Testimony of

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On behalf of the

Independent Community Bankers of America

Before the

United States Senate
Committee on Banking, Housing and Urban Affairs

Hearing on

"Housing Finance Reform: National Mortgage Servicing Standards"

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Opening

Chairman Johnson, Ranking Member Shelby, members of the Committee, I am Jack Hopkins, President and CEO of CorTrust Bank, a $660 million asset, nationally-chartered bank headquartered in Mitchell, South Dakota. As a third generation community banker, I am pleased to represent ICBA's nearly 5,000 members at this important hearing on "National Mortgage Servicing Standards."

As this committee considers the development of national mortgage servicing standards, I urge you to ensure that they do not add to the regulatory burden of community banks, which are servicing their portfolios successfully and have not contributed to widely-reported problems. We must preserve the role of community banks in mortgage servicing because the alternative is further consolidation in the servicing industry, which will only harm borrowers, especially those in rural and underserved housing markets.

CorTrust Bank was founded in 1930, at the outset of the Great Depression, and was built, tested and proven under historically challenging economic conditions. We survived the Great Depression and numerous recessions since that time, including the most recent financial crisis, by practicing conservative, commonsense lending. We have emerged from the crisis well-capitalized and ready to lend to support the recovery. CorTrust Bank serves 16 communities in South Dakota, from Sioux Falls to rural communities with populations of less than 150, such as Artesian, where we were first chartered under the name Live Stock State Bank. We recently expanded into Minnesota.

Many ICBA member banks with similar stories – some have been in business for more than 100 years – have also emerged from the crisis well-capitalized. Despite the recent wave of bank failures and consolidations, I fully expect the community bank business model will thrive in the future, to the benefit of consumers, communities, and the economy.

Servicing is Key to Relationship Banking and Helps Community Banks Remain Competitive

Residential mortgage lending has been an important component of CorTrust's business since its founding and has grown more important over the years. In 1988, we first began to sell mortgages into the secondary market in order to access additional funding. Today, we have a $552 million servicing portfolio consisting of approximately 5,000 loans.

About two thirds are held by Fannie Mae, and a smaller number are held by Freddie Mac and by the South Dakota Housing Authority.

Over the years, we have discovered that mortgage lending is a great way to cement long-term relations with customers and win the opportunity to serve their additional banking needs. But in order to sustain customer relations we need to service these loans, whether they are subsequently sold or held in portfolio. We also discovered that customers do care about who services their loans. They value, and even seek out, local servicing. If they have a question, they want to be able to pick up the phone or visit a branch and sit down with a banker in their community. We built a successful ad campaign – print, TV, online – around the advantage of local servicing. The campaign has resonated with consumers and boosted our mortgage sales. Notably, much of our recent business has come in the form of refinancing mortgages away from large lenders whose borrowers are frustrated with remote, faceless servicing performed outside the community.

Servicing is key to the marketing of mortgage originations, and together, origination and servicing are integral to our relationship-banking business model. Mortgage lending represents approximately 20 percent of our business, but its significance is greater than its percentage would suggest. Viewed narrowly, loan-for-loan, it would be more profitable for us to release servicing when we sell a loan. But we chose to keep servicing in-house, even though it's at best a break-even business, because it is central to our community bank business model.

CorTrust Bank's experience is typical of community banks. Servicing helps community banks remain competitive in the mortgage origination business. Today, community banks represent approximately 20 percent of the mortgage market, but more importantly, community bank 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 mortgage option. Any broad based recovery of the housing market must involve community bank mortgage lending.

Community bank servicing is based on close ties to customers and communities. Because CorTrust Bank's servicing team consists of only four people, customers always know who is on the other end of a telephone or across the desk. A customer who dials our 1-800 number will generally get one of two people on the line. Alternatively, a customer can walk into one of our 24 locations and deal with a staff person face-to-face.

Most importantly, we intervene early to keep mortgages out of default. We know, for example, when an employer closes in our community and how that closure impacts the income of our borrowers. A servicer based 1,000 miles away won't have such knowledge. Smaller servicing portfolios and better control of mortgage documents also provide an advantage over the large servicers. For these reasons, community banks have generally been able to identify repayment problems at the first signs of distress. Our staff will contact a late customer on the 16th day – the first day of delinquency – to find out what their circumstances are and discuss solutions.

Community Bank Servicing Improves Loan Performance

This personalized approach to servicing is a natural complement to conservative, commonsense underwriting. We make sure loans are affordable for our customers and they have the ability to repay. Loans are underwritten based on personal knowledge of the borrower and their circumstances – not based on statistical modeling done in another part of the country. We don't underwrite option adjustable rate mortgage (ARM) loans or other exotic credit products. This combination of quality, personalized underwriting and servicing yields results. CorTrust Bank's delinquency rate on loans transferred to Fannie Mae is 0.83 percent. Our delinquency rate on loans transferred to other programs is a bit higher, yielding an average delinquency rate of 1.7, which is consistent with the general pool of community-bank originated loans and about one-third of the national average. In the most frenzied, exuberant years of mortgage lending, 2005 through 2007, the general pool of GSE loans was seriously delinquent at a rate four or five times higher than loans originated by community banks and sold to GSEs. In the history of CorTrust Bank mortgage lending, we've had very few mortgage loans go into foreclosure. Community bank originated and serviced mortgages perform better in all market conditions.

