Testimony of

John Fenton

President and CEO of Affinity Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

“Housing Finance Reform: The Continuation of the 30-Year Fixed-Rate Mortgage”

Before the

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

October 20, 2011

Introduction

Good morning, Chairman Johnson, Ranking Member Shelby and Members of the Committee. My name is John Fenton, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I appreciate the opportunity to share my views with the committee on housing finance reform and the value of the 30-year fixed-rate mortgage to credit unions and our members. Thank you for holding this important hearing.

I am president and chief executive officer of Affinity Federal Credit Union, headquartered in Basking Ridge, New Jersey. I also serve as chairman and chief executive officer of Affinity Financial Services, LLC, a wholly owned subsidiary of Affinity Federal Credit Union. Affinity Financial Services provides diversified financial services, including insurance, investment products, and mortgage origination and servicing.

Prior to joining Affinity in 1995, I was president and CEO of Synergy Federal Credit Union from 1987 to 1995. I have also held the positions of vice president of administration and finance at East Bergen Teachers Federal Credit Union (1982-1987) and vice president of finance at the Clifton Savings and Loan Association (1975-1982).

Affinity Federal Credit Union was chartered on December 13, 1935, the year after the Federal Credit Union Act was passed and signed into law by President Roosevelt. It was formed as the W. E. Headquarters Federal Credit Union to provide cooperative credit and to serve employee-member needs of Western Electric Company.

In 1974, the membership base of the credit union was extended to include AT&T employees and the credit union changed its name to GHQ Federal Credit Union (General Headquarters).

In 1984, with assets of $93.7 million, headquarters were moved across the river from New York City to New Providence, New Jersey, and GHQ became the second largest credit union in the state of New Jersey. At the close of 1986, the credit union changed its name from GHQ to AT&T Employees Federal Credit Union (AT&T EFCU) to more accurately reflect the current membership.

In 1995, I was named the new President and CEO, and was charged to be a catalyst for change. Although serving a single sponsor for most of these sixty years, the announcement that AT&T would be split into three separate companies encouraged the credit union to adopt a new name and Affinity Federal Credit Union was chosen.

Today, Affinity is the largest credit union in the state of New Jersey with 21 branches, more than 137,000 members from more than 2,000 businesses and organizations, and total assets in excess of $2 billion

As you may know, NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU–member credit unions collectively account for approximately 62 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding housing finance reform and the continuation of the 30-year fixed-rate mortgage.

Background on Credit Unions

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, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 93 million Americans. 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)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

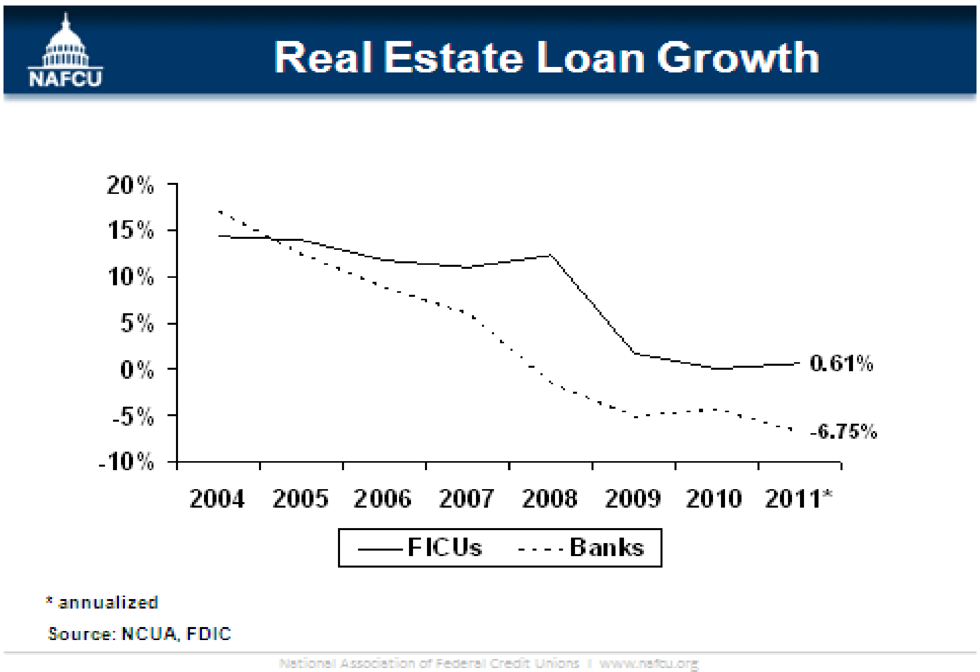
- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

