all banks and thrifts and 97 percent of all credit unions industry wide. Typically, advances utilization rates are fairly consistent across asset size groups, though smaller institutions are currently funding a larger portion of their balance sheets with advances than larger institutions. Many of these smaller institutions have limited or no direct access to the capital markets other than through their FHLBank.

In addition to depository institutions, over 250 insurance companies are now members of an FHLBank. Insurance companies are a significant part of the System, representing almost 13 percent of outstanding advances. These members play an important role in the housing market by holding substantial amounts of single and multifamily mortgages and agency debt. Many insurance company members are also active participants in the Affordable Housing Program (AHP) and the Community Investment Program (CIP) as an extension of their involvement in economic development activities.

The mortgage finance and community lending industry is broad and varied. This variety is crucial to both financial innovation and the diversification of risk across institutions of differing size, geography, charter, and business model. By providing equal access to liquidity, the System supports the current structure of the industry and this structure can be a source of stability and strength moving forward. As Congress looks to restructure the housing finance system in this country, all member types of the FHLBank System will have an important role to play in meeting the Nation's housing finance needs.

Dependable Access to a Deep, Liquid Market for FHLBank Debt

The market for FHLBank debt is one of the most liquid. To the end investor, this liquidity represents an appealing characteristic. Collectively, the FHLBanks issue debt in significant volume on a daily basis. The size, frequency, and consistency of issuance mean that it takes less time for the market to absorb new issues during both normal and stressed markets. In turn, this makes it profitable for dealers to allocate capital against FHLBank underwriting and trading. Greater capital allocations, in turn, mean greater liquidity in the market.

This liquidity enables the FHLBanks to fund at attractive levels across a host of terms and structures. In turn, they pass this advantage on to their members. All members receive the benefit of attractive funding, regardless of their size. Because advances are made at relatively narrow spreads to borrowing costs, attractive issuance levels for FHLBank debt translates directly into lower advance rates for

members. In turn, these members are able to pass these benefits on to their communities in the form of affordable credit.

Another benefit of the depth and liquidity of the market for FHLBank debt is that the System is able to rapidly scale up its issuance with member demand for advances. The FHLBank debt franchise is well recognized and highly desired by a host of global investors due to its liquidity and credit quality. During 2008 and 2009, against a dislocated bond market, the System was able to increase debt outstanding by $365 billion over 14 months. This added funding provided a lifeline to financial institutions across the country. It is because of the depth and liquidity of the FHLBank debt market that the System is able to tap the markets in size when demand surges—even during extreme distress.

Advances and Member Services

Members use advances to fund new originations and existing portfolios of mortgages, to purchase mortgage-backed securities, and to manage the substantial interest rate risk associated with holding mortgages in portfolio. Some members layer in term advances alongside their deposits, altering the duration profile of their liabilities to better suit their assets and mitigate risk. Other members use shorter-term, on-demand liquidity to offset unexpected deposit runoff or to take advantage of an opportunity to quickly add assets. By enabling members to effectively manage their balance sheets, advances lower the cost of extending credit to American consumers.

In accordance with statutory requirements, all advances are secured by eligible collateral and the purchase of capital stock. When FHLBanks issue advances, they lend against both the credit of the member-borrower and the quality of the collateral. Each FHLBank establishes its own processes and procedures for assessing the credit worthiness of borrowers and the appropriate lending value of pledged collateral. FHLBanks regularly monitor actual and potential borrowers' financial condition to ensure appropriate credit actions have been taken to protect the FHLBank against any potential loss arising from any extension of credit. In addition to evaluating members' financial reports, FHLBanks also monitor macroeconomic trends and local laws and regulations, and regularly interact with the member's management teams to ensure they stay attuned to the member's financial condition.

Each FHLBank establishes the types of assets that will be accepted as eligible collateral, defines the specific underwriting requirements and identifies the lendable value that will be applied to each eligible asset. Collateral practices vary among the FHLBanks with regional differences accounting for some of the differences. For example, some districts are dominated by larger commercial banks where others are primarily served by community financial institutions. Some markets display a concentration of loans exceeding the conforming loan limits, where others are well within the limits. On the coasts, there is a higher concentration of commercial real estate lending, and in the midwest some institutions specialize in agricultural lending. Based on these regional differences and the risk appetite of each FHLBank, collateral practices will vary. Examples of these variations include, but are not limited to, the types of assets accepted as eligible collateral, the specific underwriting requirements applied to each asset class, the member's collateral reporting requirements, pricing techniques, and on-site collateral reviews.

The valuation and management of member collateral is a process that relies on regional expertise and market knowledge. During a time when many institutions attempted to streamline or outsource credit underwriting and collateral evaluation processes, the FHLBanks stuck to the basics and combined conservative collateral valuation practices with effective credit policies. The System has an impressive track record as a result.

Beyond assessments and risk management, FHLBanks provide a variety of member services, such as correspondent services that leverage local knowledge to deliver value. While these services vary across the System, it is clear that the strong relationships between FHLBanks and their members are mutually beneficial and integral to the strength of each cooperative.

FHLBank Mortgage Programs

The System has an excellent track record of working with members to manage risk in the mortgage purchase programs that some FHLBanks have administered for over 16 years. In these programs, a participating FHLBank purchases traditional conventional single-family mortgages originated by member institutions under a risk-sharing agreement between the FHLBank and the member. The FHLBanks essentially offer two different versions of mortgage purchase programs. The Mortgage Partnership Finance (MPF) Program generally involves the selling member providing a credit enhancement to the FHLBank that can be called upon

if the performance of the pool of loans sold incurs losses above a certain level. The FHLBank of Chicago created the program and administers many aspects of the program for participating FHLBanks. Another MPF variation allows members to sell their loans through their FHLBank to Fannie Mae, although without any risk sharing obligation. The other program is the Mortgage Purchase Program offered by a few FHLBanks that essentially involves the creation of a reserve account against the pool of loans sold by the member that is paid out to the member over time depending on the loss experience of the pool.

The collective portfolio of mortgage loans held by the FHLBanks in both programs carries a 1.94 percent seriously delinquent rate in comparison to a 6.16 percent seriously delinquent rate for all conventional loans nationwide. Total actual credit losses from mortgages held in portfolio since the program's inception in 1997 have been less than 5 basis points of the average portfolio balances annually.

These programs are an example of the success that can be achieved from "skin-in-the-game" mortgage partnerships. Community bankers exemplify "skin-in-the-game" business principles on a daily basis—their success is dependent upon being fully invested in the success and survival of the communities that they serve. Prudent underwriting, adequate appraisals, and the provision of appropriate credit products that suit an individual borrower's needs are fundamental operating principles for community bankers.

The FHLBank of Topeka offers the Mortgage Partnership Finance (MPF) Program. The MPF program is critically important to supporting our housing finance and community and economic development mission and is especially important for our community financial institution members. The district that we serve is comprised of smaller and more rural communities where agriculture is a leading economic force. With a total population of 13.7 million, we are the smallest of the FHLBank districts. The median size of our counties is much smaller than the median size of counties across the U.S.

Our MPF program is focused on serving community financial institutions and providing a reliable secondary market conduit for them. Ninety-three percent of the current MPF balances have been aggregated from community financial institutions with total assets of approximately $1 billion or less. Since inception, over 240 members have sold loans to the FHLBank of Topeka using the MPF program. The portfolio is broadly distributed with the largest concentration held by a single participating member at 6 percent, with the next largest concentrations at just over 2 percent. The average size of a participating member's mortgage loans in our MPF portfolio is approximately $24 million. Our MPF program is broadly representative of our financial institutions and the local communities that they serve.

The fundamental MPF concept—that the actual lender making the credit decision should retain "skin in the game" will drive better credit performance in mortgage portfolios—has a proven successful track record. This concept of lender retained risk has been at the forefront of the mortgage finance reform debate. Congress and regulators need only look to the FHLBanks' mortgage programs to see the concept in action. Our MPF portfolio of mortgage loans carries a 0.4 percent seriously delinquent rate in comparison to a 6.16 percent seriously delinquent rate for all conventional loans nationwide. Since inception, annual credit losses on our MPF program have not exceeded 2 basis points of the average portfolio balances.

The FHLBank mortgage programs have been highly successful in adding value to members through product innovation and service. At a time when other secondary market participants are consolidating their services, increasing delivery and guarantee fees and imposing surcharges on low volume lenders (or providing high volume lenders with discounts), members have recognized that they can rely on their FHLBank to meet their secondary market needs. The mortgage purchase programs allow community financial institutions to be competitive with larger financial institutions and mortgage lenders and to remain active housing lenders within their communities.

