



Testimony of

**Samuel A. Vallandingham**  
**President and CEO**  
Of  
**The First State Bank**  
**Barboursville, WV**

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

Before the

United States House of Representatives  
Committee on Financial Services  
Subcommittee on Housing and Insurance

Hearing on

**“Housing Finance: Private Sector Perspectives on Housing  
Finance Reform”**

October 25, 2017  
Washington, D.C.

## **Opening**

Chairman Duffy, Ranking Member Cleaver, and members of the Subcommittee, I am Samuel Vallandingham, President and Chief Executive Officer of First State Bank, a \$200 million community bank in Barboursville, West Virginia. I am pleased to be here today on behalf of the Independent Community Bankers of America and the nearly 5,700 community banks we represent. Thank you for convening this hearing titled: “Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform.”

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 America’s housing market. 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 option to help families buy a home.

A vibrant community banking sector makes mortgage markets everywhere more competitive and fosters affordable and competitive interest rates and fees, better customer service, and more product choice. The housing market is best served by a diverse group of lenders of all sizes and charter types. Nearly eight 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.

First State Bank was founded by my great grandfather in 1905 and has survived the Great Depression and numerous recessions since that time, including the most recent financial crisis, by practicing conservative, commonsense lending and serving our community through good times and bad. I’m proud to note that First State Bank was awarded SBA Lender of the Year in 2001 and SBA Community Bank of the Year in four consecutive years: 2005, 2006, 2007, and 2008. We emerged from the crisis well-capitalized and our lending has supported the recovery.

Many American community banks have similar stories. And with meaningful regulatory relief, particularly in the mortgage lending area, I fully expect the community bank business model will thrive in the future, to the benefit of consumers, communities, and the broader economy.

Residential mortgage lending has been an important component of First State's business since its early years and has grown more important over the years. Today, we have a nearly \$600 million portfolio consisting of approximately 5,500 loans. Most of these loans are held by Freddie Mac, and a smaller number are held by Fannie Mae. First State Bank and our customers depend on our access to Fannie Mae and Freddie Mac. Many of First State Bank's mortgage loans come from other smaller community banks that depend on my bank for access to the secondary market.

### **Fair Access to the Secondary Market**

Secondary market sales are a significant line of business for many community banks. According to an ICBA survey, nearly 30 percent of community bank respondents sell half or more of the mortgages they originate into the secondary market.<sup>1</sup> 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. Selling loans to the GSEs allows the community bank to retain the servicing on those loans, thereby keeping their relationship with that borrower. Loans that are serviced by locally based institutions tend to lead to better outcomes for borrowers and their communities. Many non-GSE secondary market investors require transfer of servicing when they purchase a loan.

While community banks choose to hold many of their loans in portfolio, it is critical for them to have robust secondary market access to support lending demand with their balance sheets. 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 lending, which support economic growth in our communities.

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. 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 a single loan for cash, not securities, is critical to my bank because I don't have the lending volume to aggregate loans and create mortgage backed securities, before transferring them to Fannie Mae or Freddie Mac. In addition, I'm assured that the GSEs won't appropriate data from loans I've sold to solicit my customers with other banking products.

---

<sup>1</sup> ICBA Mortgage Lending Survey. September 2012.

## 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.

ICBA's approach to GSE reform is simple: use what's in place today and is working and focus reform on aspects of the current system that are not working or that put taxpayers at risk. If reform is not done right, the secondary market could be an impractical or unattractive option for community banks. Proposals that would break up, wind down, sell or transfer parts of the GSEs' infrastructure to other entities would end up further concentrating the mortgage market in the hands of the too-big-to-fail players, putting taxpayers and the housing market at greater risk of failure. Further, they run the risk of disrupting liquidity in the \$5 trillion housing market that community banks and homebuyers depend on.

As stated earlier, my bank provides secondary market services to smaller community banks, and I depend on direct access to Fannie and Freddie to provide the liquidity and interest rate protection that I pass on to my community bank clients and our borrowers. My business model would not survive if the GSEs were gone and my only access to the secondary market was through Wells Fargo or Wall Street. If that were the case, many community banks would exit the business and many communities would lose local mortgage lenders.

Below are some of the key principles community banks require in a first-rate secondary market.

- ***Lenders should have competitive, equal, direct access on a single-loan basis.*** The GSE secondary market must continue to be impartial and provide competitive, equitable, direct access for all lenders on a single-loan basis that does not require the lender to securitize its own loans. Pricing to all lenders should be equal regardless of size or lending volume.
- ***An explicit government guarantee on GSE MBS is needed.*** For the market to remain deep and liquid, government catastrophic loss protection must be explicit and paid for through the GSE guaranty fees, at market rates. This guarantee is needed to provide credit assurances to investors, sustaining robust liquidity even during periods of market stress.
- ***The TBA market for GSE MBS must be preserved.*** Most mortgage lenders are dependent on a liquid to-be-announced (TBA) market that allows them to offer interest rate locks while hedging interest rate risk with GSE mortgage-backed securities (MBS) that will be created and delivered at a later date. Creating new GSE MBS structures, or using customized capital markets structures that provide front end credit risk transfers, generally makes the resulting MBS "non-TBA."

