2004

PRIORITY ISSUES

Policy & Advocacy

Cover Photo: ACB banker members visit Washington each year. Pictured here are Pennsylvania members.

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America's Community Bankers has adopted a wide-ranging set of positions that reflect the breadth of our membership and their interests. Each was developed with extensive input from community bank members and their representatives on our Government Affairs Steering Committee and Board of Directors.

ACB's Action Priorities for 2004 are:

- Mission and Regulation of Fannie Mae and Freddie Mac;
- Regulation of the Federal Home Loan Bank System;
- National Predatory Lending Standards;
- Credit Unions' Taxation & Regulation;
- Regulatory Capital Standards;
- Tax Incentives for Savings and Investment; and
- Bankruptcy Reform.

These priorities reflect the importance of home lending to our members and their communities; our concerns about equitable tax, regulatory and capital treatment for community banks; the importance of savings incentives; and the need to ensure greater personal responsibility in the nation's financial system.

In addition to holding a tight focus on these key action areas, ACB will continue to stand for fundamental policy principles. These include:

- Maintaining charter choice;
- Promoting the value of the mutual institution charter;
- Maintaining our effective bank regulatory structure;
- Improving financial literacy; and
- Supporting the efforts of minority-owned and multi-cultural financial institutions.

You can find our positions on all of our issues, plus more detail about our action priorities, in America's Community Bankers 2004 Policy Positions handbook and at **www.AmericasCommunityBankers.com**.

Mission and Regulation of Fannie Mae and Freddie Mac

ACB Position

ACB recommends policy makers strengthen safety and soundness oversight for Fannie Mae and Freddie Mac. Mission oversight should also be strengthened to ensure their congressionally mandated secondary market role. They should not use the benefits of their quasi-government agency status to enter the primary market or discourage competition by private companies in mortgage lending, servicing, and related markets.

To accomplish these goals, ACB recommends the following:

- Strengthen the safety and soundness regulation of Fannie Mae and Freddie Mac *(see GSE Regulatory Reform on pg. 5 for details)*;
- Maintain a clear distinction between "primary" and "secondary" market activities;
- Fannie Mae and Freddie Mac should not market directly to consumers or use technology to enter the primary market;
- The method of calculating the conforming loan limit should not set higher regional limits or higher limits in states with high-cost metropolitan areas;
- Fannie Mae and Freddie Mac's housing goals should focus more directly on affordable housing;
- Fannie Mae and Freddie Mac should enhance their financial disclosures, but they should not be required to register their debt with the SEC.

ACB opposes proposals to revoke or limit Fannie Mae and Freddie Mac's Treasury line of credit or to eliminate their GSE status.

Explanation

The secondary mortgage market is a valuable tool for the nation's home lenders. It provides liquidity and helps them manage interest rate risk. The secondary market also improves the

distribution of capital so that it is available in all regions.

To help achieve these purposes and increase the availability of financing for affordable housing, Fannie Mae and Freddie Mac receive significant statutory benefits not provided to other firms in the mortgage market. Unless Fannie Mae and Freddie Mac are prevented from participating in the primary market they could become dominant, squeezing out competition necessary to meet diverse credit needs.

ACB has identified a number of activities that serve no legitimate secondary market purpose and are outside the scope of Fannie Mae and Freddie Mac's charters.

- Identifying, soliciting, or contacting potential borrowers;
- Advising, prequalifying, and counseling borrowers;
- Negotiating and setting loan terms and options;
- Taking loan applications, obtaining third-party reports (such as appraisals), and loan processing;
- Making decisions to extend credit;
- Providing or obtaining mortgage insurance;
- Loan document preparation;
- Obtaining or providing other settlement services;
- Creation of Freddie Mac and Fannie Mae Internet sites and toll free numbers targeted at consumers;
- Using automated property valuation models which crowd out competing systems;
- Promoting their corporate "brands" through advertising and other promotional activities directed to consumers.

Primary market lenders have consistently outperformed Fannie Mae and Freddie Mac in providing loans to low-income families and to borrowers in underserved rural and central city areas. Fannie Mae and Freddie Mac should work to improve their performance in those areas, rather than seeking ways to increase the upper limits on conforming loans. Proposals to increase the limits in high-cost areas or in entire states

would not serve any public purpose and might further undermine the GSE's statutory commitment to finance affordable housing and provide credit in underserved areas.

