Testimony of

Janice Sheppard

Senior Vice President of Mortgage Compliance at Southwest Airlines Federal Credit Union

On behalf of

The National Association of Federal Credit Unions

"A Legislative Proposal to Protect American Taxpayers and Homeowners by Creating a Sustainable Housing Finance System"

Before the

United States House Financial Services Committee

July 18, 2013

Introduction

Good afternoon, Chairman Hensarling, Ranking Member Waters and Members of the Committee. My name is Janice Sheppard, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I appreciate the opportunity to share NAFCU's views with the committee on housing finance reform and the, "Protecting American Taxpayers and Homeowners (PATH) Act." NAFCU appreciates Chairman Hensarling's leadership in releasing comprehensive draft legislation that addresses the future of the Government Sponsored Enterprises (GSEs) and the Federal Housing Administration (FHA), as well as a number of mortgage-related regulations. The unveiling of the PATH Act is an important part of the housing finance reform debate. Accordingly, we thank you for holding this important hearing on the draft legislation today.

Throughout my career in financial services I have had a deep focus on consumer and home loan production, the secondary mortgage market, and servicing and loss mitigation in addition to building compliance guidelines. At Southwest Airlines Federal Credit Union (SWAFCU), I serve as Senior Vice President of Mortgage Lending and Compliance. Prior to my work for SWAFCU I was the Mortgage Production Manager at Community Credit Union in Plano, Texas where I oversaw underwriting at 17 office locations. In addition to my work at SWAFCU, I am an active member of the American Credit Union Mortgage Association (ACUMA) which brings together the shared real estate lending and financing interests of thousands of credit unions. I have also been past president of the Texas Credit Union Real Estate Network, a state-based group of credit union mortgage personnel that work to enhance the expertise of its members and provide continuing educational and professional development.

Headquartered in Dallas, Texas, SWAFCU also has branches in Houston, Texas and Phoenix, Arizona. Serving more than 37,500 members with assets totaling over $295 million, SAWFCU provides diversified financial services including mortgage origination and servicing.

As you 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 68 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.

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, 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 96 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 nearly 80 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:

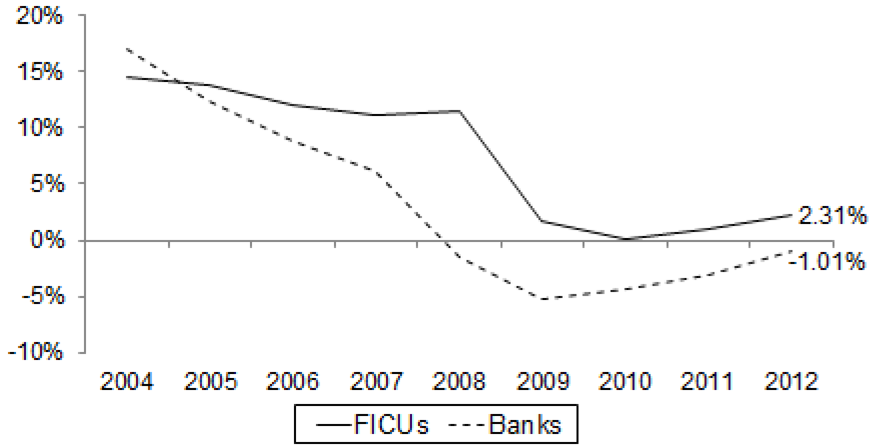
- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

The nation's approximately 6,800 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.

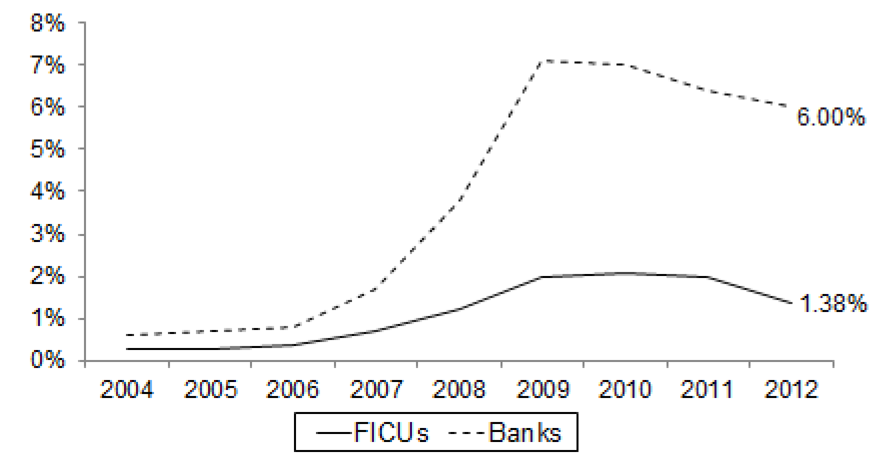
As has been noted by Members of Congress on all points of the political spectrum, credit unions were not the cause of the recent economic crisis, and examination of their lending data indicates that credit union mortgage lending has outperformed bank mortgage lending during the recent downturn. This 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 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 Loan Growth