Housing and Community Lending Programs

For more than 20 years, the FHLBanks' Affordable Housing Program (AHP) has been one of the largest private sources of grant funds for affordable housing in the United States. It is funded with 10 percent of the FHLBanks' net income each year. These grant funds are distributed through a competitive process to projects developed through partnerships of member institutions and local developers and housing organizations. AHP grants subsidize the cost of owner-occupied housing for individuals and families with incomes at or below 80 percent of the area median income (AMI), and rental housing in which at least 20 percent of the units are reserved for households with incomes at or below 50 percent of AMI. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an advance. AHP funds

are primarily available through a competitive application program at each of the FHLBanks. AHP funds are also awarded through a home ownership set-aside program to assist low and moderate income households in purchasing homes, with at least one-third of the funds being used to assist first-time homebuyers. The AHP allows for and encourages funds to be used in combination with other programs and funding sources, such as the Low-Income Housing Tax Credit. These projects serve a wide range of neighborhood needs: many are designed for seniors, the disabled, homeless families, first-time homeowners and others with limited resources. As of year end 2012, more than 806,000 housing units have been built using AHP funds, including 490,000 units for very low-income residents. The total AHP dollars awarded from 1990 through 2012 is approximately $4.8 billion.

Each Federal Home Loan Bank also operates a Community Investment Program (CIP) that offers below-market-rate loans to members for long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods. Members use CIP advances to fund the purchase, construction, rehabilitation, refinancing, or predevelopment financing of owner-occupied and rental housing for households with incomes at or below 115 percent of AMI. The program is designed to be a catalyst for economic development since it supports projects that create and preserve jobs and help build infrastructure to support growth. Lenders have used CIP to fund owner-occupied and rental housing, and to construct roads, bridges, and sewage treatment plants as well as to provide small business loans. From 1990 to 2012, the FHLBanks' CIPs have lent over $68 billion for a variety of projects, resulting in 771,000 housing units.

The FHLBanks' Community Investment Cash Advance (CICA) programs offer funding, often at below-market interest rates and for long terms, for members to use to provide financing for projects that are targeted to certain economic development activities. These include commercial, industrial, manufacturing, and social services projects, infrastructure, and public facilities and services. CICA lending is targeted to specific beneficiaries, including small businesses, and households at specified income levels.

I would like to take some time to inform you about some of the programs and initiatives that my bank, the FHLBank of Topeka, has undertaken on behalf of our members, particularly our smaller members, to help them serve the lending and credit needs of their communities.

The AHP supports our housing finance mission by providing subsidies to its members for the provision of affordable owner-occupied and rental housing to very low-, low-, and moderate-income households. More than 33,000 housing units have been built using AHP funds and more than $145 million have been awarded through our competitive program.

In addition to the competitive application program, AHP funds are also awarded through the home ownership set-aside program. Under this program, an FHLBank may set aside up to the greater of $4.5 million or 35 percent of its AHP funds each year to assist low- and moderate-income households purchase homes. Our members obtain the AHP set-aside funds and then use them as grants to eligible households. The FHLBank of Topeka's set-aside is geared to our smaller, community-based members. We limit the amount of funds each member may use annually and we restrict the use of the funds to the purchase of homes only in nonurban areas of our district. Since the program's inception in 1995, participating members have used just over $28 million to assist 7,255 households purchase homes.

FHLBank members are able to obtain advances (loans) through the Community Investment Program (CIP) and Community Investment Cash Advances (CICA) programs. For ease of our member's use, the FHLBank of Topeka has separated the housing and economic development portions of these programs into our Community Housing Program (CHP) and Community Development Program (CDP). Advances taken through CHP and CDP are priced below our normal interest rates and may be for longer terms, allowing our members to provide financing for projects that are targeted to housing or economic development activities at fixed rates.

Throughout our district, members have used CDP to match fund loans or pools of loans to their customers for a variety of activities, including: commercial real estate, small business lending, farm real estate, and a variety of agricultural credit needs. Members meet the commercial lending needs in their communities by:

- Match funding loans for single projects on a case-by-case basis
- Funding a group of eligible loans as a pool
- Funding loan participations

Since 1999, our members have been approved for nearly $2.2 billion in CDP funds, financing more than 1,700 projects involving the creation or retention of 4,500 jobs.

Corporate Governance

Congress established a unique ownership and governance structure for the FHLBanks, which has served the FHLBanks well in the past and continues to do so today. A critical feature of this structure is that the FHLBanks are wholly owned by their members/customers so each FHLBank's interests are simultaneously aligned with those of its members and customers. In addition, the boards of directors of the FHLBanks are independent of management. No member of management may serve as a director of an FHLBank.

The Federal Home Loan Bank Act provides that a majority of each FHLBank's directors must be elected by its member financial institutions from among officers and directors of those institutions. Members vote for directors representing member institutions from their States. At least two-fifths of the directors must be independent (nonmember) directors. The HERA Act of 2008 altered the governance structure of the FHLBanks to provide for the election of independent directors by the FHLBanks' members, rather than their appointment by the regulator. HERA also required that at least two of each FHLBank's independent directors must represent the "public interest" by having more than 4 years of experience in representing consumer or community interests on banking services, credit needs, housing, or financial consumer protection. The remaining independent directors must have demonstrated knowledge or experience in financial management, auditing and accounting, risk management practices, derivatives, project development, organizational management, or such other expertise as the FHFA Director provides by regulation.

The Federal Home Loan Bank Act also provides that no member may cast a number of votes in the election of directors greater than the average number of required shares held by members in its specific State. This prevents large members holding relatively large amounts of an FHLBank's capital stock from dominating director elections and, in practice, means that the majority of each FHLBank's member directors generally represent the small institutions that make up the great majority of members.

The statutory framework that controls the composition of the FHLBanks' boards of directors ensures that each FHLBank's board of directors will have a balance of interests represented. With no members of management on the board of directors, directors are in a position to independently oversee management actions. The members that contribute capital and benefit from the FHLBank's products and services are assured a majority of the directors. The director election voting preferences for small members ensure that larger members cannot dominate the board of directors and that an FHLBank's policies will not be detrimental to small members. Finally, the large contingent of independent directors ensures that the FHLBanks will benefit from perspectives and expertise independent of the membership.

Risk Management

The Federal Home Loan Banks are highly regulated entities, subject to regulation and supervision by the Federal Housing Finance Agency (FHFA).

As 12 independent institutions, each FHLBank is responsible for appropriately developing and implementing its own risk management activities. The cooperative structure of the FHLBanks eliminates many of the incentives a publicly traded company might have to raise its risk profile, and in fact discourages FHLBanks from taking excessive risk. Just as FHLBank members do not expect equity investment returns on their capital stock investments in an FHLBank, they also do not expect equity investment risk in that investment. Members purchase FHLBank capital stock in order to obtain access to FHLBank funding products, and must maintain capital stock investments in the FHLBank as long as they continue to be members. Members provide the capital that supports their advance transactions with the FHLBanks. In this environment, members expect stability, reliability and consistency of returns and credit product pricing. These member expectations are reflected in the oversight provided by each FHLBank's board of directors, a majority of which is comprised of directors representing member institutions.

Through a rigorous process, each FHLBank continually manages the pool of collateral backing an advance. This includes frequent monitoring of performance, pricing, and valuation. Members are required to maintain a sufficient pool of performing collateral, so they regularly replace delinquent loans and add collateral based on changes in haircuts and valuations. These precautions ensure sufficient overcollateralization at all times.

When an FHLBank lends to a troubled member, it does so in consultation with that member's primary regulator. In the event that the member subsequently becomes insolvent, this process enables the FDIC to minimize losses to the Deposit Insurance Fund. In a liquidation scenario, the FDIC typically pays off outstanding advances in exchange for the timely release of collateral in an attempt to maximize the resolution value of the institution. Should the FDIC opt out of this arrangement, the FHLBank can liquidate the collateral to pay off any advances.

For an FHLBank to take a loss on an advance the liquidation value of a member's pledged assets plus the member's investment in FHLBank stock would have to be less than the outstanding advance plus prepayment fees (the fair value of the advance). This is extremely unlikely—since the establishment of the System in 1932, no FHLBank has taken a credit loss on an advance. In the event that collateral was insufficient to cover a defaulting member's borrowings, the next line of defense to FHLBank shareholders would be the failed member's investment in capital stock. This capital is proportional to either the size of the member (asset-based stock purchase requirement) or to the outstanding balance of advances (activity-based stock purchase requirement, which increases along with activity). It is hard to envision a situation in which a member would lose its capital investment in an FHLBank due to the failure of another member.

From the vantage point of debt investors and taxpayers, the FHLBanks' joint and several liability structure provides additional insulation from any loss that might occur at an individual FHLBank. Even if an FHLBank suffers losses, the aggregate amount of capital stock and retained earnings on the balance sheet of the 12 FHLBanks, collectively, would provide a deep layer of insulation from losses. The combination of the FHLBanks' cooperative structure and the multiple layers of risk mitigation provide an abundance of private capital to buffer bondholders and taxpayers from potential losses.

Financial Condition

The FHLBank System reported net income of $2.6 billion in 2012, up from $1.6 billion in 2011, making 2012 the most profitable year since 2007. For the third consecutive year, all 12 FHLBanks were profitable. As a result of this profitability, the FHLBanks have been able to continue building their retained earnings. As of YE 2012 retained earnings were at $10.5 billion, having grown 250 percent since 2008 as the FHLBanks prudently strengthened this component of capital as a risk mitigant. Having completed their statutory obligation in 2011 under the Federal Home Loan Bank Act to make payments related to the Resolution Funding Corporation, all of the FHLBanks have entered into a Joint Capital Enhancement Agreement to further strengthen their financial soundness. Under this agreement, each FHLBank, on a quarterly basis, allocates 20 percent of its net income to a separate restricted retained earnings account established by that FHLBank. These restricted retained earnings accounts cannot be used to pay dividends to members and continue to build at each FHLBank until they are equal to one percent of that FHLBank's total outstanding consolidated obligations.

