Statement of

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Good Afternoon Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee. My name is Andrew Jetter and I am the President and CEO of the Federal Home Loan Bank of Topeka. I appreciate the opportunity to speak to you today on behalf of the Council of Federal Home Loan Banks (Council), a trade association representing all of the Federal Home Loan Banks (FHLBanks).

**Federal Home Loan Bank System Overview**

Initially, I would like to describe the FHLBanks and their critical role in providing cost-effective funding and other services to members to assist them in financing housing and community and economic development. Following that, I will address our understanding of the role of community financial institutions in providing mortgage finance, the challenges they face, and how the FHLBanks currently assist them in that role.

The FHLBanks were created in 1932 to support America's housing finance system through their member thrift institutions and insurance companies. Since that time, Congress has expanded the mission of the FHLBanks to include support for affordable housing, community development, and other forms of community lending and has expanded eligibility for membership in the FHLBanks to commercial banks, credit unions, and community development financial institutions. Advances (fully secured loans to member institutions) represent the core of the FHLBanks' business. Members rely on the FHLBanks to provide competitive access to liquidity across all economic and credit cycles. This liquidity enhances the financial strength of local lenders so that they can meet the housing finance and other credit needs of their communities through a range of products and services.

During the nation's financial crisis, when dislocations in the capital markets made funding from other sources difficult, the FHLBanks were a critical source of funding for U.S. financial institutions, preventing far greater losses and potential failures. The FHLBanks were able to increase their lending to members of every asset size and in every part of the country by $370 billion - from a total of $650 billion in the second quarter of 2007 to over $1 trillion in the third quarter of 2008. The FHLBanks were able to carry out this essential liquidity function for their members without requiring taxpayer assistance. The crucial role played by the FHLBanks was recognized in an extensive study prepared by the staff of the Federal Reserve Bank of New York. This study found that during the financial crisis the Federal Home Loan Bank System was "by far, the largest lender to U.S. depository institutions while most of the Federal Reserve's liquidity operations have been for the benefit of non-depository institutions or foreign financial institutions."[1] The backstop role played by the FHLBanks was also recognized by William

[1] Federal Reserve Bank of New York, Staff Report No. 357 at pages 28-29 (November, 2008).

Dudley, President of the Federal Reserve Bank of New York, who noted that when the interbank lending market dried up in 2007, depository institutions turned to the Federal Home Loan Bank System for needed liquidity.[2]

**The FHLBank System's Unique Structure Has Enabled It to Successfully Fulfill Its Mission Since 1932**

The FHLBanks have been able to successfully fulfill their mission as a result of several unique characteristics: their cooperative structure; a scalable, self-capitalizing, operating model; broad participation by a diverse membership; and dependable access to a deep, liquid market for FHLBank debt.

**Cooperative Structure**

The FHLBank System has a unique structure, comprised of twelve independent cooperatives and the Office of Finance that issues debt on behalf of those twelve regional FHLBanks. The FHLBanks are overseen by an independent regulator, the Federal Housing Finance Agency (FHFA), established by the Housing and Economic Recovery Act of 2008 (HERA Act of 2008). Each FHLBank is a separate and distinct corporate entity with its own stockholder - member institutions and its own board of directors. While the FHLBanks issue debt collectively and are jointly and severally liable for the repayment of those debt obligations, there is no single controlling entity with responsibility for or authority over the FHLBanks. Each FHLBank operates independently under the authority granted by Congress through the Federal Home Loan Bank Act, as amended, and in accordance with the regulations established by the FHFA.

Each FHLBank operates within a district originally established by the Federal Home Loan Bank Board, one of the predecessors to the FHFA. Each FHLBank's capital stock can only be purchased by its member institutions. Each member must purchase the FHLBank's capital stock in order to become a member, and must maintain capital stock holdings sufficient to support its business activity with the FHLBank in accordance with the individual FHLBank's capital plan.

[2] "May You Live in Interesting Times," Remarks of William Dudley, Executive Vice President of the Federal Reserve Bank of New York, October 17, 2007.

**Scalable, Self-Capitalizing, Operating Model**

The FHLBank System is built to be scalable - advance levels ebb and flow with credit cycles to match member demand. Since the height of the crisis, advances have declined by more than half as weak asset growth and excess liquidity have reduced members' need for advances. The decline in advance levels, following their rapid expansion, demonstrates that the FHLBank model works as intended.

As cooperatives, FHLBanks are not subject to the growth imperative that often drives the decisions of publicly-traded corporations. Demand for advances expands and contracts with economic and market conditions and the FHLBanks' capital stock outstanding appropriately adjusts to these changes. Although the specific requirements vary based on each FHLBank's capital plan, an institution must hold a certain level of capital stock to be a member. In addition, a member must maintain "activity-based" capital stock in proportion to the amount of advances it has outstanding.

