INDEPENDENT COMMUNITY BANKERS of AMERICA®

May 10, 2013

United States Senate
Washington, D.C. 20510

Dear Senator:

On behalf of the 7,000 community banks represented by ICBA, I would like to take this opportunity to communicate our views on reform of the secondary market for residential mortgages. We are aware new proposals are being considered and crafted to address Fannie Mae and Freddie Mac and their transition out of conservatorship. We wish the Senate to have the benefit of the community bank perspective as they do so. Community banks play a critical role in mortgage lending nationwide and especially in small towns and rural areas not effectively served by larger banks.

Key features community banks seek in a first-rate secondary market include:

Equal and direct access on a loan by loan basis. A robust secondary market must be impartial and provide equal access and pricing to all lenders regardless of their size or lending volume. 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. They must be permitted to sell a single loan at a time for cash rather than be forced to aggregate loans and securitize them. Community banks generally do not have the ability, resources, or scale needed to safely and efficiently securitize loans.

Financial strength, reliability and liquidity. A secondary market must be financially strong, reliable, and well regulated to effectively serve mortgage originators and their customers even in challenging economic circumstances. The structure must 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.

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. Secondary market entities must not be allowed to use or sell this data so community banks can maintain their customer relationships and franchises.

Originators must have option to retain servicing and servicing fees must be reasonable. Currently, large aggregators insist the lender release servicing rights along with the loan. Although low margin, loan servicing is a crucial aspect of the relationship-lending business model.

Limited purpose and activities. The resources of any secondary market entities must be focused on supporting residential and multifamily housing and not used to compete with originators at the retail level where they would enjoy an unfair advantage.

Private capital must protect taxpayers. Securities issued by the 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.

ICBA Concerns with Bipartisan Policy Center Proposal

In view of the principles list above, ICBA is deeply concerned that the proposal for secondary market reform in the recent report of the Bipartisan Policy Center (BPC) fails to take community bank direct access to the secondary market into account. Because community banks do not have the volume or the resources to aggregate and securitize pools of loans, they would be required to sell their residential mortgages to larger retail competitors that do have such capacity. The current BPC model, if adopted into legislation, would increase the market power of a small number of mega-banks or Wall Street firms and drive mass consolidation and concentration of the mortgage market. Any solution that fuels such consolidation would only create even greater systemic risk and set up the financial system for a bigger financial collapse than the one the country has just been through. We shared these concerns directly with the BPC in a recent meeting.

ICBA's concerns with the BPC proposal are expressed in greater detail in our statement for the record for the Senate Banking Committee March 19 hearing titled: "Bipartisan Solutions for Housing Finance Reform."

Thank you for your consideration.

Sincerely,

/s/

Camden R. Fine

Attachment: ICBA Statement for the Record for the March 19 Senate Banking Committee hearing titled: "Bipartisan Solutions for Housing Finance Reform."

INDEPENDENT COMMUNITY BANKERS of AMERICA®

March 19, 2013

Housing finance reforms must protect critical role of community banks

On behalf of the 7,000 community banks represented by the Independent Community Bankers of America (ICBA), thank you for convening today's hearing titled: "Bipartisan Solutions for Housing Finance Reform." Thousands of small communities across America – communities primarily served by community banks – have a large 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 these communities. ICBA is deeply concerned the proposals for secondary market reform in the recent report of the Bipartisan Policy Center (BPC) fail to take community bank direct access into account. The BPC model, if adopted, would increase the market power of a small number of mega-banks or Wall Street firms and drive mass consolidation of the mortgage market under the pretense of creating a private sector solution. Any solution that fuels such consolidation would only set up the financial system for an even bigger collapse than the one the country has just been through.

These concerns, as well as a broader discussion of community banks and the secondary market, are detailed in this statement for the record.

Role of Community Banks in the Mortgage Market

Community banks represent approximately 20 percent of the mortgage market, but more importantly, much of this mortgage lending is concentrated in the small towns and rural areas of our country, which are not effectively served by megabanks. Community banks have a starkly different business model than that of larger mortgage lenders, which are driven by volume and margins. Community banks are relationship lenders with deep roots in their communities. Their viability is linked to the communities they serve. Any mortgage reforms or any rules or regulations that make mortgage lending impractical for community banks will curtail or even eliminate credit choice for small town and rural customers. It is critical the housing finance system preserve the role of community banks.