Role of Community Financial Institutions in the Housing and Mortgage Finance Market

Community financial institutions remain significant players in housing finance, notwithstanding the continuing pace of greater concentration being observed in both mortgage originations and servicing. The core strength community financial institutions bring to the market is their deep knowledge of local markets and their personal relationship with customers. In smaller communities and in rural markets, community financial institutions are often the sole source of mortgage credit as larger institutions focus on more populated areas.

While not having the dominant share of mortgage originations, community financial institutions originate a significant amount of mortgage loans. As shown in the table below, during the first quarter of 2013, $435 billion of mortgages were originated. Community banks and thrifts with less than $10 billion in total assets originated $55 billion of residential mortgage loans during the first quarter of 2013.

Table 1: Largest Mortgage Originations
($ billions)

		1Q 2013	1Q 2012	$ Chg	% Chg	Mkt Sh
1	Wells Fargo & Company	$ 109.8	$ 130.4	$ (20.5)	-15.7%	25.2%
2	Chase	55.7	40.8	14.8	36.3%	12.8%
3	Quicken Loans Inc.	25.5	10.9	14.6	134.2%	5.9%
4	Bank of America	25.0	16.0	9.0	56.5%	5.8%
5	U.S. Bank Home Mortgage	22.5	20.1	2.4	12.0%	5.2%
6	CitiMortgage, Inc.	19.3	15.6	3.7	23.5%	4.4%
7	PHH Mortgage	13.3	14.0	(0.6)	-4.5%	3.1%
8	Flagstar	12.4	11.2	1.3	11.2%	2.9%
9	PennyMac	8.8	1.9	7.0	376.3%	2.0%
10	SunTrust Bank	8.8	7.7	1.2	15.3%	2.0%
	Top Ten	301.3	268.4	32.8	12%	69%
	All Others	134.0	115.1	18.9	16%	31%
	Totals	$ 435.3	$ 383.5	$ 51.7	13%	100%

Source: MortgageStats.com

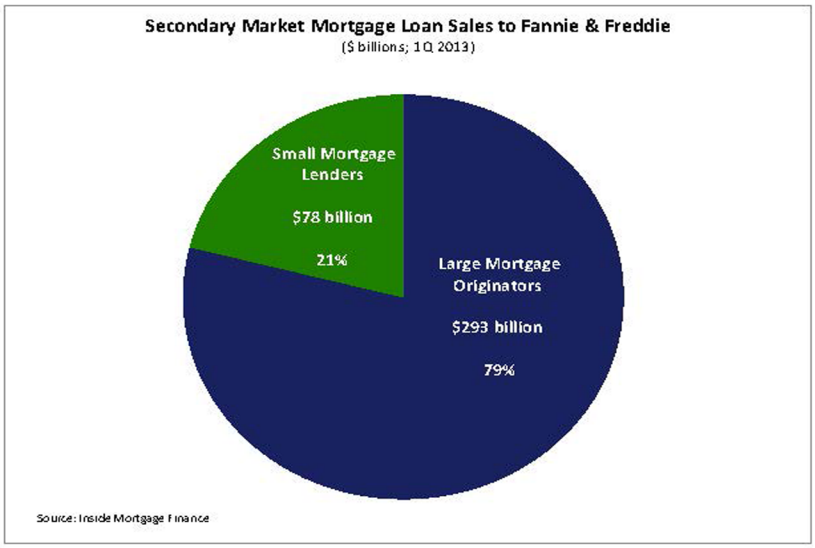
Community financial institutions play an important role as an investor in mortgage loans and mortgage-backed securities. As portfolio lenders, community financial institutions invest in mortgage loans originated in their local markets. Some institutions have had success holding in portfolio both conforming and nonconforming mortgages. Other lenders have developed a strategy of holding nonconforming mortgages and selling conforming mortgages. Nonconforming mortgages, whether because they exceed the conforming limit (jumbos) or because they do not meet all of the underwriting criteria of the agencies, still can be well underwritten and of high quality. There are occasions where a lender may need to make an accommodation in underwriting the loan such that it does not qualify under the secondary market rules. When this occurs, the ability of these loans to be placed into the lender's portfolio ensures a broader section of the community has access to home loans.

U.S. banks and thrifts held $2.4 trillion in residential mortgage loans on their books at March 31, 2013. Of the $2.4 trillion 43 percent was held by smaller financial institutions.

Community financial institutions also play a significant role in supporting liquidity in the mortgage-backed securities market through purchases of MBS securities. As of March 31, 2013, banks and thrifts held $1.7 trillion on their balance sheet with smaller financial institutions holding approximately $0.8 trillion. Community banks and thrifts with total assets of less than $10 billion held $0.3 trillion of these mortgage-backed securities.

Community financial institutions often prefer to retain servicing of their mortgage originations, including those sold into the secondary market. The primary reason is to maintain the personal customer relationship between the community financial institution and their customers. While the mortgage servicing industry has undergone significant consolidation over the past decades, community financial institutions continue to strive to maintain high quality and cost effective servicing for their customers. As of March 31, 2013, the top ten mortgage servicers serviced $6.2 trillion of residential mortgages, or 79 percent of the total and the remainder—primarily community financial institutions—serviced $1.7 billion, or 21 percent of the total.

Community financial institutions maintain a disciplined approach to managing risks, including risks on their balance sheet. As such, community financial institutions will have limits as to the levels of fixed-rate residential mortgage loans that they desire to carry on their balance sheet. Therefore, it is not uncommon that these financial institutions need to sell off portions of their new mortgage loan originations into the secondary market. During the first quarter of 2013, small financial institutions and mortgage lenders sold $78 billion to Fannie Mae and Freddie Mac.



Community Financial Institution Challenges in Mortgage Finance and the Secondary Market

Community financial institutions have always played a critical role in housing and mortgage finance in support of their local communities. But today they face enormous challenges and uncertainty.

The FHLBanks are currently conducting a survey of our members to determine the issues that are impacting their mortgage business and what role they would like the FHLBanks to play in support of their mortgage activities moving forward. Some of the initial results would indicate a high level of uncertainty regarding their ability to continue to profitably make residential mortgages.

Much of the concern relates to new rules around qualified mortgages and the capital requirements under the new Basel III rules. Although some of these proposed rules were recently finalized with changes favorable to community financial institutions, there continues to be a high level of concern with the time, attention, resources and costs needed to comply.

One favorable change in Basel III relates to risk-based capital (RBC) rules for credit enhancements that would impact the credit enhancement members provide under the MPF Program. During the Program's nearly 16 plus year history, the RBC rules have been somewhat punitive given the superior credit performance of the loans as the rules did not seem to fully account for the credit structure supporting the loans or the FHLBank's first loss account (FLA) designed to cover normal and expected losses. The newly adopted Basel III rules more appropriately account for the FLA and provide a much better result in terms of required RBC. We hope that members would be given the option to apply this treatment earlier than the implementation date of Basel III. At the same time, however, the formulas applied to the credit structure are relatively complicated and our members will require education and assistance to comply with the new rules and calculations.

Increased regulation—combined with the possibility that larger financial institutions will have an increased aggregation role moving forward—is very troubling to our members. Our members value the ability to underwrite the mortgages made in their communities and to continue to service the loans. Both of which would be greatly diminished if selling to larger aggregators or securitization sponsors is the only path to the secondary markets in the future.

Freddie Mac recently announced their intent to charge a $7,500 fee to originators with less than $5 million in annual business—many of which would be community-based financial institutions. In 2012, approximately 40 percent of the FHLBank of Topeka's participating members sold less than $5 million into our MPF Program. While Freddie Mac subsequently rescinded their low activity fee, we believe that this illustrates how a large aggregator may work with small community-based institutions.

There are other challenges created by new and proposed regulations governing mortgage servicing and mortgage loan originations that will add to the cost and complexity of regulatory compliance. While there has been much discussion on finding ways to reduce this burden on community financial institutions, more needs to be done.

FHLBank Support of Mortgage Lenders

The FHLBanks play a variety of important roles in supporting community financial institutions in their role of financing homes.

Our community financial institutions use advances from the FHLBanks in a variety of ways. On a broad level, the FHLBanks provide a key supplement to the deposit funding institutions primarily rely on. Today, community financial institutions are experiencing strong deposit growth, but this is not typical. When businesses and communities are growing, community financial institutions experience strong loan demand. Meeting that loan demand just from deposits is generally not an option and that is when community financial institutions rely on their FHLBanks to provide additional funding.

For portfolio lenders, it is important to manage the interest rate risk involved in longer-term fixed-rate loans. The FHLBanks offer a variety of advance products to meet the needs of those lenders. Members can obtain long-term fixed-rate funding to match the mortgages held in portfolio. Amortizing advances are available that can be matched to a portfolio of mortgages the member holds. Advances are available that allow the member the option to prepay the advance without fee to match the convexity of the member's mortgage portfolio. The FHLBanks also provide technical assistance to members in understanding how to quantify and manage the interest rate risk from a portfolio of fixed-rate loans. When a community financial institution sells to other institutions, FHLBanks will provide warehouse lending, funding the loan between the time the loan is closed and the loan is sold.

