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INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

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Committee on Financial Services

Hearing on

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

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Chairman Hensarling, Ranking Member Waters, and members of the committee, my name is William A. Loving, Jr., and I am President and CEO of Pendleton Community Bank, a $260 million asset bank in Franklin, West Virginia that serves four rural markets in West Virginia and one Virginia community. I am also Chairman of the Independent Community Bankers of America and I testify today on behalf of the 7,000 community banks we represent. Thank you for convening this hearing on the Protecting American Taxpayers and Homeowners (PATH) Act. ICBA appreciates your thoughtful and diligent efforts to improve our mortgage financing system. Community bankers and their customers have a great deal at stake in the future of housing finance. Any changes to housing finance must preserve equal and direct access to the secondary market to safeguard the role of community banks in providing mortgage credit in the communities we serve. It is critically important to borrowers and the broader economy that the details of any reform are done right. We look forward to working with the Committee and providing ongoing input into the reform process from the community bank perspective.

Community Banks and the Housing 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 ensure any reform supports beneficial competition and avoid further consolidation and concentration of the mortgage lending industry.

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] While many community banks choose to hold most of their mortgage loans in portfolio, robust secondary market access remains critical for them to support mortgage lending demand. This is particularly true for fixed-rate lending. For a community bank, it is prohibitively expensive to hedge the interest rate risk that comes with fixed-rate lending. Secondary market sales eliminate this risk.

While many community banks remain well-capitalized following the financial crisis, others are being forced by their regulators to raise new capital above minimum levels. With the private capital markets still largely frozen for small and mid-sized banks, some are being forced to contract their lending in order to raise their capital ratios. In this environment, the capital option provided by selling mortgage loans in the secondary markets is especially important. Selling mortgage loans into the secondary market frees up capital for additional residential lending as well as other types of lending, such as commercial and small business, which is critical to supporting credit flow in small towns and communities.

[1] ICBA Mortgage Lending Survey. September 2012.

While Pendleton Community Bank holds most of its mortgage loans in portfolio, in recent years we've sold an increasing volume of loans into the secondary market. In 2013 to date we've sold 30 loans with a value of $3.9 million, which is already more in number and value than we sold all of last year or in any prior year. We would sell more loans but for the challenge of identifying "comparable" sales in our rural markets where properties have unique characteristics.

Pendleton's secondary market sales are driven by customer demand for 30-year fixed rate loans. As a relationship lender, meeting this customer demand is critical to our broader customer relationships and to our business model. As the housing market recovers, I expect that we will continue to sell an increasing number of loans into the secondary market. Secondary market access is critical even for a bank such as Pendleton that is primarily a portfolio lender.

Key Features of a Successful Secondary Market

The stakes involved in getting housing-finance market policies right have never been higher. 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 seek in a first-rate secondary market.

Equal and direct access on a loan by loan basis. To be sustainable and robust, a secondary market must be impartial and provide equal access and equal pricing to all lenders regardless of their size or lending volume. A secondary market entity must have an appropriate structure to ensure it does not offer favorable terms to only the largest lenders. Such an outcome would drive further industry consolidation, reduce competition, increase systemic risk and disadvantage the millions of customers served by small lenders. Further, small and mid-sized lenders must continue to be able to access the secondary market directly without selling through a financial institution that competes with them on a retail basis. This access must include the ability to sell individual loans for cash rather than be forced to aggregate loans and securitize them. Most small or mid-sized lenders do not have the ability or the scale to securitize loans and sell those securities in the capital markets.

Financial strength, reliability and liquidity. A secondary market must be financially strong and reliable enough to effectively serve mortgage originators and their customers even in challenging economic circumstances. It must be able to generate the volume of securities necessary to quickly achieve the levels of liquidity needed to ensure the "to-be-announced" (TBA) market for mortgage-backed securities (MBS) continues to operate smoothly, thereby driving the most competitive interest rates for mortgage borrowers. 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 attract new customers, community banks seek to deepen and extend 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 their customer relationships and franchises after transferring loans.

Originators must have 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 customer 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, providing the opportunity to meet the additional banking needs of mortgage 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 the secondary market entities must be backed by private capital and third party guarantors. 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 and sustain robust liquidity even during periods of market stress.