Community Banks and the Secondary Market

While community banks choose to hold many of their mortgage loans in portfolio, it is critical for community banks to have robust secondary market access to support mortgage lending demand. This is particularly true for fixed-rate lending. For a community bank, it is very expensive to hedge the interest rate risk that comes with fixed-rate lending. Secondary market sales eliminate this risk. Importantly, when community banks sell mortgages to Fannie Mae or Freddie Mac, they receive assurances loan data won't be appropriated to solicit customers with other banking products.

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.

What Community Banks Need in a Mortgage Finance System

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 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 a single loan at a time 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 draw in 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 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.

Bipartisan Policy Center Proposal

While the proposed secondary market structure set forth in the recent BPC report does satisfy some of the principles enumerated above, ICBA is deeply concerned it would severely limit community bank access to the secondary market, drive broad consolidation among lenders and servicers, and harm consumers, particularly in small towns and rural areas.

The BPC proposal would create a new Public Guarantor modeled on the Government National Mortgage Association (GNMA) to replace Fannie Mae and Freddie Mac. The Public Guarantor would provide catastrophic loss protection to MBS that have private credit enhancements. However, the role of the Public Guarantor would be much narrower than that currently played by Fannie Mae and Freddie Mac. It would not purchase mortgages as Fannie Mae and Freddie Mac currently do and would guarantee only MBS issued by approved issuers. Only Wall Street banks and large aggregators have the scale and the capital to be direct issuers. Community banks do not and cannot issue MBS because their volume is simply too small. Even mid-sized banks would be challenged by the complexities of hedging a mortgage pipeline and the large amount of capital required. One only need look at the small number of GNMA issuers and the outsized concentration of GNMA issuance by a small number of large bank aggregators. If the BPC proposal were enacted, virtually all of the GSEs' current business from small to mid-sized lenders would be captured by a small number of large issuers who would effectively serve as gatekeepers to the secondary market. Community banks and mid-sized banks would be shut out and forced to sell their loans to these mega-lenders.

Currently, there are thousands of direct sellers to Fannie Mae and Freddie Mac. If the BPC proposal were enacted, that number would likely shrink to a relative few direct issuers to the Public Guarantor – a drastic reduction with a drastic impact on the market. A small number of players would control not only the entire secondary mortgage market but would also control the servicing market. Also, since the Public Guarantor could not build a retained portfolio, the system would have to rely initially on the issuers to create the liquidity for these securities through the large volumes they securitize and their willingness to hold these securities on their balance sheet, if needed.

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The excessive power enjoyed by a relative few market players under the BPC model would have a highly adverse impact on the market place. It would lead to large scale consolidation among lenders as well as servicers. Borrowers, particularly in small towns and rural areas, would have much less access to credit. Credit would be priced higher and consumer choice would be limited. According to the BPC's analysis, mortgage rates would rise by 81 basis points over current levels to cover the cost of private credit enhancements and the guarantee fees for the catastrophic government guaranty. However, the costs of various private credit enhancers are difficult to predict as all would likely have very different views of the credit risk they would be absorbing. Further, the proposed system of multiple credit enhancers or other guarantors creates additional operational costs which have not been fully researched and makes the securitization process even more complex and costly. Based on these considerations, ICBA urges this committee to reject the BPC proposal.

Closing

As we consider the future of housing finance, we must ensure the existence of a strong secondary market for residential loans available to all lenders in all geographic locations and of all sizes. The future secondary market must be financially strong, reliable and liquid, provide equal access for originators to sell loans on a single loan basis and retain servicing, be limited in purpose and activities and depend on private capital to absorb initial losses backstopped by government-provided catastrophic loss protection to keep the market stable in times of duress. Reform of the GSEs should not result in a market dominated by a handful of large financial institutions that cross-sell the customers of community banks or other small to mid-sized lenders. This is why ICBA believes the BPC proposal to be unacceptable.

Thank you for the opportunity to submit this statement for the record. ICBA looks forward to working with this committee on secondary market reform that recognizes the critical role of community banks in thousands of small and rural communities across America.

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