



Credit Union National Association

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TESTIMONY
OF
BILL HAMPEL
SENIOR VICE PRESIDENT AND CHIEF ECONOMIST
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON SECURITIES, INSURANCE AND INVESTMENT
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

HEARING
ON
“CREATING A HOUSING FINANCE SYSTEM BUILT TO LAST: ENSURING ACCESS
FOR COMMUNITY INSTITUTIONS”

JULY 23, 2013

Testimony
of
Bill Hampel
Senior Vice President and Chief Economist
Credit Union National Association
Before the
Subcommittee on Securities, Insurance and Investment
Committee on Banking, Housing and Urban Affairs
United States Senate
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“Creating a Housing Finance System Built to Last: Ensure Access for Community Institutions”
July 23, 2013

Chairman Tester, Ranking Member Johanns, Members of the Subcommittee:

Thank you very much for the opportunity to testify at today’s hearing entitled, “Creating a Housing Finance System Built to Last: Ensuring Access for Community Institutions.” My name is Bill Hampel, Senior Vice President and Chief Economist at the Credit Union National Association (CUNA) headquartered in Madison, Wisconsin. CUNA is the largest credit union industry trade association representing America’s state and federally chartered credit unions and their nearly 97 million members.

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 96 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 [13%], consumer loans [39%] and small business loans [7%]. Just last year alone, credit unions

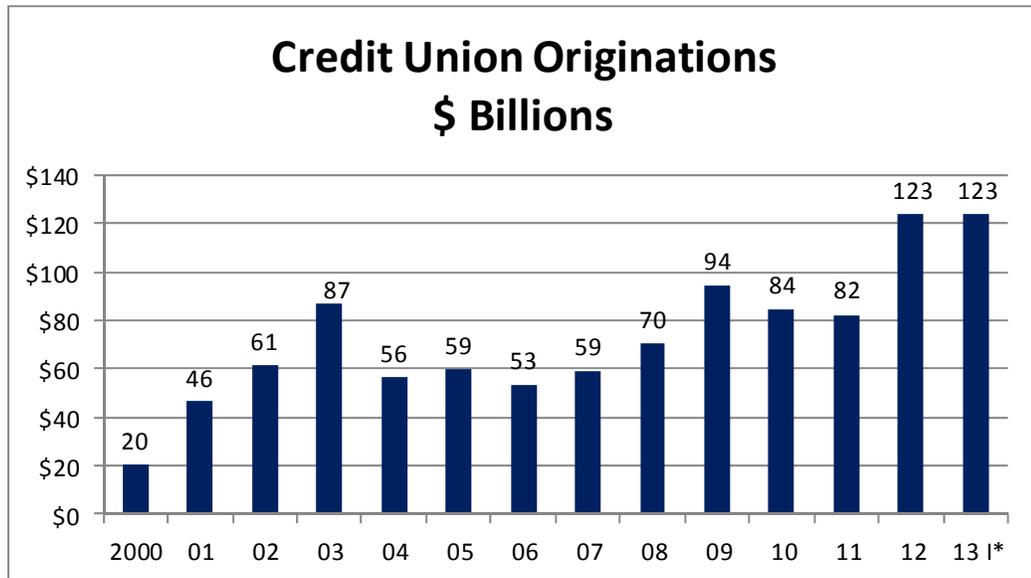
originated \$123 billion of first mortgages, representing 6.5% of the entire mortgage origination market. Credit unions are now significant players in residential real estate finance, and historically our market share has risen annually to reflect the growing demand of our members.

Currently, 4,300 credit unions (62%) offer first mortgages to their members. Because larger credit unions are more likely to offer mortgages than smaller ones, 88 million (92%) 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 mortgages products in order to ensure they can continue meeting their members' mortgage needs.

Historically, with fields of membership tied to larger employers, credit unions have a greater presence in urban areas than in rural districts. At the end of 2012, 1.1% of credit union members belonged to credit unions headquartered in rural districts. These credit unions originated \$750 million of first mortgage loans in 2012, or 1.2% of the number of loans originated in 2012.