We support their secondary market needs through our MPF and MPP programs when they have loan originations that they do not wish to hold in their portfolios. Our MPF and MPP program's premise rests on the simple, yet powerful, idea that by combining the credit expertise of a local lender with the funding and hedging advantages of the FHLBanks, a stronger, and more economical and efficient method of financing residential mortgages would result. These mortgage programs give mortgage lenders the best options of mortgage lending—lenders retain the credit risk in their loans and transfer the interest rate and prepayment risks to the FHLBank. Participating financial institutions are able to preserve their customer relationships and are paid to manage the credit risk of their customers. These programs charge no lender surcharges—allowing smaller community financial institutions equitable access and the ability to more effectively compete in the mortgage finance market against their larger competitors.

A majority of community banks, thrifts, and credit unions participating in the mortgage programs hold approximately $1 billion or less in total assets and are more comfortable dealing with their FHLBank than selling directly to Fannie Mae. These members already have a relationship with their FHLBank and obtain better pricing through the FHLBanks. Small banks, thrifts, and credit unions do not have sufficient volumes to qualify for discounts on guarantee fees charged by Fannie Mae to protect against credit losses. The volume pricing available to the FHLBanks and passed on to small community financial institutions is a huge benefit that allows them to compete on rates against larger financial institutions and mortgage lenders. The MPF program also allows small banks, thrifts, and credit unions to retain mortgage servicing and maintain more control over the customer relationship. Community lenders can retain servicing or can work with the servicers approved for the program.

Some of the FHLBanks offer a product called MPF Xtra. Through MPF Xtra, mortgage loans are aggregated through FHLBanks and sold to Fannie Mae. This service complements our other mortgage programs. More notably, the program provides a crucial service to community financial institution members that want to continue to make home loans. For our members that want 30-year fixed-rate mortgages to be available at a competitive price, our role as an aggregator and our price point compare favorably with selling directly to Fannie Mae.

There are numerous other ways in which community financial institutions and the FHLBanks partner to serve their communities. From providing letters of credit for securing public unit deposits to providing direct grants to support low- to moderate-income housing, the FHLBanks partner with community financial institutions to serve the public.

S.1217—the "Housing Finance Reform and Taxpayer Protection Act of 2013"

The Council welcomes the opportunity to share with you our views on housing finance reform generally, and more specifically our views on the recently introduced bill S.1217—the "Housing Finance Reform and Taxpayer Protection Act of 2013". We commend you for your extensive efforts in working to achieve a sustainable housing finance system for the future that does not expose the taxpayer to unnecessary risk.

The Council believes that the FHLBanks have a critical role to play in serving their members in the housing finance system of the future. The unique characteristics of the FHLBank System that have made it possible for the FHLBanks to carry out their mission of serving their members and their communities (their regional, scalable, self-capitalizing, cooperative structure; broad participation by a diverse membership; and dependable access to a deep, liquid market for FHLBank debt) should be maintained in a future housing finance system. The FHLBanks have demonstrated their role as a safe and reliable provider of liquidity throughout the recent financial crisis, and their regional, self-capitalizing, cooperative structure will enable them to serve their members' needs in a safe and sound manner in a future housing finance system.

We are pleased that S.1217 recognizes the importance of maintaining a role for institutions of all sizes in the housing finance system of the future, and contains provisions intended to preserve equal and reliable secondary market access for small and midsize community financial institutions to help maintain reliable access to mortgage credit throughout all parts of the country. We appreciate that the bill provides different options for the FHLBanks to serve their members as the housing finance system of the future evolves. With the support and guidance of our members, we are open to exploring opportunities to expand our support of community lenders. At the same time, we emphasize the paramount importance of maintaining and protecting our continuing role as a reliable source of liquidity for our members.

We look forward to working with you and your members as the legislative process moves forward.

Conclusion

Over their long history, the FHLBanks have played a critical role in supporting their member financial institutions' ability to meet the housing finance and credit needs of their local communities in all economic cycles and in all parts of the United States. The FHLBank cooperative model performed exceptionally well throughout one of the worst financial crisis in this Nation's history, without requiring any taxpayer assistance. The FHLBanks remain economically strong today and continue to serve a vital function for their financial institution members and the communities they serve.

Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the FHLBanks and housing finance reform. I would be happy to answer any questions you have.

PREPARED STATEMENT OF MICHAEL MIDDLETON

CHAIRMAN AND CHIEF EXECUTIVE OFFICER, COMMUNITY BANK OF TRI-COUNTY, WALDORF, MARYLAND, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

JULY 23, 2013

Chairman Tester, Ranking Member Johanns, my name is Michael Middleton, Chairman and Chief Executive Officer of the Community Bank of Tri-County in Waldorf, Maryland. I appreciate the opportunity to be here to represent the American Bankers Association (ABA) and present our views regarding reforming the Government's role in secondary mortgage markets. ABA represents banks of all sizes and charters and is the voice for the Nation's $14 trillion banking industry and its two million employees.

The ABA commends Senators Corker, Warner, Tester, Johanns, Hagan, Heitkamp, Heller, and Moran on the introduction of the Housing Finance Reform and Taxpayer Protection Act (S.1217) to address the Federal Government's role in the mortgage market and resolve the longstanding conservatorship of Fannie Mae and Freddie Mac.

This bipartisan legislation is a positive first step in what is certain to be a long process toward creating a sustainable, rational, and limited role for the Federal Government in supporting and regulating a mortgage market that is appropriately and predominately filled by the private sector. The bill follows principles long advo-

cated by the ABA, and builds upon the framework detailed by the Bi-Partisan Policy Center's Housing Commission, on which ABA's CEO, Frank Keating, served.

S.1217 creates the Federal Mortgage Insurance Corporation (FMIC) which would serve as a public guarantor of eligible mortgages and a regulator of the issuers, aggregators and credit enhancers involved in a revised secondary market. The approach taken with the FMIC addresses a number of key concerns with the Government's role in the housing finance markets. It provides a set of incentives to shrink the Government's involvement, while establishing the structure for a liquid and private market.

We would also note that to fully protect taxpayers from additional losses like those suffered by Fannie Mae and Freddie Mac during the financial crisis, it will be necessary to impose similar reforms on the Farm Credit System, which continues to follow the discredited model of privatized gains and public losses which failed so badly in the housing sector. Without similar reforms to the Farm Credit System, it is only a matter of time until taxpayers again are put at risk.

The task ahead will not be easy. The mortgage market is a complex and intricate part of our Nation's economy that touches the lives of nearly every American household. Fannie Mae, Freddie Mac, Farm Credit System, and the Federal Housing Administration currently constitute the bulk of available financing for the American mortgage market. It is, therefore, imperative that reform be done so as not to inflict further harm on an already fragile housing economy and, most importantly, does not inadvertently harm creditworthy Americans who want to own a home. Reform must be deliberate, as the current situation is not viable for the long term. Addressing the many concerns and interests of a wide range of participants will require much negotiation, compromise and cooperation. There is much work yet to be done, but this bill is a solid foundation on which to begin the process.

In my statement today, I would like to make three key points:

- S.1217 is consistent with principles long advocated by the ABA, and builds upon the framework for single-family housing finance detailed by the Bi-Partisan Policy Center's Housing Commission;
- S.1217 moves to facilitate the reduction of the Federal Government's role in single-family housing finance; and
- Although S.1217 addresses a number of key concerns with GSE reform, there remain a number of outstanding issues that must be addressed to ensure the viability of the new system and that the mortgage markets continue to function properly.

I. S.1217 Is Consistent With Principles Long Advocated by the ABA

ABA believes the Government's role in housing finance must be dramatically reduced. It should be limited to ensuring access to the secondary market for lenders of all sizes and governmental agencies should not compete directly with the private market. This structure must provide for stability and accessibility of the capital markets in the event of a market failure.

S.1217 is an important first step in addressing the role of the Federal Government in supporting and regulating mortgage markets. As Congress works to develop a consensus on broad reforms, ABA believes lawmakers should be guided by the following principles developed by the bankers serving on ABA's GSE Policy and Federal Home Loan Bank Committees:

1. The primary goal of any Government-sponsored enterprise (or a GSE successor) in the area of mortgage finance should be to provide stability and liquidity to the primary mortgage market for low- and moderate-income families.
2. In return for the GSE (or a GSE successor) status and any benefits conveyed by that status, these entities must agree to support all segments of the primary market, as needed, in all economic environments.
3. Strong regulation, examination, and authority for immediate corrective action of any future GSE must be a key element of reform.
4. Any GSE or successor involved in the mortgage markets must be strictly confined to a well-defined and regulated secondary market role and should not be allowed to compete with the private, primary market.
5. Any reform of the secondary mortgage market must consider the vital role played by the Federal Home Loan Banks and must in no way harm the traditional advance businesses of FHLBanks, their member's access to advances or to its mission as it has been defined and refined by Congress over time.
6. GSEs or successors must both be allowed to pursue reasonable risks, but the risk/reward equation must be transparent and more rigorously defined and regulated.