During periods of credit expansion, the activity-based stock requirement automatically provides additional capital to support advances growth. For example, in the recent liquidity crisis, the signficiant increase in advances was accompanied by the purchase of additional capital stock to support those advances, thereby providing additional capital to the FHLBanks in direct proportion to the increase in assets. This allowed each FHLBank to meet the liquidity needs of its members while preserving the safety and soundness of the cooperative.

An FHLBank's capital stock cannot be issued to or held individually by members of an FHLBank's board of directors, its management, its employees, or the public, and is not publicly traded. There is no market for FHLBank capital stock other than among FHLBank members. The price of an FHLBank's capital stock cannot fluctuate, and all FHLBank capital stock must be purchased, repurchased, or transferred only at its par value. There are no stock options or other forms of stock-based compensation for FHLBank management, directors, or employees.

**Broad Participation by a Diverse Membership**

The membership of the FHLBank System consists of thrifts, commercial banks, credit unions, insurance companies, and community development financial institutions. At the end of first quarter of 2013, the FHLBanks had 7,604 members, composed of: 967 thrifts; 5,169 commercial banks; 1,185 credit unions; 268 insurance companies; and 15 community development financial institutions.

The composition of the FHLBank membership closely approximates the composition of the banking industry: 88 percent of members have less than $1 billion in assets compared with 91 percent of all banks and thrifts and 97 percent of all credit unions industry wide. Typically, advances utilization rates are fairly consistent across asset size groups, though smaller institutions are currently funding a larger portion of their balance sheets with advances than larger institutions. Many of these smaller institutions have limited or no direct access to the capital markets other than through their FHLBank.

In addition to depository institutions, over 250 insurance companies are now members of an FHLBank. Insurance companies are a significant part of the System, representing almost 13 percent of outstanding advances. These members play an important role in the housing market by holding substantial amounts of single and multi-family mortgages and agency debt. Many insurance company members are also active participants in the Affordable Housing Program (AHP) and the Community Investment Program (CIP) as an extension of their involvement in economic development activities.

The mortgage finance and community lending industry is broad and varied. This variety is crucial to both financial innovation and the diversification of risk across institutions of differing size, geography, charter, and business model. By providing equal access to liquidity, the System supports the current structure of the industry and this structure can be a source of stability and strength moving forward. As Congress looks to restructure the housing finance system in this country, all member types of the FHLBank System will have an important role to play in meeting the nation's housing finance needs.

**Dependable Access to a Deep, Liquid Market for FHLBank Debt**

The market for FHLBank debt is one of the most liquid. To the end investor, this liquidity represents an appealing characteristic. Collectively, the FHLBanks issue debt in significant volume on a daily basis. The size, frequency, and consistency of issuance mean that it takes less time for the market to absorb new issues during both normal and stressed markets. In turn, this makes it profitable for dealers to allocate capital against FHLBank underwriting and trading. Greater capital allocations, in turn, mean greater liquidity in the market.

This liquidity enables the FHLBanks to fund at attractive levels across a host of terms and structures. In turn, they pass this advantage on to their members. All members receive the benefit of attractive funding, regardless of their size. Because advances are made at relatively narrow spreads to borrowing costs, attractive issuance levels for FHLBank debt translates directly into lower advance rates for members. In turn, these members are able to pass these benefits on to their communities in the form of affordable credit.

Another benefit of the depth and liquidity of the market for FHLBank debt is that the System is able to rapidly scale up its issuance with member demand for advances. The FHLBank debt franchise is well recognized and highly desired by a host of global investors due to its liquidity and credit quality. During 2008 and 2009, against a dislocated bond market, the System was able to increase debt outstanding by $365 billion over 14 months. This added funding provided a lifeline to financial institutions across the country. It is because of the depth and liquidity of the FHLBank debt market that the System is able to tap the markets in size when demand surges—even during extreme distress.

**Advances and Member Services**

Members use advances to fund new originations and existing portfolios of mortgages, to purchase mortgage-backed securities, and to manage the substantial interest rate risk associated with holding mortgages in portfolio. Some members layer in term advances alongside their deposits, altering the duration profile of their liabilities to better suit their assets and mitigate risk. Other members use shorter-term, on-demand liquidity to offset unexpected deposit runoff or to take advantage of an opportunity to quickly add assets. By enabling members to effectively manage their balance sheets, advances lower the cost of extending credit to American consumers.

In accordance with statutory requirements, all advances are secured by eligible collateral and the purchase of capital stock. When FHLBanks issue advances, they lend against both the credit of the member-borrower and the quality of the collateral. Each FHLBank establishes its own processes and procedures for assessing the credit worthiness of borrowers and the appropriate lending value of pledged collateral. FHLBanks regularly monitor actual and potential borrowers' financial condition to ensure approppropriate credit actions have been taken to protect the FHLBank against any potential loss arising from any extension of credit. In addition to evaluating members' financial reports, FHLBanks also monitor macroeconomic trends and local laws and regulations, and regularly interact with the member's management teams to ensure they stay attuned to the member's financial condition.

