Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Committee on Financial Services

United States House of Representatives

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Before the
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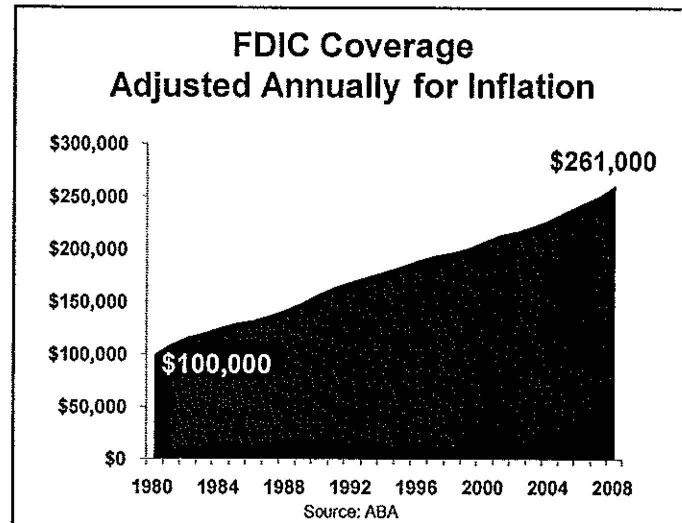
Chairman Frank and members of the Committee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.

We appreciate the opportunity to testify on H.R. 703, which is designed to promote bank liquidity and lending through changes to the deposit insurance coverage, improvements in the HOPE for Homeowners Program, and prompt availability of capital through the TARP's Capital Purchase Program for small community banks. ABA supports this bill and believes that it provides important improvements that will help enhance liquidity and capital in the banking industry and make the HOPE for Homeowners a more viable option to assist troubled borrowers. Let me address each of the major elements of H.R. 703.

I. Changes to Deposit Insurance Levels, Borrowing Authority and Systemic Risk Assessments

Deposit Insurance Levels: ABA supports making permanent the $250,000 deposit insurance limit that was set on a temporary basis in the Emergency Economic Stabilization Act (EESA). This increase, from $100,000, helped heighten consumer and small business confidence and also resulted in some additional funding for banks. However, this increase expires at the end of 2009. It is important that this issue be addressed by Congress as quickly as possible. As a practical matter, with each passing month, it becomes more difficult for banks to effectively offer certificates

of deposit (CDs) over $100,000 with longer maturities because the expiration date on the insurance increase is moving closer. For example, by June, banks will only be able to offer six-month CDs in the $100,000 to $250,000 range that are fully insured. This limitation may create a large funding problem at year-end as CDs are being written to correspond to the expiration date. Moreover, the limitations on insured CD funding will hurt the ability of banks to fund loans with longer-term deposits. Finally, the expiration date and differing levels of insurance on CDs will be confusing to customers.



Congress, when it made changes to the Federal Deposit Insurance Corporation (FDIC) in 2005, did implement an inflation adjustment to the $100,000 level going forward.[1] This adjustment did not reflect the impact that inflation has had on the $100,000 level since 1980 (when the limit was raised from $40,000). Had the adjustment been made since 1980 (using the consumer price index), the deposit insurance limit today would have been $261,000 (see the chart).[2] Moreover, per capita incomes have risen by more than five times since 1980, lending further support for the increased coverage level.

Increasing the coverage level comes with a significant cost to the banking industry, as it must pay premiums to assure adequate reserves to support these newly insured deposits. The FDIC estimates that the increase in coverage from $100,000 to $250,000 will increase insured deposits by about 15 percent, or $680 billion. This reduces the reserve ratio (which is calculated by taking the Deposit Insurance Fund balance and dividing by insured deposits) by about 10 basis points. To bring the reserve ratio back to the pre-$250,000 range would take a premium payment of $7.8 billion. A one-time charge at this level would significantly impair banks' ability to lend, particularly as it would come on top of high premiums already being assessed to cover current and expected

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[1] The first inflation adjustment authorized under the 2005 deposit insurance bill would be effective January 1, 2010, and the level would be adjusted every five years after that.

[2] Using the Personal Consumption Expenditure Chain-type Price Index (which is the index used in the law for FDIC coverage), the $100,000 level in 1980 would be equal to $233,000 today.

losses faced by the FDIC.[3] Spreading out this cost by extending the restoration plan period for the reserve ratio to regain the 1.15 percent statutory level – from 5 years to 8 years – is extremely important. ABA supports this important change.