National Servicing Standards Should Exempt Community Banks

As a result of widely-reported, abusive servicing at some large banks, "robo-signing," wrongful foreclosures, and other high profile scandals, Congress, the regulators, state officials, and the media have focused on servicing. In June, Fannie Mae published Announcement SVC-2011-08, "Delinquency Management and Default Prevention." These new servicing standards are very prescriptive with regard to the method and frequency of delinquent borrower contacts. They are a challenge to implement and have reduced our flexibility to use methods that have proved successful in holding down delinquency rates.

As Congress and the agencies consider how to address the deficient servicing standards of some large lenders, they must recognize community banks have fundamentally different standards, practices, and risks. Overly prescriptive servicing requirements should not be applied across the board. Examples of difficult and unnecessary requirements include rigid timelines for making contacts that leave no discretion to the servicer; mandatory property inspections; establishing a single point of contact for the borrower; the creation of a special servicing group for delinquent loans; requiring significant oversight of third-party providers; developing burdensome compliance programs; and annual independent audits of controls and processes. Many of the proposals I've seen would require us to establish a call center to comply, a prohibitive and unnecessary expense for a community bank such as mine. Our small size and our local presence in the communities we serve make many of these requirements unnecessary. For example, borrowers are able to quickly find the right person in the bank to address their issues.

In practice, community bank servicing is consistent with the goals and the spirit of national standards proposals I have seen, which promote more personalized service, improved accountability and control of documents. But, in the proposals I've seen, the means of achieving those goals are overly prescriptive. CorTrust Bank services loans with care, diligence, and accountability because quality servicing contributes to the reputation we enjoy in our communities. We don't need threat of enforcement to incentivize quality servicing.

The most significant risk in applying standards that are too rigid and prescriptive to all banks, regardless of size, is that the additional expense would cause many community banks to exit the mortgage servicing business and accelerate consolidation of the servicing industry, leaving it to the largest lenders. Loss of servicing would make it harder for community banks to compete for origination business and would thereby accelerate consolidation in that business as well. Were this to happen, rural and small town customers in particular would be left with fewer mortgage choices, interest rates and fees would be less competitive, and customer service and product choice would suffer. The secondary markets, without well-performing, community bank-originated loans to shore them, would be less stable. We all witnessed the danger and devastating fallout that resulted from the concentration of mortgage lending in a few major market players. We must promote beneficial competition and avoid further consolidation and concentration of the mortgage lending industry.

Any national standards developed by Congress or the regulators must exempt community bank lenders. There are a number of ways of accomplishing this. One possibility is to exempt lenders that are both below a threshold number of loans (or aggregate dollar value of loans) and whose delinquency rate is below its regional average. As a lender exceeds its regional average, servicing standards could be applied on an incremental basis, so that one delinquent loan does not bring on the full array of standards that apply to a large bank. However you choose to structure the exemption, I urge you not to tamper with our success in a service that is so important to our business and that of other community banks.

Servicing Compensation Must Cover Costs and Incentivize Diligent Servicing

A separate but related issue is compensation for servicing. Because the income provided by servicing is only enough to cover costs, ICBA is very concerned about a recent Federal Housing Finance Agency (FHFA) proposal to change both the method and the amount of compensation paid for servicing mortgage loans for Fannie Mae or Freddie Mac. The proposal would significantly reduce or eliminate all together the minimum servicing fee of 25 basis points earned for performing mortgages and would implement a specific fee paid for non-performing loans. This proposal would result in a sharp reduction in mortgage servicing fee income for community banks, who predominantly service performing loans, and does nothing to improve the financial condition of Fannie Mae or Freddie Mac. Further, changing the servicing fee structure could cause significant change to the value of existing mortgage servicing rights held by community banks which may impact their capital position and likely increase consolidation of the servicing business. Moreover, by rewarding the servicers of non-performing loans – and the originators who typically retain servicing rights – the proposal would create a perverse incentive. Loan servicing fees should be structured to incentivize diligent servicing, which can make the difference between keeping a loan current and a lapse into non-performance.

Closing

Thank you for holding this hearing and for the opportunity to testify and present the good story of community bank mortgage servicing. For many community banks, servicing is integral to competitive mortgage origination and is a crucial aspect of relationship business lending. While I appreciate your concern with servicing practices that have harmed consumers and impeded the housing market recovery, I urge you not to tamper with the success of community banks in serving their customers and keeping loans out of delinquency.