- ***Strong oversight from a single regulator will promote sound operation.*** Weak and ineffective regulation of the GSEs enabled them to stray from their primary mission as aggregators, guarantors, and securitizers. As required by HERA, the FHFA must ensure the secondary market operates in a safe and sound manner so taxpayers are not put at risk. It is incumbent upon FHFA to ensure the GSEs are adequately capitalized commensurate with their risks and compliant with their primary mission.
- ***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 that lenders release servicing rights along with their loans. Transfer of servicing entails transfer of customer data which can be used for cross-selling. While servicing is a low-margin business, it is a crucial aspect of the relationship-lending business model, giving originators the opportunity to meet the other lending or financial services needs of their customers. Additionally, in general, consumers receive better service when their loans are serviced on a local level than when they are serviced by entities that did not originate their loan and are located out of their market area.
- ***Complexity should not force consolidation.*** Under the current GSE model, selling loans is relatively simple. Sellers take out commitments to sell loans on a single-loan basis and are not required to obtain complex credit enhancements, except for private mortgage insurance for loans exceeding 80 percent loan-to-value or other guarantees. Any future secondary market/GSE structure must preserve this relatively simple process for community banks and other small lenders that individually do not have the scale or resources to obtain and manage complex credit enhancements from multiple parties.
- ***The GSEs must be allowed to rebuild their capital buffers.*** ICBA believes the first step in GSE reform must be restoring the GSEs to a safe and sound condition. Regardless which approach or structure reform takes, the existing system must be well capitalized to prevent market disruption or additional taxpayer support in the event of one or both GSEs requiring a draw from the U.S. Treasury during what's likely to be a lengthy debate and transition period to any new structure or system.
- ***GSE shareholder rights must be upheld.*** Any reform of the housing finance system must address the claims of GSE shareholders and respect the rule of law that governs the rights of corporate shareholders.

## **ICBA's Way Forward**

ICBA's approach to GSE reform is simple: use what is in place today and is working, and address or change the parts that are not. Our approach has two parts: reforms that can be accomplished administratively by FHFA within HERA, and reforms that will require Congressional action.

### *Administrative Reforms*

- FHFA should end the net worth sweep of revenues to Treasury and, following HERA, require both GSEs to develop capital restoration plans. These plans would include continued use of credit risk transfers, provided they meet a targeted economic return threshold that balances GSE revenue and capital building needs with prudent credit risk management standards.
- FHFA should review and approve those capital plans, establish prudent risk based capital levels as required by HERA, and set reasonable timeframes and milestones for achieving re-capitalization goals.
- FHFA should monitor the GSEs' performance against their respective plans and release each GSE from conservatorship as they become well-capitalized.
- The GSEs should complete construction of the Common Securitization Platform and issue their respective MBS from the platform. Ownership/management of the CSP should remain with the GSEs through the current LLC structure. Expanding access to the CSP to other entities should be up to Common Securitization Solutions, LLC (CSS) board, with final approval by FHFA.
- Launch of the Uniform Mortgage Backed Security (UMBS) should be deferred until both GSEs are recapitalized and released from conservatorship.

### *Legislative Reforms*

- Congress should create a catastrophic mortgage insurance fund to be administered by the FHFA which would be funded through GSE guaranty fees. The size of the fund should be determined based on actuarial standards and should be similar to the FDIC's deposit insurance fund. The fund would stand behind the explicit U.S. government guarantee of the GSE MBS.
- Congress should change the GSE corporate charters from the current government-chartered, shareholder-owned, publicly traded companies, to regulated financial utilities that are shareholder owned. All current shareholders should be able to exchange common and junior preferred GSE shares for a like amount of shares in the new structures. The Treasury should exercise its warrants for senior preferred shares of GSE stock and convert those shares to stock in the new structure. No dividends should be paid to any shareholders until the company is deemed well capitalized per its recapitalization plan by the FHFA. The Treasury should be required to divest itself from its shares once a company is well capitalized.

The worst outcome in GSE reform would be to allow a small number of mega-firms 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.

### **Recapitalization of the GSEs Cannot Wait**

Finally, I would like to highlight for this committee an immediate risk facing the GSEs, the mortgage market, and taxpayers.

Though Fannie Mae and Freddie Mac have returned to profitability and have resolved the majority of their defaulted loans, the quarterly sweep of their earnings to the Treasury – some \$265 billion in eight years – has seriously depleted their capital buffers. In fact, Fannie Mae and Freddie Mac have less capital today than when they were placed in conservatorship eight years ago and, absent a change in policy, are on track to fully deplete their capital by year-end. When this happens, one or both companies are likely to require a draw from the Treasury. This in turn could trigger a market disruption that spikes interest rates and freezes home purchases and refinancing. This self-inflicted crisis can and must be avoided. We urge this committee to support the efforts of FHFA and the Treasury to protect taxpayers from another bailout.

### **Relief from Burdensome and Costly Mortgage Regulation**

We appreciate the focus of this hearing on the critical issue of housing finance reform and the secondary markets. I must also mention the urgency of reforming burdensome mortgage regulations that risk driving community banks from the mortgage market. ICBA thanks this committee for passing bills that will provide relief from the Consumer Financial Protection Bureau's (CFPB's) "qualified mortgage," escrow, small servicer, and Home Mortgage Disclosure Act (HMDA) rules.

We are urging the Senate to take up and pass these bills expeditiously. However, with implementation of new HMDA rule rapidly approaching on January 1, 2018, we request that Congress pass legislation that would delay implementation, as recommended by the Treasury Department's June 2017 report, "A Financial System That Creates Economic Opportunities."

Community banks rely on third party vendors to overhaul their systems for compliance with the new rule. Unfortunately, we do not believe vendors are prepared for the January 1 compliance date in large part because the CFPB has continued to revise and retool its guidance in response to lender comments. There is an enormous risk of compliance failure on January 1 and in the following months and a disruption in the flow of mortgage credit in our communities.

We appreciate this committee's support for a delay in the TILA-RESPA Integrated Disclosure rule, and urge you to enact a similar delay in the HMDA rule for one year.

## **Closing**

Thank you again for the opportunity to testify today. 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.