



Testimony of

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On behalf of the  
**Independent Community Bankers of America**

Before the

United States House of Representatives  
Committee on Financial Services  
Subcommittee on Oversight and Investigations

Hearing on

**“Oversight of the Federal Home Loan Bank System”**

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Washington, D.C.

Chairman Neugebauer, Ranking Member Capuano, and Members of the Subcommittee, my name is Tim Zimmerman and I am President and CEO of Standard Bank, a \$435 million asset size community bank headquartered in Monroeville, PA, and a member of the Federal Home Loan Bank of Pittsburgh. I also serve as Chairman of ICBA's Federal Home Loan Task Force. I am pleased to represent ICBA's nearly 5,000 members at today's hearing on the Federal Home Bank System.

I welcome this opportunity to share Standard Bank's experience with our Federal Home Loan Bank, which is broadly typical of community banks nationwide. The 12 regional FHLBanks are a critical resource to community banks, the vast majority of which are FHLB members and active advance users or look to the FHLBanks as a primary source of liquidity when needed. FHLBank advances play a significant role in supporting community bank mortgage, small business, and agricultural lending and in helping community banks manage the interest rate risk in their portfolios. The FHLBanks help community banks like mine compete with the too-big-to-fail banks in our markets by offering a variety of correspondent services as well.

Agricultural community banks must have access to FHLBank advances to compete with Farm Credit System lenders, the only government sponsored enterprise that offers credit at the retail level, with the advantage of direct access to low cost capital markets funding. The FHLBanks serve a vital role and must remain a strong, stable, and reliable source of funding for community banks. Their value was proven during the recent financial crisis when they continued to provide advances without disruption, while other segments of the capital markets ceased to function.

As Congress debates the future of the housing finance system, I urge you to preserve the role of the FHLBanks. The model has worked well since inception and there is no reason to tamper with it. It is also very important to maintain the distinction between the FHLBanks and Fannie Mae and Freddie Mac or their potential successors. While the FHLBanks are government sponsored enterprises, they are very different than Fannie Mae and Freddie Mac in that they have no conflict between a public mission and private ownership that drove excessive risk taking and ultimately forced Fannie Mae and Freddie Mac into conservatorship.

### **FHLBanks Support Role of Community Banks in the Mortgage Market**

Any broad based recovery of the housing market must involve community bank mortgage lending, to which the FHLBanks lend critical support. Community banks represent approximately 20 percent of the mortgage market, but more importantly, our mortgage lending is often concentrated in the small towns and rural areas of this country, which are not effectively served by large banks.

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. Community banks work closely with their customers to ensure that

they obtain the right affordable mortgage for their situation. The housing market is best served by a large and geographically-dispersed number of lenders. We all witnessed the danger and devastating fallout that resulted when mortgage lending became concentrated in a few major market players. A healthy mortgage market must have beneficial competition and avoid further consolidation and concentration.

### **FHLBank Advances Support Lending**

ICBA member surveys show that while the FHLBanks offer a wide range of products and services, the availability of advances – or collateralized loans – is by far the most important reason why they choose to be FHLBank members. Standard Bank, for example, holds \$33.2 million in advances, as of the end of August.

FHLBanks offer advances in a variety of maturities, from overnight to over 20 years, and customize terms to help their members manage interest rate risk. Community banks use advances to fund new originations and existing portfolios of mortgages and other types of loans and to manage the substantial interest rate risk associated with holding longer term fixed rate loans in portfolio. Some community banks use advances to adjust the duration of their liabilities to better match their assets and manage risks. Short-term, on-demand advances can be used to provide liquidity in the event of unexpected deposit runoff or to take advantage of an opportunity to lend. Advances benefit a broad spectrum of American consumers by lowering the cost of credit.

While deposits are the most important source of funding for community banks, advances are a critical complement to deposits. During periods when loan growth outstrips deposit growth, community banks must be able to turn to advances as a dependable and convenient source of funds in order to serve their communities. Without access to advances at such times, community banks would lose market share to large banks, which are able to directly access the capital markets to raise funds. Moreover, advances can be customized to match fund the longer duration of many customer loans in a way that is not possible with checking or savings accounts or certificates of deposit. There is an ongoing need for advances to structure funding for loans.

### **Community Financial Institutions**

Because most community banks have assets of less than \$1.04 billion, they qualify as “community financial institutions” (as defined by the 1999 Gramm-Leach-Bliley Act) and therefore are eligible to pledge collateral in the form of small business loans and agriculture loans. Smaller community banks are able to use advances to meet the broad spectrum of credit needs of their communities and thereby create and sustain jobs during these challenging economic times. The broader mission of the FHLBanks is another aspect in which they differ from Fannie Mae and Freddie Mac which are focused exclusively on residential mortgage lending.