7. GSEs or successors must operate within a framework of market procedures and regulation governing the securitization of all mortgage assets.
8. A better alternative to arbitrary "skin in the game" is the establishment of strong minimum regulatory standards to assure sound underwriting for all mortgages, regardless of whether they are sold or held. Comparable standards should be established for all loan originators with comparable levels of effective regulatory oversight.
9. Accounting and regulatory changes should be developed to more appropriately reflect and align securitizations with underlying risks. True sales treatment and regulatory capital charges should appropriately reflect the reality of true risk-shifting activities, as well as balance sheet exposures.
10. Affordable housing goals or efforts undertaken by the GSEs or successors should be delivered through and driven by the primary market, and should be structured in the form of affordable housing funds available to provide subsidies for affordable projects. GSEs or successors must provide for fair and equitable access to all primary market lenders selling into the secondary market.

ABA has long maintained that the primary goal of any Government-sponsored enterprise in the area of mortgage finance should be to provide stability and liquidity to facilitate the ability of the primary mortgage market to provide credit for borrowers who have the credit and skill sets required to achieve and maintain home ownership. S.1217 would replace Fannie Mae and Freddie Mac with a new Federal guarantor, the Federal Mortgage Insurance Corporation (FMIC), modeled in part on the Federal Deposit Insurance Corporation (FDIC).

The FMIC is designed to provide fully priced and fully paid Federal guarantees on securities backed by loans meeting specified requirements. By fully pricing the risks associated with insuring these mortgage loans, the legislation addresses a key shortcoming that has plagued the existing system and provides for the development of a private market. For too long, the guarantee fees (G fees), paid to insure loans backed by the current GSEs, were too low—the compensation being paid for what amounts to full Government backing was simply not priced correctly.

Although the conservator of the GSEs, the Federal Housing Finance Agency (FHFA) has raised the G fee to encourage development of the private market, and to begin to repay the Government for its current support, more needs to be done both to protect taxpayers and to encourage the return of capital to the private market. G fees must be set high enough so that the private market will be able to price for risk in a fashion that allows for safe and sound investment and lending at a rate that is comparable (and eventually better) than the rate charged by the GSEs or any successor such as the FMIC. Such a structure also allows the FMIC tools to intervene if necessary in the event of crisis or market failure.

Underwriting will also play an important role in the proposed FMIC. The FMIC will only cover eligible loans that meet strict underwriting requirements. In order to be eligible a loan must have at least a 20 percent downpayment as well as meeting Qualified Mortgage requirements. While we support this approach, we note that it does make it that much more essential for the Consumer Financial Protection Bureau to get the Qualified Mortgage rules right, and that banks be given the appropriate time needed to come into compliance with those rules.

Another provision of this legislation is the lowering of the maximum loan limit for eligible single family mortgage loans to a more reasonable $417,000. The current maximum loan limit of $625,500 in high cost areas and $417,000 in all other regions is dramatically higher than necessary for the purchase of a moderately priced home, especially in light of housing price declines nationwide. While some high-cost areas persist (and a recovery of the housing market will entail a hoped for stabilization and recovery in home values), the conforming loan limits for most of the Nation should be reduced. This will assist the development of a private market for loans outside of the conforming loan limits as a step to a more fully private market for most loans.

The legislation allows the Federal Home Loan Banks (FHLBs) to continue their existing mission, providing a key source of liquidity to our Nation's banks, while also allowing for the FHLBs to act as aggregators and issuers of securities guaranteed by the FMIC. The FHLBs play a vital role in the mortgage markets and community economic development that must be protected. This plan preserves the traditional advance business of the FHLBs and access to advances by their members, particularly for community banks which play a vital role in providing mortgage finance and economic development.

The bill would allow for a potential expansion of the role played by the FHLBs in housing finance if they choose to become aggregators and issuers for the FMIC.

In doing so, the FHLBs would be required to establish a new subsidiary, authorized by this bill, which would be separately capitalized from the existing FHLBs. The bill makes clear the intent that activities of any subsidiary are not part of the joint and several obligations applicable to the FHLB system. We support this intent and would like to work with the authors and the Committee to ensure that any necessary additional provisions to protect the existing FHLB system and its members which may be identified as the process continues are also incorporated. In particular, we emphasize that existing capital in the FHLB system is fully deployed, and as a general circumstance is a member asset that would not be available to capitalize new ventures.

The bill also provides for the creation of a mutual entity to ensure small-lender access to the capital markets if such access were not available through another issuer, or through a Federal Home Loan Bank issuer. Small-lender access to the secondary market is of vital importance. In order for community banks to remain competitive, they must have access to the liquidity provided by the secondary market on an equitable basis regardless of size, location or market served. We applaud the attention the bill pays to this concern, though we note that capitalization of a new cooperative owned by small lenders may pose a challenge. We also note that many community banks also have existing relationships with larger institutions which may choose to become issuers under the bill's provisions, while others engage in correspondent or other arrangements with larger institutions. FMIC is tasked with maintaining equitable access to the portals for smaller lenders. Preserving this multiplicity of access points will be important as the reform process evolves, and we want to work with the Committee to ensure that in establishing new structures and access points, existing relationships and mechanisms are not inadvertently harmed.

Similarly, we note that the bill would ensure that existing debt already guaranteed by Fannie Mae and Freddie Mac benefits from the full faith and credit of the United States. Because of the trauma suffered by the financial markets and the borrowers they served during the recent financial crisis, it is important to move forward in a cautious and well-considered fashion. By ensuring that currently guaranteed mortgages remain covered, this plan would prevent an unexpected shock that could destabilize mortgage markets.

II. S.1217 Would Reduce the Federal Government's Role in Housing Finance

ABA believes that the role of the Government in housing finance should be dramatically reduced from its current level and a private market for the vast majority of housing finance should be fostered. The Government's role should be limited to well-targeted borrowers and covered loans and ensuring stability and accessibility of the capital markets in the event of market failure. The proposed FMIC intends to reduce governmental involvement and foster private sector financing—ensuring that financing can involve private sector banks of all sizes. Multiple sources of liquidity for private market lenders will lead to a more diverse and ultimately safer housing financing system.

A well-regulated private market should be the desired financing source for the bulk of borrowers whose income and credit rating qualify them for conventional financing. Private markets function much more efficiently, better allocating the limited resources and credit. Additionally, a larger private market means fewer loans guaranteed by taxpayers, reducing the potential liability.

As proposed, the FMIC's role would be much more limited than the existing role of Fannie Mae and Freddie Mac. Currently, the GSEs undertake a wide set of mortgage market services, securitizing, bundling and issuing mortgage-backed securities. There is no reason for this function to be performed by a Government entity. By limiting the FMIC's scope to simply insuring and regulating these markets, the bill creates the environment for a strong and healthy private market to perform the same function. And because the legislation requires participating private entities to take a first loss position ahead of any Government guarantee provided by the FMIC, it limits taxpayer exposure.

The FMIC's role would be two-fold. It would insure the smaller set of covered loans, ensuring a liquid and resilient housing finance market as well as the availability of credit. Also important, would be its role as regulator. The FMIC would replace the Federal Housing Finance Agency, regulating the players in the new housing finance market. Strong regulation, examination and authority for prompt corrective action are key elements of any reform proposal and which, if implemented correctly, will also help to reduce taxpayer liability.

III. A Number of Issues Must Be Addressed To Ensure Viability of the New System and To Allow Mortgage Markets To Function Properly

This bill is an important step in the right direction. In order for it to accomplish its goal of a more limited governmental role while also ensuring that mortgage markets continue to function properly, a number of outstanding issues must be addressed.

The First Loss and Capitalization Requirements Will Limit the Number of Private Entities Participating in Securitizations

A key concern is the ability of private sector entities to participate in the activities given the capital requirements set forth in the bill. Although the bill allows private entities to participate in the securitization, bundling and issuing of mortgage-backed securities, doing so requires a separately capitalized entity. These entities are required to have capital sufficient to cover any losses and are required to maintain a first loss position of not less than 10 percent of the face value of any covered security. At a time when the financial services industry is being asked to raise capital levels, it will likely be difficult, if not infeasible, for many potential participants to fund these separately capitalized entities and, thus, to participate.

Presently, a host of new banking regulations are coming into effect including Basel III and new leverage requirements—requiring banks to raise capital levels. ABA fears that few, if any, financial services institutions will have the free capital to fund a separately capitalized entity to undertake the securitization activities with the first loss positions required under the bill, particularly when other capital requirements are taken into consideration. Potentially, only a handful of large banks and other institutions with significant access to capital markets may be able to participate. This will only serve to further concentrate the industry. As previously noted, we also have similar concerns about the Federal Home Loan Banks' and the proposed mutual entity's ability to capitalize sufficiently to meet the bill's requirements. This concern would extend to the other credit enhancers such as mortgage insurers and guarantors encompassed by the bill.

ABA supports the overall structure envisioned by the bill with the FMIC acting as a guarantor, and private entities acting as aggregators, issuers and credit enhancers, but we believe further work is needed in setting the appropriate level of first loss and capitalization required of these entities.

