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July 21, 2010

Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Department of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

RE: eDocket Number: TREAS-DO-2010-0001
RE: eDocket Number: HUD-2010-0029

Dear Sir or Madame:

The Independent Community Bankers of America¹ (ICBA) welcomes the opportunity to provide its views on establishing a more stable and sound housing finance system. The comments that follow reflect our current positions, but ICBA continues to discuss these complex issues with its members and would be pleased to share additional thoughts and suggestions as the debate goes forward.

Future of Housing Finance

Our housing finance system must continue to be sufficiently flexible that it provides a variety of finance options to meet the needs of different consumers, housing types, and locations. One size does not fit all. Some community banks have sufficient mortgage volume to sell mortgages directly to Fannie Mae or Freddie Mac, others do not and use a conduit or aggregator to facilitate mortgage lending, while others hold all mortgage loans in portfolio until they are repaid or mature. Funds to support our housing finance system come from a variety of sources: from local bank deposits, state and local government programs, federal programs, domestic and international investors, public and private sectors.

¹ *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 20,000 locations nationwide and employing over 300,000 Americans, ICBA members hold \$1 trillion in assets, \$800 billion in deposits, and \$700 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

As we look at reforms of the housing finance system, we must be very careful that any changes do not disrupt its recovery. Not all parts of the system are functioning well yet and its recovery must not be jeopardized lest it further impact millions of current and future homeowners and renters and the investors of existing debt and asset-backed securities. It would also greatly impact financial institutions that are recovering from the economic downturn along with companies that are directly or indirectly involved in the housing finance system.

Clearly changes are needed so that the recent housing finance problems are not repeated. Fortunately, a renewed focus has been placed on the traditional “common sense” underwriting practices long embraced by community banks—making sure the loan is affordable for the borrower and the borrower has the ability to repay the loan. Community banks generally did not make subprime loans with the characteristics that have led to recent problems, such as “teaser” rates, lack of appropriate documentation and very high or unlimited reset payments and interest rates. As responsible community-based lenders, community banks require appropriate documentation of borrower income and do not make loans that compel borrowers to refinance or sell in order to remain solvent. Community banks do not have aggressive subprime marketing programs targeting particular low-income areas or low-income borrowers. However, they do help borrowers with non-traditional credit histories or imperfect credit. Commonly, community bank loans to these borrowers are not sold into the secondary market, but are kept in portfolio, thus the bank has every incentive to ensure is not a predatory loan. This also permits the bank and the borrower to work out a solution early on if repayment problems arise.

Future of the GSEs

ICBA has been a strong supporter of Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBanks) because of the services they have provided community banks. Community banks across the nation have benefited greatly by the liquidity these entities provide and by the robust secondary mortgage market they have created which over the years has enabled community banks to offer mortgage products to their customers and invest in mortgage-backed securities. These government sponsored enterprises (GSEs) have made it possible to combine wholesale funding and community bank service at the local level.

Though very different in key respects, all three housing GSEs provide community banks with irreplaceable access to money markets. This access allows community banks to offer the same home mortgage products to their customers that the largest firms offer to theirs. Without the GSEs, community banks would be unable to offer their customers long-term fixed rate mortgages. In addition, the FHLBanks provide members advances for liquidity, asset/liability management, and to fund long-term loans to small businesses and other customers. It is critically important that the GSEs remain reliable sources of funding and liquidity and continue to support a residential mortgage secondary market for our nation’s community banks.

A number of policy proposals have surfaced recently to reform the GSEs, ranging from abolishing Fannie and Freddie and allowing the private securitization market to take over, to restoring Fannie and Freddie to their former selves. Other ideas include creating a covered bond market that would allow banks to issue mortgage-backed debt to finance mortgage loans, or allowing each of the twelve Federal Home Loan Banks to securitize loans. Some favor a plan that would allow

financial institutions to charter their own GSE-type units with the government providing a guarantee for the securities.

Corporate Structure, Governance and Mission

Critical questions must be addressed relating to corporate structure, governance, and mission. These are crucial issues that will require careful study as the solutions will have long-term effects.