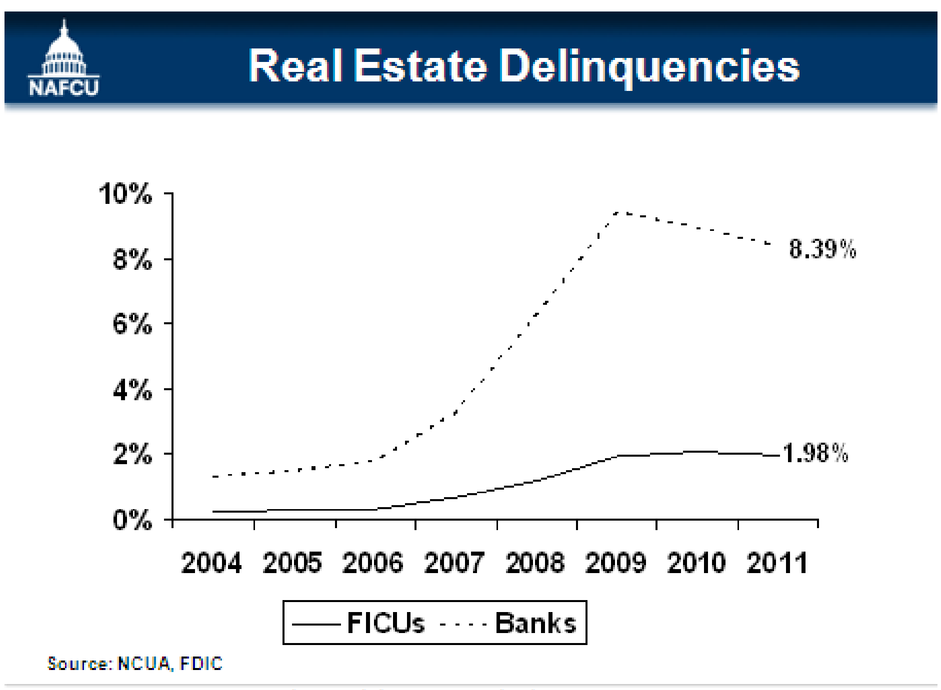
The nation's approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. 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. As consolidation of the commercial banking sector has progressed, 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.

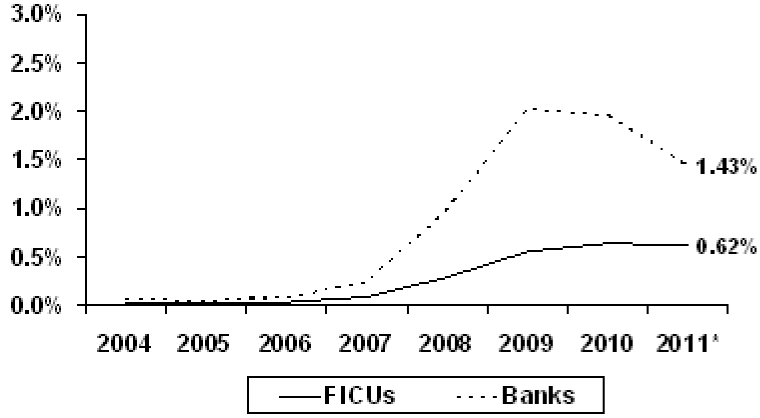
Credit Union vs. Bank Mortgage Lending

Credit unions were not the cause of the recent economic crisis, and an examination of their lending data indicates that credit union mortgage lending has outperformed bank mortgage lending during the recent downturn. This is due in part to the fact that credit unions were not the cause of the proliferation of sub-prime loans, instead focusing on placing their members in solid products that they could afford. The graphs below highlight how credit union real estate loan growth has outpaced banks during the downturn, and how credit unions have fared better with respect to real estate delinquencies and real estate charge-offs. The fourth graph demonstrates how credit unions are holding more long-term real estate loans as a percentage of total real estate loans than banks.