The FMIC Should not Serve as the Regulator for the Federal Home Loan Banks

ABA also has concerns with tasking the FMIC with the regulation of the Federal Home Loan Bank System. While it is logical and prudent to have the FMIC regulate approved issuers under the new system, including any subsidiary of the Federal Home Loan Banks that serves as an issuer, we fear that having the FMIC regulate the entire FHLB System will create potential conflicts of interest that may harm the System and its members. Essentially the FMIC and its regulated entities will serve as a replacement for Fannie Mae and Freddie Mac. The Federal Home Loan Banks will continue in their traditional role, which means that they will function as a counterpart and, in some respect, competitive alternative to the FMIC. It is ill-advised to have one competitor regulate another. For this reason, we strongly urge that an alternative structure be considered for the regulation of the Federal Home Loan Banks in carrying out their traditional mission. One potential alternative is to keep that function as part of an ongoing single purpose Federal Housing Finance Agency.

A More Thorough Examination Is Needed on the FMIC's Role in Multifamily Housing Finance

Although this bill moves to reform most aspects of the Government's involvement in housing finance markets, it would retain a large role for the FMIC in multifamily finance. Currently Fannie Mae and Freddie Mac play an outsized role in the finance of multifamily real estate. This bill does little to change that, other than to transfer existing authorities and activities from the GSEs to the FMIC. We believe that a more thorough examination is needed regarding the proper role of the Government in the multifamily finance market, and that additional legislation may be needed to more appropriately reform the multifamily housing market and the role played by the Federal Government in multifamily finance.

Conclusion

S.1217 provides an important first step towards creating a sustainable, rational and limited role for the Federal Government in supporting and regulating a healthy mortgage market provided predominantly by the private sector. The mortgage market is an important part of our Nation's GDP, which touches the lives of nearly

every American family. As such it is important that these reforms are carefully considered, so as to ensure the continued functioning of the labor market.

We emphasize our caution that Congress be deliberate and reasoned in crafting such a monumental endeavor to avoid any disruptions of the nascent housing market recovery which would materially impact the Nation's broader economic recovery.

ABA commends the authors of this legislation for approaching this difficult issue in a manner that encourages discussion and moves to the establishment of a healthy private mortgage market. The ABA stands ready to work with the authors and the entire Congress to achieve such ends.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

STATEMENT SUBMITTED BY THE COMMUNITY HOME LENDERS ASSOCIATION

The Community Home Lenders Association is pleased to submit this written statement to the Senate Banking Committee on this hearing which focuses on the importance of ensuring that consumers have access through smaller community lenders to affordable mortgage loans under a reformed housing finance system.

The Community Home Lenders Association (CHLA) is a national nonprofit association of small and midsized community based nonbank mortgage lenders. The mission of the CHLA is to advocate for Federal mortgage programs, rules and regulations which treat community mortgage lenders fairly, and which reflect the critical importance that these lenders play in providing access to mortgage credit for borrowers, in increasing competition in mortgage markets, and in giving borrowers the option of obtaining mortgage loans and services at the personalized, local level which community mortgage lenders provide.

One of the strengths of our mortgage finance system has been the role that securitization has played in providing long-term fixed-rate mortgages for single- and multifamily housing. Securitization allows mortgage lenders located anywhere in the country to originate loans and sell them off, thus replenishing the originator's reserves and capacity to originate new loans. This has created a vibrant market in which smaller banks, credit unions, and nonbank mortgage lenders can actively participate in mortgage markets, provided they are responsible and originate according to loan underwriting standards that the ultimate purchasers or guarantors establish.

For many decades, this process worked well, creating a TBA market for 30-year fixed-rate loans and fueling a vibrant housing market which has increased home ownership rates and helped the housing sector play a vital role in the economy. Obviously, though, this process did not always work so well, such as during the subprime housing boom, with the result being the Federal Government putting Fannie Mae and Freddie Mac into receivership, advancing hundreds of billions of tax dollars to cover GSE loan losses, and providing TARP funds to major financial institutions that were over-exposed to mortgages.

Now, Congress is at a crossroads, facing momentous decisions on how to deal with Fannie and Freddie, and how to restructure our Nation's mortgage finance system, to achieve the twin goals of continuing to provide available, affordable long-term fixed-rate mortgage loans to meet our Nation's housing needs, while at the same time responsibly protecting taxpayers.

In this respect, the CHLA commends the Subcommittee for holding his hearing, and the Committee for beginning a debate on these critical issues. The CHLA also commends the work of a bipartisan group of Senators in introducing S.1217, a comprehensive bill to reform our mortgage finance system. The CHLA believes S.1217 is an excellent start, with many good provisions. Still, much more work lies ahead in debating these issues, finding ways to strengthen the bill's provisions, and ultimately implementing a workable solution.

The CHLA is taking this opportunity to submit a written statement to focus on the critical importance of getting mortgage reform right in terms of creating a diverse mortgage market that continues to include community based lenders, and smaller banks and credit unions. This is essential to having a truly competitive mortgage market, in which consumers have real choices. We also need to get this right, because if we don't, we may end up with a mortgage market dominated by a few large banks and financial institutions that are "too big to fail," and, because of their central role in housing finance, effectively "too important to fail."

On the central debate about whether there should be a continued Federal guarantee of MBS, the CHLA takes the position that such a guarantee is warranted, and that S.1217 forms a good starting point for achieving that goal. A Federal guarantee would provide essential liquidity to ensure affordable fixed-rate long term mortgages for our Nation's housing needs, while also ensuring countercyclical lending when the private sector exits the market due to adverse economic conditions. A Federal guarantee is also important to ensuring that mortgage credit is available in all regions and for all property types. The CHLA believes this can be done in a way that protects taxpayers, through risk sharing to create market discipline and private absorption of first losses, guarantee fees that reflect the true risk to the Government, and sound regulation.

But regardless of the details of how mortgage reform is done, the CHLA would like to identify the key issues and principles that we believe must be debated and addressed, in order to ensure a broad, consumer-oriented mortgage market.

Making Sure There Is a Cash Window for Smaller Loan Originators

The CHLA appreciates that a great deal of effort went into S.1217 to address concerns about smaller lenders having access to mortgage markets if the originator can't securitize the loans themselves. This includes language about the importance of access to a "cash window," and authorization of a both cooperative and the FHLB's to serve this function.

However, the CHLA believes it is critical, both in the drafting of the legislation and its implementation, that such access is actually achieved. The CHLA would like to make two important points. First, the FLHB provision may be very helpful to banks and credit unions, but does not help nonbank community mortgage lenders. In fact, the existence of the FHLB option, if it works, could put less pressure on making sure the cooperative works, which would mean that only nonbank community lenders are left out. Secondly, whether through revised language or through a very strong commitment in practice to make this work, the CHLA believes it is critical to ensure that the cooperative—or whatever mechanism is designed to provide a cash window—ACTUALLY works in practice. Because, if not, we could lose a very vital portion of our housing finance system.

Fair and Equitable Pricing

One of CHLA's concerns comes from the experience with the GSEs, in which volume discounts and other features were at times used to create a pricing structure which unfairly discriminated against smaller loan originators. Consumers are best served—and fairness dictates—that regardless of how mortgage reform is done, all players in a position of power within the market should have a pricing structure that is fair and equitable, that provides for access to secondary markets on full and equal terms to all qualified loan originators, of all types and sizes.

The CHLA notes that S.1217 requires that the new regulator shall carry out the bill in a manner that credit unions and community and mid sized banks shall have equal access to any common securitization platform and are not discriminated against through discounts for volume pricing or other mechanisms. This is a good start, but the CHLA has two recommendations to strengthen this. First, the CHLA believes it is important to modify the bill where it refers in places like this to smaller banks and credit unions to also refer to community based nonbank mortgage lenders, as these lenders play an important part in our mortgage markets and should have comparable treatment. Secondly, the CHLA believes that prohibitions against volume discounts or other mechanisms that discriminate against smaller lenders should apply not just to a Federal insurance guarantee on the MBS, but also to other key players in the process, including guarantors and issuers.

In addition to concerns about price discrimination, it is also important that net worth and capital requirements not be utilized in a manner that unreasonably discourages qualified loan originators and servicers. It is fair and reasonable for loan originators to have sufficient capital to be a going concern, to meet buyback/indemnification responsibilities and for servicers to meet advance obligations. But net worth requirements should always be transparent and nondiscriminatory among lenders, and should be reasonably related to indemnification and advance exposure.

Without such equitable treatment, smaller and midsize mortgage lenders would not be able to compete on equal terms, and the result could be a market dominated by only the biggest lenders.

Avoid Conflicts Between Securitizers and Origination Affiliates

Another major concern is the fact that many of the Nation's largest securitizers also have extensive loan origination distribution networks. Regardless of how mortgage reform is done, it is likely that the largest banks and securities firms will control the process of securitizing mortgages. If these same securitizers channel this power into exclusively purchasing loans from their affiliated mortgage originators, in short order small community based lenders, banks, and credit unions could quickly be cut out of the mortgage origination business.

These types of concerns could be exacerbated if, as is likely, risk sharing is required. Currently even moderately sized mortgage originators are able to securitize Fannie Mae and Freddie Mac loans, as there is a relatively simple Federal guarantee. However, if securitizations in a reformed world generally require risk sharing through the securitization structure itself—eg., through subordinated tranches—then many moderately sized lenders may no longer have the expertise and capability of doing these more complicated securities structures. They may then be cut out of the securitization market.