Each FHLBank establishes the types of assets that will be accepted as eligible collateral, defines the specific underwriting requirements and identifies the lendable value that will be applied to each eligible asset. Collateral practices vary among the FHLBanks with regional differences accounting for some of the differences. For example, some districts are dominated by larger commercial banks where others are primarily served by community financial institutions. Some markets display a concentration of loans exceeding the conforming loan limits, where others are well within the limits. On the coasts, there is a higher concentration of commercial real estate lending, and in the midwest some institutions specialize in agricultural lending. Based on these regional differences and the risk appetite of each FHLBank, collateral practices will vary. Examples of these variations include, but are not limited to, the types of assets accepted as eligible collateral, the specific underwriting requirements applied to each asset class, the member's collateral reporting requirements, pricing techniques, and on-site collateral reviews.

The valuation and management of member collateral is a process that relies on regional expertise and market knowledge. During a time when many institutions attempted to streamline or outsource credit underwriting and collateral evaluation processes, the FHLBanks stuck to the basics and combined conservative collateral valuation practices with effective credit policies. The System has an impressive track record as a result.

Beyond assessments and risk management, FHLBanks provide a variety of member services, such as correspondent services that leverage local knowledge to deliver value. While these services vary across the System, it is clear that the strong relationships between FHLBanks and their members are mutually-beneficial and integral to the strength of each cooperative.

**FHLBank Mortgage Programs**

The System has an excellent track record of working with members to manage risk in the mortgage purchase programs that some FHLBanks have administered for over 16 years. In these programs, a participating FHLBank purchases traditional conventional single-family mortgages originated by member institutions under a risk-sharing agreement between the FHLBank and the member. The FHLBanks essentially offer two different versions of mortgage purchase programs. The Mortgage Partnership Finance (MPF) Program generally involves the selling member providing a credit enhancement to the FHLBank that can be called upon if the performance of the pool of loans sold incurs losses above a certain level. The FHLBank of Chicago created the program and administers many aspects of the program for participating FHLBanks. Another MPF variation allows members to sell their loans through their FHLBank to Fannie Mae, although without any risk sharing obligation. The other program is the Mortgage Purchase Program offered by a few FHLBanks that essentially involves the creation of a reserve account against the pool of loans sold by the member that is paid out to the member over time depending on the loss experience of the pool.

The collective portfolio of mortgage loans held by the FHLBanks in both programs carries a 1.94 percent seriously delinquent rate in comparison to a 6.16 percent seriously delinquent rate for all conventional loans nationwide. Total actual credit losses from mortgages held in portfolio since the program's inception in 1997 have been less than 5 basis points of the average portfolio balances annually.

These programs are an example of the success that can be achieved from "skin-in-the-game" mortgage partnerships. Community bankers exemplify "skin-in-the-game" business principles on a daily basis—their success is dependent upon being fully invested in the success and survival of the communities that they serve. Prudent underwriting, adequate appraisals, and the provision of appropriate credit products that suit an individual borrower's needs are fundamental operating principles for community bankers.

The FHLBank of Topeka offers the Mortgage Partnership Finance (MPF) Program. The MPF program is critically important to supporting our housing finance and community and economic development mission and is especially important for our community financial institution members. The district that we serve is comprised of smaller and more rural communities where agriculture is a leading economic force. With a total population of 13.7 million, we are the smallest of the FHLBank districts. The median size of our counties is much smaller than the median size of counties across the U.S.

Our MPF program is focused on serving community financial institutions and providing a reliable secondary market conduit for them. Ninety-three percent of the current MPF balances have been aggregated from community financial institutions with total assets of approximately $1 billion or less. Since inception, over 240 members have sold loans to the FHLBank of Topeka using the MPF program. The portfolio is broadly distributed with the largest concentration held by a single participating member at 6 percent, with the next largest concentrations at just over 2 percent. The average size of a participating member's mortgage loans in our MPF portfolio is approximately $24 million. Our MPF program is broadly representative of our financial institutions and the local communities that they serve.

The fundamental MPF concept - that the actual lender making the credit decision should retain "skin in the game" will drive better credit performance in mortgage portfolios - has a proven successful track record. This concept of lender retained risk has been at the forefront of the mortgage finance reform debate. Congress and regulators need only look to the FHLBanks' mortgage programs to see the concept in action. Our MPF portfolio of mortgage loans carries a 0.4 percent seriously delinquent rate in comparison to a 6.16 percent seriously delinquent rate for all conventional loans nationwide. Since inception, annual credit losses on our MPF program have not exceeded 2 basis points of the average portfolio balances.