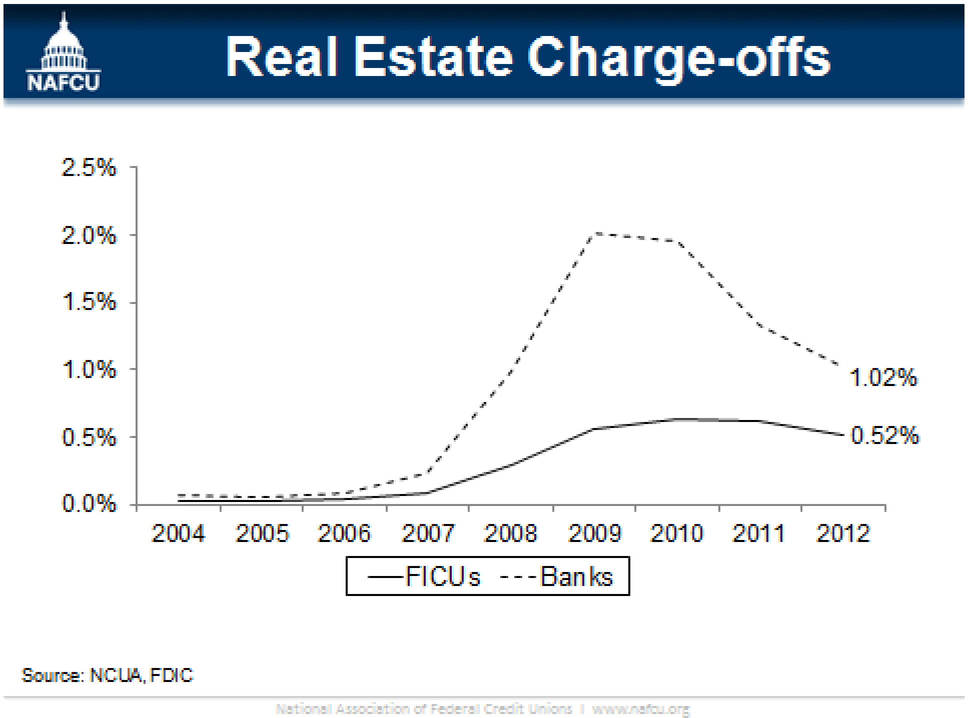
Source: NCUA, FDIC

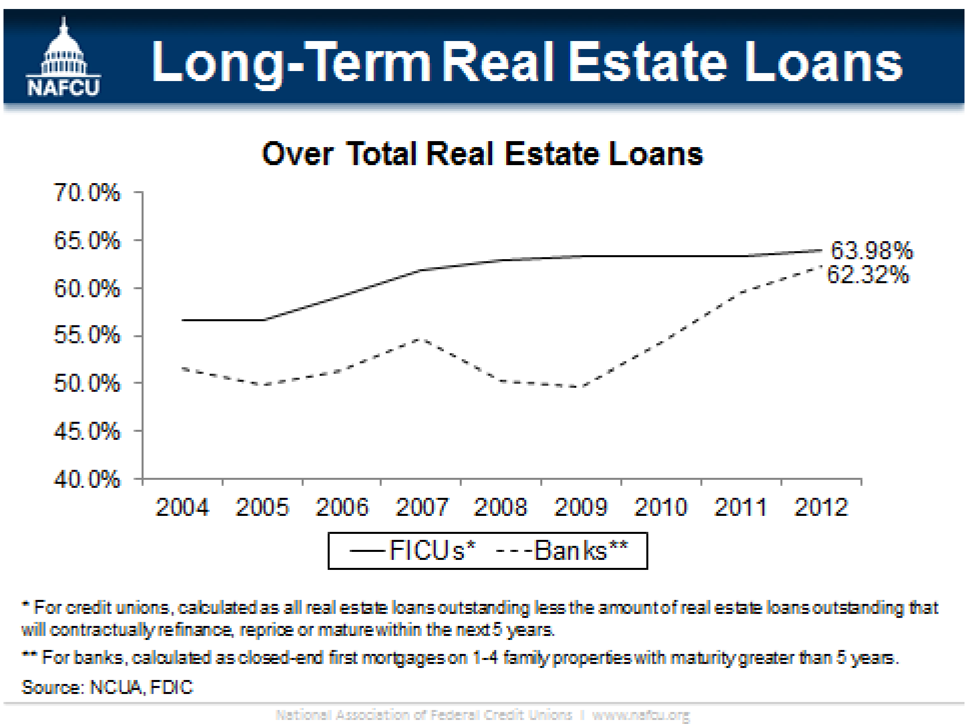
Real Estate Delinquencies*