Treasury Borrowing Authority: We also believe that enlarging FDIC's borrowing authority with the Treasury is a reasonable change giving the FDIC more flexibility to manage cash flows related to bank failures and to back-stop the insurance fund should it be necessary. Cash-flow issues occur as the FDIC acquires assets in failures that need to be sold off in an orderly fashion. We would emphasize that this is a line of credit, and any draws on it by the FDIC constitutes a borrowing that ***must be repaid by the banking industry***. Moreover, there has already been a tremendous amount of confusion in the media about Treasury borrowing by FDIC and how the agency uses this line to manage cash flows. Great care must be taken to be sure that the public understands that this provides flexibility to the FDIC and says nothing about the potential losses that FDIC anticipates over the next few years.

Systemic Risk Assessments: The FDIC has used its systemic risk exception authority several times over the last six months in ways that no one could have predicted when this authority was enacted into law in 1991. While a creative approach was certainly required in this difficult environment, the programs announced have taken the FDIC well beyond its chartered responsibilities to protect insured depositors in the event of a bank failure. The FDIC Debt Guarantee Program (under its Temporary Liquidity Guarantee Program) is an example of protection now provided by the FDIC that is not directed at depositors. In fact, bank or financial holding companies are perhaps the most likely institutions to issue guaranteed debt under this program. Moreover, in contrast to reimbursement for insured deposits ***after*** a bank fails, the guarantee provides protection ***without*** the failure of the institution or the FDIC acting as receiver or conservator.

While the FDIC is charging for the guarantee, there is no experience with this type of guarantee or with the other systemic risk exceptions that have been made. In fact, there is no

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[3] The average premium for 2009 is expected to be around 11.6 basis points (doubling the 2008 rates) and will generate approximately $8.7 billion in revenue for the FDIC's Deposit Insurance Fund. Over the current 5-year recapitalization plan, the FDIC will raise about $46.5 billion in premium income, and the fund balance at the end of that period is projected to be approximately $68 billion. When combined with interest income on the fund, the cost of the additional protection from moving from $100,000 to $250,000 is estimated to be about 1.2 basis points per year. Thus, extending the period for recapitalization has a significant positive impact on the cost to the banking industry of such a change in depositor protection.

historical performance that might guide the pricing, exposure, and expected losses – a troubling situation particularly in this difficult economic period where risk and uncertainty have risen significantly. While the expectation of the FDIC is that the pricing will cover the costs of the program, should it not, the entire banking industry must bear the cost under current law. We would note, for example, that while over 3,500 banks – almost half of all banks – opted out of the debt guarantee program, they would ***still bear a share of cost*** if there were a loss from any institutions that had opted-in.[4] Moreover, some holding companies are issuing significant levels of FDIC-guaranteed debt, yet would not necessarily bear an appropriate share of any costs that might occur because the bank is small relative to the parent company. Thus, providing the FDIC flexibility to spread the cost of any systemic risk determination across institutions that benefited the most – including holding companies – is appropriate.

However, the determination about how costs should be fairly distributed will be challenging and subject to significant debate and dispute. It would be appropriate for the FDIC to detail situations where the systemic risk exception might be used – ***and what limitations there are to ensure that such authority is used prudently*** – and how costs might be allocated should there be losses in these different situations. Certainly, while no one expects perfect foresight regarding the next situation that might trigger a systemic risk exception, such detailed scenarios would provide how costs would be allocated.

ABA also believes that any systemic risk ***assessment*** should be clearly and directly associated with the systemic risk determination that created the loss and not be used in any way as an alternative funding mechanism to cover other costs of the FDIC or used to expand the mission of the FDIC beyond what Congress has determined to be appropriate. For example, this authority would not be used to pre-fund assessments to pay for losses that the FDIC contemplates may be incurred as a result of invoking the systemic risk authority; rather, it would be used to recover losses actually incurred. Clarifying language that directly connects the costs to the specific systemic risk determination is needed.

Risk-Based Premium Penalty Rates May Hurt Liquidity: Finally, we would note that while these proposed legislative actions may help promote bank liquidity and lending, the FDIC is proposing changes to its risk-based assessment formula that may have the opposite effect. For

[4] Moreover, many banks opted into the program only to give them the ***option*** to issue guaranteed debt. These banks may never actually issue guaranteed debt but could end up paying the costs of other losses incurred.

example, the FDIC has proposed significant additional costs (i.e., added insurance premiums) for use of Federal Home Loan Bank (FHLB) advances. The threshold proposed by the FDIC would unfairly penalize banks that have relied on these very stable sources of liquidity. Moreover, FHLB advances are a cost-effective way to raise funds, help banks manage interest rate risk by match-funding to the term of the loan, and facilitate community development loans.