Recent accounting irregularities have highlighted the need for enhanced financial disclosure by Fannie Mae and Freddie Mac. However, the benefits of enhanced disclosure can be realized through registering the GSEs' equity securities. Given the volume of their issuances, it would be burdensome and costly to the nation's homeowners for the GSEs to register their debt.

As long as Fannie Mae and Freddie Mac remain committed to their secondary market role, ACB opposes reducing or eliminating their line of credit with the Treasury. Similarly, we oppose eliminating their GSE status through privatization.

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J. Edward Norris, III, Chairman, President & CEO, Plantation Federal Bank, Pawleys Island, SC, testifies before the Federal Housing Finance Board

GSE Regulatory Reform

Both the Administration and Congress have proposals to strengthen regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

ACB strongly supports ongoing efforts to strengthen the regulation of the housing government sponsored enterprises, Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Any new regulator must have these key characteristics:

- Be independent of the political process;
- Have authority to determine its budget outside the Congressional appropriations process; and
- Have supervision and enforcement powers equivalent to those of the federal banking regulators, including the ability to set capital levels.

The agency that regulates Fannie Mae and Freddie Mac must possess authority over programs and mission as well as safety and soundness.

Regulation of the FHLBank System can be provided by a consolidated GSE regulator, but only if adequate safeguards are provided to recognize and maintain the unique characteristics of the System and ensure the FHLBanks' access to the capital markets.

Regulation of the Federal Home Loan Bank System

ACB Position

ACB believes that the FHLBanks should continue to operate as cooperatives owned by their members. The FHLBanks should maintain their primary mission – housing and community development funding – while addressing their members' changing needs.

To accomplish these goals, ACB supports the following:

- Strengthen the regulation of the FHLBank System *(see GSE Regulatory Reform on pg. 5 for details)*;
- Enhance the FHLBanks' financial disclosures without making them subject to inappropriate SEC regulation;
- Improve the FHLBanks' corporate governance by increasing the role of stockholders and improving the qualifications and financial acumen of all directors;
- Maintain a strong and effective capital structure for the FHLBanks; and
- Develop industry-wide consensus on issues such as multi-district FHLBank membership and Acquired Member Assets programs.

Explanation

ACB members hold more than half of the stock in the FHLBanks. For many of them it is their single largest asset. They depend on FHLBank advances to fund home mortgage lending. Thus, the FHLBanks are vitally important to ACB members and, ultimately, to America's homeowners.

ACB believes the FHLBank System's regulator, the Federal Housing Finance Board, should adopt an enhanced financial disclosure regime for the FHLBanks. It should not require the FHLBanks to give up their long-standing exemption from SEC registration. SEC registration could lead to substantial operational and accounting difficulties,

making it difficult for the FHLBanks to fulfill their statutory housing mission.

The FHLBanks' financial structure is becoming more complex and the System is expanding and moving in new directions. Thus, it is vital that both elected and appointed FHLBank directors have the skills to properly oversee the System.

Members of the FHLBanks provide the capital necessary to support the System and its activities. The Finance Board (or its successor agency) should continuously monitor the implementation of the capital plans mandated by the Gramm-Leach-Bliley Act of 1999. The FHLBanks should modify these plans to require individual members to provide capital support for their individual activities. This would be better than asking all of the members – whether or not they participate – to indirectly support these activities through an excessive increase in retained earnings.

Two other important issues confront the System. First, several of the FHLBanks are seeking changes in the Acquired Member Assets (AMA) programs. These programs buy mortgages from FHLBanks. Second, the FHLBank System is faced with proposals to permit institutions to join more than one FHLBank. ACB supports multi-district membership (MDM) if the Finance Board determines it is currently authorized by statute.

ACB believes all members of FHLBank System should have an opportunity to participate in the resolution of the AMA and MDM issues so that the cooperative nature of the System is maintained.

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National Predatory Lending Standards

ACB Position

ACB is committed to ensuring that all Americans have fair and equitable access to credit, and that consumers have the necessary skills to make wise credit and other financial decisions. ACB also supports the development of a national legislative response such as provisions in the Ney-Lucas proposal, the "Responsible Lending Act" (H.R. 833). H.R. 833 would establish national uniform standards to combat predatory lending practices, avoiding a patchwork of state and local laws that could disrupt the national market for real estate credit.

Explanation

A uniform national standard would help consumers by:

- Preventing abusive and deceptive lenders from shopping for venues that lack tough laws and enforcement capability;
- Promoting efforts to educate consumers to help them defend themselves against predatory lending;
- Reducing costs for both consumers and businesses by maintaining an efficient national credit market; and
- Improving consumer access to credit and permitting lenders to reward good performance with lower rates.

Vigorous enforcement of anti-predatory lending laws with respect to unsupervised lenders is critical, whether or not Congress enacts a uniform national standard. The joint report by the Federal Reserve Board and the Department of Housing and Urban Development issued in 1998 acknowledged this, stating: "Abusive mortgage loans are not generally a problem among financial institutions that are subject to regular examination by federal and state banking agencies. Abuses occur mainly with mortgage creditors and brokers that are not subject to direct supervision."

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Credit Unions’ Taxation & Regulation

ACB Position

Credit unions that expand beyond their traditional role and operate like banks should pay taxes and comply with the Community Reinvestment Act (CRA). Until these credit unions pay taxes and comply with the CRA, the National Credit Union Administration (NCUA) should stop expanding their fields of membership and lending powers. Congress should also reject proposals to give credit unions additional powers.

Explanation

Congress chartered credit unions in 1934 to serve people of modest means who have a common bond, such as employment. In return, credit unions were made exempt from taxation and Congress did not include them in the CRA. However, in October of 2003, the General Accounting Office (GAO) found “that credit unions served a slightly lower proportion of low- and moderate-income households than banks.”

There are now two distinct credit union industries. One operates as intended. The other, comprising most of an industry with over $600 billion in assets, competes directly with tax-paying banks but are exempt from taxes and the CRA. The current Administration budget projects that credit unions will receive an $8 billion federal tax break between 2005 and 2009.

The credit union regulator, NCUA, has abetted this shift in credit union focus by:

- Expanding the community charter by liberalizing the definition of local community and making it easier to add new communities;
- Repealing the Community Action Plan, which would have imposed community reinvestment requirements;
- Rejecting the Treasury’s request that it impose a credit-risk capital requirement for corporate credit unions; and

- Ignoring Treasury's concern that liberalized business lending regulations do not comply with the Credit Union Membership Access Act's 12.25 percent cap.

The business lending regulation for credit unions is particularly troubling. It says that a credit union does not have to count loan participations it buys from another credit union against the cap, lowers loan-to-value requirements, and lowers business lending capital requirements. These decisions raise significant safety and soundness issues by granting credit unions additional powers while decreasing regulatory requirements.

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ACB's MBank Council, which addresses the needs of financial institutions serving minority and multi-cultural communities, conducts a roundtable discussion with Office of Thrift Supervision officials. From left: Paul C. Hudson, Broadway Federal Bank, Los Angeles, CA; Scott Albinson, OTS managing director for supervision; OTS Director James Gilleran; Wilburn Phillips, Home Federal Savings Bank, Detroit, MI; Council Chairman Joseph M. Guerra, UniBank, Miami, FL; and George E. Gary, Columbia Savings and Loan Assn., Milwaukee, WI

Regulatory Capital Standards

ACB Position

Any new capital standard established for U.S. banking companies should treat similar risks in comparable ways, regardless of the size of the institutions involved. This is essential to avoid competitive inequities. If U.S. regulators apply Basel II standards to very large banks, they must provide an option for other banks to adopt modified capital requirements so that the benefits and incentives of risk-sensitive capital management techniques are available to all U.S. financial institutions.

Explanation

The 1988 Basel I accord established very broad and relatively inflexible risk-based capital standards. For example, all institutions must maintain four percent capital against first mortgages and an eight percent overall capital level to be well-capitalized. The Basel II proposal allows large, complex banks to use their own internal risk ratings to determine their capital requirements.