The PATH Act

ICBA appreciates Chairman Hensarling introducing legislation to protect taxpayers, enhance the role of private capital in the housing finance system, and provide needed regulatory relief for community bank mortgage lenders. These critical elements of reform are reflected in the PATH Act.

The core feature of the PATH Act is the National Mortgage Market Utility (Utility), a non-government, not-for-profit entity that would serve as a platform for the securitization of residential mortgages. ICBA appreciates that the Utility is intended to provide open and impartial access to all lenders, to prevent discrimination based on size or lending volume, and to maximize the participation of community banks. We also appreciate that the Utility will be prohibited from competing with lenders in the origination market. These features of the Utility reflect ICBA principals enumerated above.

That said, we are keenly interested in how the Utility would perform in a live marketplace dominated by large lenders wielding outsized market power. We believe there is uncertainty in this regard and the potential for unintended consequences. Below are some of the questions we have with regard to the proposed secondary market structure:

- As mentioned earlier, community banks generally do not have the level of loan production or scale to safely and economically securitize mortgage loans. We are concerned that in order to compete with the largest lenders, community banks would be forced to either hold more loans on balance sheet to create larger pools or sell them to a large aggregator that would require the bank to give up servicing rights, appropriate customer data, and compete for our customers.
- Would the owners of the Utility have the ability to appropriate customer data? This would be a concern for community banks for the reasons noted above.
- We note that the Act would authorize any Federal Home Loan Bank (FHLB) to aggregate mortgages for securitization. This is a promising option, though nothing in the Act compels the FHLBs to perform this service. If they choose not to, most community banks would have no access to the securitization channel.

- FHLB aggregation should not be the only option for community banks. The majority of community banks that now sell directly to Fannie Mae and Freddie Mac do so through the GSE's cash window. Can the Utility accommodate this option?

We hope that the Utility can be implemented in a way that does not, despite the intent of the statute, marginalize community bank mortgage lenders or lead to further consolidation of the mortgage market. ICBA looks forward to working with you to address these questions and concerns as the PATH Act advances.

Finally, ICBA would like to express our strong appreciation for the mortgage lending regulatory relief provided by the PATH Act. In particular, ICBA supports the provision of "qualified mortgage" status for all loans held in portfolio, thereby shielding them from legal liability under the new ability-to-repay rules. This commonsense provision, which mirrors a provision of ICBA's Plan for Prosperity, is based on the natural incentive of lenders to ensure that loans held in portfolio are properly underwritten. We also applaud the PATH Act's repeal of the new credit risk retention requirement. The credit risk retention and ability-to-repay requirements have the potential to stunt community bank participation in the mortgage market and drive further consolidation of that market. Additional regulatory relief provisions of the PATH Act will also help to keep community banks in the mortgage market to the benefit of their customers and communities.

As the PATH Act is debated, ICBA requests that you consider adding relief from new servicing standards that are overly prescriptive and reduce community banks' flexibility to use methods that have proved successful in holding down delinquency rates. Community banks' small size and local presence in the communities we serve make many of the new requirements unnecessary. The CFPB's recent servicing rule provides a small servicer exemption for banks that service fewer than 5,000 loans. Many community banks service larger portfolios that should qualify for an exemption because they use the community bank servicing practices and obtain the strong performance results. ICBA's Plan for Prosperity calls for raising the small servicer exemption threshold to 20,000 loans. To put this proposed threshold in perspective, the average number of loans serviced by the five largest servicers subject to the national mortgage settlement is 6.8 million.[2] An exemption threshold of 20,000 would demarcate small servicers from both large and mid-sized servicers. It would help preserve the important role of community banks in servicing mortgages and deter further industry consolidation which is harmful to borrowers.

Closing

Thank you again for the opportunity to testify today. We look forward to working with this committee to reform our mortgage finance system. 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 that the details of reform are done right to ensure that community banks and lenders of all sizes are equally represented and communities and customers of all varieties are served.

[2] Source: Office of Mortgage Settlement Oversight (www.mortgageoversight.com).