In addition, the FDIC proposes to charge higher premiums to banks that use elevated levels of brokered deposits, but the FDIC proposal fails to distinguish among ***different*** types of brokered deposits. This is critical, since some so-called "brokered deposits" – such as reciprocal deposits and sweeps from broker-dealers to affiliated banks – are designed to maintain relationships with customers and provide safe, stable and low-cost funding for banks. ABA supports changing the law governing brokered deposits to explicitly distinguish these and similar types of customer deposits from the more volatile brokered deposits the original law was intended to cover.

II. Improvements Would Make the HOPE for Homeowners Program a More Viable Option to Assist Troubled Borrowers

Mr. Chairman, we reiterate our continued support for the HOPE for Homeowners program and our commitment to working with this committee to further improve HOPE for Homeowners. We believe the changes to the program recently announced by the Department of Housing and Urban Development have the potential to attract many more borrowers and lenders. Additionally, we are pleased to see further changes included in H.R. 703. We would like to comment both on those changes and on other recommendations for improving the program:

- **Streamlining the process.** The current underwriting process for HOPE for Homeowners is complex and confusing, both for borrowers and lenders. Existing technology platforms cannot be used to originate a HOPE for Homeowners loan, and the investment of both time and money to modify or create new platforms is too substantial to be economically feasible, especially when loan origination departments are running above capacity. As a result, HOPE for Homeowners loans all have to be processed ***manually***. This is time-consuming and frustrating for the borrower and lender alike. We encourage FHA to explore the use of the streamlined underwriting process it currently employs for FHA refinances as a

model for HOPE for Homeowners originations. Additionally, we urge FHA to relax Direct Endorsement requirements to give servicers (and their contract underwriters) greater flexibility to structure broader home retention solutions for more borrowers.

- **Second lien holders must be given greater incentives to extinguish or subordinate their interests.** Second lien holders present a substantial impediment to refinancing under the HOPE for Homeowners program. Recent changes adopted in law allow for payments to second lien holders as incentives to extinguish or subordinate their interests. FHA should immediately implement a process for providing sufficient cash payments as incentives for second lien holders.

- **Servicers should be incentivized to allow for loan restructurings using HOPE for Homeowners.** The H.R. 703 provides for such incentives. We support this added tool.

- **Lenders and servicers should be provided protection against litigation when acting reasonably and in good faith.** All loan mitigation programs, including HOPE for Homeowners, face the hurdle of litigation risk from investors when loans have been securitized. After the announcement of the HOPE for Homeowners program, at least two mortgage-backed securities (MBS) investors sent letters to their servicers threatening litigation if the servicers were to implement the HOPE for Homeowners program. Investors have been particularly opposed to the principal reductions required by HOPE for Homeowners. Legislation is needed to provide a "safe harbor" for lenders and servicers that implement loss mitigation solutions where it can reasonably be concluded that such a solution is in the general interest of investors through a net present value calculation. Such a safe harbor should explicitly include principal reductions that demonstrably result in a better return for investors than foreclosure. ***We applaud the inclusion of a safe harbor in H.R. 703.*** We would further recommend that the safe harbor also specifically include trustees. We would be pleased to provide a specific proposal to the committee on how to include trustees.

- **Incentives to participate should be provided for borrowers with no equity.** A sad reality is that some borrowers who find themselves with no equity in their homes will choose to simply walk away from the property (and the loan obligations) rather than participate in HOPE for Homeowners. This is largely because the HOPE for Homeowners does not provide them with incentives to keep the property and/or does not provide the borrower with a monthly payment that is affordable. We believe that the equity and appreciation sharing components of HOPE for Homeowners discourage potential borrowers from participating in HOPE for Homeowners. Most homeowners view their home not just as a place to live, but also as an investment. Denying equity or appreciation to borrowers puts them in the position of renters rather than owners, and many borrowers will find it cheaper to simply become a renter after walking away from the property. The equity and appreciation sharing components of the program should be eliminated or significantly reduced.

  Again, ABA supports the provisions in H.R. 703 to scale the equity sharing back to only the equity created as a result of the HOPE for Homeowners refinancing and would further limit the sharing to a period of five years. These changes are logical and represent a fairer balance for the borrower and the government.