Real Estate Charge-offs

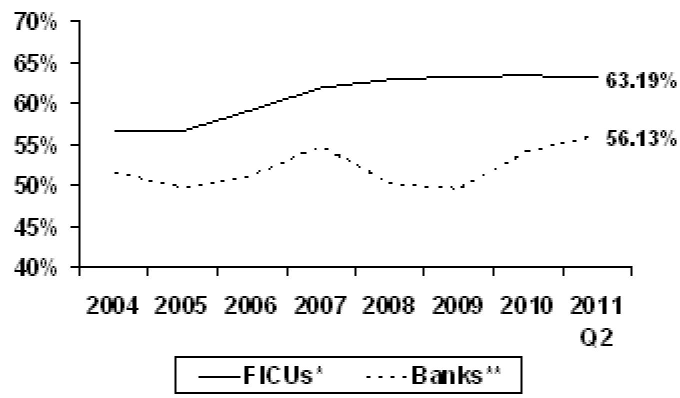


* annualized

Source: NCUA Call Report

Long-Term Real Estate Loans*

Long-Term RE Loans-to-Total RE Loans



* For credit unions calculated as all real estate loans outstanding less the amount of real estate loans outstanding that will contractually refinance, reprice or mature within the next 5 years

** For banks calculated as closed-end first mortgages on 1-4 family properties with maturity greater than 5 years

Source: NCUA Call Report

The 30-Year Fixed-Rate Mortgage

The 30-year fixed-rate mortgage (FRM) we know today had its origins in the reforms of President Franklin Delano Roosevelt's New Deal. Congress created the Federal Housing Administration (FHA) in 1934 as part of the *National Housing Act of 1934* (Housing Act) during President Roosevelt's first term. The goal of the Housing Act was to enable home ownership for a broad sector of the American public. President Roosevelt's measure was in response to the Great Depression, which included a collapse of the banking system and subsequent mass foreclosures.

When the FHA was created, the housing industry was in dire straits. Millions of Americans lost their homes. Two million construction workers had lost their jobs. Terms were difficult to meet for homebuyers seeking mortgages. Mortgage loan terms were often limited to 50 percent of the property's market value, with a repayment schedule spread over three to five years, and ending with a balloon payment. America had become a nation primarily of renters. Only 40% of occupied homes were owned.

At this time Fannie Mae and the Federal Deposit Insurance Corporation (FDIC) were also formed. The creation of these entities allowed the government to restructure loan opportunities and create the 30-year fixed-rate mortgage (FRM). These entities have allowed tens of millions of home mortgages and tens of thousands of multifamily projects to come to fruition.

Prior to the introduction of the 30-year FRM, U.S. homeowners were at the mercy of adjustable interest rates. After making payments on a loan at a fluctuating rate for a certain period, the borrower would be liable for the repayment of the remainder of the loan (balloon payment). Before the innovation of the 30-year FRM, borrowers could also be subject to the "call in" of the loan, meaning the lender could demand an immediate payment of the full remainder. The 30-year FRM was an innovative measure for the banking industry, with lasting significance that enabled mass home ownership through its predictability. Congress gave credit unions the authority to offer 30-year mortgages in 1977.

Over the long-term, a 30-year FRM can be more expensive than an adjustable-rate mortgage (ARM). The ARM, however, is subject to fluctuations of a number of indicators in the market, and therefore carries greater risk to the borrower. Homebuyers who value more certainty in mortgage payments, and who can resist the lure of more risky but possibly cheaper financing, the 30-year fixed-rate mortgage offers the greatest long-term option, as it protects borrowers against interest rate spikes.

The FRM is the dominant instrument of mortgage originations. The FRM is regarded as a consumer-friendly instrument because it is straight forward, easy to understand, and provides for a predictable monthly payment schedule. The table on the next page outlines first mortgage activity (both new and outstanding) at federally-insured credit unions for the first half of 2011. As you can see longer term fixed-rate mortgages (defined as greater than 15 years) make up the largest percent of the total loans granted and outstanding in terms of dollar amounts. Shorter term fixed-rate mortgages (15 years and under) are the next highest, buoyed by the current low interest rate environment. In 2009, during a higher interest rate environment, fixed-rate mortgages made up over 80% of the total loans made, with longer term fixed-rate mortgages accounting for over 55% of the total loans made by insured credit unions.