The FHLBank mortgage programs have been highly successful in adding value to members through product innovation and service. At a time when other secondary market participants are consolidating their services, increasing delivery and guarantee fees and imposing surcharges on low volume lenders (or providing high volume lenders with discounts), members have recognized that they can rely on their FHLBank to meet their secondary market needs. The mortgage purchase programs allow community financial institutions to be competitive with larger financial institutions and mortgage lenders and to remain active housing lenders within their communities.

**Housing and Community Lending Programs**

For more than 20 years, the FHLBanks' Affordable Housing Program (AHP) has been one of the largest private sources of grant funds for affordable housing in the United States. It is funded with 10 percent of the FHLBanks' net income each year. These grant funds are distributed through a competitive process to projects developed through partnerships of member institutions and local developers and housing organizations. AHP grants subsidize the cost of owner-occupied housing for individuals and families with incomes at or below 80 percent of the area median income (AMI), and rental housing in which at least 20 percent of the units are reserved for households with incomes at or below 50 percent of AMI. The subsidy may be in the form of a grant or a below-cost or subsidized interest rate on an advance. AHP funds are primarily available through a competitive application program at each of the FHLBanks. AHP funds are also awarded through a homeownership set-aside program to assist low and moderate income households in purchasing homes, with at least one-third of the funds being used to assist first-time homebuyers. The AHP allows for and encourages funds to be used in combination with other programs and funding sources, such as the Low-Income Housing Tax Credit. These projects serve a wide range of neighborhood needs: many are designed for seniors, the disabled, homeless families, first-time homeowners and others with limited resources. As of yearend 2012, more than 806,000 housing units have been built using AHP funds, including 490,000 units for very low-income residents. The total AHP dollars awarded from 1990 through 2012 is approximately $4.8 billion.

Each Federal Home Loan Bank also operates a Community Investment Program (CIP) that offers below-market-rate loans to members for long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods. Members use CIP advances to fund the purchase, construction, rehabilitation, refinancing, or predevelopment financing of owner-occupied and rental housing for households with incomes at or below 115 percent of AMI. The program is designed to be a catalyst for economic development since it supports projects that create and preserve jobs and help build infrastructure to support growth. Lenders have used CIP to fund owner-occupied and rental housing, and to construct roads, bridges, and sewage treatment plants as well as to provide small business loans. From 1990 to 2012, the FHLBanks' CIPs have lent over $68 billion for a variety of projects, resulting in 771,000 housing units.

The FHLBanks' Community Investment Cash Advance (CICA) programs offer funding, often at below-market interest rates and for long terms, for members to use to provide financing for projects that are targeted to certain economic development activities. These include commercial, industrial, manufacturing, and social services projects, infrastructure, and public facilities and services. CICA lending is targeted to specific beneficiaries, including small businesses, and households at specified income levels.

I would like to take some time to inform you about some of the programs and initiatives that my bank, the FHLBank of Topeka, has undertaken on behalf of our members, particularly our smaller members, to help them serve the lending and credit needs of their communities.

The AHP supports our housing finance mission by providing subsidies to its members for the provision of affordable owner-occupied and rental housing to very low-, low-, and moderate-income households.  More than 33,000 housing units have been built using AHP funds and more than $145 million have been awarded through our competitive program.

In addition to the competitive application program, AHP funds are also awarded through the homeownership set-aside program. Under this program, an FHLBank may set aside up to the greater of $4.5 million or 35 percent of its AHP funds each year to assist low- and moderate-income households purchase homes. Our members obtain the AHP set-aside funds and then use them as grants to eligible households. The FHLBank of Topeka's set-aside is geared to our smaller, community-based members. We limit the amount of funds each member may use annually and we restrict the use of the funds to the purchase of homes only in non-urban areas of our district. Since the program's inception in 1995, participating members have used just over $28 million to assist 7,255 households purchase homes.

FHLBank members are able to obtain advances (loans) through the Community Investment Program (CIP) and Community Investment Cash Advances (CICA) programs. For ease of our member's use, the FHLBank of Topeka has separated the housing and economic development portions of these programs into our Community Housing Program (CHP) and Community Development Program (CDP). Advances taken through CHP and CDP are priced below our normal interest rates and may be for longer terms, allowing our members to provide financing for projects that are targeted to housing or economic development activities at fixed rates.

Throughout our district, members have used CDP to match fund loans or pools of loans to their customers for a variety of activities, including: commercial real estate, small business lending, farm real estate, and a variety of agricultural credit needs. Members meet the commercial lending needs in their communities by:

- Match funding loans for single projects on a case-by-case basis
- Funding a group of eligible loans as a pool
- Funding loan participations

Since 1999, our members have been approved for nearly $2.2 billion in CDP funds, financing more than 1,700 projects involving the creation or retention of 4,500 jobs.