What should the corporate structure of the secondary market be? Of the structures currently under debate, the cooperative structure or that of a public utility appears to be the most suitable for the needs of community banks. The cooperative structure has served the FHLBanks well as its users also provide capitalization that is at risk. If the secondary market is capitalized by private, non-user capital, the private utility structure may be appropriate to set pricing and control undue risk taking. In making any changes to the GSEs, the Administration and Congress need to be mindful of the significant costs to community banks and other market participants to change operational processes, computer systems and re-training of staff if the future secondary market is operationally different than the current system. For example, just changing the GSEs' names would entail a significant re-write of most mortgage processing, underwriting and servicing technology platforms.

What should be the ownership structure of the secondary market? Should the users be the owners such as in the FHLBank and Farm Credit systems? Should they provide all of the capital or should there be outside shareholders? Public ownership and the need to maximize shareholder wealth created problems for Fannie Mae and Freddie Mac as they sought to regularly increase earnings to meet or exceed investment analyst expectations. Full or partial ownership by users would move the focus away from profits and more toward the attractive pricing of loans sold and securitized, a benefit to users and their customers. Community banks have long told ICBA that although they appreciate the dividends they receive on their FHLBank member stock, their priority is low advance rates. Due to the losses taken on Fannie Mae and Freddie Mac preferred stock (described more in detail later), community banks could shy away from new stock purchases to capitalize a new secondary market; however they likely would be willing to provide capital to a secondary market if it ensured them access. Ownership structure is an issue that ICBA will continue to discuss with its members in the coming months.

What should the governance structure be? Should users elect directors (some users, some outside independent directors)? Should there be presidentially appointed directors? ICBA continues to discuss what an appropriate governance structure should be as we discuss corporate structure. Regardless of structure, all users should be fairly represented.

What should the mission be? The primary mission of Fannie Mae and Freddie Mac is to provide stability to the secondary market for residential mortgages, access to mortgage credit throughout the nation, to increase the liquidity of mortgage investments and to improve the distribution of investment capital for residential mortgage financing. Should this be changed? Are there other functions the secondary market entities could take on to help community banks and their customers?

Key Principles

ICBA continues to study these proposals and consider these questions. What is clear is that community banks need a stable secondary market for residential mortgages. Without a reliable secondary market for residential mortgage loans, many community banks would be unable to offer this service to their customers. As the Administration and Congress considers how to resolve the conservatorship of Fannie Mae and Freddie Mac, and re-build America's housing finance system, ICBA has developed the following key principles that we believe must be reflected in the future structure of the secondary market for residential mortgages.

The secondary market for residential mortgages must be impartial. The secondary market must provide equitable access and pricing to all lenders regardless of size or volume. Lenders large and small need secondary market access and consumers benefit by their activity in the mortgage market. Some proposals for change would result in further dominance of the housing finance system by a handful of large financial institutions. Recent history has demonstrated that there needs to be less, rather than more concentration in the housing finance system of we are to avoid "too big to fail" institutions controlling the housing finance system. The only entrance to the secondary market for smaller lenders must not be through their direct competition.

The secondary market must be financially strong and reliable. Legislation in 2009 established a world class regulator for Fannie Mae and Freddie Mac; strong regulatory oversight must be maintained to ensure that the secondary market operates within its mission and in a safe and sound manner.

The secondary market entities must have a limited mission focused on supporting residential and multifamily housing in all communities in the U.S. Resources should be focused on supporting housing finance. Fannie Mae and Freddie Mac created uniformity in the market through the underwriting and processing systems they developed. The secondary market entities should continue to develop technical innovations that can be shared with their users to the ultimate benefit of consumers.

The secondary market entities need to have the operational flexibility to hold some mortgages in portfolio when market conditions dictate, along with their securitization authorities. Recent market events demonstrate the important role Fannie Mae and Freddie Mac have played in providing liquidity and market stability when other sectors of the market cease to function. The ability to hold a certain level of mortgages in portfolio during disruptions in the market is an important tool in keeping a secondary market functioning. It is our understanding that the ability to hold loans in portfolio also has helped the two GSEs serve smaller lenders that can only offer a secondary market relatively low volume. Portfolio levels can be controlled through regulations and regulatory oversight.

The conflicting requirements of a public mission with private ownership must be eliminated. Fannie Mae and Freddie Mac had aggressive housing goals for the purchase of mortgages from underserved populations and in underserved areas that some have suggested supported loans that were unaffordable for borrowers. The effort to reconcile these goals with the demands of maximizing shareholder wealth created an environment where the two GSEs took on inordinate amounts of risk. This conflict must be eliminated going forward.

Congress should consider requiring the secondary market entities to dedicate a portion of their earnings to support housing programs in a form such as the FHLBank Affordable Housing Programs in return for the benefits of GSE status and in the place of the current housing goals. While legislation created a housing fund for Fannie Mae and Freddie Mac, it has not come to fruition due to their financial difficulties. The FHLBank Affordable Housing Program has a long history as a very successful vehicle to help support affordable housing in a very structured, regulated manner. Dedicating a percentage of income to such a program would provide a return benefit to the public for the benefits of GSE status.

An appropriate capital structure, including the accumulation of retained earnings must be an important component of the secondary market structure to attract and maintain capital and to protect user or private capital. Many community banks were encouraged by regulators to purchase preferred stock in Fannie Mae and Freddie Mac and lost essentially all of their investment. A strong financial condition, which includes retained earnings held by the GSEs, will help to attract needed equity capitalization going forward.

Congress must ensure that a secondary market with government ties continues to exist. Whether the Fannie Mae and Freddie Mac charters are retained or a new secondary market is created, it must have some government tie going forward to ensure continued steady and favorable access to the capital markets. The government ties to Fannie Mae and Freddie Mac kept money flowing through the conforming mortgage market when other sectors, such as the jumbo mortgage market stopped functioning. Government ties have also attracted a wide array of investors, including insured depository institutions with limited investment options.

Any changes to the GSEs should not impact the trillions of dollars of GSE mortgage-backed securities (MBS) outstanding. Most community banks invest in GSE MBS and any major market disruption could impact the values of those securities which would impact the capital positions of community banks. Also, currently, agency MBS carry a 20% risk weighting therefore less capital is held for them.

More than one secondary market entity should exist in the future. The existence of more than one secondary market entity fosters competition, providing better access for community banks and lowering mortgage rates and closing costs for consumers.

The function of Fannie Mae and Freddie Mac should not be incorporated into the FHLBank system. There has been a suggestion that Fannie Mae and Freddie Mac be split up and incorporated into the FHLBank system. While the FHLBanks have had a limited secondary market function, one that has benefitted community banks, the focus of their business must remain that of providing liquidity to their members to support housing, economic development, small farm, small agribusiness and small business lending.

Importance of the FHLBanks

The vast majority of community banks are FHLBank members and are active advance users or look to them an alternative source of liquidity. The FHLBanks must remain a strong, stable, reliable source of funding for community banks. Initial results of a survey ICBA is conducting of its membership show that liquidity and advances of various maturities continue to rank at the top of the list of products and services the FHLBank members find most important. As the financial

crisis has moved through the financial system, many of the FHLBanks have suffered financial stress too, as mark-to-market accounting forced them to write down the value of securities, and debt issuance spreads widened increasing the cost of funds to members. Yet, throughout the financial crisis, the FHLBanks continued to provide advances to their members without disruption, while other segments of the capital markets ceased to function. Daily, community banks depend on their FHLBanks for liquidity, asset/liability management and to enable them to match fund longer term loans.

As the Administration and Congress consider changes to the housing finance system, the FHLBanks must remain a healthy, stable, reliable source of funding, liquidity and other products to serve the needs of all member-owners and help them provide lendable funds for the local communities they serve. Some FHLBank members have had dividends cut and stock redemptions restricted or eliminated as their FHLBanks rebuild after facing financial difficulties. It is important that the FHLBanks continue to take the steps necessary to regain their full financial strength.

The FHLBanks have been repaying their REFCORP obligations more quickly than expected due to strong earnings. This rapid pay-off has caught the attention of some who look at the FHLBanks as a potential source of funds for other purposes. There are already suggestions that the FHLBanks should continue to make the payments once the obligations are completely repaid. Once the FHLBanks complete their REFCORP payments, the earnings that would otherwise go to them should be kept in the FHLBank system to build retained earnings and protect the system's financial condition. The recent problems in our financial system underscore the need to ensure that the FHLBanks, along with other financial institutions, have the strength to face future challenges. Once the system has built sufficient safeguards to protect it against future financial challenges, funds may be used within the system for programs that help members serve their communities. The FHLBanks, their members and the consumers and businesses they serve across the country should not be penalized because the FHLBanks paid off their debts early.

ICBA continues to study the role the FHLBanks should play in facilitating a secondary market for residential mortgages. In a 2009 report, the Congressional Research Service suggested that Fannie Mae's and Freddie Mac's mortgage portfolios and other assets be divided among the FHLBanks. ICBA does not believe this is the right solution to the resolution of the two housing GSEs. Further, we would have significant concerns about any proposal to incorporate the function of Fannie Mae and Freddie Mac into the FHLBank system. While community banks have benefitted from the existing FHLBank secondary market programs, the primary business of the FHLBanks must remain advances. When surveyed, ICBA members have consistently said that advances are by far the most important reason why they are FHLBank members.

ICBA continues to support the regional structure of the FHLBanks as it best suits member needs. ICBA members see great benefit in the local knowledge and personal touch fostered by a regional FHLBank structure. Regional FHLBanks are better able to understand the environment in the communities their members serve, particularly the special needs of rural communities.

GSE Preferred Shareholders Must Be Made Whole

An unfortunate by-product of the government's take-over of Fannie and Freddie was that the value of GSE preferred shares plummeted, injuring more than a thousand community banks that purchased these shares with the encouragement of their regulators. Banks are generally prohibited from investing in the stock of other corporations, making AAA-rated GSE preferred shares an attractive option, and one that Treasury and the regulators promoted.

The actions of then, Treasury Secretary Paulson, primarily to protect the interests of the Chinese government (as he admitted in his book On the Brink), resulted in an "ambush" of preferred shareholders by placing the preferred shares in a second position and eliminating all dividend payments. Despite earlier warnings by ICBA, Paulson's actions sent the entire market for financial preferred shares into a freefall, making it even more difficult for community banks to raise needed capital when additional capital was desperately needed.

Notably, nearly \$36 billion in Fannie Mae and Freddie Mac preferred stock was outstanding prior to Fannie Mae and Freddie Mac being placed into conservatorship. An estimated \$15 to \$20 billion of that was held by the banking sector and almost one-third of banks reported holdings including many community banks. This action has directly resulted in the failure of many banks by wiping out any excess capital that may have been available prior to the normal losses experienced in the recession. These actions continue to have detrimental consequences on many community banks today by driving down capital levels and reducing the amount of available credit.

As the Administration considers the future of housing finance, ICBA urges you to ensure that this injustice is corrected by restoring the dividend payments on Fannie Mae and Freddie Mac preferred shares and paying injured holders the amount of suspended dividends since September 7, 2008, on an estimated \$20 billion in GSE preferred holdings. As options are being considered to lift Fannie Mae and Freddie Mac out of conservatorship, ICBA urges that it be done in a way that will restore a reasonable value to the preferred shares. Helping restore the \$15 to \$20 billion in community bank capital value crushed by the unwarranted Treasury actions can foster \$150 to \$200 billion in new lending as banks leverage this capital.

Conclusion

Our housing finance system must continue to be sufficiently flexible to provide a variety of finance options to meet the needs of different consumers, housing types, and locations. Changes are needed so that the recent housing finance problems are not repeated. The renewed focus on the traditional "common sense" underwriting practices must continue, practices long embraced by community banks. But care must be taken that the changes are not so dramatic that they disrupt the still fragile current housing finance system and hurt its investors. Community banks rely on Fannie Mae and Freddie Mac to provide a reliable secondary market for residential mortgage loans they offer to their customers. Community banks rely on the FHLBank system to provide liquidity, asset/liability management and long-term funding. Access to these GSEs is vital to the ability of community banks to provide financing options to meet the needs of the customers and communities they serve.

Thank you for your consideration. ICBA looks forward to working with you on these important housing finance policy issues.

Sincerely,

/s/

Camden R. Fine
President and CEO