FICU First Mortgage Loans

As of June 30, 2011 (Source: NCUA 5300 call report)

	# of Loans Granted YTD	Amt of Loans Granted YTD (in $millions)	Percent of Total	# of Outstanding Loans	Amt of Loans Outstanding (in $millions)	Percent of Total	Delinquency Rate
Fixed-Rate							
>15 years	79,040	$13,908	41.5%	524,862	$82,179	36.2%	
15 years or less	83,451	$10,092	30.1%	662,815	$54,372	23.9%	
Other Fixed-Rate	2,762	$322	1.0%	13,281	$1,475	0.6%	1.71%
Balloon/Hybrid							
>5 years	9,178	$1,921	5.7%	98,098	$19,669	8.7%	
5 years or less	17,020	$3,248	9.7%	184,611	$34,618	15.2%	
ARM							
>1 year	9,651	$564	1.7%	75,859	$6,646	2.9%	3.29%
1 year or less	16,705	$3,472	10.4%	189,834	$28,301	12.5%	
Total	217,807	$33,527	100.0%	1,749,360	$227,261	100.0%	2.19%

With a fixed-rate mortgage, the lending institution assumes the risk associated with any interest rate increase. Having too many long-term fixed-rate mortgages in portfolio subjects the financial institution to greater interest rate risk, and can be cause for concern for examiners. At Affinity FCU we mitigate risk in our long-term FRM portfolio by hedging with interest rate swaps, caps, and matched borrowing. Selling on the secondary market to Fannie Mae and Freddie Mac is also an important risk mitigation tool. The securitization activities of Fannie Mae and Freddie Mac help lower the relative cost of the 30-year FRM and are an important factor in its viability.

Credit unions cannot raise funds from the capital markets, only from their members. The development of secondary markets for loans and mortgage backed securities (MBSs) through government sponsored enterprises (GSEs) was key to allowing credit unions to offer loans of longer terms. Credit unions were able to offer longer-term funding to match the terms of the mortgages and transfer some of that risk through loan sales to secondary markets. Without the Housing Act and the support of the GSEs, it is not clear that today's mortgage loans would have a 30-year term. Without a government role in the secondary market, the 30-year FRM may still exist, but likely with higher cost to the consumer and scarce availability. The system of long-term fixed-rate mortgages financed through stable securitization has helped provide remarkable stability in the US economy, as well as strong and sustainable homeownership.

There is no evidence that the recent economic downturn and collapse of the housing market was due to the presence of long-term fixed-rate mortgages, especially at credit unions. The success of credit unions during the economic downturn is evidence of this. Credit unions did not aid in the proliferation of sub-prime ARMs. Credit union loans are seen as quality loans, and their performance has backed that up. This is evidence that the 30-year FRM is not problematic by itself, and can be an important product for consumers and financial institutions. At Affinity FCU, we found that when our members got into trouble it was not from a particular first mortgage product; rather, it was likely from one of the following two factors: 1) loss of a job or unemployment; and 2) a decline in home value after a large amount of equity was pulled out in a line of credit.

The Future of the 30-year FRM

Full privatization of the secondary market is not a good option because the focus will shift away from the best interest of the consumer and overall housing market, to a business' bottom line. The existence of private label securitization of real estate loans was a significant factor in the recent housing market crisis. Going forward, a totally privatized secondary market will not allocate enough capital because of the inherent risks, both credit and interest rate, without some sort of government guarantee. Without a government role, 30-year (and other longer term) fixed-rate mortgages will become riskier propositions for credit unions. For safety and soundness reasons, additional risk will have to be passed on to the consumer. While some additional risk being borne by the consumer may not be a bad thing in and of itself, lack of a government role as a stabilizing force in the secondary market would have a significant impact on the ability of credit unions to offer affordable, consumer-friendly mortgage products such as the 30-year FRM. We believe that it would further limit the availability of long-term, fixed-rate mortgage products, and substantially increase the costs of mortgages to the consumer.

It should be noted that the government support for the secondary market does not only come from support and guarantees for the GSEs, but also in an indirect way when government entities purchase mortgage backed securities (MBSs). This government role in the market helps serve as a check on interest rates for the consumer. The loss of this government role would likely drive up rates.

If the government totally withdrew from the housing market, it could lead to an absence of, or at least a limited availability of, longer term FRMs. This would cause risk to be shifted back to the consumer and the cost associated with that risk would likely drive many low and moderate income consumers out of the homeownership market. Furthermore, not having an outlet to sell 30-year FRMs currently held in portfolio, if needed, could create additional risk for financial institutions such as credit unions.

The Housing Act, its creation of the FHA, and the resulting introduction of the 30-year fixed-rate mortgage, brought long-term stability to the American housing market and helped to stimulate economic recovery in the United States in the wake of the Great Depression. Accordingly, NAFCU believes that limiting the availability of the 30-year fixed-rate mortgage in these tough economic times will further drive down the already struggling housing market.

The 30-Year FRM and other products at Affinity Federal Credit Union

At Affinity FCU, we offer fixed-rate mortgage products in 10, 15, 20, and 30-year terms. Our 30-year FRM has traditionally been the most popular loan product with our members as it drives affordability and accounts for over 64% of our fixed-rate mortgage portfolio and nearly 48% of our overall loan portfolio. Our 15 and 20 year fixed-rate mortgages combined make up nearly another 22% of our total loan portfolio. This demonstrates a clear interest from our members in having a longer term fixed-rate mortgage product.

I should note that in the current record low interest rate environment, we are seeing increased interest in the shorter term fixed-rate products, as monthly payments are more affordable. This has also been seen in our adjustable-rate products, as people who have shorter time frames may opt for the historic low rates of ARMs in this current rate environment. We believe it is important that any reforms do not try to limit financial institutions to offering only “plain vanilla” products. As member-owned institutions, credit unions have a strong track record of offering products our members want, working to place them in the right product for their needs. It is important that housing finance reform does not close the door on the ability of credit unions to match the member with the best mortgage product for them.

We also believe preference for mortgage products is somewhat generational. Post World War II and the baby boom generation tended to prefer the stability of long-term fixed-rate products, as many bought houses that they were going to live in for a number of years. Today, in a more mobile society, we see members who are approaching retirement or know they may be moving in a set time opting for a shorter term product to build faster equity when they buy or refinance. At the same time, we see many first-time or younger home buyers still opting for the stability of longer term fixed-rate products. It is important to note that few 30-year mortgages ever go to their full term, as homeowners will likely move, refinance or pay off the loan early long before loan maturity. Still, we have found that our members prefer the certainty of these longer-term fixed-rate products in their financial planning.

Managing Interest Rate Risk

Recent trends in asset portfolios, coupled with the current interest rate environment presents a unique challenge to credit union management. Over the last few years, interest rates have fallen to record lows, credit unions have experienced vigorous share growth, and credit union participation in the mortgage lending arena has increased to historic highs. Given these trends, it is more important now than ever to have a solid risk management program. The National Credit Union Administration (NCUA) has been active in watching interest rate risk at credit unions from long-term fixed-rate mortgages, issuing a letter to credit unions on the matter as far back as September 2003 and issuing an interagency (along with banking regulators) interest rate risk advisory in 2010. Additionally, they are currently in the process of finalizing a new interest rate risk rule.

The low interest rate environment is an additional deterrent for attracting private capital. In any housing reform, government support is going to be a necessity for the foreseeable future. Curtailing that support will lead to additional credit stress on individuals and further threaten the safety and soundness of the financial system. Rates will rise exacerbating an already stressed economy if lenders do not have readily available avenues to manage risk.

Credit unions hedge against interest rate risk in a number of ways, including interest rate swaps, caps, borrowing and selling products for securitization on the secondary market. Lenders, such as credit unions, must be able to manage risk. Funding low-rate long-term fixed-rate paper with short-term deposits is a recipe for disaster. Lenders must have continued and unfettered access to hedging mechanisms. Unfortunately, the three ways that lenders manage interest rate risk (loan sales, term FHLB borrowings and plain vanilla interest rate swaps) are in the crosshairs of public policy debates.

Some of the options put forth as part of housing finance reform such as tighter underwriting standards, increasing guarantee fees, reducing conforming loan limits, increasing down payments and limiting FHLB borrowings all could impact lender access to risk management tools. These ideas must be carefully orchestrated so that lenders can manage risk, rates are kept at a level that supports the recovery and consumers have access to credit on reasonable terms.

Fannie Mae and Freddie Mac, as well as the Federal Home Loan Banks, are valuable partners for credit unions who seek to hedge against these interest rate risks by selling their fixed-rate mortgages to them on the secondary market. Because Fannie and Freddie will buy loans on the secondary market, the credit union is not only able to mitigate the risk associated with interest rates, but they are also able to reinvest those funds into their membership or institution by offering them new loans or additional forms of financial services. Without this relationship with Fannie and Freddie credit unions would be unable to provide the services and financial products that their memberships demand and expect.

It should also be noted that the government plays an important role in helping to set standards and bring conformity to the housing market. The tools that Fannie and Freddie provide help smaller institutions, such as credit unions, make the conforming loans that are sought on the secondary market. Changing standards to eliminate or make conformity difficult could make it hard for credit unions to sell loans on the secondary market, constraining their ability to manage risk in this way.

Housing Finance Reform

In the three years since the federal government took control of Fannie Mae and Freddie Mac from their stockholders through conservatorship, the future of the government-sponsored enterprises and the secondary mortgage market has become a topic of debate. The development and reform of housing finance policy is highly significant to NAFCU and credit unions.

In February, the Department of Treasury released a proposal that would ultimately wind down Fannie Mae and Freddie Mac by offering three different scenarios for moving forward with varying degrees of government involvement. Several pieces of legislation, from comprehensive to piecemeal approaches, have also been introduced in the House and Senate.

NAFCU would like to stress the importance of retaining a system that provides credit unions with the secondary market access necessary to serve the mortgage needs of their 93 million members. As you consider legislative proposals, NAFCU would like to reiterate a core set of principles we believe must be considered to ensure that credit unions are treated fairly during any housing finance reform process:

- A healthy and viable secondary mortgage market must be maintained. A secondary mortgage market, where mortgage loans are pooled and sold to investors, is essential in providing the liquidity necessary for credit unions to create new mortgages for their members.

- To effectuate competition and ensure access for credit unions, there should be at least two Government Sponsored Enterprises (GSEs) that would perform the essential functions currently performed by Fannie Mae and Freddie Mac.

- The U.S. government should issue explicit guarantees on the payment of principal and interest on MBSs. The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in the MBSs and facilitate the flow of liquidity.

- During any transition to a new system (whether or not current GSEs are to be part of it) credit unions have uninterrupted access to the GSEs, and in turn, the secondary market.

- Credit unions could support a model for the GSEs that is consistent with a cooperative or a mutual entities model. Each GSE would have an elected Board of Directors, be regulated by the Federal Housing Finance Agency, and be required to meet strong capital standards.

- A board of advisors made up of representatives from the mortgage lending industry should be formed to advise the FHFA regarding GSEs. Credit unions should be represented in such a body.

- While a central role for the U.S. government in the secondary mortgage market is pivotal, the GSEs should be self-funded, without any dedicated government appropriations. GSE's fee structures should, in addition to size and volume, place increased emphasis on quality of loans and risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of many agency securities.

- Fannie Mae and Freddie Mac should continue to function, whether in or out of conservatorship, and honor the guarantees of the agencies at least until such time as necessary to repay their current government debts.

- NAFCU does not support full privatization of the GSEs because of serious concerns that small community-based financial institutions could be shut-out from the secondary market.

- The Federal Home Loan Banks (FHLBs) serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Reform of the nation's housing finance system must take into account the consequence of any legislation on the health and reliability of the FHLBs.

A vibrant and responsive secondary market for 30-year fixed-rate paper and access to term funding through the FHLB system are essential for community based lenders so they can manage risk, offer a continuing supply of credit to consumers and small businesses and support the economic recovery.

NAFCU strongly believes that any reforms must not disrupt the fragile housing finance system that is slowly beginning to recover. As you know, any such disruption could trigger a "double-dip" recession and such an occurrence will have a devastating impact on our country's economy as well as the global finance system. In addition, we believe it is critical that the essential functions of Fannie Mae and Freddie Mac are retained until taxpayer dollars that the federal government injected into the GSEs are recovered. The essential functions include, but are not limited to, purchasing and guaranteeing mortgages originated by credit unions.

Conclusion

The 30-year fixed-rate mortgage product remains the most popular mortgage product available today. As such, it is necessary for the health of our housing market and continued recovery of our economy that it remains readily available. The ability of credit unions to make these loans and mitigate their interest rate risk by selling these loans to GSEs on the secondary market is as important to economic vitality as their availability in the marketplace. By allowing credit unions to hedge against interest rate risk by selling these mortgages, credit unions are better able to serve their members by continuing to offer products and services they want and need.

We thank you for your time and the opportunity to testify before you here today on this important issue to credit unions and our nation's housing market. I would welcome any questions that you may have.