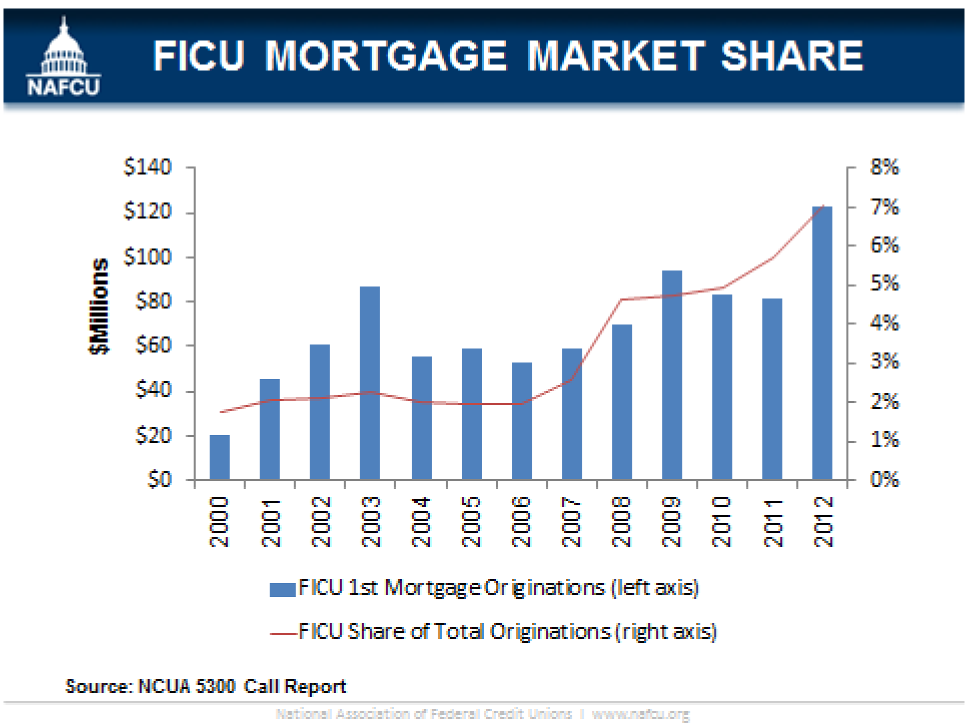
FICU delinquencies are 60 days or more late; bank delinquencies are 90 days or more late