## **Agricultural Lending**

Many agricultural bank members of ICBA report that FHLBank advances are absolutely essential for their ability to remain competitive in agricultural and agribusiness lending. In particular, long-term fixed rate agricultural real estate loans of 10 or more years would be nearly impossible for a community bank to make without the use of FHLBank advances. These loans cannot be funded with short-term deposits because of the interest rate risk that would result from the mismatch between the short-term liability and the long-term asset.

Making long-term, fixed rate loans for land, equipment, land improvement, and other purposes is important to customer retention. If a rural banker cannot meet a customer's need for a long-term fixed rate loan, the banker risks losing all of that customer's business, likely to a tax-advantaged Farm Credit System lender, or a large bank lender. The FHLBanks provide small, rural banks consistent access to affordable funds and important tools to manage interest rate risk that are available to a large bank with internal Treasury functions.

Other agricultural lenders use advances to fund their short-term agricultural production loans. As much as 50 percent of such lending during peak seasonal demand times, for some agriculturally-oriented bankers, is supported by advances. These lenders rely on advances because their liquidity can fluctuate sharply due to the seasonal credit demands of farmers, ranchers and agribusinesses. FHLBank advances help bankers meet the cyclical challenges inherent in agricultural lending and play a critical role in helping the rural economy to prosper and remain vibrant.

## **FHFA Proposal Would Undermine Agricultural FHLBank Members**

ICBA strongly opposes a current Federal Housing Finance Agency advanced notice of proposed rulemaking that would re-impose a mortgage lending test on FHLBank members. As noted above, the 1999 Gramm-Leach-Bliley Act created the Community Finance Institution designation for institutions below a specified asset threshold (currently at \$1.04 billion) and authorized them to borrow long-term advances for small business, agribusiness, and agricultural loans and pledge those loans as collateral for long-term advances. GLBA also lifted the mortgage asset test for Community Finance Institutions, which is significant for rural lenders who have few residential mortgage lending opportunities but greatly benefit from FHLBank membership. Many banks believe it is critical that they continue to be able to pledge agricultural and other non-housing collateral for advances. It's very troubling that the FHFA has now proposed to reverse by regulation Congress's removal of the asset test. The proposal cuts against the grain of Congress's clearly expressed intention of expanding the mission and role of FHLBanks beyond residential housing finance to supporting small and medium sized businesses and other critical community needs such as senior housing.

## **Community Banks Benefit From FHLBanks' Strong Credit Rating**

The FHLBank System is able to fund advances by selling debt instruments in the world capital markets using their strong credit rating. This market access is absolutely critical to community banks' ability to compete with large banks and serve their communities. Because the debt instruments are joint obligations of the regional Home Loan Banks they carry less risk and lower interest rates. Buyers include mutual funds, commercial banks and government bodies – both in the U.S. and abroad. Broad market access is critical to the FHLBanks' financial strength and reliability.

## **FHLBank Model Worked During Crisis**

The recent financial crisis vividly demonstrated the value of the FHLBank model. Even during the worst days of the financial crisis, FHLBank members were able to continue borrowing advances without interruption. Advances expanded dramatically during the financial crisis as many parts of the credit markets shut down. Standard Bank's advances more than doubled from \$25 million at March of 2007 to \$51 million at September of 2008. Thus, thousands of community banks continued to serve their customers due to the liquidity the FHLBanks provided. As the crisis abated, access to other capital market alternatives recovered and loan demand subsided, and outstanding FHLBank advances have contracted significantly. This is exactly how the model was designed to work in a crisis – scalable and expanding and contracting with the demand for credit. The financial crisis would no doubt have been worse without the existence of the FHLBank System, which provided one of the few lifelines available.

## **FHLBanks Offer Other Important Products and Services**

### ***Mortgage Partnership Programs***

The FHLBanks also offer a residential mortgage secondary market option for their members through the Mortgage Partnership Finance and similar programs. Through these programs, members sell mortgages to their FHLBank but are also obligated to provide a credit enhancement which is typically 2 to 3 percent of the face value of the mortgage loan. The FHLBank manages the interest rate risk inherent in the long term mortgages that it purchases.

Standard Bank sells all of our fixed rate loans with a term of more than 15 years into the secondary market to avoid interest rate risk exposure. Without this option, we would not be able to make the long-term fixed rate loans our customers expect and would not be able to compete with large banks. Standard Bank used to sell such mortgages exclusively to Freddie Mac. However, recently Freddie Mac has imposed new restrictions and unfavorable pricing that has caused us to now sell exclusively to the Pittsburgh MPF. While most community banks continue to sell primarily to Fannie Mae or Freddie Mac, the MPF Programs of the various FHLBanks are an important alternative and competitive source of secondary market access.

### *Special Programs to Support Community Lending*

Like all FHLBanks, the FHLBank of Pittsburgh offers a number of programs that help their members support their communities and offer special loan programs or loan rates that would not be possible without their assistance.

- Affordable Housing Program (AHP) – Each year the FHLBank allocates 10 percent of its net income to fund the AHP which supports projects that provide affordable housing to low income individuals. Standard Bank has sponsored two programs through this program. In 2008, using AHP funds we sponsored the Safe Harbor Home Project for \$300,000; and in 2011, we sponsored the Union Mission Permanent Supportive Housing Program for \$250,000. Both of these programs provide support for the homeless in Westmoreland County, Pennsylvania.
- Community Lending Program – The FHLBank provides lower cost advances (on average 20 basis points below traditional advances) based on the amount of community based loans that a bank originates. The loans must be for community and economic development projects that create housing, improve business districts and strengthen neighborhoods. Most of the loans Standard has used to obtain CLP advances are loans to small and medium sized businesses. Almost all of the Bank's \$33 million of advances outstanding were done under this program.
- Banking on Business (BOB) – The FHLBank sets aside funds used to lend money to small businesses, especially start-ups that may lack sufficient equity or initial cash flow. This program assists communities in creating jobs, providing capital to underserved areas and promoting local economic growth. Standard Bank has participated in the BOB program seven times from 2005 to 2011 with total loan originations of \$421,000.

Under the BOB program the member bank must provide at least 40 percent of the total project cost. The FHLBank's BOB funds are in a second lien position behind the member and are limited to 50 percent of the member's loan.

### *Correspondent Services*

Finally, the FHLBank of Pittsburgh's correspondent services are an added benefit of membership.

- Deposit Accounts – The FHLBank provides Standard Bank with a convenient method to settle electronic transactions such as ACH and wires as well as daily interest without having to sweep to other investment accounts.
- Electronic Funds Transfer Services – Standard Bank uses the FHLBank for foreign wires and settlement of other ACH transactions. The FHLBank is considered a

contingency back up for deposit services that the Federal Reserve provides to Standard Bank.

- Safekeeping Services – Standard Bank maintains securities at the FHLBank of Pittsburgh for which they collect and remit the monthly and quarterly principal and interest payments.

While I have used the FHLBank Pittsburgh's programs as an example, all of the FHLBanks offer comparable services though with different terms and different degrees of emphasis among them.

### **Future of the FHLBanks**

As Congress and the Administration consider changes to the housing finance system, we urge you to preserve the significant role of the FHLBanks which helps keep community banks competitive in their mortgage, small business, and agricultural lending with the large banks and the tax-advantaged Farm Credit System. There is no reason to tamper with a model that has worked well since inception and proved its critical value during the recent crisis. The following features of the FHLBanks must be preserved:

- The FHLBanks must be kept distinct from Fannie Mae and Freddie Mac. ICBA opposes proposals to merge the FHLBank System with Fannie Mae and Freddie Mac. This is not the right solution to address the future of the two housing GSEs. While community banks have benefitted from the existing FHLBank secondary market programs, the primary business of the FHLBanks must remain advances.
- Community banks are well served by the regional nature of the FHLBanks which allows each bank to tailor its products and services to the needs of the regional economy. It is important to preserve regional FHLBanks which are better able to understand the environment in the communities their members serve, particularly the special needs of rural communities. The FHLB system is owned and governed by its members and any move towards consolidation should develop from the grass roots level, based on what members perceive to be the best operational and/or geographic structure for their district FHLB to meet their needs.
- The cooperative nature of the system also must be maintained with membership having a strong voice in governance. ICBA recognizes the need for both large and small institution membership and the benefits both bring to, and derive from, the system. The cooperative structure of the FHLBanks gives small members the same access to products and services offered to the largest members. Forty percent of all directors are independent, and the rules for election of member directors limit the number of votes that large members can cast, effectively ensuring that smaller members are well-represented. As a result, 63 percent of all member directors represent institutions with less than \$1 billion in assets.

## **Closing**

Thank you again for convening this hearing. We appreciate the opportunity to discuss the importance of the FHLBanks to community banks. While housing has been the FHLBanks historic mission focus, they now provide support to community financial institutions for a much broader range of lending and banking services. The FHLBanks proved solid and effective in supporting liquidity and housing finance through the financial meltdown. Their loss, or any changes that would impair their ability to offer low cost funding, would present a very significant challenge to community banks serving a variety of markets from coast to coast. Consumers, small businesses, agricultural borrowers, and the broader economy would feel the impact

United States House of Representatives  
Committee on Financial Services

**“TRUTH IN TESTIMONY” DISCLOSURE FORM**

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

<b>1. Name:</b>  Timothy Zimmerman President/CEO Standard Bank, PaSB	<b>2. Organization or organizations you are representing:</b>  ICBA
<b>3. Business Address and telephone number:</b> 	
<b>4. Have <u>you</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<b>5. Have any of the <u>organizations you are representing</u> received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.</b>	
	
<b>7. Signature:</b>	

*Please attach a copy of this form to your written testimony.*