There are many potential ways to address these concerns. One blunt instrument might be to limit market share of any one lender. Alternatively, there may be ways to do this by constraining the ability of securitizers to exclusively channel loans to

lender affiliates, or to ensure, in practice, that there is a competitive guarantee option that is not tied to securitizers, such as private mortgage insurance. However, regardless of the solution, Congress should acknowledge the challenge, and take steps to anticipate and address concerns about these factors that could lead to a highly concentrated mortgage market.

Risk Sharing Must Be Done Right

As noted, there seems to be an increasing likelihood that, regardless of the way mortgage reform unfolds, risk sharing will play an important role. The CHLA applauds the Federal Housing Administration (FHFA) for its pilot program to investigate various risk sharing models. Before Congress and the Nation commit to any mortgage structure that heavily relies on risk sharing, there needs to be some degree of assurance that this can work, and work on a scale needed to meet our Nation's mortgage needs. We should not gamble with housing, which plays such a critical component in our Nation's economy.

Moreover, risk sharing should be done right. First, any guarantee should be incontestable; a guarantee should be a guarantee, not an opportunity to negotiate with the lender to see whether they might first foot the bill for losses, even though the lender did everything right in underwriting the loan. Correspondingly, the lender should bear its traditional historical responsibilities—underwriting loans according to loan standards, taking buyback risk related to reps and warranties, and assuming servicing responsibility for advances.

Finally, if risk sharing is to become an important component of lending, Congress and the regulators should strive to create a broad and competitive market for different guarantee sources, so that the market does not become concentrated as a result of a narrow range of options.

Single Securitization Platform

The CHLA applauds the both the provisions of S.1217, and the efforts of the FHFA to create a single securitization platform. The CHLA believes these are important steps to create the most competitive possible market for consumers, by creating opportunities for all lenders, including community based nonbank mortgage bankers, community banks, and credit unions.

In closing, the CHLA is pleased to participate in this important debate about the future of America's housing finance system, and to offer these views and recommendations.

STATEMENT SUBMITTED BY THE MORTGAGE BANKERS ASSOCIATION

Chairman Tester, Ranking Member Johanns, and Members of this Subcommittee, as Fannie Mae and Freddie Mac (the GSEs) approach their fifth full year in conservatorship, it is important that policy makers begin defining the future role of the Federal Government in the mortgage market. Two bills, including a bipartisan bill introduced by Senators Bob Corker and Mark Warner, have recently been introduced in Congress and signal a promising beginning to this important debate.

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to support the important role played by community lenders in our Nation's housing market. Congress needs to ensure that any end state it considers affords lenders of all sizes the securitization options to directly access the secondary market—this principle is critical to level the playing field and create a vibrant, competitive market for the engine of the American Dream.

Background

As Congress considers both transitional and end-state reforms, it should ensure that the federally supported secondary market provides equal access and execution options that work for smaller, community-based lenders. Community lenders are crucial to this marketplace, providing Americans across the country with safe, sus-

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the Nation's residential and commercial real estate markets; to expand home ownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's Web site: *www.mortgagebankers.org.*

tainable, and affordable mortgage credit. Policy makers should proceed carefully to ensure that a future housing finance system promotes a robust and competitive mortgage market.

According to HMDA data from 2011, more than 7,500 lenders originated mortgages in that year. Fannie Mae and Freddie Mac report that roughly 1,000 lenders are direct sellers to the GSEs, and Ginnie Mae currently has more than 250 issuers. The vast majority of these lenders are smaller independent mortgage bankers and community banks.

Not every smaller lender has the financial capacity or expertise to directly manage the risks and complexities of the secondary market. Many prefer instead to sell whole loans to aggregators. Others are uncomfortable selling only to aggregators because they do not want to risk losing other key product relationships with their customers. For some, it is critical to have direct access to the secondary market during times when the aggregators reduce their demand. Lenders with the appropriate skills and capital should have the opportunity to make their own choices about how, when, where, and to whom to market loans they originate, based on their core competencies and other strategic objectives.

Unfortunately, current GSE practices sometimes limit the choices of otherwise qualified lenders. Eliminating these practices would be a significant transition step toward a vibrant future mortgage market, and in fact need not await legislative action.

Congress should, however, ensure that the future mortgage market is accessible to smaller, community-based lenders in a meaningful way. These lenders need a secondary market system that delivers:

- Price certainty, including guarantee fees that reflect the risk of the underlying loan and the true counterparty risk of the originator
- Execution for both servicing-retained and servicing-released loans
- Single-loan and/or small pool executions with a low minimum pool size
- Ease of delivery; and
- Quick funding.

The cash windows operated by the GSEs provide some, though not all, of these aspects today. Moreover, while Ginnie Mae provides a means of securitizing individual loans, the complexity of the process has kept many smaller originators from becoming direct issuers, resulting in fewer Ginnie issuers relative to GSE direct sellers.

MBA Position

MBA believes that an explicit Government backstop is absolutely necessary for a vibrant, competitive secondary mortgage market. Serious consideration should be given to expanding the membership criteria of the Federal Home Loan Bank system (FHLBs). For example, Congress could allow nondepository institutions to purchase a class of capital stock that would provide nondepository mortgage lenders the opportunity to participate in and contribute to the market liquidity provided by the FHLBs.

Small mortgage lenders also require certain elements to be present in order to enjoy meaningful access to the secondary market. These elements will be elaborated upon below.

Explicit Federal Guarantee

A vibrant, competitive mortgage market that is accessible to all creditworthy borrowers will require an explicit Federal guarantee, albeit one that is well defined, limited, and called upon only after deep layers of private capital have been exhausted. An important corollary is that any reforms—whether transition steps or end-state reforms—should also ensure that the federally supported secondary market provides equal access and execution options that work for smaller, community-based lenders. This is an important precondition for a vibrant, competitive mortgage market that works for borrowers, investors, and the American taxpayer.

Expand FHLB Membership

MBA believes serious consideration should be given to expanding FHLB membership to include nondepository mortgage lenders. These lenders are often smaller, community-based independent mortgage bankers focused on providing mainstream mortgage products to consumers. In exchange for membership in the FHLB system, these institutions could be required to hold a limited class of stock with appropriate restrictions. Expanding FHLB access to these institutions would enhance market liquidity and ensure a broader range of mortgage options for consumers.

Key Elements for Small Lenders

Increase Price Certainty and Transparency—One concern with the current market structure's ability to provide meaningful, equitable access for all lenders has been varied pricing offered to different loan sellers. Although the GSEs have claimed that these disparities have narrowed, there is little transparency on the terms of pricing and underwriting criteria offered throughout the market, despite the fact the enterprises have been operated by an agency of the Federal Government for almost 5 years.

The Federal Housing Finance Agency (FHFA) currently has the authority to eliminate these opaque pricing and underwriting terms, and should do so as soon as possible. In addition, any successor to the GSEs that operates with a Federal guarantee should have a transparent fee structure based on the risk inherent in the transaction. This approach would recognize that private capital providing credit risk protection in front of the Government guarantee may price differently across originators. Finally, the use of underwriting concessions should be eliminated (except perhaps for limited-time pilot programs), and access to special programs, products, and delivery options should be open to any lender meeting required minimum eligibility standards that do not include delivery volume.

Enhance Execution Options for Smaller Lenders, Including Allowing for Single-Loan Execution—Because of the risks associated with the GSEs' large retained portfolios, most proposals regarding the future of the federally backed secondary mortgage market do not envision the successors to the GSEs having a balance sheet to fund a cash window. Today, there are existing and potentially new means available to regulators and the GSEs for delivering a small number of loans into multilender pools. For example, the Ginnie II and Fannie Majors programs both allow single-loan execution.

However, these programs are more complex than using the cash windows, and thus only a small number of lenders utilize them. While Congress debates the long-term future of the market, these processes can and should be simplified now in order to build a successful platform for sustainable, single-loan, multilender execution. For example, although multilender securities might not price as well in the capital markets as larger pools from a single lender, any discount could be reduced by pooling practices that increase the size of these multilender securities. In addition, it is important for some smaller lenders that they be able to securitize loans on a servicing-released basis.

Currently, the GSEs have programs in place which facilitate bifurcation of originator and seller reps and warrants so that originators can deliver loans servicing-released. However, participation in these programs is tightly restricted. Such programs are necessary going forward, and should be made more broadly available to smaller lenders as soon as possible. MBA believes these programs do not require direct facilitation from any other market participant and that smaller sellers should be able to negotiate reps and warrants directly with any approved servicer.

Quicker Funding—It is also important for smaller originators to have an option for receiving quicker funding. Today, GSE cash windows provide daily funding. Congress should consider including in its ultimate reform plan more frequent settlement dates to permit quicker funding. Broker-dealers already provide a bid for off-settlement-date trades using interpolated pricing. The expectation is that this market could grow if more sellers utilize it, benefiting community lenders and reducing costs for borrowers.

To be approved today, direct sellers to the GSEs or issuers in the Ginnie Mae program must meet financial and managerial standards. Smaller lenders who wish to be direct issuers will likely need to meet the standards set by the public guarantor in a future model. These standards need to be set at levels that allow for meaningful access by smaller lenders.

