



Statement of

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“Chairman’s Housing Reform Outline: Part 2”

Before the

United States Senate Committee on Banking, Housing, and Urban Affairs

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## Introduction

Good morning, Chairman Crapo, Ranking Member Brown, and Members of the Committee. My name is Carrie Hunt, and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) where I serve as Executive Vice President of Government Affairs and General Counsel. I appreciate the opportunity to share NAFCU's views on housing finance and the Chairman's Housing Reform Outline. In addition to our testimony, NAFCU member credit unions look forward to continuing to work with you beyond today's hearing to ensure access to the secondary mortgage market for credit unions and their 116 million members.

### Credit Union Principles in Housing Finance Reform Efforts

As the future of housing finance has become a focal point in Congress, the Administration, and among regulatory agencies, NAFCU has established an updated set of principles that the association would like to see reflected in any reform efforts. The objective of these principles is to help ensure that credit unions are treated fairly during any housing finance reform process. The following are NAFCU's housing finance reform principles:

- **A healthy, sustainable and viable secondary mortgage market must be maintained.**  
Credit unions must have unfettered, legislatively-guaranteed access to the secondary mortgage market. In order to achieve a healthy, sustainable and viable secondary market, there must be vibrant competition among market participants in every aspect of the secondary market. Market participants should include, at a minimum, at least one government-sponsored enterprise (GSE), the Federal Home Loan Banks (FHLBs), Ginnie Mae, and private entities.
- **The U.S. government should issue an explicit government guarantee on the payment of principal and interest on mortgage-backed securities (MBS).**  
The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in MBS, and facilitate the flow of liquidity through the market.
- **The GSEs should be self-funded, without any dedicated government appropriations.**  
Although the U.S. government should be involved in the secondary mortgage market, the GSEs should not be government-funded mortgage programs. The GSEs' fees should provide the revenue necessary for sustained independent operation. Those fee structures should, in addition to size and volume, place increased emphasis on the quality of loans. Risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of the GSEs' securities.

- **Creation of a Federal Housing Finance Agency (FHFA) board of advisors.**  
 A board of advisors made up of representatives from the mortgage lending industry should be formed to advise the FHFA regarding the GSEs and the state of the secondary mortgage market. Credit unions should be represented in such a body.
- **The GSEs should be allowed to rebuild their capital buffers.**  
 Rebuilding capital buffers ensures the safety and soundness of the GSEs, maintains investor confidence, prevents market disruption, and reduces the likelihood of another taxpayer bailout in the event of a future catastrophic market downturn. The GSEs should be permitted to begin rebuilding capital slowly over a period of several years.
- **The GSEs should not be fully privatized at this time.**  
 There continues to be serious concerns that in a fully privatized system, in which the GSEs are sold off to the secondary market, small, community-based financial institutions could be shut out of the secondary market. Any privatization efforts should be gradual and ensure that credit unions have continued access to the GSEs and the secondary mortgage market.
- **The FHLBs must remain a central part of the mortgage market.**  
 The FHLBs serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Housing finance reform must take into account the consequence of any legislation on the health and reliability of the FHLBs.
- **Credit risk transfer (CRT) transactions should be expanded and the Common Securitization Platform (CSP) and Single Security retained.**  
 Although there are concerns regarding credit unions' ability to participate in certain CRT transactions, the GSEs should continue to expand CRT as well as initiatives to create deeper mortgage insurance to further disperse risk among private investors. Credit unions should be permitted to participate in transactions such as front-end CRTs through a special purpose vehicle, such as a credit union service organization or the FHLBs. The CSP and Single Security have the potential to simplify the sale of loans to the GSEs and allow greater, more affordable access to the secondary mortgage market.
- **The FHFA or its successor should continue to provide strong oversight of the GSEs and the new system, whatever it may look like.**  
 A strong, reliable single federal regulator helps to provide consistency and focus to the GSEs so they can stay on track with their core missions and objectives. The FHFA helps maintain safety and soundness in the secondary mortgage market. A new system should also utilize the current regulatory framework and GSE pricing and fee structures.

- **The transition to a new system should be as seamless as possible.**  
Regardless of whether the GSEs in their current form are part of a new housing finance system, credit unions should have uninterrupted access to the GSEs or their successor(s) and the secondary mortgage market as a whole, in particular through the cash window and small pool options.

### **Background on Credit Unions and Credit Union Mortgage Lending**

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created as a way to promote thrift and make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes” (12 § USC 1752(1)). Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for over 116 million Americans. Despite the passage of over 80 years since the *Federal Credit Union Act* was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low-cost, personal financial services; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation’s approximately 5,400 federally-insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions, united by a common bond, all credit union members have an equal say in the operation of their credit union—“one member, one vote”—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

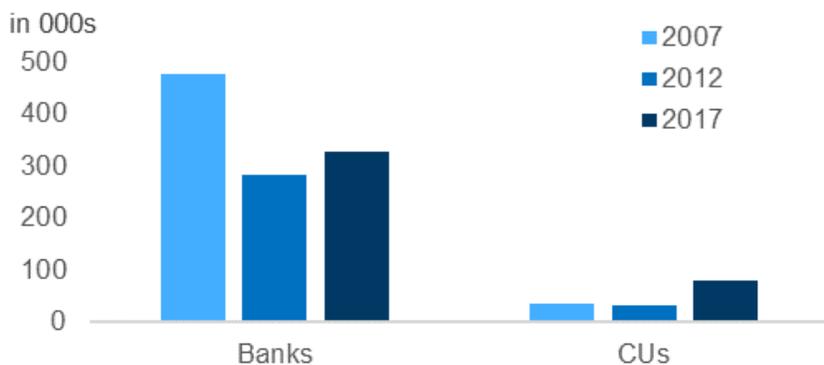
Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. Since the Great Recession, consolidation of the commercial banking sector has progressed at an increasingly rapid rate. With the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers’ minds has begun to shift not only to

services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

As has been noted by Members of Congress across the political spectrum, credit unions were not the cause of the Great Recession, and an examination of their lending data indicates that credit union mortgage lending outperformed bank mortgage lending during the recent downturn. This is partly because credit unions did not contribute to the proliferation of subprime loans. Before, during, and after the financial crisis, credit unions continued to make quality loans through sound underwriting practices focused on providing their members with solid products they could afford.

In addition, both during and after the crisis, credit unions have been committed to helping the portions of their communities that are most in need with high quality products and services. Recent *Home Mortgage Disclosure Act* (HMDA) data indicates the extent of credit union lending to communities within census tracts defined as “distressed” in 2007 by the Federal Financial Institutions Examinations Council (FFIEC). As evidenced in the chart below, the one-to-four family, first-lien purchase loan originations made by credit unions in these communities held up better through the Great Recession than those made by banks (from 2007 to 2012, there was a 33 percent decline in credit union mortgages versus a 59 percent decline in bank mortgages). In 2017, credit unions expanded their mortgage loan originations by 70 percent in these “distressed” areas as compared to 2007, whereas bank mortgage lending actually decreased by 46 percent during that same period. This is just one example of credit unions’ willingness to serve communities that other lenders have abandoned.

### Nbr. of Mortgage Originations in Distressed Areas

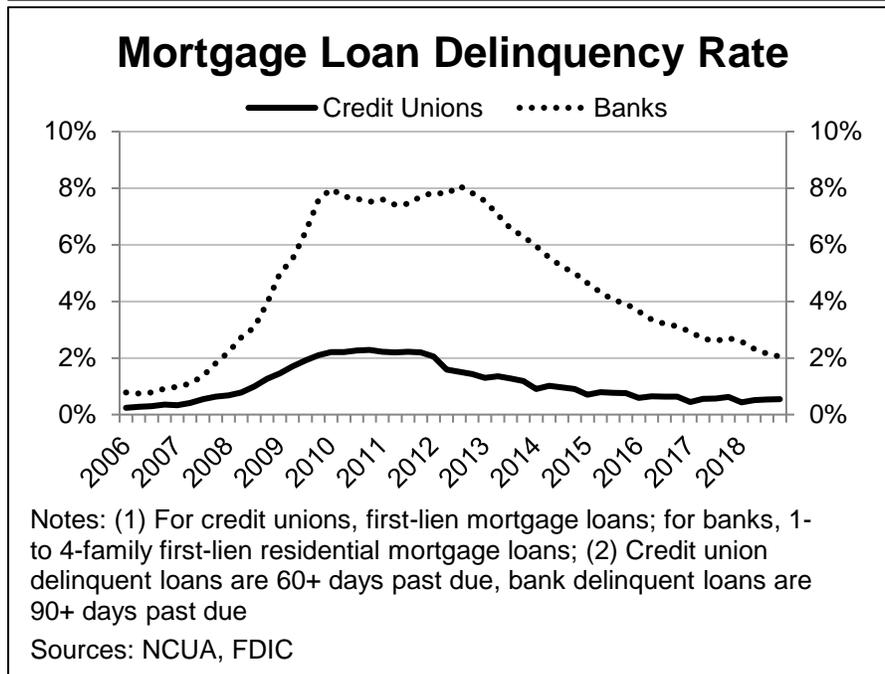
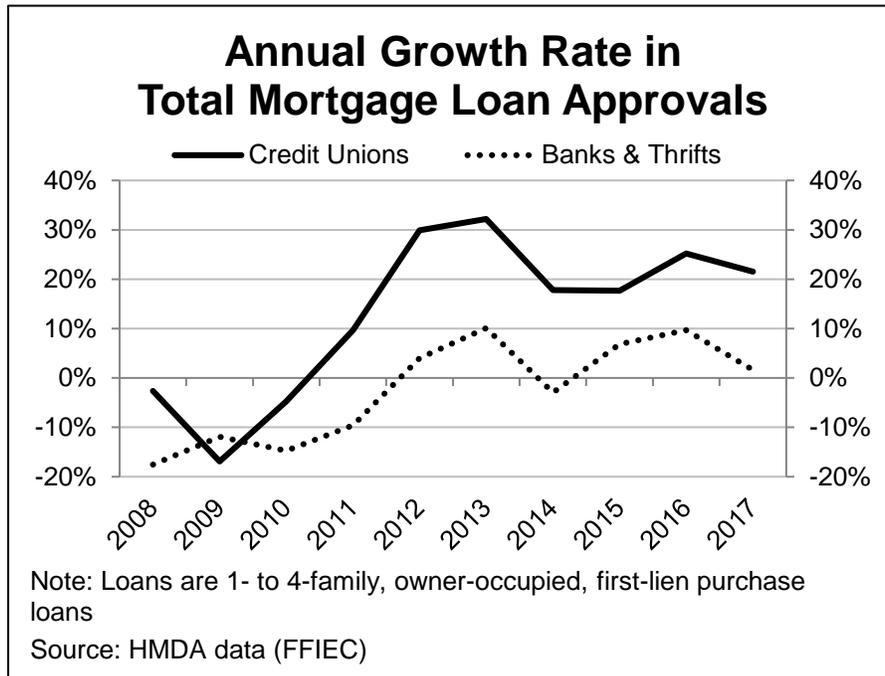


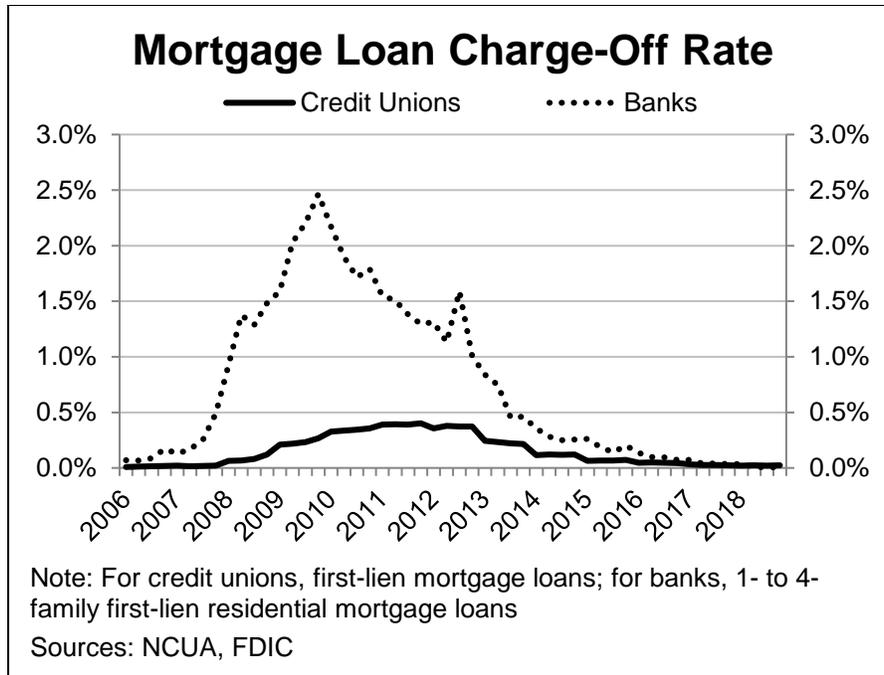
Note: Figures reflect 1- to 4-family, first-lien purchase loan originations in MSAs where median income declined between 2007 and 2012

Source: FFIEC

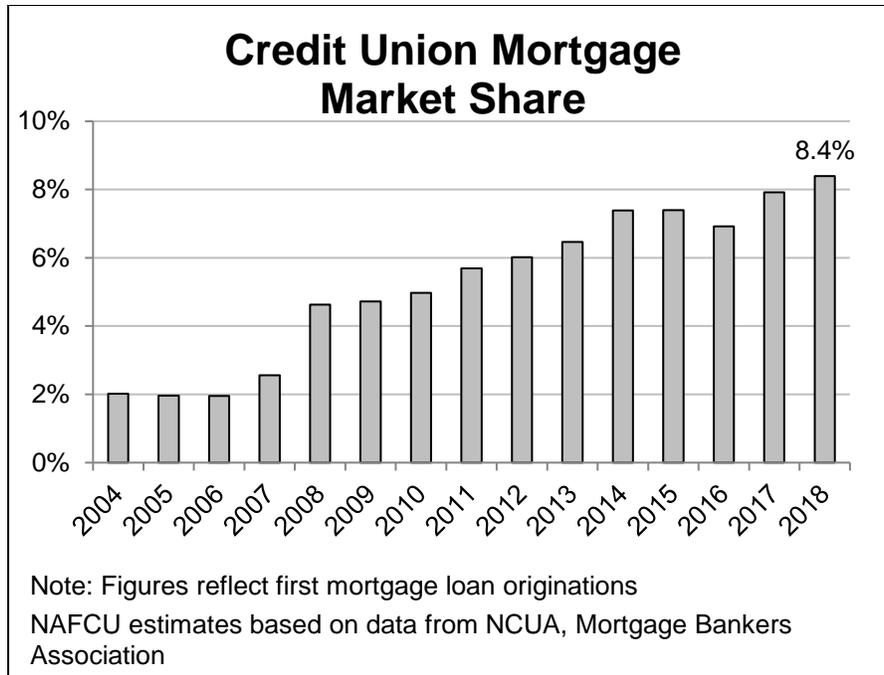
As the housing market continues to recover from the financial crisis, and Congress works to put into place safeguards to ensure such a crisis never happens again, credit unions continue to focus

on providing their member-owners with the basic financial products they need and demand. The graphs below highlight how credit union real estate loan growth has outpaced banks since the downturn and how credit unions have fared better with respect to real estate delinquencies and real estate charge-offs. It is with this data in mind that NAFCU urges members of the Committee to recognize the historical performance and high quality of credit union loans as housing finance reform moves forward.

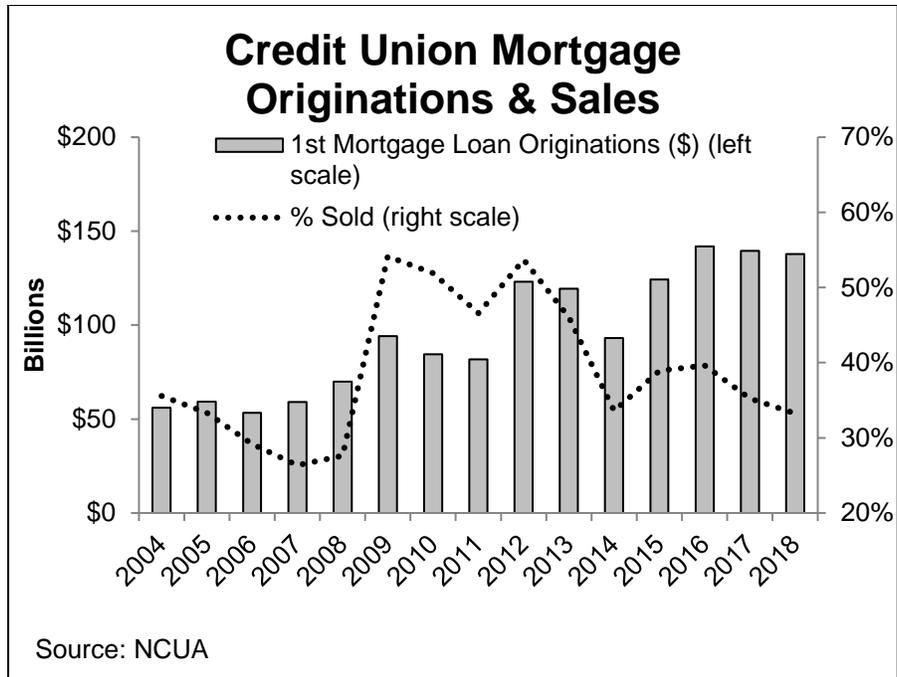




As evidenced in the above charts, credit union mortgage lending continues to be strong, outpacing that of banks on many fronts. The current secondary market set up plays a role in that strength. That is why a primary concern of credit unions in reform is continued, unencumbered access to the secondary mortgage market. This includes adequate transition time to any new system. A second concern, which is equally as important, is the GSEs' (or any secondary market entity's) recognition of the quality of credit union loans through a fair pricing structure. As credit unions originate a relatively low number of loans compared to others in the marketplace—federally-insured credit unions had roughly 8 percent of first mortgage originations in 2018 (see chart below)—NAFCU's member credit unions are opposed to any pricing structure based on loan volume, institution asset size, or other geopolitical issues that could lead to discrimination and disadvantage their member-owners. As such, credit unions should have access to pricing focused on the quality, not quantity of their loans.



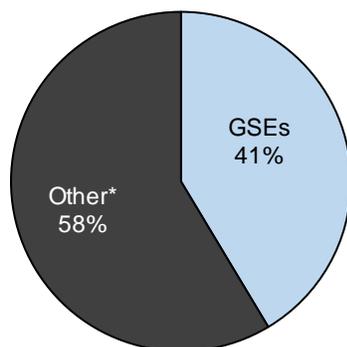
Recent trends in asset portfolios, coupled with the current interest rate environment, present a unique challenge to credit union management. Until recently, interest rates had fallen to record lows, credit unions experienced vigorous share growth, and credit union participation in the mortgage lending arena increased to historic heights. Even though interest rates have begun to return to more normal levels, credit union first mortgage originations remain strong. Between 2007 and 2018, the credit union share of first mortgage originations expanded from 2.6 to 8.4 percent. The portion of credit union first mortgage originations sold into the secondary market increased overall from 26 percent in 2007 to 33 percent in 2018, according to National Credit Union Administration (NCUA) call report data (see chart below).



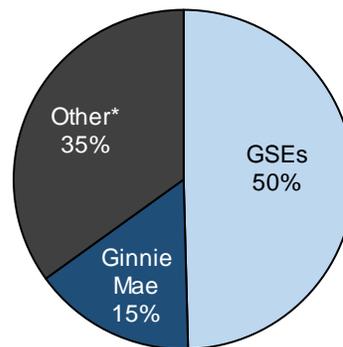
Credit unions hedge against interest rate risk in a number of ways, chief among these is selling products to be securitized and sold on the secondary market. Lenders must have guaranteed access to secondary market sources (including Fannie Mae, Freddie Mac, and the FHLBs) because they are valuable partners for credit unions that seek to sell their fixed-rate mortgages. Not only does the selling of mortgage loans allow credit unions to better manage their risk, but it also means they are able to reinvest those funds to provide new loan products and additional financial services for their members. Responses to NAFCU’s 2018 Federal Reserve Meeting Survey highlight the growing utilization of the GSEs among credit unions. Survey respondents indicated that 23 percent sell mortgages to Fannie Mae, 10 percent sell to Freddie Mac, and another 23 percent sell to both. Additionally, many credit unions’ board policies restrict the percentage of real estate loans that may be held on their balance sheet in order to help mitigate risk. Without these critical relationships to help reduce risk and access liquidity, credit unions would be unable to provide the services and financial products their memberships demand and expect.

HMDA data also shows how heavily credit unions have come to rely on the GSEs when they sell to the secondary market. Between 2007 and 2017, the portion of credit union first mortgages that were sold to Fannie Mae and Freddie Mac grew from 41 percent to 50 percent.

**CU Mortgage Sales by Purchaser Type (2007)**



**CU Mortgage Sales by Purchaser Type (2017)**



\*Includes banks, mortgage banks, credit unions finance or life insurance companies, affiliate institutions, and other types of purchasers

Source: FFIEC

### **Key Elements of the Current System**

As you consider reform, it is important to note that there are many key elements to the current system. Credit union partnerships with the GSEs play an important role in their mortgage lending functions. Programs such as Fannie Mae's Desktop Underwriter® platform and Freddie Mac's Loan Prospector® are important tools for credit unions. They help ensure conformity and consistency across portfolios, whether credit unions sell the loan or not. Using these tools provides credit unions with a level of efficiency that they might not otherwise achieve. Additionally, it enhances the member experience by automating and expediting parts of the loan process. If comprehensive housing finance reform includes any significant changes to these programs, it could have widespread adverse effects on credit union operations.

Access to such technology must be preserved in any new model. The GSEs' tools provide critical benefits to small lenders. There are some opportunities for improvement, including updating the GSEs' antiquated credit risk scoring platform, which would subsequently lessen some punitive results in loan level pricing adjustments borne by the consumer.

Consequently, NAFCU is naturally wary of efforts to eliminate the GSEs. The current aggregation model at the GSEs has had benefits for credit unions. We do not want to see a regression to the previous aggregation model used before conservatorship, where market share agreements with the largest lenders created underwriting exceptions and lower guarantee fees based on volume, not on the underlying loan risk. This priced out smaller lenders and forced them to sell to larger lenders, instead of directly to the GSEs. These practices created huge volumes of underpriced risk that were a part of the predatory culture that precipitated the financial crisis. Instead, we want a system that ensures equal market access for lenders of all sizes and business models and maintains a deep,

liquid market for long-term options. Furthermore, the functions of the cash window at the GSEs (as a single loan execution process and best-efforts loan commitments) are also vital to many credit unions and should be maintained in any new system. The cash window serves as a quick and efficient means of liquidity for credit unions that would otherwise be unable to sell to the GSEs. We are pleased to see the Chairman's outline recognizes this.

### **The Chairman's Housing Reform Outline**

NAFCU would like to thank Chairman Crapo for his thoughtful efforts to advance the housing finance reform debate with the release of his housing reform outline. NAFCU recognizes a number of strengths of the outline, including the requirement of strong capital standards, a guaranteed cash window for small lenders, the prohibition of volume-based discounts, and the preservation of credit risk transfer transactions. We are committed to continuing to work with the Committee as it considers this proposal so that credit unions are afforded the protections necessary to ensure they can continue to provide their communities with access to credit.

NAFCU strongly supports the establishment of a capital framework for the GSEs and other potential guarantors in a future housing finance system. In NAFCU's comment letter to the FHFA, dated November 15, 2018, regarding the recently proposed Enterprise Capital Requirements rule, NAFCU recommended the FHFA focus on working with the U.S. Department of the Treasury to modify the Senior Preferred Stock Purchase Agreements to allow the GSEs to rebuild capital now. The FHFA should also permit the GSEs to submit capital restoration plans, as outlined in the *Housing and Economic Recovery Act of 2008* (HERA). These two steps may be done during conservatorship and are critical for the GSEs to meet the proposed capital standards. NAFCU makes clear that such steps should only be taken if Congress can successfully codify certain improvements that have occurred during conservatorship, including the elimination of pricing discrimination for mortgages sold to the GSEs. As the Committee works on in this area, we urge you to not shut the door to a piecemeal approach to legislative reform so that such protections can be put in place and the GSEs can begin to rebuild their capital should comprehensive reform stall.

Even with a measured, piecemeal approach to reform, NAFCU has concerns about a multiple guarantor model. The tight regulatory structure that guarantors should be subject to in order to avoid some of the past abuses that led to the financial crisis would likely minimize the potential returns from introducing more competition into the housing finance system. In the event of a severe stress event similar to the financial crisis, all of the guarantors may have difficulty maintaining a sufficient volume of loans to securitize, which could lead to guarantor failures and create an even more economically stressful environment.

The more guarantors in the market, the higher the systemic risk. To that end, NAFCU also has questions about the bill's protections against vertical integration. Although insured depository institutions cannot become guarantors, the outline is unclear as to whether non-depository, bank-affiliated institutions, including bank holding companies, could assume this function. Even more concerning is the lack of clarity regarding the potential for non-depository fintech companies that engage in mortgage lending to become guarantors. Both of these scenarios present potential obstacles for credit unions to function on a level playing field with respect to selling their mortgages on the secondary market. These scenarios pose a risk of vertical integration at a guarantor; a possibility that must be prohibited. Although, NAFCU supports a future housing finance system that encourages competition and innovation, tailored regulations must in place to prevent the abuses of the past from reemerging, including predatory lending practices.

NAFCU strongly supports structures that foster vibrant competition; however, there are other ways to encourage competition aside from on the MBS. NAFCU supports the continuation of the Common Securitization Platform (CSP) and Uniform Mortgage-Backed Security (UMBS). The outline only provides that the CSP “*may* be sold or transferred to Ginnie Mae” (emphasis added) and does not provide details on what would become of Common Securitization Solutions, LLC. NAFCU encourages you to consider the potential benefits of a system that incorporates the CSP and UMBS. Guarantors can still compete on technology and other services and will likely be more innovative with the UMBS in place. This would also dramatically reduce the potential for a “race to the bottom” among guarantors, which will protect lenders and consumers and ensure a safe and sound housing finance system.

Relatedly, NAFCU recognizes the importance of a limited government role in the housing finance system, particularly in the form of an explicit government guarantee on the payment of principal and interest on MBS that is reinforced by credit enhancements. Such a guarantee is a key part of the foundation of any successful future housing finance system and should help ensure the continued availability of the 30-year fixed rate mortgage. NAFCU commends the outline's inclusion of a Ginnie Mae guarantee on the payment of interest and principle on MBS.

Despite the potential benefits of a Ginnie Mae explicit government guarantee on MBS, NAFCU is concerned about the potential complications that may arise in a bifurcated system where both Ginnie Mae and the FHFA are responsible for supervising market participants. NAFCU's principles call for a single, strong independent regulator that can provide stability and confidence in the market. The outline is somewhat ambiguous as to the relationship between the FHFA and Ginnie Mae under the new structure, particularly with respect to the governance of each entity. The outline also does not address what will happen with Ginnie Mae's existing MBS program, including providing a guarantee on securities of single-family mortgages originated through the Federal Housing Administration, U.S. Department of Veterans Affairs, and the U.S. Department of Agriculture's Rural Development. As more details of the outline emerge, we encourage you to

ensure that the roles of the FHFA and Ginnie Mae are clearly defined because any ambiguity has the potential to create confusion and potentially conflicting directives for market participants.

Additionally, NAFCU is concerned about the rate at which Ginnie Mae's systems, processes, and procedures can be brought up to the standards envisioned under the bill. The outline proposes a new, much more extensive role for Ginnie Mae in the secondary mortgage market, yet Ginnie Mae currently lags behind Fannie Mae and Freddie Mac in its technological capabilities and focus on services available to lenders. Although Ginnie Mae, in recent years, has made substantial efforts to conduct outreach and provide more service to credit unions, it is important to note that asking Ginnie Mae to step in and fill such a major role in the market would be a huge challenge requiring significant transition time, oversight and flexibility. Although use of the CSP could simplify the transition to Ginnie Mae as well as reduce barriers to entry for new market participants, other technological improvements would still be necessary for an efficient and effective transition. As the Committee considers questions of how to ensure a smooth transition to a future state, NAFCU would like to stress the importance of getting it done right, versus getting it done quickly.

One important aspect of getting it done right is ensuring small lenders can compete on a level playing field. To that effect, NAFCU is disappointed that the outline is silent on the ability of small lenders to retain the servicing rights on loans sold into the secondary market. It is critical for credit unions to maintain a strong, healthy relationship with their members throughout the life of the loan – from origination to maturity – so that certain servicing standards are met and the member remains satisfied with the process. The retention of servicing rights is a key element that must be protected in any housing reform proposal.

NAFCU also has questions about statutorily setting a mandated minimum down payment for loans made on the primary market. Credit unions have a long history of developing sound loan products designed to meet the needs of their members. A statutorily mandated down payment, without regulatory flexibility, has the potential to stifle the ability of credit unions to meet the needs of their members.

Affordable housing remains a significant need for many Americans, and the GSEs' efforts in implementing the Duty to Serve requirements have helped alleviate some of these issues, but more must be done. NAFCU supports the Duty to Serve requirements of the *Federal Housing Enterprise Financial Safety and Soundness Act* of 1992, as amended by HERA, and appreciates the inclusion of a new Market Access Fund (MAF) to account for the difficulties in providing financial services to underserved and low-income communities. However, NAFCU would like to stress the importance of a continued focus on the three areas outlined in the Duty to Serve requirements: manufactured housing, affordable housing preservation, and rural markets. Considering the outline replaces the Duty to Serve requirements with the MAF, NAFCU encourages you to maintain programs for the three underserved areas outlined in HERA in the text of any future bill.

## **The Importance of Servicing Rights to Credit Unions**

Any new housing finance system must contain provisions that ensure credit unions can retain servicing rights to loans they make to their members. As noted above, we are troubled by the outline's silence on the ability of credit unions to maintain servicing rights. Many consumers turn to credit unions for lower rates and more palatable fee structures, but they also want to work with a reputable organization that they trust will provide them with high quality service. Because credit unions work so hard to build personal relationships with their members, relinquishing servicing rights has the potential to jeopardize that relationship in certain circumstances.

A number of credit unions retain servicing rights on all of their loans. This was especially beneficial during the Great Recession, as it allowed credit union members to approach their institutions when they were facing economic hardship and allowed credit unions to work closely with their members to help keep them in their homes. In addition, maintaining the servicing rights throughout the life of the loan ensures no disruption to credit union members. The ability to retain servicing rights must be preserved for credit unions of all sizes in any new housing finance system. If national servicing standards are created, they should be done in such a way as to not create new burdens on credit unions.

## **Transition to a New Housing Finance System**

NAFCU and our member credit unions also have general concerns about overall costs and workability of, including the transition to, any new housing finance system. Although the outline envisions these concerns, we urge general caution and enhanced flexibility as major changes are contemplated to the housing finance system to ensure any reform is done right. As noted above, we believe that transitioning Ginnie Mae and the GSEs should be done methodically over expeditiously. Housing finance reform must ensure equal and competitive access for credit unions, while avoiding further concentration of the primary and secondary mortgage markets to the largest of lenders, Wall Street firms, and emerging fintech companies. It is critical that any increased costs associated with establishing a new housing finance system be minimized so as to not increase the cost of borrowing for consumers and not serve as a barrier to entry for small lenders.

If Congress acts to bring broad reforms to the nation's housing finance system, getting the transition right will be critical. It is of the utmost importance to ensure a smooth transition to a reformed system because credit unions need certainty that changes outlined in legislation and accompanying regulation will function as intended. Credit unions must be kept up-to-date during this transitional period, and lawmakers should build flexibility into the transitional period to account for unforeseen implementation challenges. NAFCU and its member credit unions believe

that Congress should first agree on a set of reforms and then, based on the nature and complexity of the reforms, establish a timeframe for transition. Arbitrarily pledging to adhere to a transitional timeframe before finalizing and beginning implementation of reforms could create otherwise avoidable issues for the GSEs and new guarantors as well as outside stakeholders.

In order to ease the transition if a new system is established, Congress should consider grandfathering currently approved Fannie Mae and Freddie Mac lenders and certifying them across to new guarantors en bloc. This could reduce confusion and, if executed properly, could make the process run more smoothly for all involved. It could take time for lenders to be certified with the new guarantors in the system, and this time should be factored into the transition time. NAFCU and its member credit unions also believe it is important that a new system be up and running before new guarantors are permitted to enter the system.

### **Conclusion**

NAFCU appreciates the Committee's attention to this important issue and thanks Chairman Crapo for advancing this debate. There are several positive aspects of the outline before the Committee today, but there are also a number of unanswered questions and concerns. More details of the proposal need to be known. The current system works for credit unions, and we urge you to move cautiously and in a bipartisan manner with any reforms. As you consider housing finance reform, we urge you to adhere to the credit union principles outlined in my testimony. Whatever approach is taken to reform the system, it is vital that credit unions continue to have unfettered access to the secondary market and receive fair pricing based on the quality of their loans. The government must also continue to play a role by providing an explicit government guarantee to help stabilize the market.

Thank you for the opportunity to provide our input on this important issue. NAFCU and its member credit unions look forward to working with you as housing finance reform legislation moves forward. I thank you for your time today and welcome any questions you may have.