To implement Basel II, each country would need to adopt regulatory changes. U.S. banking regulators issued an advance notice of proposed rulemaking (ANPR) in June 2003. Under the ANPR, only the 10 to 12 largest U.S. banking organizations with total assets of $250 billion or more (or total on-balance sheet foreign exposure of at least $10 billion) were intended to be covered. Regulators expect an additional 8 to 10 U.S. institutions to adopt Basel II.

While more flexible than Basel I, banks that adopt Basel II will find it costly and complex to implement. As a result, adopting Basel II is not a viable option for community banks.

If the U.S. implements Basel II, our financial institutions will be subject to different capital standards based on size. This could hurt community banks because mortgage and retail

lending enjoy more favorable capital treatment under Basel II.

To avoid this result, U.S. regulators should add more flexibility to the current risk-based capital system, giving institutions the ability to tailor capital requirements to their own risk profiles. Less complex institutions that wish to develop internal risk-management models should have that option. This additional flexibility under Basel I should be uniformly available to commercial banks and savings institutions.

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The Hon. Michael Oxley, Chairman, House Committee on Financial Services, with William W. Zuppe, ACB Chairman and Chairman & CEO, Sterling Savings Bank, Spokane, WA

Tax Incentive for Savings and Investment

ACB Position

ACB strongly urges Congress to enact legislation that broadens the types of tax-favored savings vehicles available to consumers. ACB supports saving incentives such as the Lifetime Savings Account (LSA), the Retirement Savings Account (RSA), and the Employer Retirement Savings Account (ERSA) proposed by President Bush. We also support retention of the traditional deductible Individual Retirement Account (IRA) because it attracts savers who need an upfront tax deduction. ACB recommends a $1,000 tax exemption for interest on deposit accounts paid to individuals.

ACB also supports the "Community Development Home Ownership Tax Credit Act," which would create a tax credit for developer/investors that build or substantially rehabilitate homes for sale to low-income buyers in targeted communities.

Community bank deposit accounts should be approved investment vehicles for Section 529 college savings plans.

Explanation

A $1,000 tax exemption for the first $1,000 in interest earned on deposit accounts will encourage savings. It will also help prevent an outflow of funds from community banks that may be caused by the tax exemption for dividends, enacted as part of the "Jobs and Growth Tax Relief Reconciliation Act of 2003."

The "Community Development and Home Ownership Tax Credit Act" is based on President Bush's proposed "Renewing the Dream Tax Credit." The Act would encourage investors to provide private capital to build or rehabilitate homes for sale to low-income families in lower-income and distressed communities.

Section 529 college savings plans have become a popular investment for parents saving funds to send their children to college. Most of the plans set up by states do not include deposit accounts of community banks or other regulated financial institutions as allowable investments, which deprives community banks and the economics they serve of access to this source of long-term funds.

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Fredrick Willets, III, Chairman, President & CEO, Cooperative Bank, Wilmington, NC, discusses flood insurance with the Hon. Robert Ney, Chairman, House Subcommittee on Housing and Community Opportunity

Bankruptcy Reform

ACB Position

ACB supports the following reforms of the nation's bankruptcy laws:

- Needs-based bankruptcy;
- A limitation on repeat filings;
- The elimination of cramdowns;
- The ability to proceed against non-bankrupt co-debtors; and
- Elimination of unnecessary creditor representation requirements.

Explanation

During five of the past six years, even in times of record economic expansion, there have been more than one million bankruptcy filings each year. In 1980, during a very difficult economic period, just 300,000 bankruptcy petitions were filed. If current practices continue, approximately 1 out of every 7 U.S. households will have filed for bankruptcy within this decade. To allow the complete discharge of debts by higher income consumers who have the ability to repay impairs credit availability and unfairly raises costs to other consumers.

Bankruptcy should not be a mere convenience or financial planning tool for the rich, but rather should be a safety net for those who genuinely need it. The following elements are essential for reform, and have been the basis of bills passed in recent years in both houses of Congress.

Needs-based Bankruptcy – A needs-based system would distinguish between debtors who have virtually no assets or earning power and those with higher incomes and the ability to repay all or a portion of their indebtedness. Debtors with no assets or earning power should receive a Chapter 7 discharge, while debtors with the ability to repay all or a portion of their obligations should be required to establish a repayment plan.

Repeat Filings – The Bankruptcy Code currently permits a debtor to file under Chapter 7 (debt discharge) every six years and places no limitation on Chapter 13 (repayment plan) filings. In addition, the Code permits unlimited conversion from Chapter 13 to Chapter 7. The Code further permits debtors to file for bankruptcy solely to delay resolution of the estate. Debtors who file for bankruptcy more than once a year should not receive the benefits of the automatic stay.

Cramdowns – Before 1993, many bankruptcy courts routinely reduced the value of secured liens to an amount equivalent to the market value of the collateral (at the time of bankruptcy) and designated the remaining value as unsecured. In the Nobelman case, the Supreme Court ruled that this cramdown procedure was improper in connection with a debtor's principal residence. However, some district courts have held that, under certain circumstances, the secured liens on residential real estate can be crammed down. Therefore, it is necessary to codify the language from Nobelman.

Co-debtor Automatic Stay – The current Bankruptcy Code extends the benefits of the automatic stay achieved in Chapter 13 to co-debtors. Creditors should be permitted to pursue co-debtors who are not involved in the bankruptcy system.

Creditor Representation – Ordinarily, the creditor need not be represented by an attorney in a creditors meeting at which the debtor appears and submits to examination under oath. However, if the case involves less than $5,000 in assets, the creditor must be represented by an attorney. Creditors should be allowed to represent themselves in all bankruptcy proceedings.

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About America's Community Bankers

America's Community Bankers represents the nation's community banks. Our members, whose aggregate assets total more than $1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

ACB seeks free, fair, and open competition, and we provide community banks with the tools they need to compete effectively and to help their communities grow.

ACB members have diverse business strategies based on housing finance, consumer and business financial services and community development. They have pioneered major innovations in helping consumers obtain much-needed products and services, such as interest-bearing checking accounts and flexible mortgages. They provide capital for local businesses and help build their communities by lending to religious institutions, schools and hospitals.

Customer deposits in ACB member institutions are federally insured by the Federal Deposit Insurance Corporation (FDIC). The primary federal regulators of ACB member institutions include the FDIC, the Office of Thrift Supervision, the Office of the Comptroller of the Currency and the Federal Reserve. ACB's diverse membership includes both stock and mutual institutions, some of which are federally chartered and others are state-chartered. We are committed to preserving the safety and soundness of our nation's banking system and giving community banks the flexibility to provide consumers with the products and services they need in the most cost-efficient way.

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George Loban, Co-Chairman and President, First Federal FSB, Hastings, MN, testifies before the House Financial Services Committee on preservation of the Fair Credit Reporting Act

COMPAC

America's Community Bankers Community Campaign Committee (COMPAC) is a political action committee that was established to raise funds and support candidates who understand our industry. COMPAC is a voluntary, bipartisan fund and every dollar contributed goes directly to support federal candidates. Only individual contributions are acceptable.

Your contribution to COMPAC is an investment in the future of your industry, your institution and your community. Decisions made by Congress impact how we operate and compete effectively in today's economy. COMPAC contributions maximize the impact of America's Community Bankers by supporting candidates who are willing to listen to us and address our concerns. It is critical that your issues are heard by members of Congress.

COMPAC

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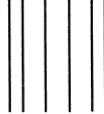

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2004 CAPITOL HILL VISITS FEEDBACK FORM

1. Member(s) of Congress with whom you met.

2. Did you meet with the Member personally?
   - ❑ Yes
   - ❑ No

3. Name and title of any staff at the meeting:

4. When did your meeting occur (date & time):

5. How many people were in your delegation?

6. Which issues did you discuss?
   - ❑ Regulation of Freddie Mac and Fannie Mae
   - ❑ The Federal Home Loan Bank System
   - ❑ Predatory Lending
   - ❑ Credit Unions
   - ❑ Capital Standards
   - ❑ Tax Incentives for Savings and Investment
   - ❑ Bankruptcy Reform
   - ❑ Other ______________________________

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7. What ACB Legislative follow-up is needed?

Comments ______________________________

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YOUR NAME, INSTITUTION, CITY, STATE

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