**Corporate Governance**

Congress established a unique ownership and governance structure for the FHLBanks, which has served the FHLBanks well in the past and continues to do so today.  A critical feature of this structure is that the FHLBanks are wholly owned by their members/customers so each FHLBank's interests are simultaneously aligned with those of its members and customers.  In addition, the boards of directors of the FHLBanks are independent of management. No member of management may serve as a director of an FHLBank.

The Federal Home Loan Bank Act provides that a majority of each FHLBank's directors must be elected by its member financial institutions from among officers and directors of those institutions. Members vote for directors representing member institutions from their states. At least two-fifths of the directors must be independent (non-member) directors. The HERA Act of 2008 altered the governance structure of the FHLBanks to provide for the election of independent directors by the FHLBanks' members, rather than their appointment by the regulator. HERA also required that at least two of each FHLBank's independent directors must represent the "public interest" by having more than four years of experience in representing consumer or community interests on banking services, credit needs, housing, or financial consumer protection. The remaining independent directors must have demonstrated knowledge or experience in financial management, auditing and accounting, risk management practices, derivatives, project development, organizational management, or such other expertise as the FHFA Director provides by regulation.

The Federal Home Loan Bank Act also provides that no member may cast a number of votes in the election of directors greater than the average number of required shares held by members in its specific state. This prevents large members holding relatively large amounts of an FHLBank's capital stock from dominating director elections and, in practice, means that the majority of each FHLBank's member directors generally represent the small institutions that make up the great majority of members.

The statutory framework that controls the composition of the FHLBanks' boards of directors ensures that each FHLBank's board of directors will have a balance of interests represented. With no members of management on the board of directors, directors are in a position to independently oversee management actions. The members that contribute capital and benefit from the FHLBank's products and services are assured a majority of the directors. The director election voting preferences for small members ensure that larger members cannot dominate the board of directors and that an FHLBank's policies will not be detrimental to small members. Finally, the large contingent of independent directors ensures that the FHLBanks will benefit from perspectives and expertise independent of the membership.

**Risk Management**

The Federal Home Loan Banks are highly regulated entities, subject to regulation and supervision by the Federal Housing Finance Agency (FHFA).

As 12 independent institutions, each FHLBank is responsible for appropriately developing and implementing its own risk management activities. The cooperative structure of the FHLBanks eliminates many of the incentives a publicly traded company might have to raise its risk profile, and in fact discourages FHLBanks from taking excessive risk. Just as FHLBank members do not expect equity investment returns on their capital stock investments in an FHLBank, they also do not expect equity investment risk in that investment. Members purchase FHLBank capital stock in order to obtain access to FHLBank funding products, and must maintain capital stock investments in the FHLBank as long as they continue to be members. Members provide the capital that supports their advance transactions with the FHLBanks. In this environment, members expect stability, reliability and consistency of returns and credit product pricing. These member expectations are reflected in the oversight provided by each FHLBank's board of directors, a majority of which is comprised of directors representing member institutions.

Through a rigorous process, each FHLBank continually manages the pool of collateral backing an advance. This includes frequent monitoring of performance, pricing and valuation. Members are required to maintain a sufficient pool of performing collateral, so they regularly replace delinquent loans and add collateral based on changes in haircuts and valuations. These precautions ensure sufficient overcollateralization at all times.

When an FHLBank lends to a troubled member, it does so in consultation with that member's primary regulator. In the event that the member subsequently becomes insolvent, this process enables the FDIC to minimize losses to the Deposit Insurance Fund. In a liquidation scenario, the FDIC typically pays off outstanding advances in exchange for the timely release of collateral in an attempt to maximize the resolution value of the institution. Should the FDIC opt out of this arrangement, the FHLBank can liquidate the collateral to pay off any advances.

For an FHLBank to take a loss on an advance the liquidation value of a member's pledged assets plus the member's investment in FHLBank stock would have to be less than the outstanding advance plus prepayment fees (the fair value of the advance). This is extremely unlikely— since the establishment of the System in 1932, no FHLBank has taken a credit loss on an advance. In the event that collateral was insufficient to cover a defaulting member's borrowings, the next line of defense to FHLBank shareholders would be the failed member's investment in capital stock. This capital is proportional to either the size of the member (asset-based stock purchase requirement) or to the outstanding balance of advances (activity-based stock purchase requirement, which increases along with activity). It is hard to envision a situation in which a member would lose its capital investment in an FHLBank due to the failure of another member.

From the vantage point of debt investors and taxpayers, the FHLBanks' joint and several liability structure provides additional insulation from any loss that might occur at an individual FHLBank. Even if an FHLBank suffers losses, the aggregate amount of capital stock and retained earnings on the balance sheet of the 12 FHLBanks, collectively, would provide a deep layer of insulation from losses. The combination of the FHLBanks' cooperative structure and the multiple layers of risk mitigation provide an abundance of private capital to buffer bondholders and taxpayers from potential losses.