Source: NCUA, FDIC

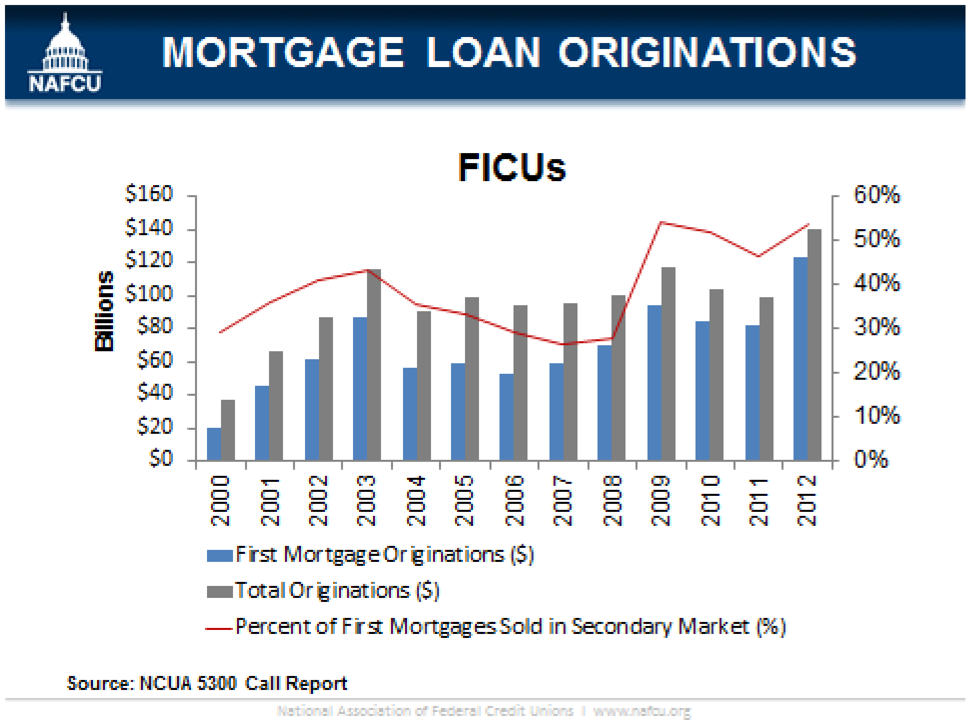




While the housing market continues to recover from the financial crisis, and Congress works to put into place safeguards to ensure such a crisis never happens again, credit unions continue to be focused on providing their member-owners with the basic financial products they need and demand. Credit unions have a solid track record of making safe and sound mortgage loans their members can afford. As the Committee works on housing finance reform issues, a primary concern of credit unions is continued unfettered access to the secondary mortgage market including adequate transition time to a new system—should lawmakers see such a change necessary. A second concern, equally as important, is recognizing the quality of credit union loans through a fair pricing structure. Because credit unions originate a relatively few number of loans compared to others in the marketplace – federally insured credit unions had about 7 % of the first mortgage originations in 2012 (see chart below) – they cannot support a pricing structure based on loan volume, institution asset size, or any other geopolitical issue that will lend itself to discrimination and disadvantage their member-owners.



Recent trends in asset portfolios, coupled with the current interest rate environment, present a unique challenge to credit union management. In the past 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 heights. Credit union mortgage originations more than doubled between 2007 and 2013, and the credit union share of first mortgage originations expanded from 2.5 to about 7 percent. The portion of first mortgage originations sold into the secondary market also more than doubled over that same period, from 25.7 percent in 2007 to 53.6 percent in 2012, according to National Credit Union Administration (NCUA) call report data (see chart below).



While credit unions hedge against interest rate risk in a number of ways, selling products for securitization on the secondary market remains a key component of safety and soundness. Lenders must have continued and unfettered access to secondary market sources including Fannie Mae, Freddie Mac, Ginnie Mae and the Federal Home Loan Banks (FHLBs) as they are valuable partners for credit unions who seek to hedge interest rate risks by selling their fixed-rate mortgages to them on the secondary market. Not only does this allow credit unions to better manage risk, but they are also able to reinvest those funds into their membership by offering new loan products or additional forms of financial services. A 2012 NAFCU real estate survey highlights the growing use of GSEs among credit unions. More than three-quarters of respondents indicated that credit union board policy restricted the percentage of real estate loans that could be held on their balance sheet, with a median limitation of 35 percent. Simply put, without these critical relationships, credit unions would be unable to provide the services and financial products 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. Changing standards to eliminate or make conformity difficult could make it harder for credit unions to sell loans onto the secondary market as they do not have the economies of scale larger market participants enjoy.

Key Credit Union Concerns in Housing Finance Reform Efforts

In 2010, as the future of housing finance became a focal point in Congress, with the Administration, and among the regulatory agencies, the NAFCU Board of Directors established a set of principles that the association would like to see reflected in any reform efforts. These principles were aimed to help ensure that credit unions are treated fairly during any housing finance reform process. They are outlined below:

- NAFCU believes a healthy, sustainable and viable secondary mortgage market must be maintained. Credit unions must have unfettered, legislatively-guaranteed access to such market. In addition, in order to achieve a healthy, sustainable and viable secondary market, NAFCU believes there must be healthy competition among and between market participants in every aspect of the secondary market. Market participants should include, at a minimum, multiple Government Sponsored Enterprises (GSEs), Federal Home Loan Banks, Ginnie Mae (as insurer of FHA, VA, and other government-backed loans), and private entities.

- 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 at this time 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.

NAFCU's Views on the PATH Act

As the country recovers from the worst financial crisis since the Great Depression, and Fannie Mae and Freddie Mac continue to operate in conservatorship, NAFCU appreciates the emphasis Chairman Hensarling has placed on ensuring a sustainable housing finance system moving forward. Over the past five months, the Financial Services Committee has held 11 hearings on the state of housing finance and how public policy decisions will help shape the future in this regard. This kind of robust discussion and debate is welcomed by our nation's credit unions. The unveiling of the "Protecting American Taxpayers and Homeowners Act of 2013" (the PATH Act), the most comprehensive proposal put forward to date, is also an important step in the debate.

As discussed above, our primary concerns in the housing finance reform debate are continued credit union access to a healthy and viable secondary market and pricing recognition for the high quality of credit union loans. NAFCU believes the current system, with a government guarantee to investors on timely payment of principal and interest on mortgage backed securities, is an important element at this time. The current system helps to ensure credit unions have the access to the secondary market they need to thrive and continue to meet the mortgage needs of their member-owners. NAFCU members are not wedded to a system with a government guarantee on mortgage backed securities, if our concerns can be addressed through a different approach. Still, credit unions need to be guaranteed that a future system will address the basic primary concerns they continue to have as small yet reliable players in the marketplace. Furthermore, private capital can be fickle and is never guaranteed to be available to the marketplace. That is why the GSEs act as such a stabilizing force today.

While NAFCU appreciates the serious and comprehensive effort put forth by the PATH Act, we have outstanding concerns with aspects of the proposal in Title I that call for an immediate wind-down of the GSEs, and the impact the omission of the GSEs and a government guarantee could have on reliable market access for credit unions.

We believe that any reforms should focus on the consumer and not disrupt the recovery underway in the housing market. The guaranteed access to the secondary market was a critical component of credit unions being able to continue to meet the mortgage needs of Americans during the recent economic downturn. When banks and others stopped lending, credit unions were there to step in. Maintaining this guaranteed access is an important hedge against the next economic downturn.

It should also be noted that without a government role in the secondary market, the 30-year fixed-rated-mortgage may still exist, but it could have higher cost to the consumer and scarcer availability. Credit unions have found that when members got into trouble it was often 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 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.

We are pleased to see the provisions in the bill that would address the growing trend of local communities obtaining mortgages by the power of eminent domain.

We support the inclusion of Section 261, which extends the time that those who have had previous mortgages foreclosed upon have to wait for an FHA-loan from 3 years to 7 years. Enactment of this provision would discourage the trend of strategic defaults on mortgages that some credit unions have seen, while the waiver provision included would ensure that those who were foreclosed on due to hardship have the opportunities that they need.

In regards to the establishment of a market utility in Title III, we would note that NAFCU's primary concern is guaranteed equitable access for credit unions to the secondary market and guaranteed equitable pricing. The concept of the FHFA's securitization platform (transferred to the utility in this proposal), in and of itself, may not adequately address these concerns. In our comment letter to the FHFA, we expressed appreciation that the platform is designed to accommodate a market with or without a government guarantee. While we remain optimistic about the possibilities of the platform, especially in terms of improving efficiencies, we are concerned that the fundamental question of guaranteed access remains to be an uncertain proposition, especially with the winding down of the GSE's without suitable replacement as prescribed in Title I of the draft bill.

NAFCU believes that Title IV "Removing Barriers to New Investment" is a very important aspect of housing finance reform and the PATH Act and is pleased to see its inclusion in this proposal. There are many beneficial provisions in this section to credit unions, some of which I outline below.

In particular, NAFCU strongly supports Section 403 of the discussion draft to address the Consumer Financial Protection Bureau's (CFPB) definition of 'points and fees' under the 'ability-to-repay' rule set to take effect in January next year. NAFCU has taken advantage of every opportunity available to educate and weigh in with the CFPB on aspects of the ability-to-repay rule that are likely to be problematic for credit unions and their members. While credit unions understand the intention of the rule and importance of hindering unscrupulous mortgage lenders from entering the marketplace, it is time for Congress to step in and address unfair and unnecessarily restrictive aspects of this CFPB rule. Accordingly, NAFCU supports Chairman Hensarling's efforts incorporating into the PATH Act provisions from Rep. Huizenga's bipartisan *Consumer Mortgage Choice Act* (H.R. 1077).

Making important exclusions from the 'qualified mortgage' cap on points and fees will go a long way toward ensuring many affiliated loans, particularly those made to low- and moderate-income borrowers, attain 'qualified mortgage' status and therefore are still made in the future.

As NAFCU has testified in the past, the CFPB's new mortgage regulations released in January are a prime example of the growing compliance burden our nation's credit unions face. Covering everything from the scope of coverage under the *Home Ownership and Equity Protection Act*, comprehensive changes to mortgage origination and servicing, amended rules associated with the *Truth in Lending Act* and *Financial Institutions Reform, Recovery, and Enforcement Act*, changing requirements for escrow accounts and issuing rules under Dodd-Frank relative to what constitutes a "qualified mortgage"-- the breadth and pace of new requirements is daunting. The less than 12 month timeframe for implementation of the rules should cause serious pause for lawmakers and regulators. NAFCU strongly supports Section 406 of the PATH Act that recognizes the irrationality of this timeline and delays the mandatory implementation of all Dodd-Frank related mortgage rules for one additional year.

The inclusion of Section 407 to repeal the credit risk retention regulations from Section 941 of the *Dodd-Frank Act* is also a positive addition to the proposed legislation. While credit unions are technically exempt, the rule's impact will nevertheless ultimately be felt by all participants in the mortgage market. NAFCU also strongly supports Section 409 of the PATH Act which exempts from the 'qualified mortgage' definition residential mortgage loans held in portfolio, and Section 413, which requires notice of a junior mortgage or lien.

NAFCU also remains very concerned about CFPB's proposed rule integrating mortgage disclosures under the *Real Estate Settlement Procedures Act* (Regulation X) and the *Truth in Lending Act* (Regulation Z) requiring that borrowers receive final Closing Disclosure three business days prior to consummation. While the rule may be well intended, it does not allow for the kind of flexibility necessary to accommodate the nature of real estate transactions and could even discourage the borrower from making reasonable changes to their purchase. Accordingly, NAFCU strongly supports Section 411 of the PATH Act that would allow consumers the ability to waive the 3 day requirement. NAFCU is also pleased that this section permits mortgages financed through a 40 year product to also be considered as a 'qualified mortgage.'

In short, the mortgage-related provisions in the PATH Act described above would have a positive effect on credit unions. Enacting these provisions would help to ensure that we can continue to serve the mortgage needs of our nearly 96 million member-owners rather than focus on misguided regulations that will cause unprecedented compliance and legal burdens. NAFCU lauds Chairman Hensarling for his foresight by including these important provisions in his bill. We look forward to providing additional feedback on these much needed reforms as the committee continues to look for common-sense ways to cut down on the ever-increasing regulatory burden credit unions face.

Moving forward, NAFCU is hopeful that the committee also considers, whether in this bill or others, directing the CFPB to revise aspects of the 'ability-to-repay' rule that dictates a consumer have a total debt-to-income (DTI) ratio that is less than or equal to 43 percent in order for that loan to be considered a 'qualified mortgage'. NAFCU believes this arbitrary threshold will prevent otherwise healthy borrowers from obtaining mortgage loans and will have a particularly serious impact in rural and underserved areas where consumers have a limited number of options. We believe that the CFPB should either remove or increase the DTI requirement on qualified mortgages.

In addition to the mortgage related provisions contained in the draft bill, NAFCU would also like to recognize the important changes that would be made with respect to the examination process at credit unions. NAFCU has long supported Chairman Capito's *Financial Institutions Examination Fairness and Reform Act* (H.R. 1553) and believes it is important step forward in ensuring that the supervisory environment financial institutions face is fair and timely.

We would note that as Title IV contains provisions relating to Basel III for community banks, we believe provisions implementing risk-based capital for credit unions should also be included and paired with these provisions for community banks. Including the risk-based capital language introduced as part of H.R. 2572, the *Regulatory Relief for Credit Unions Act*, introduced by Committee Vice-Chairman Gary Miller, would be one way to accomplish this.

NAFCU also supports Section 502 of the *PATH Act* that permits insured depository institutions to treat a non-accrual loan as an accrual loan if the loan is current, no monthly payment has been more than 30 days delinquent during the previous 6-month period, and loan payments are being made according to contract terms and all parties agree to any refinances and modifications. This bipartisan provision is appropriate for a recovering economy, as it would ensure community based financial institutions aren't penalized for working with borrowers to modify their loans.

Finally, we are also pleased to see Section 504, preserving attorney-client privilege for information provided to the FHFA, included in the proposal.

Conclusion

We appreciate the opportunity to provide our input on this important issue. Chairman Hensarling deserves credit for putting forward the most comprehensive proposal on housing finance reform to date. We look forward to working with Chairman Hensarling, Committee Members and your staffs to address our comments as housing finance reform and the PATH Act proposal move forward.

I thank you for your time today and would welcome any questions that you may have.