- **We agree that the insurance requirement should be reconsidered.** The current structure of the HOPE for Homeowners program requires up front and annual insurance premiums and requires that loans must be structured as 30-year fixed rate loans (40-year loans will be allowed when recent statutory changes are implemented). These requirements limit the affordability of HOPE for Homeowners loans for many borrowers. We concur with the elimination or substantial reduction of the upfront and annual premiums in the early years of the loan and the use of more flexible rate requirements for loss mitigation. For example, we urge the consideration of interest-only features or lower interest rates in the early years of the loan with gradual payment increases to facilitate keeping borrowers in the home now. We support H.R. 703 which reduces the upfront and ongoing premium requirements for borrowers participating in the program.

III. Fully Fund the Capital Purchase Program as Originally Announced

The ABA strongly supports the provisions in H.R. 703 that direct the Treasury to take all the necessary actions to provide capital under the Capital Purchase Program (CPP) under TARP for community banks and to do so on comparable terms afforded to other CPP recipients. We strongly believe that the current commitment should be fulfilled in order to prevent competitive disparities from occurring and to assure that ***every community*** has the same opportunity for its banks to participate, ***so that increased credit availability will spread across the country.***

By explicitly citing S-corporations, mutually-owned insured depository institutions and privately held (non-stock) institutions, H.R. 703 acknowledges the critical role these community institutions play in meeting the credit needs of cities and towns across America. It also recognizes that the current situation is unfair to many regions of the country and individual communities where S-corporation or mutual institutions are the most prevalent local source of credit. For example, in many New England communities, mutual institutions predominate. Currently those communities do not have the same opportunity for their banks to participate in the CPP. These community banks are particularly important in funding small businesses, which will be the first to generate new jobs as the economy recovers. While they did not cause the current problems in our economy, they stand ready to be a significant part of the solution. Simply put, the CPP should allow all healthy banks, regardless of their corporate structure or charter type, to participate.

Moreover, they should be allowed to participate on comparable terms. While Treasury has worked very hard to offer economically comparable terms to the various types of corporate charters, variations have occurred. For instance, investments in S-corporations that are stand-alone banks will be treated as Tier 2 capital, while investments in other participating institutions will be treated as Tier 1 capital. We urge Congress to direct Treasury to permit such S-corporations to form holding companies, assign the debt to the holding companies, and receive equal treatment under the capital rules.

As these corporate structures may not be fully understood by some policymakers, let me describe briefly the structure of those banks:

- ***S-corporation banks:*** Many community banks are organized under this structure. These banks are subject to many restrictions, including on the number of shareholders (which is

limited to 100) and on the type of stock they may issue (S-corporations may only issue a single class of stock). The senior preferred stock investment that Treasury initially proposed would have constituted a second class of stock and, therefore, S-corporations would not have been able to participate. ABA supported a proposal developed by the federal banking regulators that would allow S-corporation banks to issue to Treasury a type of subordinated debt so that the CPP investment would be, as a general matter, on similar economic terms as other participants. On January 14, 2009, Treasury provided such terms, which will allow about 2,500 institutions the option to participate in the program.

- ***Mutual banks:*** There are over 700 banks or bank holding companies organized under mutual ownership. Stand-alone mutual banks cannot issue shares. Some mutual holding companies have issued minority shares, but must retain a majority interest in the hands of the mutual ownership interest if they are to remain mutually owned. Even if they have the capacity to issue additional preferred shares, they may not be able to comply with requirements established by Treasury for exchanged-traded, SEC filing companies. Finally, a majority of mutual holding companies have not been authorized to issue minority shares, and cannot comply with the terms currently available under the CPP. We propose two alternatives. Instead of preferred stock, mutual capital certificates could be used. Mutual capital certificates are subordinate to all deposit accounts and debt obligations, and are entitled to be paid dividends. Alternatively, subordinated debt could be ***used as a replacement*** investment with some type of redemption fee.

Regardless of the corporate structure, all banks provide vital services to their communities and all should be allowed to compete on equal terms. Therefore, it is imperative that Treasury adopt policies that would allow mutual organizations to participate in the CPP and to issue term sheets for these organizations expeditiously.

Conclusion

Mr. Chairman, I appreciate the opportunity to present the views of the American Bankers Association and express our support for H.R. 703. The ABA stands ready to work with this Committee to enact these important changes.