Conclusion

As policy makers begin transitioning the market toward the desired end state for the GSEs—either through regulatory, administrative, or legislative actions—there are two items that need particular attention.

First, the cash window needs to remain in place until an operable single-loan execution process is up and running. As the GSE portfolios wind down, sufficient balance sheet space needs to be maintained to aggregate loans from smaller lenders who are not yet ready to securitize.

Second, the FHFA securitization platform initiative needs to include plans for the acceptance of small lot deliveries into multilender pools, perhaps initially designed as an expansion of Fannie Mae's Majors program. Every effort should be made to further simplify this program so that it can be a viable, competitive option for lenders of every size.

Making the secondary market work for smaller lenders is critical for providing a competitive market, which ultimately benefits homebuyers. Policy makers should take the steps available today to make sure that secondary market reform provides smaller lenders with opportunities for direct access.

MBA is eager to work with the Chairman, Ranking Member Johanns, and all other Members of this Chamber and the Congress as a whole to ensure that the mortgage market in American remains vibrant, competitive, and accessible.

LETTER SUBMITTED BY CHAIRMAN TESTER FROM B. DAN BERGER, EXECUTIVE VICE PRESIDENT, GOVERNMENT AFFAIRS, NAFCU

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B. Dan Berger
Executive Vice President
Government Affairs

July 22, 2013

The Honorable Jon Tester
Chairman
Subcommittee on Securities, Insurance, and Investment
Senate Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Mike Johanns
Ranking Member
Subcommittee on Securities, Insurance, and Investment
Senate Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Tester and Ranking Member Johanns:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the interests of our nation's federal credit unions, I write today with respect to tomorrow's hearing, "Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions." As you know from previous correspondence, the future of housing finance is of great importance to our nation's credit unions. Accordingly, NAFCU members are encouraged by the title of the hearing and the acknowledgement that secondary mortgage market access is critical for community institutions.

First, we would like to praise your role in crafting the *Housing Finance Reform and Taxpayer Protection Act* (S. 1217). This bipartisan effort, led by Senators Bob Corker (R-TN) and Mark Warner (D-VA), is an important step in the housing finance reform debate and we acknowledge the hard work put forward by the cosponsors and their staffs in crafting this comprehensive proposal. We are pleased that, through your leadership, the bipartisan approach put forth in S. 1217 makes an effort to help address the concerns of community financial institutions.

It is with the these concerns in mind that NAFCU would like to reiterate to the subcommittee the importance of retaining a housing finance system that provides credit unions with unrestricted access to the secondary mortgage market. This source of liquidity is critical in allowing credit unions to manage interest rate risk and enables them to serve the mortgage needs of their 95 million member-owners across the country. As the housing market continues to recover from the financial crisis, it is especially critical that lawmakers and regulators strike the necessary and proper balance for the government's role in the housing finance sector.

In addition to a healthy and viable secondary mortgage market that provides necessary access for community-based financial service providers like credit unions, Congress, in any reform effort,

must put into place safeguards that will prevent discrimination based on type of institution, an institution's asset size or any geopolitical issues. To ensure this type of discrimination does not take place, NAFCU believes there needs to be a heavy focus on fair pricing that reflects loan quality as opposed to standards almost exclusively based on loan volume. Because credit unions originate a relatively few number of loans compared to others in the marketplace – federally insured credit unions had about 7% of the first mortgage originations in 2012 – they cannot support a pricing structure based on loan volume, institution asset size, or any other geopolitical issue that will lend itself to discrimination and disadvantage their member-owners. Loan quality and underwriting standards are the best way to ensure a healthy and efficient secondary market and a strong housing economy.

In 2010, as the future of housing finance became a focal point in Congress, with the Administration, and among the regulatory agencies, the NAFCU Board of Directors was the first in the credit union industry to establish a set of principles that credit unions would like to see reflected in any reform efforts. These principles were aimed to help ensure that credit unions are treated fairly during any housing finance reform process. They are outlined below:

- NAFCU believes a healthy, sustainable and viable secondary mortgage market must be maintained. Credit unions must have unfettered, legislatively-guaranteed access to such market. In addition, in order to achieve a healthy, sustainable and viable secondary market, NAFCU believes there must be healthy competition among and between market participants in every aspect of the secondary market. Market participants should include, at a minimum, multiple Government Sponsored Enterprises (GSEs), Federal Home Loan Banks, Ginnie Mae (as insurer of FHA, VA, and other government-backed loans), and private entities.

- The U.S. government should issue explicit guarantees on the payment of principal and interest on MBSs. The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in the MBSs and facilitate the flow of liquidity.

- During any transition to a new system (whether or not current GSEs are to be part of it) credit unions have uninterrupted access to the GSEs, and in turn, the secondary market.

- Credit unions could support a model for the GSEs that is consistent with a cooperative or a mutual entities model. Each GSE would have an elected Board of Directors, be regulated by the Federal Housing Finance Agency, and be required to meet strong capital standards.

- A board of advisors made up of representatives from the mortgage lending industry should be formed to advise the FHFA regarding GSEs. Credit unions should be represented in such a body.

- While a central role for the U.S. government in the secondary mortgage market is pivotal, the GSEs should be self-funded, without any dedicated government appropriations. GSE's fee structures should, in addition to size and volume, place increased emphasis on

quality of loans and risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of many agency securities.

- Fannie Mae and Freddie Mac should continue to function, whether in or out of conservatorship, and honor the guarantees of the agencies at least until such time as necessary to repay their current government debts.

- NAFCU does not support full privatization of the GSEs at this time because of serious concerns that small community-based financial institutions could be shut-out from the secondary market.

- The Federal Home Loan Banks (FHLBs) serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Reform of the nation's housing finance system must take into account the consequence of any legislation on the health and reliability of the FHLBs.

We hope that these principles can ultimately be reflected in any housing finance reform proposal that the Committee may consider.

Finally, while we still have some questions over the practicality of the approach proposed in S. 1217, the attention to market-access for community lenders is an important aspect of this legislation. We look forward to working with you, the bill's sponsors, and the Committee to address the concerns of credit unions as this bill makes its way through the legislative process.

Thank you for this opportunity to provide input on this critical issue. NAFCU welcomes the opportunity to provide additional views on housing finance reform as the legislative process progresses. If my colleagues or I can be of assistance to you, or if you have any questions regarding this issue, please feel free to contact myself, or NAFCU's Vice President of Legislative Affairs, Brad Thaler at (703) 842-2204.

Sincerely,

B. Dan Berger
Executive Vice President, Government Affairs

cc: Members of the Subcommittee on Securities, Insurance, and Investment

LETTER SUBMITTED BY CHAIRMAN TESTER FROM DOUGLAS M. BIBBY, PRESIDENT, NATIONAL MULTI HOUSING COUNCIL; AND DOUGLAS S. CULKIN, CAE, PRESIDENT, NATIONAL APARTMENT ASSOCIATION

July 23, 2013

The Honorable John Tester
Chairman
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Securities, Insurance, and Investment
United States Senate
Washington, DC 20510

The Honorable Mike Johanns
Ranking Member
Committee on Banking, Housing, and Urban Affairs
Subcommittee on Securities, Insurance, and Investment
United States Senate
Washington, DC 20510

Dear Chairman Tester and Ranking Member Johanns:

On behalf of the National Multi Housing Council and the National Apartment Association, we would like to commend you for holding this hearing today: *Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions*. The efforts to reform the housing finance system are challenging and must be done in a thoughtful, deliberative manner. While today's hearing is focused on community institutions, we would like to remind you of the significant role that multifamily housing plays in the housing finance system.

One in three Americans rent, and 17 million of those households are building their lives in apartments. Many factors influence the apartment industry's health and its ability to meet the nation's growing demand for rental housing, but the availability of consistently reliable and competitively priced capital is the most essential.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. Yet those shortcomings were largely confined to the residential home mortgage sector. The Government Sponsored Enterprises' (GSEs') (i.e., Fannie Mae and Freddie Mac) very successful multifamily programs were not part of the meltdown and have actually generated over $10 billion in net profits to the government since being placed into conservatorship.

More than just preforming well, the GSEs' multifamily programs serve a critical public policy role. Unfortunately, even during normal economic times, private capital alone cannot fully meet the industry's financing needs. The GSEs ensure that multifamily capital is available in all markets at all times, so the apartment industry can address the broad range of America's housing needs from coast to coast and everywhere in between.

As you begin the debate on housing finance reform in earnest, NMHC/NAA urge lawmakers to recognize the unique needs of the multifamily industry and to retain the successful components of the existing multifamily programs in whatever housing finance structure that succeeds them. We believe the goals of a reformed housing finance system should be to:

1. Ensure mortgage liquidity in all markets at all times;
2. Ensure capital availability for the wide range of properties, sponsors and renters;
3. Expand private capital participation;
4. Limit/mitigate market disruptions; and
5. Insulate the taxpayer from losses.

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Thank you for your dedication to this critically important issue. We look forward to working with you in this process.

Sincerely,

Douglas M. Bibby
President
National Multi Housing Council

Douglas S. Culkin, CAE
President
National Apartment Association

cc: Subcommittee on Securities, Insurance, and Investment