### Financial Condition

The FHLBank System reported net income of $2.6 billion in 2012, up from $1.6 billion in 2011, making 2012 the most profitable year since 2007. For the third consecutive year, all 12 FHLBanks were profitable. As a result of this profitability, the FHLBanks have been able to continue building their retained earnings. As of YE 2012 retained earnings were at $10.5 billion, having grown 250 percent since 2008 as the FHLBanks prudently strengthened this component of capital as a risk mitigant. Having completed their statutory obligation in 2011 under the Federal Home Loan Bank Act to make payments related to the Resolution Funding Corporation, all of the FHLBanks have entered into a Joint Capital Enhancement Agreement to further strengthen their financial soundness. Under this agreement, each FHLBank, on a quarterly basis, allocates 20 percent of its net income to a separate restricted retained earnings account established by that FHLBank. These restricted retained earnings accounts cannot be used to pay dividends to members and continue to build at each FHLBank until they are equal to one percent of that FHLBank's total outstanding consolidated obligations.

### Role of Community Financial Institutions in the Housing and Mortgage Finance Market

Community financial institutions remain significant players in housing finance, notwithstanding the continuing pace of greater concentration being observed in both mortgage originations and servicing. The core strength community financial institutions bring to the market is their deep knowledge of local markets and their personal relationship with customers. In smaller communities and in rural markets, community financial institutions are often the sole source of mortgage credit as larger institutions focus on more populated areas.

While not having the dominant share of mortgage originations, community financial institutions originate a significant amount of mortgage loans. As shown in the table below, during the first quarter of 2013, $435 billion of mortgages were originated. Community banks and thrifts with less than $10 billion in total assets originated $55 billion of residential mortgage loans during the first quarter of 2013.

**Table 1: Largest Mortgage Originations**
($ billions)

| | | 1Q 2013 | 1Q 2012 | $ Chg | % Chg | Mkt Sh |
|---|---|---|---|---|---|---|
| 1 | Wells Fargo & Company | $ 109.8 | $ 130.4 | $ (20.5) | -15.7% | 25.2% |
| 2 | Chase | 55.7 | 40.8 | 14.8 | 36.3% | 12.8% |
| 3 | Quicken Loans Inc. | 25.5 | 10.9 | 14.6 | 134.2% | 5.9% |
| 4 | Bank of America | 25.0 | 16.0 | 9.0 | 56.5% | 5.8% |
| 5 | U.S. Bank Home Mortgage | 22.5 | 20.1 | 2.4 | 12.0% | 5.2% |
| 6 | CitiMortgage, Inc. | 19.3 | 15.6 | 3.7 | 23.5% | 4.4% |
| 7 | PHH Mortgage | 13.3 | 14.0 | (0.6) | -4.5% | 3.1% |
| 8 | Flagstar | 12.4 | 11.2 | 1.3 | 11.2% | 2.9% |
| 9 | PennyMac | 8.8 | 1.9 | 7.0 | 376.3% | 2.0% |
| 10 | SunTrust Bank | 8.8 | 7.7 | 1.2 | 15.3% | 2.0% |
| | Top Ten | 301.3 | 268.4 | 32.8 | 12% | 69% |
| | All Others | 134.0 | 115.1 | 18.9 | 16% | 31% |
| | Totals | $ 435.3 | $ 383.5 | $ 51.7 | 13% | 100% |

Source: MortgageStats.com

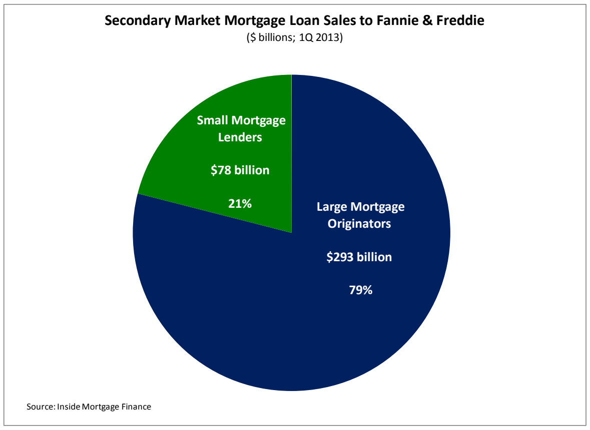
Community financial institutions play an important role as an investor in mortgage loans and mortgage-backed securities. As portfolio lenders, community financial institutions invest in mortgage loans originated in their local markets. Some institutions have had success holding in portfolio both conforming and non-conforming mortgages. Other lenders have developed a strategy of holding non-conforming mortgages and selling conforming mortgages. Non-conforming mortgages, whether because they exceed the conforming limit (jumbos) or because they do not meet all of the underwriting criteria of the agencies, still can be well underwritten and of high quality. There are occasions where a lender may need to make an accommodation in underwriting the loan such that it does not qualify under the secondary market rules. When this occurs, the ability of these loans to be placed into the lender's portfolio ensures a broader section of the community has access to home loans.

U.S. banks and thrifts held $2.4 trillion in residential mortgage loans on their books at March 31, 2013. Of the $2.4 trillion 43 percent was held by smaller financial institutions.

Community financial institutions also play a significant role in supporting liquidity in the mortgage-backed securities market through purchases of MBS securities. As of March 31, 2013, banks and thrifts held $1.7 trillion on their balance sheet with smaller financial institutions holding approximately $0.8 trillion. Community banks and thrifts with total assets of less than $10 billion held $0.3 trillion of these mortgage-backed securities.

Community financial institutions often prefer to retain servicing of their mortgage originations, including those sold into the secondary market. The primary reason is to maintain the personal customer relationship between the community financial institution and their customers. While the mortgage servicing industry has undergone significant consolidation over the past decades, community financial institutions continue to strive to maintain high quality and cost effective servicing for their customers. As of March 31, 2013, the top ten mortgage servicers serviced $6.2 trillion of residential mortgages, or 79 percent of the total and the remainder – primarily community financial institutions – serviced $1.7 billion, or 21 percent of the total.

Community financial institutions maintain a disciplined approach to managing risks, including risks on their balance sheet. As such, community financial institutions will have limits as to the levels of fixed- rate residential mortgage loans that they desire to carry on their balance sheet. Therefore, it is not uncommon that these financial institutions need to sell off portions of their new mortgage loan originations into the secondary market. During the first quarter of 2013, small financial institutions and mortgage lenders sold $78 billion to Fannie Mae and Freddie Mac.




**Community Financial Institution Challenges in Mortgage Finance and the Secondary Market**

Community financial institutions have always played a critical role in housing and mortgage finance in support of their local communities. But today they face enormous challenges and uncertainty.

The FHLBanks are currently conducting a survey of our members to determine the issues that are impacting their mortgage business and what role they would like the FHLBanks to play in support of their mortgage activities moving forward. Some of the initial results would indicate a high level of uncertainty regarding their ability to continue to profitably make residential mortgages.

Much of the concern relates to new rules around qualified mortgages and the capital requirements under the new Basel III rules. Although some of these proposed rules were recently finalized with changes favorable to community financial institutions, there continues to be a high level of concern with the time, attention, resources and costs needed to comply.

One favorable change in Basel III relates to risk-based capital (RBC) rules for credit enhancements that would impact the credit enhancement members provide under the MPF Program. During the Program's nearly 16 plus year history, the RBC rules have been somewhat punitive given the superior credit performance of the loans as the rules did not seem to fully account for the credit structure supporting the loans or the FHLBank's first loss account (FLA) designed to cover normal and expected losses. The newly adopted Basel III rules more appropriately account for the FLA and provide a much better result in terms of required RBC. We hope that members would be given the option to apply this treatment earlier than the implementation date of Basel III. At the same time, however, the formulas applied to the credit structure are relatively complicated and our members will require education and assistance to comply with the new rules and calculations.

Increased regulation - combined with the possibility that larger financial institutions will have an increased aggregation role moving forward - is very troubling to our members. Our members value the ability to underwrite the mortgages made in their communities and to continue to service the loans. Both of which would be greatly diminished if selling to larger aggregators or securitization sponsors is the only path to the secondary markets in the future.

Freddie Mac recently announced their intent to charge a $7,500 fee to originators with less than $5 million in annual business – many of which would be community-based financial institutions. In 2012, approximately 40 percent of the FHLBank of Topeka's participating members sold less than $5 million into our MPF Program. While Freddie Mac subsequently rescinded their low activity fee, we believe that this illustrates how a large aggregator may work with small community-based institutions.

There are other challenges created by new and proposed regulations governing mortgage servicing and mortgage loan originations that will add to the cost and complexity of regulatory compliance. While there has been much discussion on finding ways to reduce this burden on community financial institutions, more needs to be done.

**FHLBank Support of Mortgage Lenders**

The FHLBanks play a variety of important roles in supporting community financial institutions in their role of financing homes.

Our community financial institutions use advances from the FHLBanks in a variety of ways. On a broad level, the FHLBanks provide a key supplement to the deposit funding institutions primarily rely on. Today, community financial institutions are experiencing strong deposit growth, but this is not typical. When businesses and communities are growing, community financial institutions experience strong loan demand. Meeting that loan demand just from deposits is generally not an option and that is when community financial institutions rely on their FHLBanks to provide additional funding.

For portfolio lenders, it is important to manage the interest rate risk involved in longer term fixed rate loans. The FHLBanks offer a variety of advance products to meet the needs of those lenders. Members can obtain long-term fixed rate funding to match the mortgages held in portfolio. Amortizing advances are available that can be matched to a portfolio of mortgages the member holds. Advances are available that allow the member the option to prepay the advance without fee to match the convexity of the member's mortgage portfolio. The FHLBanks also provide technical assistance to members in understanding how to quantify and manage the interest rate risk from a portfolio of fixed rate loans. When a community financial institution sells to other institutions, FHLBanks will provide warehouse lending, funding the loan between the time the loan is closed and the loan is sold.

We support their secondary market needs through our MPF and MPP programs when they have loan originations that they do not wish to hold in their portfolios. Our MPF and MPP program's premise rests on the simple, yet powerful, idea that by combining the credit expertise of a local lender with the funding and hedging advantages of the FHLBanks, a stronger, and more economical and efficient method of financing residential mortgages would result. These mortgage programs give mortgage lenders the best options of mortgage lending – lenders retain the credit risk in their loans and transfer the interest rate and prepayment risks to the FHLBank. Participating financial institutions are able to preserve their customer relationships and are paid to manage the credit risk of their customers. These programs charge no lender surcharges – allowing smaller community financial institutions equitable access and the ability to more effectively compete in the mortgage finance market against their larger competitors.

A majority of community banks, thrifts and credit unions participating in the mortgage programs hold approximately $1 billion or less in total assets and are more comfortable dealing with their FHLBank than selling directly to Fannie Mae. These members already have a relationship with their FHLBank and obtain better pricing through the FHLBanks. Small banks, thrifts and credit unions do not have sufficient volumes to qualify for discounts on guarantee fees charged by Fannie Mae to protect against credit losses. The volume pricing available to the FHLBanks and passed on to small community financial institutions is a huge benefit that allows them to compete on rates against larger financial institutions and mortgage lenders. The MPF program also allows small banks, thrifts and credit unions to retain mortgage servicing and maintain more control over the customer relationship. Community lenders can retain servicing or can work with the servicers approved for the program.

Some of the FHLBanks offer a product called MPF Xtra. Through MPF Xtra, mortgage loans are aggregated through FHLBanks and sold to Fannie Mae. This service complements our other mortgage programs. More notably, the program provides a crucial service to community financial institution members that want to continue to make home loans. For our members that want 30-year fixed-rate mortgages to be available at a competitive price, our role as an aggregator and our price point compare favorably with selling directly to Fannie Mae.

There are numerous other ways in which community financial institutions and the FHLBanks partner to serve their communities. From providing letters of credit for securing public unit deposits to providing direct grants to support low- to moderate- income housing, the FHLBanks partner with community financial institutions to serve the public.

**S. 1217 – the "Housing Finance Reform and Taxpayer Protection Act of 2013"**

The Council welcomes the opportunity to share with you our views on housing finance reform generally, and more specifically our views on the recently introduced bill S. 1217 – the "Housing Finance Reform and Taxpayer Protection Act of 2013." We commend you for your extensive efforts in working to achieve a sustainable housing finance system for the future that does not expose the taxpayer to unnecessary risk.

The Council believes that the FHLBanks have a critical role to play in serving their members in the housing finance system of the future. The unique characteristics of the FHLBank System that have made it possible for the FHLBanks to carry out their mission of serving their members and their communities (their regional, scalable, self-capitalizing, cooperative structure; broad participation by a diverse membership; and dependable access to a deep, liquid market for FHLBank debt) should be maintained in a future housing finance system. The FHLBanks have demonstrated their role as a safe and reliable provider of liquidity throughout the recent financial crisis, and their regional, self-capitalizing, cooperative structure will enable them to serve their members' needs in a safe and sound manner in a future housing finance system.

We are pleased that S.1217 recognizes the importance of maintaining a role for institutions of all sizes in the housing finance system of the future, and contains provisions intended to preserve equal and reliable secondary market access for small and mid-size community financial institutions to help maintain reliable access to mortgage credit throughout all parts of the country. We appreciate that the bill provides different options for the FHLBanks to serve their members as the housing finance system of the future evolves. With the support and guidance of our members, we are open to exploring opportunities to expand our support of community lenders. At the same time, we emphasize the paramount importance of maintaining and protecting our continuing role as a reliable source of liquidity for our members.

We look forward to working with you and your members as the legislative process moves forward.

## Conclusion

Over their long history, the FHLBanks have played a critical role in supporting their member financial institutions' ability to meet the housing finance and credit needs of their local communities in all economic cycles and in all parts of the United States. The FHLBank cooperative model performed exceptionally well throughout one of the worst financial crisis in this nation's history, without requiring any taxpayer assistance. The FHLBanks remain economically strong today and continue to serve a vital function for their financial institution members and the communities they serve.

Chairman Tester, Ranking Member Johanns, and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the FHLBanks and housing finance reform. I would be happy to answer any questions you have.