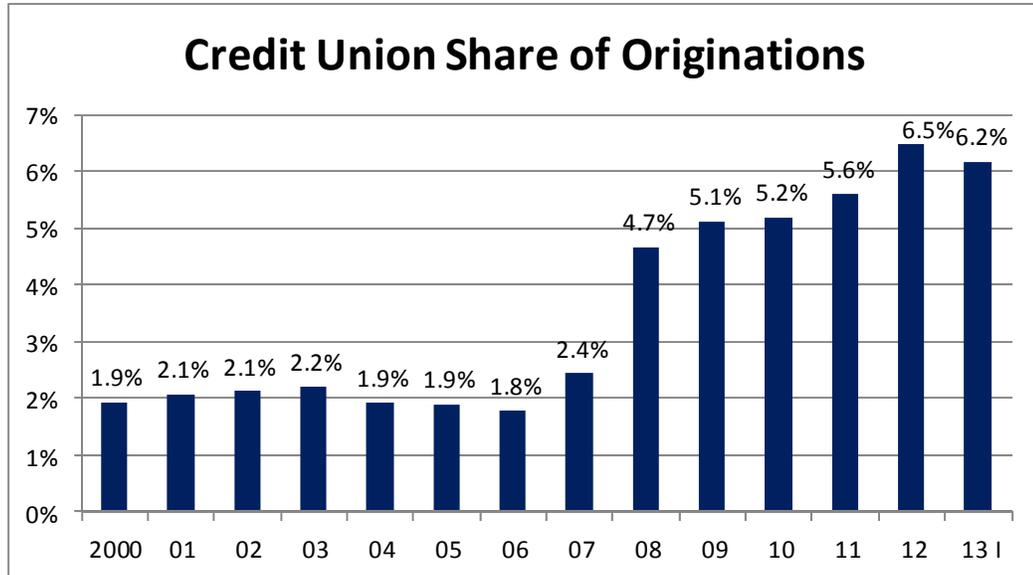
From 2000 to 2006, annual credit union originations of first mortgages averaged just under \$55 billion. As the subprime mortgage crisis began to weaken the secondary market for mortgage loans in 2006 and 2007, credit union origination volume began to rise dramatically. Homebuyers increasingly turned 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 over \$120 billion in 2012 and the first quarter 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.



*2013: First quarter, annualized

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 \$1.9 trillion in 2012, at an annual rate of \$2 trillion in the first quarter 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.

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 2012, and as much as 58% in the first quarter of 2013.

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

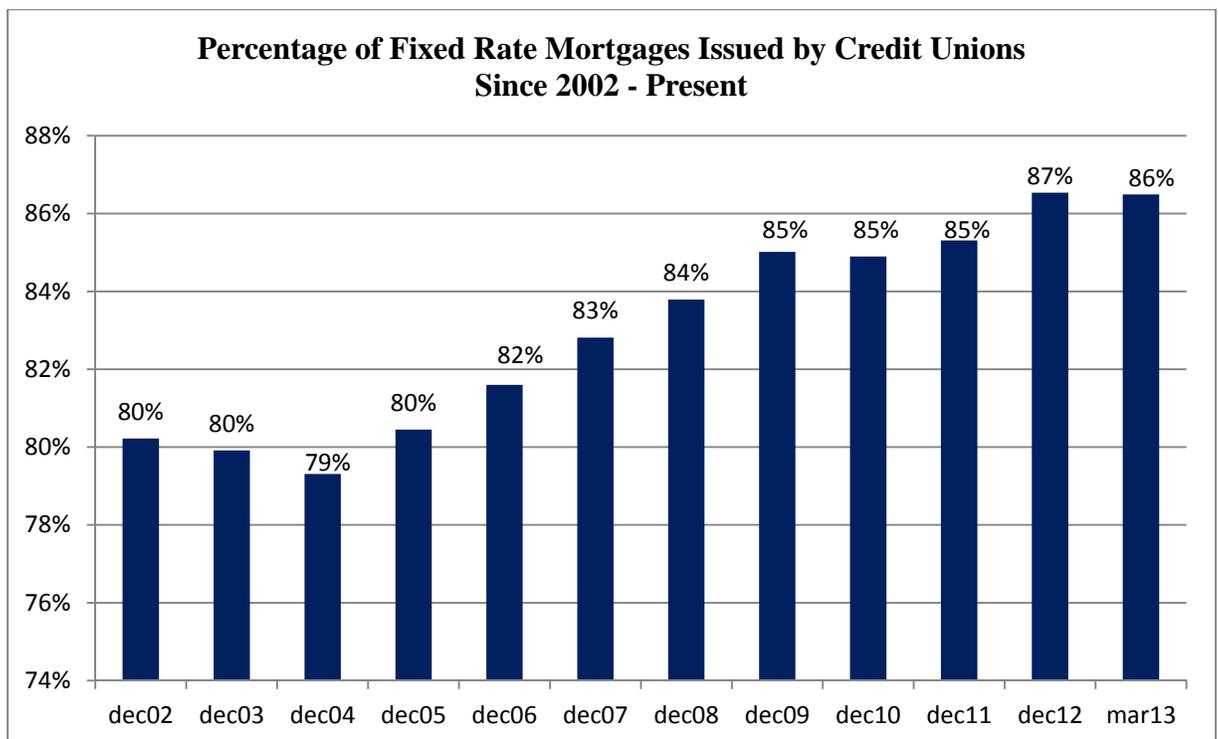
service. Many credit unions are reluctant to entrust the core function of serving members to others, unless they have a stake and a say in the entity doing the servicing. Credit unions are also concerned that third-party servicers might use the data they gather about credit union members to market competing products or services. 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 \$248 billion of first mortgages that credit unions hold in portfolio, they also service \$145 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. 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) induce management to eschew higher-risk, higher-return strategies. As a result, credit union operations are 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 product over 80% of the time, compared to a variable rate mortgage (see graph below). Just in the first quarter of 2013, 86% of the mortgages issued by credit unions were fixed rate products. Congress should acknowledge that the American homebuyer prefers a fixed rate mortgages and do everything in its power to ensure this important mortgage product remains a valuable part of housing finance.



Overview of CUNA Principles for Housing Finance Reform

As Congress studies and debates the issue of housing finance reform, we would like to share with this Committee our general principals with respect to the secondary market needs of credit unions:

- 1) There must be equal and unbiased access to the secondary market for lenders of all sizes.
CUNA understands that the users – lenders and borrowers – of a reformed secondary market will be required to share in the cost of housing finance. However, these fees should not penalize smaller institutions due to lender volume.
- 2) A strong regulator must be created so that rigorous oversight of the market will ensure safety and soundness, standardization within the system and guarantee equal access.
- 3) The new system must provide for liquidity in all economic times and recognize that all qualified borrowers have the ability to obtain a mortgage.
- 4) The new housing finance system should emphasize consumer education and counseling as a means to safeguard consumers so they may receive appropriate mortgages.
- 5) Proper attention should be given to provide products that are predictable and affordable to all qualified borrowers. The 30 year fixed rate mortgage has traditionally been the product that best fulfills this requirement.
- 6) Reasonable conforming loan size limits that adequately take into consideration variations in local real estate costs should be considered as a necessary component of any legislation.
- 7) Credit unions strongly believe in the ability to retain the servicing rights of their members mortgages when sold on the secondary market.

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

The Secondary Mortgage Market Reform and Taxpayer Protection Act of 2013

Credit unions appreciate and applaud Senators Corker, Warner, Tester, Johanns, Heitkamp and Heller for introducing S. 1217, the “Secondary Mortgage Market Reform and Taxpayer Protection Act of 2013.” This bill is a right step towards reforming the housing finance system and pays special attention to smaller lenders, like credit unions, while protecting the American taxpayer.

At the heart of the legislation is the creation of the Federal Mortgage Insurance Corporation (FMIC) that will operate with a federal charter. The FMIC is designed to foster liquidity and the availability of mortgage credit in the secondary mortgage market, while protecting the taxpayer from losses. The bill calls for the wind-down of Fannie Mae and Freddie Mac within 5 years, but allows for flexibility to protect markets from overacting if more time is needed to sell the Fannie & Freddie portfolios. CUNA understands there may be negative market reaction to the shuttering of the Government Sponsored Enterprises (GSE) and we appreciate that thought has been given to the ramifications for home mortgage finance if this process takes places in an expedited manner.

The management of the FMIC will be conducted by a Director who will be appointed for 5 years and chairperson to a five person Board of Directors with varying backgrounds in mortgage insurance markets, assets management, community-based financial institutions, and multi-family housing development. Creation of the independent board is a thoughtful approach to the management of the FMIC, but because of the unique structural nature

of credit unions we urge that a seat on the FMIC be reserved for a representative of the credit union system.

Mortgage Insurance Fund & the Government Guarantee

The creation of a Mortgage Insurance Fund (MIF) with the intent to cover any losses incurred by mortgage securities traded and held in the secondary market, capitalized by premiums collected from issuers and investments held in portfolio is an acceptable approach that will protect taxpayers from losses in the event of a catastrophic economic event. CUNA appreciates that the MIF will have the “full faith and credit of the U.S. Government” and strict regulation by the FMIC, which will ensure overpricing of mortgages does not occur.

In addition to the MIF, the bill sets into place a full government guarantee as the ultimate backstop and we appreciate that it would only be used “in unusual and exigent market conditions” no more than once in any given 3 year period. CUNA fully supports the inclusion of an explicit government guarantee and the market stability that accompanies this provision.

Exclusion of the Qualified Residential Mortgage & Considerations of a Qualified Mortgage

Credit unions also welcome the inclusion of section 207 that would eliminate for credit unions and other lenders risk retention requirements that are to be implemented under Qualified Residential Mortgage (QRM) standards that are being developed by regulators. Allowing financial institutions to sell properly underwritten mortgages to the secondary market without the unnecessary burden of retaining a significant portion of the loan on a credit unions balance sheet is greatly appreciated.

We urge the committee to take a closer look at the Qualified Mortgage (QM) rule issued by the Consumer Financial Protection Bureau earlier this year as you consider housing finance reform. Historically, credit unions have been portfolio lenders, holding 60-75% of the mortgages they write on the books in most years prior to the financial crisis. The incentives of portfolio lenders are different from those that primarily sell into the secondary market, given that the lender bears the entire risk of default. Portfolio lenders have strong incentives to pay close attention to the borrower's ability to repay, and credit unions, given that their members are also their owners, have especially strong incentives to employ sound underwriting practices. There is a very real concern that credit unions will not be able to offer mortgages to their members who do not meet all of the QM standards, but nevertheless have the ability to repay a mortgage loan. Our prudential examiners may "encourage" credit unions to focus only on QMs as a way to limit a lender liability, furthermore, the secondary market may be unwilling to accept non-QM loans if viewed negatively by regulators. However, strict adherence to QM does not facilitate the kind of creative products that are possible through portfolio lending based on the individual circumstances of each member.

Simply put: credit unions have every incentive to evaluate a member's ability to repay because their members are also their owners. We encourage the Committee to work with the CFPB and prudential regulators to ensure lenders with a proven history of properly writing non-QM loans will retain the continued ability to serve the mortgage finance needs of all members who can afford an appropriately structured mortgage, whether it is QM or not.

Secondary Market Access

Section 215 would establish a "Mutual Securitization Company (MSC)" the purpose of which would be "to develop, securitize, sell and meet the issuing needs of credit

unions and community and mid-size banks with respect to covered securities.” CUNA strongly supports the creation of the MSC that will ensure credit union access to a well regulated secondary market in a manner that will safeguard fairness and market liquidity during every economic occurrence.

Credit unions do have concerns regarding the relatively low asset cap of \$15 billion per institution. As the marketplace continues to force never ending changes to the size of community based financial institutions, thought must be given to the future appearance of these organizations. Credit unions have seen the largest influx of membership in our history, gaining over 2 million members in the past year. As more Americans embrace the benefits of becoming a credit union member, we fully expect the explosion in credit union membership growth to continue. As a direct result of such growth many credit unions over the next 10 to 15 years could be above the \$15 billion asset cap. We urge the committee to consider higher caps so that more community based institutions can access the MSC. Increasing the eligibility size of credit unions and community banks will also ensure that the MSC is well capitalized, guaranteeing its future stability.

The bill would also increase the role of the Federal Home Loan Bank (FHLB) system in the securitization process of mortgages to the secondary market. CUNA encourages the increased usage of FHLBs and sees the entities as a positive force in housing finance. As we have previously noted for the sponsors of the legislation, only a small number of credit unions use the Federal Home Loan Banks, due in large part to FHLB requirements that hinder their

access. For example, in order to join a FHLB, a portion of a credit union's qualifying assets must be in either mortgages or mortgage backed securities, which creates problems for smaller credit unions. Further, state chartered privately insured credit unions are not permitted to join a FHLB.

Conclusion

In conclusion, CUNA recognizes that reforming the secondary market to ensure a viable housing market is no easy task. We greatly appreciate the leadership this Committee has put forward in addressing the needs and concerns of our members so that the American dream of homeownership will not be disadvantaged by inflated costs and government imposed limitations that could result in undue impediments that would hinder access to a safe and affordable secondary market.