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On Behalf of the Independent Community Bankers of America
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Introduction

Chairman Shelby, Ranking Member Sarbanes and Senate Banking Committee members, the Independent Community Bankers of America (“ICBA”) appreciates this opportunity to present our views on proposals for improving the regulation of the housing government-sponsored enterprises (“GSEs”).

I am Dale J. Torpey, President and CEO of Federation Bank, a \$115 million asset bank located in Washington, Iowa. I currently serve as Chairman of the Lending Committee of the ICBA. I am also currently Chairman of the Board of Directors of the Federal Home Loan Bank of Des Moines. My testimony today is delivered exclusively on behalf of the ICBA.

Potential regulatory restructuring of the housing GSEs is a matter of critical importance to the community banking industry.

As a general principle, we do not believe that the Treasury Department should direct the housing policy of our nation just as it should not run the monetary policy of our nation. In our view, should the Treasury Department be granted supervisory and regulatory oversight of either Fannie Mae/Freddie Mac or all three of the housing GSEs, its tax policy and fiscal policy responsibilities would likely present clear conflicts of interest with housing policy.

ICBA also shares the concerns that have been expressed by others regarding the historical absence of expertise in housing policy at Treasury.

Regulation of the Federal Home Loan Banks

Since the passage of the Federal Home Loan Bank System Modernization title of the Gramm-Leach-Bliley Act (Title VI of P.L. 106-102) in 1999, which liberalized membership in the Federal Home Loan Banks (“FHLBanks”) and expanded the categories of eligible collateral for FHLBank advances, thousands of community banks are using FHLBank advances as a competitive and flexible funding source. The ability of community banks to continue to utilize this increasingly important funding source is crucial to safe and sound asset-liability management, as well as their ability to meet the lending needs of their communities. Similarly, the fact that federal deposit insurance coverage levels have not increased since 1980 has given community banks further incentive to turn to FHLBank advances as a stable, alternative source of funding to meet Main Street’s lending needs.

ICBA continues to hold the view that the FHLBanks should be regulated by a separate and independent agency—a status that the existing Federal Housing Finance Board (“FHFB”) already enjoys. Under the regulatory guidance of the FHFB, the FHLBanks have a near-impeccable record of providing well-collateralized advances to thousands of institutions. The FHFB also has taken important steps, and continues to take steps, to upgrade its examination and supervision capacities focusing on safety and soundness.

At its Fall meeting earlier this month, the 110-member ICBA Board of Directors, with representation from nearly every state, discussed the issue of FHLBank regulation at length. The ICBA board voted unanimously to oppose including the FHLBanks in any proposed new

supervisory and regulatory structure for Fannie Mae and Freddie Mac in the U.S. Treasury Department.

The ICBA Board did not discuss the concept of a new, independent regulatory structure outside the Treasury Department for Fannie Mae, Freddie Mac and the FHLBanks—a concept which has been voiced by some in recent days.

The ICBA has long supported independent financial regulatory agencies—for example, agencies such as the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (“FDIC”) and the Securities and Exchange Commission (“SEC”).

While not our first preference, the ICBA may not oppose the concept of a new independent regulator for all three housing GSEs outside the Treasury Department, depending on how key details are fleshed out. The Federal Home Loan Bank Act could potentially serve as the legislative foundation for such a structure. However, two key issues would have to be worked out for such a structure to gain widespread support. First, the specific regulatory powers of such an agency would have to be determined. We note that the FHFB and the Office of Federal Housing Enterprise Oversight (“OFHEO”) do not currently have the same powers. Second, the unique ownership, operational and capital structure and mission of the FHLBanks, which is distinct from that of Fannie/Freddie, would have to be recognized and preserved in constructing the new agency.

Regulation of Fannie Mae and Freddie Mac

Community banks are significant direct or indirect users of the Fannie Mae and Freddie Mac conduits into the secondary mortgage market. The sale of mortgages originated by community banks into the secondary market increases the liquidity of these locally owned-

and operated-financial institutions, allowing them to better serve the lending needs of Main Street America. Our system of homeownership is the envy of the world and it has been the stalwart of the American economy during economically challenging times in recent years. The current system has enabled us to reach record homeownership levels and to accommodate consumer refinancing needs in the recent low interest rate environment. This must not be overlooked as part of the process when considering GSE regulatory restructuring.

Regarding proposals to bring the regulation of Fannie Mae and Freddie Mac under the Treasury Department, ICBA reiterates its staunchly-held view that any such entity must be politically independent in order to be regarded as a world-class financial regulatory agency. We firmly believe that the traditional political independence of our federal financial agencies has immeasurably strengthened the U.S. economic and financial system. Currently, the Office of the Comptroller of the Currency (“OCC”) and the Office of Thrift Supervision (“OTS”) are protected from the Treasury’s political influence.

We strongly urge Congress to make certain that any potential legislation contain appropriate firewalls and independence between Fannie and Freddie and the Treasury’s politically-appointed policy makers. Politicizing regulation is an ever-present danger, and we believe it is paramount to maintain the independence of any new regulator overseeing safety and soundness and Fannie and Freddie’s congressionally-mandated missions to support home ownership.

Other Key Issues

In the letter of invitation for today’s hearing, ICBA was also asked for its views on several other issues in the debate over housing GSE regulation.

First, what is the appropriate capital regime for the housing GSEs? We support the continuing authority of each GSE regulator to establish, and modify, as necessary, the level of risk-based capital that the GSEs are required to hold. As market and risk factors change, the regulators must be able to adjust to these changes in a timely manner. However, ICBA does not support granting the GSE regulators the authority to modify statutory or minimum capital. Such new authority could confer on the regulators the authority to de facto adjust program levels by raising minimum capital, reducing the amount of resources available for program activities.

Second, what should the funding mechanism be for the new regulator? To insulate the housing GSE regulators from undue political influence and enhance independence, ICBA supports removing funding of the GSE regulators from the appropriations process and funding them solely through a self-generated fee structure.

Third, where should authority for new program approvals be placed? We believe that in order for the housing GSEs to continue to be innovative in the development and implementation of new products to meet the demands of the marketplace, there should be a smooth and seamless process for getting these products on line. Clearly, if a FHLBank, Fannie Mae or Freddie Mac develops a program that is inconsistent with safety and soundness or with their congressionally mandated missions, there must be a review process to make that determination. But there should not be disincentives for the GSEs to be innovative and adaptive to new market conditions. Our housing finance system has evolved rapidly over the recent past due to changing technology and changes in the demands of consumers. The FHLBanks, Fannie Mae and Freddie Mac must have the flexibility to develop the housing

finance products needed by consumers in a timely manner and not have new products, programs and activities be bogged down by bureaucracy.

Fourth, what is the appropriateness of HUD's continuing role in the oversight of Fannie Mae and Freddie Mac? Because of its responsibilities and expertise, our preference is that HUD should continue to establish our nation's housing goals and control the mission activities of Fannie/Freddie to achieve those goals.

Conclusion

In closing, ICBA would urge the Committee to carefully and fully consider the issues associated with regulation of the housing GSEs before rushing to action. The ICBA has long supported world-class, independent regulatory agencies such as the FDIC and the Federal Reserve, both of which are governed by boards that are independent of the U.S. Treasury.

There is no shortage of opinions and strongly held viewpoints on these issues. We concur with the sentiments expressed by a number of members of this Committee that it is imperative that any regulatory restructuring be done right given its potential impact on the crucial housing sector of our economy and on community banks' continued ability to meet the lending needs of Main Street America.

Thank you for the opportunity to testify. I would be pleased to answer any questions.