SUSTAINABLE HOUSING FINANCE: PRIVATE SECTOR PERSPECTIVES ON HOUSING FINANCE REFORM

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Wednesday, October 25, 2017

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HOUSING
AND INSURANCE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Sean Duffy [chairman of the subcommittee] presiding.

Present: Representatives Duffy, Ross, Royce, Pearce, Posey, Luetkemeyer, Stivers, Hultgren, Rothfus, Zeldin, Trott, MacArthur, Budd, Hensarling, Cleaver, Capuano, Sherman, Beatty, and Waters.

Also present: Representative Hill.

Chairman DUFFY. The Subcommittee on Housing and Insurance will come to order. Today's hearing is entitled, "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform."

Without objection, the chair is authorized to declare a recess of the subcommittee at any time. And without objection, all members will have 5 legislative days within which to submit extraneous materials to the chair for inclusion in the record.

Without objection, members of the full committee who are not members of the subcommittee may participate in today's hearing for the purpose of making an opening statement and asking our great panel of witnesses questions.

The chair now recognizes himself for 3 minutes for an opening statement. I first want to thank the panel for taking the time out of your busy lives to come in and testify for us today, to dispense great wisdom and insight for us as we look at housing finance reform. This is one of many hearings that we are going to hold on this very topic.

If you look at the panel today, you will notice that there is a common theme, and that is finance. Well, the most important person reforming housing finance system are home buyers, it is vitally important that the way we reform the housing finance system allows for a transition that provides certainty to those that are involved in making the dream of home ownership come true, the dream of a family of finally being able to own a home.

We have seen a number of principles and proposals in the last decade on reforming the housing finance system and they have come from academics and think tanks and the private sector. Even Members of Congress have put out ideas and principles on how this reform should look.

What I hope for today is to hear from all of you on which of those principles and proposals you believe would be best for us to focus on. I want to hear from the panel about what we can preserve in the current system.

But more importantly, what isn't working? And how do we incentivize more of the private sector development? Many of you have called for an explicit government guarantee on mortgage-backed securities. And we should explore your proposals.

But can we also structure a system in which private capital comes in and bears that frontal risk where we also have that catastrophic government backstop? How do we deal with the duopoly of Fannie and Freddie to limit taxpayers' exposure on losses?

How do we expand the pool of eligible investors for credit risk transfers? Is it appropriate for the GSEs to continue to own the common securitization platform, or can we utilize that structure for all housing finance reform stakeholders?

We need a system that will allow for consumers to have a variety of options in mortgage products. One of our top goals should be a system that promotes affordability, choice, and innovation.

While incentivizing the development of options, we must also ensure that people are not entering into mortgages they cannot afford. They can't maintain because we see how disastrous this is for our economy, but also for the very families who have mortgages and they go in default and then foreclosure. So I look forward to our panel's testimony today.

And with that, I yield to the ranking member, the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. Thank you for the hearing today on private sector perspectives on housing finance reform. And thank you to the witnesses for joining us today.

Today's hearing will focus on the private sector's perspective regarding housing finance reform. And earlier this month, we had the opportunity to hear from Director Mel Watt on his assessment on the current state of FHFA.

I welcome Dr. Watt's update on FHFA's effort in developing the common securitization platform, as well as his opinion on the significance of the housing trust Fund and capital magnet fund. It is important to remember that we are in the midst of an affordable housing crisis, and this funding plays an important role in developing and creating affordable housing in our country.

The national low income housing coalition released a report recently, and in that report I pulled out something that I probably will not forget while I am here in Congress. And they wrote, and I quote, "There is no State, city or county where a minimum wage worker can afford to rent a modest two-bedroom apartment." And that is tragic.

There is some work to be done. And many of my constituents are still recovering from the financial crash of 2008 and to be sure, our entire economy is still trying to recover.

The recession greatly exacerbated the wealth gap, especially for vulnerable communities, including African Americans, Hispanics and low income individuals. Home ownership has historically been an important piece of the puzzle in building wealth in this country, a critical component of the American Dream I would add.

The recession devastated decades of accrued wealth, leaving many in dire situations with foreclosed homes as rampant unemployment plagued the communities. As we move forward in discussing GSE reform, it is important to ensure that the housing finance system is inclusive.

Though congressional efforts on housing finance reform stalled in the 113th Congress, I am hopeful that the committee will be able to work together on a bipartisan basis this Congress.

I believe that any attempt to reform the GSEs must preserve the 30-year fixed rate mortgage. And I look forward to hearing our witnesses' perspective on this.

Additionally, reform to our housing finance system must focus on preserving affordability in the housing market, protecting taxpayers, providing stability and liquidity in the market, and ensuring access to smaller lenders. I look forward to hearing from our witnesses.

And thank you, Mr. Chairman.

Chairman DUFFY. The gentleman yields back. And I do look forward to working with him.

The chair now recognizes the vice chair of this subcommittee, the gentleman from Florida, Mr. Ross, for 2 minutes.

Mr. ROSS. Thank you, Chairman Duffy, and thank you for calling this hearing. As this subcommittee prepares to address one of the most intractable, complex and, indeed, divisive policy matters facing Congress, it is important that we talk to those who work in this field day in and day out. So I thank you all for being here and joining us for this hearing.

Notwithstanding the many questions that obstruct our path forward on housing finance reform, one thing is absolutely certain: the status quo is unsustainable. Congress needs to allow Americans to have a better housing finance system rather than continue to support the endless boom and bust cycles in real estate.

Americans deserve a competitive marketplace that provides choice and opportunity to the hardworking men and women of this country. The financial crisis of 2008 was not that long ago. We should not forget that at its core, the Federal Government had created a system that was unsustainable.

According to Peter Wallison of the American Enterprise Institution, "By 2008, 19.2 million of the total 27 million sub-prime and other weak loans in the U.S. financial system could be traced directly or indirectly to U.S. Government housing policies." We saw what came of that.

The two biggest players in the housing finance world, Fannie Mae and Freddie Mac, required a taxpayer bailout in the amount of $200 billion. And yet in the flurry of new laws that followed the crisis, nothing, next to nothing was done to address the underlying structural failings that played such a large role in the financial crisis.

When Dodd-Frank was passed, legislators argued it would prevent another crisis. But much of what it did only seemed to add greater layers of bureaucracy, incentivize greater consolidation, and further obscure the weaknesses of our housing finance system.

The fact is we are doomed to repeat history unless we take the time and hearings like this one to dig into those difficult issues that our constituents sent us here to address.

I think we all know why the Federal Government is involved in housing finance. It is because we recognize that home ownership is a fundamental part of the American Dream. But today I am looking forward to hearing about ways people can achieve that American Dream without fear of another economic collapse that turns the dream of home ownership into a nightmare.

Thank you, and I yield back the balance of my time.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the gentleman from California, Mr. Sherman, for 2 minutes.

Mr. SHERMAN. One problem is the availability of affordable housing. We need to build more apartments, condos, and homes. That is in significant degree a local decision because you cannot build if they don't let you build.

The 2008 crisis came because we allowed the bond rating agencies to give AAA to Alt-A. They get paid by the issuer and if they give a good grade they get another contract. I think the market has been spooked, correctly, so much that this is unlikely to happen again until we forget that it happened.

But to blame this on Fannie Mae and Freddie Mac is absurd. The problem was the tendency to invest in bad mortgages just because they yield an extra quarter percent.

The current system works spectacularly well. Ordinary working families are able to borrow. Now, there are some problems, but compared historically, when in history have ordinary working families been able to borrow $300,000, $400,000, $500,000 at fixed rate, low rate, from people they have never met?

This is a system that ought to be preserved. The failure was when we tried to have Fannie and Freddie be both government agencies in terms of their downside and private corporations in terms of their upside. That is called crony capitalism, socialism for the wealthy, whatever term you use. It is a bad system.

So we now have a system that generates a substantial profit for the Federal Government and no one on this committee has offered the tax increase legislation to replace that profit. So we have a system that creates profit for the Federal Government, allows ordinary families to borrow huge amounts at low interest rates, and I don't know why we are talking about throwing the whole thing away.

Thank you.

Chairman DUFFY. The gentleman yields back.

We now welcome our panel and our witnesses. Our first witness is Mrs. Brenda Hughes—welcome—senior vice president of First Federal Savings on behalf of the ABA.

Our next witness is Mr. Samuel Vallandingham—I hope I got that right—president and CEO of First State Bank on behalf of Independent Community Bankers of America.

Next we have Ms. Nikitra Bailey, executive vice president at the Center for Responsible Lending. Welcome.

Next we have Mr. Kevin Chavers, managing director of BlackRock on behalf of the Securities Industry and Financial Markets Association or SIFMA. Welcome.

And finally, last but not least, we have Mr. Rick Stafford, president and CEO of Tower Federal Credit Union on behalf of the National Assessment of federally Insured Credit Unions. To all, welcome.

The witnesses will in a moment be recognized for 5 minutes to give an oral presentation of their testimony. Without objection, the witnesses' written statements will be made part of the record following your oral remarks.

Once the witnesses have finished presenting their testimony, each member of the subcommittee will have 5 minutes which they can ask all of you questions.

You will note on the table in front of you there are three lights. The green light means go, the yellow light means you have 1 minute left, and the red light means your time is up. Your microphones are sensitive so please make sure that you are speaking directly into them.

And so with that, Ms. Hughes, you are now recognized for 5 minutes for your presentation.

STATEMENT OF BRENDA K. HUGHES

Ms. HUGHES. Good morning. Chairman Duffy, Ranking Member Cleaver, my name is Brenda Hughes.

Chairman DUFFY. And Ms. Hughes, if you would just pull your microphone up so we can all—

Ms. HUGHES. OK.

Chairman DUFFY. Or pull it directly—yes.

Ms. HUGHES. OK. Thank you.

Chairman DUFFY. We want to hear your testimony. Thank you.

Ms. HUGHES. I serve as senior vice president and director of Mortgage and Retail Lending for First Federal Savings of Twin Falls, Idaho. We are a $622 million asset savings association founded in 1915. I appreciate the opportunity to be here to present APA's views on GSE reform and community bank access.

This issue is a critical one for our country. Americans have relied on access to long-term fixed rate mortgages for 70 years.

Fannie Mae and Freddie Mac have facilitated access to this product by providing access to the capital markets for primary market lenders. These GSEs have been a conservatorship for nearly 9 years. We should not delay reform any longer.

Absent aggregation and securitization, access to long-term lower rate funding would be far more difficult to come by for most primary lenders. The government backstop provided to mortgage-backed securities, guaranteed by the GSEs make them attractive to the capital markets, ensuring liquidity.

As we consider reform, these elements must be preserved and remain available to support all primary market participants, regardless of size or location. First Federal relies on this access and actively delivers loans directly to Freddie Mac, retaining servicing on these loans. We currently service approximately 5,100 loans.

Like so many banks, both large and small, access to the secondary markets or federally guaranteed secondary market is essential to our ability to meet the mortgage needs of our customers.

ABA has worked with bankers from institutions of all sizes and from all parts of the country to develop shared principles which should guide reform of the GSEs.

For my testimony today, I would like to highlight a few key principles. More detail on these principles can be found in my written testimony.

We believe that the following principles should form the basis for legislative reform efforts. First, the GSEs must be strictly confined to a secondary market role, providing stability and liquidity to primary mortgage market for low to moderate income borrowers.

They must be strongly regulated, thoroughly examined and subject to immediate corrective action for regulatory violations. In return for their GSE status, and the associated benefits, entities must agree to support all segments of the primary market in all economic environments and provide equitable access to all primary market lenders.

This includes the preservation of the to-be-announced market and both servicing and retained and sold options. Mortgage-backed securities issued by the GSEs should carry an explicit guarantee from the Federal Government. These guarantees should be fully paid for through the guarantee fees equitably assessed.

The GSEs must be capitalized appropriately. Capital requrements must be tied to sound underwriting practices to ensure that it reflects the risk borne by these institutions.

Expanding affordable housing is also an important component of the GSEs' mission. The FHLB Affordable Housing Program is a strong model that has delivered over $5.4 billion in funds to expand affordable housing, and we believe it should be used as a model in a reformed GSE system.

Credit risk transfers required by FHFA should be continued and expanded. The vital role played by the Federal Home Loan Banks, not to be confused with the roles played by Fannie Mae and Freddie Mac, is working today, and must not be impaired.

Congress has an essential role in providing the certainty necessary to ensure long-term stability of the housing finance system. Without legislative reform, past abuses may be repeated.

Some will argue that this can be accomplished via regulation, and FHFA has done an admirable job in recent years ensuring equitable treatment and addressing other past abuses. However, regulators and other regulatory approaches can change over time. While a strong regulator must be part of reform, so too, must be clear statutory guidance.

Reform not need be radical or extreme, but comprehensive. Legislation need not create an entirely new secondary market structure. In fact, guided by these key principles we believe that relatively tailored legislation that takes a surgical approach to making necessary alterations to the current system is desirable and can achieve the needed comprehensive reform.

These legislative reforms are critical. Just as the Federal debt market provides a bellwether that makes all private debt markets more efficient and liquid, an explicit, fully priced, fully paid for

Federal guarantee for a targeted portion of the mortgage market will be a catalyst for broader market growth and development.

Congress should not defer action any longer. 9 years of conservatorship is more than enough. Thank you for the opportunity to share our views with the subcommittee, and I am happy to answer any questions you have.

[The prepared Statement of Ms. Hughes can be found on page 75 of the appendix.]

Chairman DUFFY. Thank you.

Mr. Vallandingham, you are now recognized for 5 minutes.

STATEMENT OF SAMUEL A. VALLANDINGHAM

Mr. VALLANDINGHAM. Thank you, sir. Chairman Duffy, Ranking Member Cleaver, members of the subcommittee, I am Samuel Vallandingham, president and CEO of the First State Bank, a $200 million asset bank in Barboursville, West Virginia.

As a fourth generation community banker, I am pleased to be here today on behalf of ICBA and more than 5,700 community banks. ICBA strongly sports GSE reform, but it is critical to borrowers in the broader economy that the details of reform are done right.

Community bank mortgage lending is vital to the strength and breadth of America's housing market. Community banks represent approximately 20 percent of the mortgage market, but more importantly, our mortgage lending is often concentrated in rural areas and small towns, which are not effectively served by large banks.

For many rural and small town borrowers, a community bank loan is the only option for buying a home. Through a correspondent network of 60 community banks, First State Bank serves over 60 rural and suburban communities in the eastern United States.

Our bank survived the Great Depression and numerous recessions, as have many ICBA member banks by practicing conservative, commonsense lending and serving our community through good times and bad.

Today I would like to talk to you about my bank's mortgage lending and the importance of secondary market access. The First State Bank has been selling mortgages in the secondary market since 1980 to access additional funding.

Today we have a nearly $600 million servicing portfolio, consisting of approximately 5,500 loans, many of which are purchased from other community banks. Most of these loans are held by Freddie Mac and a smaller number are held by Fannie Mae. First State Bank and our customers depend on secondary market access.

The secondary market allows me to meet customer demand for fixed rate mortgages without retaining the interest rate risk these loans carry. As a small bank, it is not feasible for me to use derivatives to manage interest rate risk.

Selling in the secondary market frees up my balance sheet to serve customers who would prefer adjustable rate mortgage loans, as well as small business loans, which play a vital role in our community.

ICBA's approach to GSE reform is simple. Use what is in place today and is working well and focus reform on aspects of the current system that are not working or that put taxpayers at risk.

ICBA has developed a comprehensive set of secondary market reform principles. First, community banks must have equal and direct access. They must have the ability to sell loans individually for cash under the same terms and pricing available to larger lenders.

Second, there can be no appropriation of customer data for cross-selling of financial products. We must be able to preserve our customer relationships after transferring loans.

Third, originators must have the option to retain servicing at reasonable cost. Servicing is a critical aspect of the relationship's lending business model vital to community banks.

Finally, an explicit government guarantee on GSE mortgage-backed securities is needed. For the market to remain deep and liquid, government catastrophic loss protection must be explicit and paid for through GSE guarantee fees at market rates.

This guarantee is needed to provide credit assurance to investors, sustaining robust liquidity even during periods of market stress.

Without these principles, we could see further consolidation of the mortgage market, which would limit borrower choice and disadvantage communities. Any version of reform that effectively transfers the asset's infrastructure or functions of the GSEs to a small number of megafirms could devastate the housing market in thousands of small communities and put our financial system at risk of another financial collapse.

Finally, ICBA believes that the GSEs must be allowed to rebuild their capital buffers. Though Fannie Mae and Freddie Mac have returned to profitability, the quarterly sweep of their earnings to the Treasury has seriously depleted their capital buffers.

Absent a change in policy, they are on track to fully deplete their capital by year-end. A draw from the Treasury could trigger a market disruption. This self-inflicted crisis can and must be avoided.

While Congress debates the reform the FHFA should protect taxpayers from another bailout. ICBA urges FHFA to follow the Housing and Economic Recovery Act of 2008 and require both GSEs to develop and implement a capital restoration plan.

ICBA is pleased to see a robust debate emerging on housing finance reform and hopes to have a seat at the table on behalf of the communities we serve as these discussions continue.

Thank you again for holding this hearing and for the opportunity to testify.

[The prepared Statement of Mr. Vallandingham can be found on page 106 of the appendix.]

Chairman DUFFY. Thank you.

Ms. Bailey, you are recognized for 5 minutes.

STATEMENT OF NIKITRA BAILEY

Ms. BAILEY. Good morning, Chairman Duffy, Ranking Member Cleaver and members of the House Committee on Financial Services Subcommittee on Housing and Insurance. Thank you for the opportunity to testify regarding our Nation's housing finance system, an issue that profoundly affects American families and is critical to the overall housing industry, which is nearly 20 percent of the United States' economy.

I am executive vice president of the Center for Responsible Lending, a nonpartisan, nonprofit research and policy organization dedicated to protecting home ownership and the family wealth that it creates.

We are an affiliate of Self-Help Credit Union, local community economic development lender that is based in Durham, North Carolina, that has provided over $7 billion of financing to borrowers, homeowners, small community organizations such as health facilities and nonprofits and charter schools across the Nation.

We also have a credit union network that serves over 130,000 people in the States of North Carolina, California, Chicago, Florida and Wisconsin.

Reforming the housing finance system presents Congress with the chance to make America as good as its promise. For most families, the secondary market's purpose is simple. It is about providing opportunity to pursue homeownership and the security that homeownership offers.

Homeownership is the engine that drives the economy by creating jobs that stabilize communities all across our Nation. The jobs created by homeownership are HVAC installers, tile layers, plumbers and clerks at local home improvement stores. Homeownership has been the primary vehicle that most families use to build wealth and remain in a stable middle class.

Sadly, our housing finance system is rooted in lending discrimination. Several policies created as a response to the 1930's' Great Depression were designed to help spur economic growth and appear to treat everyone the same.

However, these policies provided affirmative benefits to white families of European ancestry, while denying mortgage credit to African Americans and people of color.

The Federal action prevented families of color from building wealth through homeownership. And I want to give you two examples of the impact of this.

In the first 35 years of the FHA's administration, 98 percent of loans went to white families, with only 2 percent of loans going to families of color.

In the State of Mississippi in the V.A. program two out of 3,229 loans went to black servicemembers who served our country in the first 3 years of the program's implementation. As a result, white families had a leg up and an ability to build wealth faster.

Borrowers of color entered into a market that was redlining, subject to predatory lending, and they were often pushed into loans that made foreclosure more probable. These families lost $1 trillion of wealth as a result of abusive lending practices.

The African American homeownership rate today is the exact rate that it was in 1968 when this Congress passed the Fair Housing Act in response to the death and assassination of one of our country's great leaders, Dr. Martin Luther King, Jr.

The Federal Government's role in perpetuating housing discrimination in the housing finance system must be addressed because the families stymied by the millstone of racism deserve a chance to succeed.

Future reforms must build on HERA and the new great protections offered by Dodd-Frank and the Consumer Financial Protection Bureau that has stabilized the mortgage market as it is on a path to receiving steady returns.

The duty to serve provisions that began in the GSEs' charters and remain in HERA, require that credit is available all across the Nation in all communities.

This directive creates liquidity for loans in every community, and especially in rural communities, and helps small lenders gain access to credit because oftentimes they are the ones serving the mortgage needs of those communities that are left behind.

We must make sure that small lenders are on equal footing with large lenders, and we must preserve the affordable housing goals.

I will end today by thanking you for your great work that you have already done. Please build on this existing reform.

And contrary to varies that Dodd-Frank stifled the market, in 2006, financial institutions had total annual profits of $171 billion, the highest level since 2013. Community bank profitability rebounded as well, and by the end of 2015, over 95 percent of community banks were profitable.

Thank you for the opportunity. I look forward to answering your questions.

[The prepared Statement of Ms. Bailey can be found on page 42 of the appendix.]

Chairman DUFFY. Thank you, Ms. Bailey.

Mr. Chavers, you are recognized for 5 minutes.

STATEMENT OF KEVIN CHAVERS

Mr. CHAVERS. Good morning. Chairman Duffy, Ranking Member Cleaver and members of the subcommittee, thank you for the opportunity to testify today on the important topic of housing finance reform.

My name is Kevin G. Chavers, and I am the managing director at BlackRock focusing on public policy issues, testifying today both on behalf of BlackRock and the Securities Industry and Financial Markets Association, better known as SIFMA.

BlackRock manages assets on behalf of individual and institutional clients across equity, fixed income, real estate, and a host of other strategies. Our clients include pension plans, charities, foundations, endowments, financial institutions, as well as individual savers around the world.

The assets we manage represents our clients' futures and the investment outcomes they seek, and it is our responsibility to help them better prepare themselves and their families for their financial goals.

SIFMA and its member firms appreciate the attention being paid to housing finance reform and believe it is timely for Congress to move forward with meaningful reforms that protect taxpayers, ensure access to affordable housing and maintain deep and liquid markets, including the preservation of a highly TBA market.

Since the financial crisis, policymakers have contemplated an array of proposals for what the next iteration of the housing finance system could look like. While SIFMA believes that some of these proposals are certainly worthy of consideration in whole or in part, we would like to take this opportunity to discuss a few key principles that SIFMA believes Congress should consider when developing any housing finance reform legislation.

At a high level, our guiding principles for reforming housing finance are the need for clearly defined and limited government role to facilitate liquidity yet protect taxpayers, transparency at all levels, and a framework to attract private capital.

The primary focus of SIFMA has been and will continue to be the preservation of a highly liquid TBA market which provides a number of important benefits to consumers, lenders and the economy. The TBA market is roughly a $5 trillion market that helps borrowers by facilitating the advance sale of conforming loans.

The forward nature of this market allows originators to offer borrowers interest rate locks well in advance of the closing, and the TBA market also offers benefits to end investors, including 401(k) plans, pensions and mutual funds, by allowing them to buy MBS with clear, predictable terms on a regular basis and to meet their own portfolio diversification needs.

Because the TBA market is so liquid over $200 billion of securities trade on an average day. And end investors do not demand steep liquidity premiums which further drives down the cost to borrowers.

Homogeneity is what makes the TBA market succeed. Because securities are sold in advance, buyers and sellers agree on terms of a trade, but buyers do not know, and nor do they need to know all the characteristics of the securities they have purchased.

These standards mean that investors can purchase MBS in the TBA market with confidence that these securities will meet a certain minimum standard of quality regardless of who originates these mortgages.

SIFMA and its members believe that to retain high levels of liquidity in today's market and protect and preserve the TBA market, any housing finance reform legislation should establish an explicit and appropriately priced government guarantee for qualifying MBS.

The guarantee promotes homogeneity by allowing investors to look beyond idiosyncratic credit risk and instead focus on the risk that loans will pre-pay at a faster or slower rate than expected, behavior which is in large part driven by changes in the interest rate environment.

These investors that are so-called rate investors may not have an interest in nor appetite for credit risk that is required for investments in, for example, the non-agency MBS market. Without a guarantee, large swaps of investors, both U.S.-based and indeed globally, would look to other products for investment opportunities.

In addition, Congress should encourage the return of additional private capital to the mortgage market through the establishment of policy certainty. Today the private label securities market is but a small corner of the market and we believe that any long-term, holistic solution must address this.

Housing finance legislation should also aim to involve new sources of private capital while being careful not to repel private actors or generate uncertainty for investors. Regulatory policies that recognize and respect the rights of investors are critical to attracting private capital to the housing markets.

Finally, any legislative reforms to the housing finance system should be undertaken in an orderly and thoughtful way, including an orderly transition from the current system to the new system and fungibility between existing GSE MBS and any future MBS.

There is tremendous downside risk of a disorderly transition and in our view, policymakers focused on creating a new system should be just as mindful of how we transition to the new system and what that will look like.

In conclusion, the circumstances that we find ourselves in today are very different than 2008 when the GSEs were first placed into conservatorship. The housing markets have largely recovered. Financial conditions of the GSEs have stabilized and the GSEs have undertaken a number of important reforms.

That said, the importance of reform is paramount. Thank you, Mr. Chairman, and I would be happy to answer any questions.

[The prepared Statement of Mr. Chavers can be found on page 68 of the appendix.]

Chairman DUFFY. Thank you.

Mr. Stafford, you are recognized for 5 minutes.

STATEMENT OF RICHARD STAFFORD

Mr. STAFFORD. Good morning, Chairman Duffy, Ranking Member Cleaver and members of the subcommittee. My name is Rick Stafford, and I am testifying today on behalf of NAFCU. I am president and CEO of Tower Federal Credit Union in Laurel, Maryland. Thank you for the opportunity to appear before you today and talk about the important issue of housing finance reform.

As you consider reform, we urge you to narrowly tailor changes. At Tower, our relationship with Fannie Mae is working fine. With technologies deployed by Fannie Mae in recent years, it is easier today in some ways for credit unions to sell a loan than it was 5 years ago. The current system is working for credit unions.

However, we recognize the challenge to the current model that exists and appreciate the opportunity to offer our thoughts on reform.

Without the GSEs, our capacity to lend in our communities would be outstripped by demand. Our ability to sell loans ensures liquidity, mitigates long-term interest rate risk, reduces concentration risk, and keeps rates competitive.

Without access to GSEs, our capacity to meet local demand would be greatly diminished. Consumers would suffer from higher rates and fees, more stringent credit requirements and fewer overall options. A viable secondary market is vital to our success.

NAFCU has been active in the housing finance reform debate and does not believe any previous proposals adequately protect the needs of community-based lenders. There are certain housing finance reform principles that are important to credit unions and should be considered in any reform effort.

I outline these in detail in my written testimony, and I would like to highlight a few key points here today. It is of the utmost importance that a healthy, sustainable and viable secondary mortgage market for credit unions is maintained. To achieve this, credit unions must have guaranteed access to the secondary mortgage market.

Efforts to fund any system must be done in a way that limits the cost to small lenders and is not a barrier to access. NAFCU wants to stress that it is critical that large institutions not be given control of the market.

Their market dominance would have negative consequences for small lenders. Congress must ensure this does not happen in a reformed system.

Any new system must recognize the high quality of credit unions' loans through a fair pricing structure. Credit unions originate comparatively fewer loans than others in the marketplace.

Thus, we do not support a pricing structure based upon loan volume, institutional asset size or any other issue that will put our member-owners at a disadvantage. Credit unions must have access to pricing that is focused on quality, not quantity.

NAFCU believes that there should be a continued role for the U.S. Government to issue an explicit guarantee on the payment of principal and interest on mortgage-backed securities. The explicit guarantee will provide certainty and stability to the market and investors and facilitate the flow of liquidity.

One of the first steps in housing finance reform should be to ensure that the GSEs are in a safe and sound condition. We do not think the GSEs should be fully privatized at this time. NAFCU supports allowing the GSEs to rebuild capital slowly over time as part of a broader reform discussion.

The transition to a new system should also be as seamless as possible. Credit unions should have uninterrupted access to the GSEs and the secondary mortgage market, in particular through the cash window and small pool options.

Our partnership with Fannie Mae is critical to Tower's mortgage lending function. Our use of Fannie Mae's desktop underwriter on all mortgage loans that we originate ensures conformity and consistency across our portfolio, whether we sell the loan or not. Access to such technology must be preserved in any reforms.

Additionally, any new housing finance system must ensure credit unions can retain servicing rights to the loans that they make to their members. At Tower, we retain servicing rights on all of our loans. Our members turn to us because they want to work with an organization that they trust. And they know that we will provide exceptional member service.

Finally, we appreciate the committee's ongoing focus on regulatory relief and encourage you to continue to look for ways to reduce regulatory burdens that hamper access to mortgage credit. I have outlined a number of ideas for relief in my written testimony.

In conclusion, credit unions exist to provide provident credit to their members. It is vital that credit unions continue to have legislatively guaranteed access to the secondary market and fair pricing based upon quality of the loans.

Thank you for the opportunity to provide our input on this important issue. I welcome any questions.

[The prepared Statement of Mr. Stafford can be found on page 86 of the appendix.]

Chairman DUFFY. I thank you, Mr. Stafford, and thank you for the panel's testimony.

The chair now recognizes himself for 5 minutes. Homeownership is oftentimes the single largest investment a family makes in their lives. Homeownership is part of the American Dream, being able to have your own house.

And making sure that we get this right is incredibly important because when we get it wrong, we saw what happened in the 2008 crisis, not just to homeowners but to a whole economy that was taken down when this system doesn't work.

And making sure we have a thoughtful conversation on how reform can make the system work better and safer and still well for the American family is what I think our focus should be.

So many of you know we are talking about how do we offload credit risk? How do we have a catastrophic government backstop? And so I want to focus my first questions on those issues. In regard to catastrophic government backstop, how do you price the backstop?

Ms. Hughes, do you know how do we look at a government backstop and price it? Or anyone from the panel if you want to take that?

Ms. HUGHES. Sorry. They are through the guarantee fees that we currently pay through our rate system.

Chairman DUFFY. No. Right, but how do we know that that is the correct price?

Ms. HUGHES. I think if you look at what is the market sustainability of those and under the current system and the losses and you balance that against the guarantee fees, I think they are appropriate.

Chairman DUFFY. Anybody else want to? You don't have to if you don't want to jump in.

Mr. VALLANDINGHAM. I would also support the use of guarantee fees to support the government backstop. The reality is that we have historical information to support that. We have monitoring.

The GSEs have improved their monitoring of collateral values and the reassessment of those values as the market dynamics change. And so they are better able to understand the changes of values through booms, busts and the period which is, I think, giving us a better insight into the risk associated with holding those MBS'.

And so I think that as we move forward, the technology that we have and the information that we are providing as lenders, is going to better enable the GSEs to assess the risk inherent in those portfolios.

Chairman DUFFY. And I bring it up because I don't think there is a good answer to it. It is challenging. Without a market to price the backstop we are trying to do our best analysis to pull the right number out of a hat. And again, markets are the only one that efficiently price.

To the panel, what percent of the credit risk can we offload do you think? What will the market bear?

Mr. Chavers, any idea?

Mr. CHAVERS. Mr. Chairman, I think the question of what percent the market will bear should be preceded by what outcomes would you like to see on the front end? At its height, extrapolating from the jumbo private label market, it was $213 billion of issuance I believe in 2003, which was the height of the size of the prime jumbo market.

But I believe the question is more one of what do you want the downstream implications to be? And that is, what is the cost ultimately to the borrower of the credit protections that you put in place before the taxpayer and what the implications are downstream.

As policymakers, you are in the position to make that determination of what market you ultimately hope to serve, balancing it against how much the appetite is in the marketplace. But the current GSE marketplace is supported in the rates market, right, and that market dwarfs the size of the private mortgage credit market ultimately.

Chairman DUFFY. Anyone else? I want to get all up in the record quickly. So there is the Mortgage Bankers Association that has a proposal creating a mortgage insurance fund to provide the government backstop. There is also the DeMarco Bright proposal, taking Ginnie Mae out of HUD and using Ginnie to provide the government backstop.

Any thoughts on either of those plans? Do you favor one or the other or some other plan that has been put out or principle that is put out?

Mr. Stafford?

Mr. STAFFORD. Thank you. My position and NAFCU's position is that the current system is working today. It is not perfect. It needs reform. It needs to be removed from conservatorship.

But the current system I think is appropriate for what credit unions need today both in the rural market and for us in more of an urban market.

Chairman DUFFY. I would just note that before 2008 there was great testimony that said, "It works. This system works. We don't need to change it. There is nothing wrong with it."

We had a great history, and it works until it doesn't work. And I would make the point that private capital at the front end reforming the way this system works, they brought us one of the greatest crisis of our time, is important for this committee to look at how we reform it and make it work better. And my time is expired.

And now I recognize the Ranking Member Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Ms. Bailey, I am going to tell you what bothers me at night when I wake up—well, a lot of things—but among them the homeownership rate is falling.

There are about 1.2 million mortgages that are turned down annually and builders are moving toward more and more luxury home building and so we are ending up just kind of pushing aside the issue of affordability and so that troubles me.

And when you consider the rental market, it is in crisis. And are any of those or other things related to this troublesome to you?

Ms. BAILEY. Indeed, sir. Access and affordability need to be central tenants of the house and finance system and we really need to pay attention to how mortgage loans are priced.

The pricing of the mortgages will determine who actually gets a mortgage and that is a fundamental question. Right now what we are experiencing in the market is market overcorrections that are pushing out creditworthy borrowers who have a history of being successful in homeownership.

Urban Institute estimates that 5.2 million loans since 2010 have not been made in the market so that means people in communities all over the country who would do well with home ownership and the opportunity to build wealth that home ownership presents, aren't given that chance and the time where our market is relatively affordable, interest rates are at historic lows, the actual cost of housing in some communities—I won't go to some of our outliers like places in California, are still relatively low.

So when we have things that are excessive risk instruments come in the market they stop borrowers from getting credit. One example of these are loan level price adjustments that the FHA allows. These are additional fees that borrowers pay based on credit scoring and ability for down payment.

These fees have a disproportionate impact on borrowers of color and they are drying up credit opportunities all over the Nation. They must be abolished, and we need to think about every proposal that is going to come before you during this discussion on housing and finance reform in how it relates to pricing. