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TESTIMONY
OF
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BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

HEARING ON
"HOUSING FINANCE REFORM: PROTECTING SMALL LENDER ACCESS TO THE SECONDARY MORTGAGE MARKET"

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Testimony
of
Bill Hampel
Senior Vice President and Chief Economist
Credit Union National Association
Before The
Committee on Banking, Housing and Urban Affairs
United States Senate
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"Housing Finance Reform: Protecting Small Lender Access to the Secondary Mortgage Market"
November 5, 2013

Chairman Johnson, Ranking Member Crapo, Members of the Committee:

Thank you very much for the opportunity to testify at today's hearing. My name is Bill Hampel, and I am Senior Vice President and Chief Economist at the Credit Union National Association (CUNA). CUNA is the largest credit union advocacy organization in the United States, representing America's state and federally chartered credit unions and their 97 million members. I am very pleased to present the credit union system's view on housing finance reform proposals before the Committee.

The system of housing finance, as it existed up until 2007, was one of many causes of the financial shock and deep recession of the last decade. With the two major government sponsored enterprises (GSEs) in conservatorship and the private secondary market still moribund, major overhaul of the system is required. The design flaws of the old system must be addressed. New rules will be required. Congress must get reform legislation right or risk further damage to an already fragile economy.

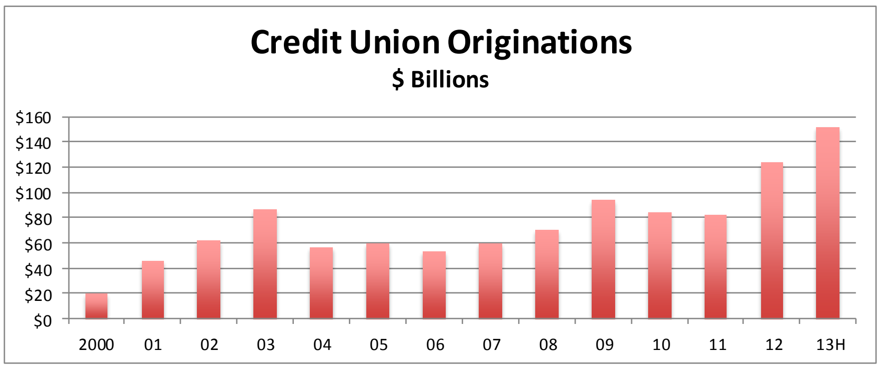
This testimony will focus on the key components of housing finance reform legislation from the perspective of the credit union system, using S. 1217, the Housing Finance Reform and Taxpayer Protection Act, as base from which to react and recommend changes.

Overview of Credit Union Mortgage Lending

As member owned, not-for-profit financial cooperatives, credit unions strive to meet their members' financial services needs, and offering home mortgages is an important part of meeting member demand. Some credit unions have made first mortgage loans since their inception, but most did not offer mortgage lending services until the 1970's. Credit unions now serve more than 97 million Americans, and first mortgage lending is an increasingly important component of credit union lending. First mortgages now account for 41% of the total loans held in portfolio, with the remaining 59% of a credit unions portfolio comprised of second mortgages [12%], consumer loans [41%] and small business loans [7%]. Just last year alone, credit unions originated $123 billion of first mortgages, representing 6.5% of the entire mortgage origination market. Credit unions are now significant players in residential real estate finance, and historically our market share has risen annually to reflect the growing demand of our members.

Currently, 4,295 credit unions (63%) offer first mortgages to their members. Because larger credit unions are more likely to offer mortgages than smaller ones, 93 million (96%) of all credit union members belong to a credit union that offers first mortgages. It is clear that consumers are choosing credit unions more and more to be their mortgage lenders, and as Congress considers housing finance reform, it is critical that credit unions have equitable and readily-available access to a functioning, well-regulated secondary market and a system that will accommodate the member-demand for long term fixed rate mortgage products in order to ensure they can continue meeting their members' mortgage needs.

From 2000 to 2006, annual credit union originations of first mortgages averaged just under $55 billion. As the subprime mortgage crisis began to weaken the secondary market for mortgage loans in 2006 and 2007, credit union origination volume rose dramatically. Homebuyers increasingly turned to their credit unions as other sources of mortgage lending dried up. Credit unions were able to meet this demand because at the time they primarily funded loans from their own portfolios, and their conservative financial management as cooperatives meant they were less affected by the financial crisis than many other lenders. By 2009, credit union originations rose to $94 billion. New loan volume fell to just above $80 billion in 2010 and 2011 before rising to $123 billion in 2012 and $132 billion the first half of 2013, at an annual rate. This recent increase in volume is due to the desire on the part of many members to refinance their loans given very low interest rates.



Total first mortgage originations from all lenders peaked at $3.1 trillion in 2005 before plunging to only $1.5 trillion in 2008. Since then, originations have recovered to just over $1.8 trillion in 2012, at an annual rate of $2 trillion in the first half of 2013. Because credit union lending increased while the broader market was wracked by the financial crisis, the credit union share of mortgage lending sharply increased, from less than 2% in 2005 to almost 6% in 2008. Since then, as the broader mortgage market recovered, credit union lending continued to grow to the point that it accounted for over 6% of the market in 2012 and 2013.

Historically, credit unions have been largely portfolio lenders. From 2000 to 2008, credit unions sold only a third of first mortgage originations, ranging from a low of 26% in 2007 to a high of 43% in 2003. The decision of whether to hold or sell a loan depends primarily on asset-liability-management issues, essentially the need to manage interest rate risk, but also at times, depends on the availability of liquidity in the credit union. Asset liability management hinges on such factors as the level of interest rates, the relative demand for fixed versus adjustable loans from members, the amount of fixed rate loans and other longer-term assets already on a credit union's books and the maturity of the credit unions funding sources. Managing credit risk is not the primary factor in secondary market decisions by credit unions. However, even for those loans intended to be held in portfolio, credit union prudential regulators strongly encourage writing all first mortgages to conformed standards for potential sale.

As long-term interest rates plunged in 2009 and again in 2011, credit unions found it increasingly important to sell longer-term, fixed rate mortgages to avoid locking in very low earning assets for the long term. As a result, the proportion of loans sold almost doubled, to an average of 52% from 2009 to the present.

Servicing member loans is very important to credit unions, for a number of reasons. As member owned cooperatives, credit unions are driven by a desire to provide high quality member service. Many credit unions are reluctant to entrust the core function of serving members to others, unless they have a stake and a say in the entity doing the servicing. Credit unions are also concerned that third-party servicers might use the data they gather about credit union members to market competing products or services. In addition, credit unions benefit from the steady servicing income stream. As such, many credit unions service both the substantial portfolios of loans they hold on their own balance sheets, and the loans they have sold to the secondary market. Currently, in addition to the $258 billion of first mortgages that credit unions hold in portfolio, they also service $151 billion of loans they have sold.

The credit quality of credit union first mortgages held up remarkably well during the recent financial crisis, especially when compared to the experience of other lenders. Other lenders experienced net charge-off rates four times higher than those at credit unions. Prior to the Great Recession, annual net charge-off rates on residential mortgage loans at both banks and credit unions were negligible, less than 0.1%. However, as the recession took hold, losses mounted. At credit unions, the highest annual loss rate on residential mortgages was 0.4%. At commercial banks, the similarly calculated loss rate exceeded 1% of loans for three years, reaching as high as 1.58% in 2009.

There are two reasons for this remarkable record at credit unions. First, as cooperatives, credit unions tend to be more risk-averse than stock-owned institutions. The incentives faced by credit union management (generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits) discourage management from adopting high-risk, higher-return strategies in pursuit of high profits. As a result, credit union operations are more consumer-friendly, less risky and subject to less volatility over the business cycle. This largely explains why credit unions were able to increase lending as the financial crisis deepened.

Second, since the bulk of credit union lending is intended to be held in portfolio rather than sold to investors, credit unions tend to pay particular attention to such factors as a member's ability to repay a loan, proper documentation and due diligence and collateral value before granting loans.

We believe that in addition to ensuring access to the secondary market for credit unions, it is also important that the housing finance system Congress puts in place accommodates the demand of credit union members and other consumers for long term, fixed rate mortgage products. The data suggest that credit union members overwhelmingly prefer fixed rate mortgages. Over the past 10 years, our members have chosen a fixed rate mortgage over 80% of the time. Just in the first half of 2013, 83% of the mortgages issued by credit unions were at fixed rates. Congress should acknowledge that the American homebuyer prefers fixed rate mortgages and do everything in its power to ensure this important mortgage product remains a valuable part of housing finance.

Credit Union Principles for Housing Finance Reform

As we have testified in the past, CUNA supports the creation of an efficient, effective, and fair secondary market with equal access for lenders of all sizes. To this end, CUNA supports housing finance reform proposals that are consistent with the following principles, and have been subject to full and fair consideration with respect to potential impact on all market participants:

Neutral Third Party

There must be a neutral third party in the secondary market, with its sole role as a conduit to the secondary market. This entity would necessarily be independent of any firm that has any other role or business relationship in the mortgage origination and securitization process.

Equal Access

The secondary market must be open to lenders of all sizes on an equitable basis. CUNA understands that the users (lenders, borrowers, etc.) of a secondary market will be required to pay for the use of such market through, for example, fees, appropriate risk premiums and other means. However, guarantee fees or other fees/premiums should not have any relationship to lender volume.

Strong Oversight and Supervision

The entities providing secondary market services must be subject to appropriate regulatory and supervisory oversight to ensure safety and soundness, for example by ensuring accountability, effective corporate governance and preventing future fraud; they should also be subjected to strong capital requirements and have flexibility to operate well and develop new programs in response to marketplace demands.

Durability

The new system must ensure mortgage loans will continue to be made to qualified borrowers even in troubled economic times. Without the backstop of an explicit federally insured or guaranteed component of the revised system, CUNA is concerned that private capital could quickly dry up during difficult economic times, effectively halting mortgage lending altogether.

Financial Education

The new housing finance system should emphasize consumer education and counseling as a means to ensure that borrowers receive appropriate mortgage loans.

Predictable and Affordable Payments

The new system must include consumer access to products that provide for predictable, affordable mortgage payments to qualified borrowers. Traditionally this has been provided through fixed-rate mortgages (such as the 30-year fixed rate mortgage), and it is important that qualified borrowers continue to have access to products that provide for predictable and affordable mortgage payments.

Loan Limits

The new housing finance system should apply a reasonable conforming loan limit that adequately takes into consideration local real estate costs in higher cost areas.

Affordable Housing

The important role of government support for affordable housing (defined as housing for lower income borrowers but not necessarily high risk borrowers, historically provided through FHA programs) should be a function separate from the responsibilities of the secondary market entities. The requirements for a program to stimulate the supply of credit to lower income borrowers are not the same as those for the more general mortgage market. We believe that a connection between these two goals could be accomplished by either appropriately pricing guarantee fees to minimize the chance of taxpayer expense, and/or adding a small supplement to guarantee fees, the proceeds of which could be used by some other federal agency in a more targeted fashion in furtherance of affordable housing goals.

Mortgage Servicing

Credit unions should continue to be afforded the opportunity to provide mortgage servicing services to their members in a cost-effective and member-service oriented manner, in order to ensure a completely integrated mortgage experience for credit union members/borrowers. To lose this servicing relationship would be detrimental not only to a vast majority of credit union members/borrowers, but could also result in fewer mortgage choices available to credit unions and their members, with higher interest rates and fees being imposed on both. If national mortgage servicing standards are developed, such servicing standards should be applied uniformly and not result in the imposition of any additional or new regulatory burdens upon credit unions.

Reasonable and Orderly Transition

The transition from the current system to any new housing finance system must be reasonable and orderly.

S. 1217

S. 1217 would wind down Fannie Mae and Freddie Mac, and replace the Federal Housing Finance Agency with a new entity, the Federal Mortgage Insurance Corporation (FMIC). FMIC would provide insurance on certain mortgage backed securities (MBS); this insurance would convey a full-faith-and-credit of the federal government guarantee. FMIC would also regulate the secondary mortgage market. The legislation would also cause the creation of a mutual securitization company designed to assist small lender access to the secondary mortgage market.

CUNA believes the general approach to housing finance reform embodied in S. 1217 to be very well thought out and sound public policy. S. 1217 corrects the fatal design flaws of the previous system, while maintaining the effective aspects of that system to create a structure designed to serve borrowers and lenders of all sizes well, preserving a backup government guarantee with sufficient protections that risk to the tax payer is reduced to nearly zero. However, we do have some suggested improvements to the law that will be necessary for it to work for small lenders, and we hope the Committee will take these suggestions into consideration when crafting a new bill. Before discussing those modifications, two general points should be covered: the danger of wringing too much risk out of the system, and the interplay of mortgage lending regulation from two sources, the Consumer Financial Protection Bureau (CFPB) and the FMIC.

There are two types of potential errors in designing a robust housing finance regime. A Type 1 error would allow excessive risk-taking, making a repeat of the crisis of the last decade likely. A Type 2 error would eliminate too much risk, making housing finance more expensive and cumbersome than it needs to be, and unnecessarily excluding too many borrowers from the market. Finding the happy medium that balances off both errors is of course very difficult. With the recent crisis still fresh in the memory, there is likely to be an understandable but unfortunate tendency to minimize Type 1 errors, at the expense of more Type 2 errors. The specific rules, parameters, prescribed underwriting criteria, etc. currently considered appropriate are likely to be more risk-averse than those necessary for a healthy, robust housing finance system in the long run. Therefore, a reformed system should have sufficient flexibility to be able to adjust and fine-tune the rules, norms and procedures as experience is gained. However, care must be taken not to set in motion a process whereby additional risks are incrementally added to the point that the system collapses. This is particularly important given the moral hazard that comes with any form of government guarantee. Balancing these pressures can best be accomplished by not laying down immutable rules, but rather by establishing institutions that will not be driven by their incentive structures to exploit the moral hazard of a government guarantee, and by empowering an independent regulatory structure with the dual mission of taxpayer protection and efficient market operation.

The Senate's development of housing finance reform legislation will, among other things, establish a new and revised regulatory structure for the mortgage market. This is necessitated by the failure of the previous regulatory structure. However, this is not the first time Congress has addressed the regulation of mortgage lending since the financial crisis. Much of the Dodd-Frank Act requires a plethora of new consumer protections in mortgage lending, currently being implemented by the CFPB. Much, although not all, of the rulemaking of the proposed FMIC will overlap with rules already promulgated by the CFPB. For example, there are the underwriting standards for a loan to be eligible to be included in a covered security, and those necessary for consumers to be protected on an "ability to repay" standard. It is quite possible that the details of those two sets of guidelines should not be exactly the same. Rather than simply defaulting to the proposed CFPB standards, the Senate may wish to establish procedures for the CFPB and the FMIC to coordinate on the future evolution of shared rules to take account both of consumer protection and effective mortgage market operation.

Small Lender Access to the Secondary Market

The secondary market must be open to lenders of all sizes on an equitable basis. Credit unions need to know that as long as they produce one or more eligible mortgages, they will be able to sell them to an issuer of government-backed securities, directly or through an aggregator, at market prices, for cash, without low-volume penalties, and with the option to retain servicing on the loans. In addition, standardization of all steps of the process is very important to credit unions.

Some form of issuer should be established so that small lenders, including credit unions, will have unfettered access to the secondary market. This entity should be independent of any firm that has any other role or business relationship in the mortgage origination and securitization process. S. 1217 envisions a mutual securitization company, regulated by the government guarantor; we believe this would be an appropriate vehicle to perform that function, provided certain changes were made with respect to membership, governance, capital and powers.

S. 1217 would cap membership in the mutual to institutions with less than $15 billion in assets. We believe that this cap is far too low, and would suggest that lenders of almost any size should be able to use the mutual, so long as they do not themselves issue covered securities. Restricting the mutual to serving just smaller lenders would preclude achieving necessary scale economies. Indeed, it would be desirable for the mutual to be among the largest if not the largest issuer of covered securities.

The mutual should have access to the common securitization platform being developed under the auspices of the FHFA, and any other relevant infrastructure of the GSEs as they are wound down. Much of that infrastructure, including personnel and technology, works very well, and it would be very inefficient to remove and replace it completely rather than to transfer it to the new mutual.

The governance structure is also important to the long-term success of the mutual. We believe the best model would be as a cooperative, with a board elected to represent all classes of membership, allocated by type and size of lender, perhaps with regional diversification too. Board elections should be on a one-member, one-vote basis within classes. The bylaws of the mutual should stipulate operating principles and requirements, such as providing access to all qualifying lenders, regardless of size. Although the operating practices and procedures of the mutual should be allowed to evolve over time based on management action and board approval, changes to the basic mission of the mutual, to provide unfettered access to the secondary market for lenders of all sizes, which should be expressed in the bylaws, should not be subject to change in the future.

The mutual will need to have sufficient capital to support a small balance sheet—enough to hold mortgages from multiple originators before they can be packaged into securities, and perhaps to hold some mortgages in the process of modification. While it may be necessary for mutual members to put up a small amount of capital, the operation of the mutual securitization company should be funded primarily by per-transaction fees.

The mutual should be permitted to issue both covered and private label securities (PLS), with clear disclosure to investors. This will provide small lenders with an outlet for non-qualified mortgage (QM) loans. It could also in the long-term reduce the government's exposure to the housing finance system by facilitating the provision of purely private capital. It could also help ensure the availability of credit to otherwise creditworthy borrowers who may just fall short of meeting the requirements of a qualified mortgage. To facilitate the issuance of PLS, all of the standardized processes applied to the creation of covered securities should also be available for private label securities. In addition, bond guarantors should be allowed to provide some coverage for PLS, so long as reserve funds for covered and private securities are not comingled.

In addition to establishing a mutual securitization company tasked with ensuring access to the secondary market for small lenders, Federal Home Loan Banks (FHLBs) should also be eligible to operate as approved issuers so long as they meet all relevant requirements. This would provide an option for small lenders. However, the eligibility of FHLBs to serve as issuers does not reduce the need for a mutual securitization company.

Government Guarantee

The new system must include consumer access to products that provide for predictable, affordable mortgage payments to qualified borrowers. Traditionally this has been provided through fixed-rate mortgages (such as the 30-year fixed rate mortgage), and it is important that qualified borrowers continue to have access to products that provide for predictable and affordable mortgage payments.

In order to facilitate the continued availability of affordable, long-term, fixed rate mortgages for American homeowners, some form of ultimate government guarantee should be available for qualifying mortgage-backed securities. However, the taxpayer must be protected from the unnecessary exercise of this guarantee by appropriate standards in mortgage lending, and by layers of sufficient private capital for loss absorption. The government guarantee should be the last, not the first line of defense. We are pleased that S. 1217 includes an explicit guarantee.

In addition to an 80% maximum loan-to-value for each mortgage in a covered security (provided by down payment, private mortgage insurance or a combination of the two), sufficient private capital should be available to absorb the first loss on any mortgage in a covered security. In theory, this could be accomplished either by a bond guarantee, a senior-subordinated deal structure or some other capital market structure. However, in practice, we believe that the bond guarantor approach would be preferable. During periods of stable financial markets, a healthy macro economy and strong housing markets, senior-subordinated deal structures are likely to underprice long-term risk compared to bond guarantors. During periods of stress, such as the recent Great Recession, senior-subordinated deals are unlikely to be available at any price, but bond guarantor coverage would likely be available, although at a premium price. In addition, a security structure system would likely favor larger over smaller originators and issuers because investors would prefer to limit due diligence to a small number of large institutions.

Another potential advantage of a bond guarantor approach would be the ability of the FMIC to step in for private bond guarantors in exigent times, to serve as a countercyclical backstop for the housing market, rather than simply suspending the requirement for first loss coverage for arbitrary periods when markets are troubled. If private bond guarantees were temporarily unavailable, or extremely expensive, FMIC could sell this coverage to issuers of eligible securities at a price determined by formula (for example 125% or 150% of the average cost of such coverage over the preceding two to five years). Once market conditions stabilize, the contract could be sold to a private bond guarantor. In other words, in stressed markets, rather than temporarily waiving the requirement for first loss coverage, the government should provide, and charge for, such coverage.

The amount of private capital necessary to protect the taxpayer is of course important. Too little capital places the taxpayer at risk. Too great a capital requirement unnecessarily raises the cost of mortgages to borrowers. The appropriate amount depends on: the amount of capital held by the ultimate government guarantee fund (FMIC), the amount of loss on any security that the private capital will be responsible for (the attachment point), the maximum loan-to-value of mortgages in covered securities and required underwriting standards for eligible mortgages. Assuming an attachment point of 10%, the amount of private capital necessary to cover a maximum 10% loss on <u>any</u> covered security will be substantially less than the amount necessary to cover a maximum 10% on <u>all</u> covered securities.[1] So long as eligible mortgages must have maximum loan-to-value ratios of 80%, or private loan-level mortgage insurance and must comply with the Qualified Mortgage (QM) rule, the likelihood that all covered mortgage backed securities would simultaneously suffer losses of at least 10% during anything short of a total economic and financial collapse (such as the Great Depression of the 1930s) is negligible. Further, the required amount of capital or reserve funds should depend on the seasoning of the securities

[1] Whether a bond guarantor's 10% first loss exposure would apply to just each guaranteed security, or to groups (e.g. a vintage of securities) would have an effect on the amount of capital required. We believe the exposure should be limited to single securities or short vintage windows, for example, for all securities guaranteed during a quarter rather than a year.

on which a bond guarantor provides first loss coverage. Older securities should require lower (not zero) reserve funds.

For all the reasons just listed, substantially less than 10% of the total exposure of private bond guarantors would be necessary to provide the 10% first loss coverage. Legislation should require the 10% first loss coverage, but leave it to the FMIC to determine the amount of private capital or reserve funds necessary to provide that 10% first loss coverage under conditions no less severe than the recent Great Recession.

In the event of the failure of a mortgage in a covered security, the FMIC should ensure timely payment of principle and interest to investors in covered securities, and immediately demand payment from the bond guarantor. The fact that investors could look to the FMIC rather than a collection of private bond guarantors for payment would contribute to the homogeneity of covered securities, increasing the liquidity of the securities. Payment from the bond guarantor to FMIC would be required so long as total losses on a security (or a defined group of securities, such as a vintage) had reached 10% of the value of the security. In the event total losses on mortgages in a security or group exceed 10% of the value of the security or group, the government backup fund should cover losses in excess of 10%.

It is likely that under this arrangement there could actually be instances when the government backup fund covered losses on covered securities without the bond guarantor itself having to fail, i.e., if one or more but not all of the securities covered by a private bond guarantor experienced losses of greater than 10%, but the guarantor's capital was not depleted. Indeed, a properly reserved bond guarantee fund should be able to cover losses up to 10% of the balance of covered securities and still remain in business. In other words, the payment of losses by FMIC after the 10% first loss coverage should not require a catastrophic event, i.e., the exhaustion of a pool of private capital.

A 10% attachment point would likely make recourse to the government backup fund extremely rare, but not unheard of. A reformed housing finance system that envisages no payments out of the privately funded reserve balance of the government guarantor would be erring on the side of being too conservative. The goal should be absolute protection of taxpayers, and that should allow the FMIC to occasionally operate as a shock absorber, using funds it has collected from market participants. This would be similar to the way the NCUSIF and the FDIC pay depositors in failed federally insured credit unions and banks, not with taxpayer funds, but with reserves paid for by insured institutions.

The government should be prohibited from assisting private bond guarantors. Instead, the government should be prepared to quickly pay all legitimate claims not covered by a private bond guarantor, and to resolve the bond guarantor if the government is not reimbursed for such claims in a timely fashion. The government should also be prepared to temporarily sell first loss coverage to issuers in times of market stress, as described elsewhere in this testimony.

The entity that provides the government guarantee should also have the regulatory responsibility, as envisioned by S. 1217. Since the entity that provides the government guarantee will be responsible for protecting the taxpayer from losses resulting from that guarantee, that entity must have the authority to establish regulations to ensure that all of the many players in the complex housing finance system act in a fashion that does not expose the taxpayer to any losses.

Underwriting Standards

Ultimately, the underwriting standards for a loan to qualify for inclusion in a covered security should be controlled by the government agency responsible for covering losses on such securities: the FMIC. A similar system has worked fairly well for the FDIC and NCUSIF in establishing prudential standards for bank and credit union operation. Therefore, the less explicitly underwriting standards are prescribed in legislation, the better. Whereas QM standards could serve as a starting point for FMIC established standards, the law should not explicitly require that only QM loans could be eligible mortgages. The ability of a borrower to repay a loan depends on a number of characteristics; not just the absolute level of each characteristic, but also the interplay among those characteristics. Many of the underwriting standards of the QM rule are entirely appropriate for an eligible mortgage: documentation requirements, payment and debt ratio calculation methods, etc. But a bright line ceiling of 43% on the debt-to-income ratio, without any ability to consider other factors, would exclude too many qualified borrowers from enjoying the benefits of FMIC covered mortgages. For example, consider a borrower applying for an adjustable rate mortgage with annual adjustments after one year, a low down payment and a barely prime credit score. For such a borrower, even a 43% debt ratio could be far too high. However, for another borrower applying for a 30-year, fixed-rate loan with a large down payment, an active and pristine credit record and other positive characteristics, a 50% debt ratio could be completely acceptable.

FMIC should be instructed by Congress to create standards that facilitate consumer access to mortgage credit consistent with the overriding goal of minimizing risk to the taxpayer of paying for losses on covered securities, recognizing that those standards should evolve through time. Those standards may be similar to QM standards, but should not be required to be the same as QM standards.

Regulatory Structure

The entities providing secondary market services must be subject to appropriate regulatory and supervisory oversight to ensure safety and soundness, for example by ensuring accountability, effective corporate governance and preventing future fraud; they should also be subjected to strong capital requirements and have flexibility to operate well and develop new programs in response to marketplace demands.

The regulator created through any reform of the housing finance system must have a role centered on supporting securitization that does not duplicate the role of other regulators in the process. Both issuers and servicers are heavily regulated by a myriad of federal agencies, including the Bureau of Consumer Financial Protection (CFPB), Department of Housing and Urban Development and Department of Agriculture, in addition to the supervision performed by prudential regulators. Credit unions and other small lenders are drowning in regulation in the mortgage area, and we fear curtailing products and services as a result. Credit union members, and our housing recovery, lose as a result of regulatory burden. It is essential that any housing finance reform not create additional regulatory burden at the originator or servicer level; in fact, if done properly, the implementation of a new housing finance system could provide an opportunity to reduce credit unions' and other small lenders' regulatory burden, as we discuss later in this testimony.

That said, the secondary market needs strong regulatory oversight to ensure equal access for small institutions and an orderly functioning of the system. At a high level, the regulator should be a neutral third party that would ensure the secondary market is open to lenders of all sizes on an equitable basis, with equal pricing regardless of lender volume. Ideally, the regulator would provide issuers who feel they are not receiving equal treatment in the secondary market with an administrative process to protest. In turn, the regulator should have substantial authority to order a remedy, including banning the secondary market participant from using FMIC.

We envision a regulator in the mold of the National Credit Union Administration (NCUA) or the Federal Deposit Insurance Corporation (FDIC), with direct examination and supervisory authority, given that the full faith and credit of the United States stands behind FMIC insurance, as it does with NCUA or FDIC insurance. The entities providing secondary market services must be subject to appropriate supervisory oversight to ensure safety and soundness, for example by ensuring accountability, effective corporate governance and preventing future fraud; they should also be subjected to strong capital requirements and have flexibility to operate well and develop new programs in response to marketplace demands. In terms of specific powers, at a minimum, the regulator should have the authority to make rules, examine and supervise secondary market participants, suspend or revoke the power of any secondary market participant to use FMIC, place any secondary market participant into conservatorship or involuntary liquidation and study the operation of the secondary mortgage market to determine if its regulations are leading to the most efficient operation.

In terms of the regulator's governance structure, we recommend a board appointed by the President with the advice and consent of the Senate that would serve for fixed terms of five or more years (so as to be longer than the term of any one President). It is important for credit unions that, by statute, the board be required to include credit union representation. The board members should have minimum qualifications set by statute and come from the private marketplace, not be representatives of another regulatory agency. We leave it to Congress to set the minimum criteria for service on the board, but note that a minimum of 10 years of mortgage lending experience should provide the operational knowledge necessary to understand issuer concerns. Staggering terms of service makes sense to ensure continuity of the board.

The regulator could be funded by a small portion of the guarantee fee. We believe the regulator should have an Office of Small Lender Access and Equality, dedicated to the concerns of credit unions and banks under $15 billion in assets. That office should have the authority to study the pricing small institutions receive in the secondary market to determine if small institutions receive fair pricing.

In terms of the regulatory issues surrounding "too big to fail" and the housing regulator's interaction with other regulators, the new housing regulator should have a seat on Financial Stability Oversight Council (FSOC) and generally should be given similar authority as the FDIC and Federal Reserve over systemically important entities under the Dodd-Frank Act. The regulator should be required to consult with FSOC before placing a systemically important secondary market participant into conservatorship. To the extent not already the case under current law, any non-bank that is a participant in the secondary market should be subject to a possible systemically important designation, and should have to draft a "living will" if so designated. The new regulator should have a direct role in reviewing the living wills of any secondary market participant, as is the case with the FDIC and Federal Reserve. Where state-chartered entities, including insurance companies, are concerned, the company would be resolved under state law, but the federal housing regulator would have the authority to step in to handle that resolution if the appropriate state authority did not take what the regulator deemed to be the necessary action, as is true of the FDIC's similar authority under the Dodd-Frank Act.

Servicing Standards

Credit unions should continue to be afforded the opportunity to provide mortgage servicing to their members in a cost-effective and member-service oriented manner, in order to ensure a completely integrated mortgage experience for credit union members. To lose this servicing relationship would be detrimental not only to a vast majority of credit union members, but could also result in fewer mortgage choices available to credit unions and their members, with higher interest rates and fees being imposed on both.

Initial national mortgage servicing standards will likely be part of the common securitization platform being developed under the auspices of FHFA. They should be applied uniformly and not result in the imposition of any additional or new regulatory burdens upon credit unions. Going forward, private market participants should be able to revise servicing standards subject to oversight by the FMIC.

The FMIC should have legal authority to ensure that the development and implementation of all servicing standards are reasonable and fairly applied for all servicers; the legislation should ensure that eligibility requirements, compensation to or fees collected from servicers are not strictly based on volume but also reflect other reasonable factors such as in the case of compensation, the performance of the loans serviced.

The mutual securitization company should have the authority to transfer mortgage servicing rights but FMIC should be empowered to oversee the process and resolve issues of concern. Tracking of servicing rights is already provided in the private sector and there is no need to require the mutual securitization company or the FMIC to undertake this function.

To ensure that all servicers are treated fairly and appropriately by the mutual securitization company, the legislation should establish an ombudsman to interact with servicers and create a review process under which complaints raised by servicers will be investigated and resolved in a timely manner.

The regulation of servicing should be bifurcated with the FMIC overseeing how standards for servicing necessary to support securitization are developed while the protection of consumers in the servicing process should be left to the CFPB. In other words, the FMIC should not be granted authority to impose any additional consumer protection servicing requirements on regulated financial institutions that service mortgage loans. Such protections have already been established under a statutory and regulatory framework under the purview of the CFPB. While improvements to the current framework, such as changes to the servicers' exemption levels to ensure regulatory burdens on smaller servicers are minimized, should be considered, the regulation and oversight of the servicing process, including standards, should be left to the CFPB.

Transition Issues

The transition from the current system to any new housing finance system must be reasonable and orderly. We urge the Committee to allow for as much time as possible for the mutual to establish itself as a dominant market participant, for investors to acquire confidence in the securities issued by the mutual. The transition should end when the new system is fully functional, rather than after any specified period. Further, we recommend that the common securitization platform now being developed under the direction of the FHFA should be available to all market participants. Finally, once the earnings of the GSEs have fully paid back all government costs of their conservatorship, any further GSE earnings during the transition should be available to cover costs of standing up the new system, and beginning the funding of the reserve balance of the FMIC.

Unless the mutual is a dominant player in the market, it runs the risk of withering. Therefore, we feel strongly that the mutual should be fully operational before either of the GSE's are shuttered. Indeed, we expect that much of the infrastructure of the two GSEs will likely be transferred to both the mutual and FMIC during the transition.

The Federal Credit Union Act limits the types of investments that credit unions can hold. Since government agency securities are one of the few investments allowed, they tend to purchase and hold many of these securities. Therefore, in order to ensure the safety and soundness of credit unions, and to ensure the new FMIC securities perform on par as the current GSE securities we suggest a phased in approach to issuing the new security that would be blended with the Fannie and Freddie issued securities to ensure the investments hold their value and market stability is maintained.

To minimize market disruption, we would suggest that Fannie Mae, Freddie Mac and the FMIC be allowed to operate simultaneously so that all parties can get acquainted with the new system. In addition to gaining familiarity with the new system, it would be appropriate for both the GSE's and the FIMC to start issuing securities with each trying to mirror or have very similar characteristics of the other. As the last step in the process before Fannie Mae and Freddie Mac are wound down, blending the two securities together and selling them for a period of time under the new FIMC name may provide the market the necessary time to become comfortable with the new security. Ideally, market participants will not notice any sudden changes on the day that the GSEs are shuttered and the new system takes over. The many changes necessary to move from the old to the new system would already have happened gradually during the transition.

Finally, the common securitization platform now being developed under the direction of the FHFA should be available to all market participants. It could be "owned" and controlled by the mutual securitization company, or a separate mutual could make up of all issuers of covered securities. Its use should be required for all covered securities, which would likely make it the default for PLS. Regardless of who owns it, if its use were required for all covered securities, the FMIC would have *de facto* regulatory control over it.

Additional Concerns Specific to Credit Unions

Statutory limitations restrict the ability of credit unions to more fully serve their members and may inhibit their ability to be complete participants in the reformed housing finance system. Therefore, we would strongly encourage the Committee to consider the following statutory changes specific to credit unions as part of the reform of the housing finance system.

Investment Authority

As noted above, the Section 107(7) of the Federal Credit Union Act (12 USC 1757(7)) limits the types of investment that Federal Credit Unions may make to loans, government securities, deposits in other financial institutions, and certain other limited investments. We believe that credit unions may need additional investment authority in order to capitalize the mutual envisioned by S. 1217, and we encourage the Committee to provide that authority.

Multifamily Housing

In discussions prior to this hearing, CUNA was asked about the impact of S. 1217 on multifamily housing credit availability and pricing. Credit unions are not significant participants in the multifamily mortgage market primarily because of the statutory cap on business lending imposed in 1998. This cap limits credit unions business loan portfolio to essentially 12.25% of the credit unions assets. Compounding the matter, the Federal Credit Union Act considers a loan made on a 1-4 family non-owner occupied residence a business loan; whereas the same loan made by a bank would be considered a residential loan. Comprehensive housing finance reform legislation may provide the opportunity to correct this disparity in the statute. We encourage the Committee to include language that would amend the Federal Credit Union Act and consider loans made on 1-4 family residential properties as residential loans.

Relief from Dodd-Frank Act Mortgage Regulations

As Congress considers comprehensive housing finance reform legislation, it also may be prudent to consider changes to Dodd-Frank Act related mortgage regulations. The CFPB has finalized many thousands of pages of regulations with which credit unions and other community-based financial institutions must comply, despite the fact that they did not cause the mortgage crisis and have, throughout history, employed the strong underwriting principles the rules are designed to require.

The compliance obligations imposed by these rules – some of which were finalized in September and are effective in January – are simply overwhelming to many credit unions, and the tight timeframe for compliance puts the availability of mortgage credit at risk. While there has been suggestion by the CFPB and other regulators that they may not cite financial institutions for noncompliance for a period of time after the compliance date, the law carries a private right of action which would make credit unions and others vulnerable to lawsuits for noncompliance even as they work in good faith toward compliance. Another year would ensure that mortgage credit remains available to millions of credit union members while credit unions all over the country continue to understand how to implement the most sweeping regulatory changes to mortgage lending in U.S. history, and would be welcome relief to credit unions. We encourage Congress either through this legislation or as a separate bill to address this issue.

In addition to addressing the compliance dates of the mortgage regulations, we encourage the Committee to address several other areas of the mortgage regulations, including the definition of points and fees for the purposes of the CFPB's ability-to-repay rule, the credit risk retention requirements for the "qualified residential mortgage" rule and changes to the qualified mortgage rule.

We note that Senator Manchin has introduced S. 949, the Consumer Mortgage Choice Act, which would exclude from the definition "all title charges, regardless of whether they are charged by an affiliated company, provided they are bona fide and reasonable." Defining points and fees in this way will maintain a competitive marketplace, prevent over-pricing or limited choice in low-moderate income areas and allow consumers to enjoy the existing benefit of working through one entity for their new mortgage or refinance. A statutory revision would make this definition clearer and stronger than the CFPB's amended rule.

We hope the Committee will also consider including language in the housing finance reform bill to repeal the credit risk retention requirement in the "qualified residential mortgage" rule, and to allow the consumer to waive the requirement that mortgage disclosures be provided to the consumer three business days before closing.

Finally, we encourage the Committee to consider language to repeal the defense to foreclosure provision of the Dodd-Frank Act. The litigation risk created by the defense to foreclosure provision has caused many credit unions to worry that prudential examiners will severely restrict the ability of credit unions to keep non-QM loans that do not enjoy the QM rule's safe harbor in their portfolio after the rule goes into effect. This would make QM the effective requirement for safety and soundness and risk mitigation purposes. These changes would do a great deal to alleviate the very real concern of credit unions that they will not be able to offer mortgages to their members who do not meet all of the QM standards but who nevertheless have the ability to repay a mortgage loan. These changes will also help facilitate the kind of creative products that are possible through portfolio lending that individualize the process of getting a mortgage based on the individual circumstances of each member.

Conclusion

We are encouraged that the Committee has engaged in a process to consider comprehensive housing finance reform. Unquestionably, the housing finance system is in need of repair, and it is critical that Congress get reform legislation right or risk further damage to an already fragile economy. We appreciate that the Committee has sought our views on this legislation and look forward to providing continued assistance as the legislation moves through the process. On behalf of America's credit unions and their 97 million members, thank you for your consideration of our views.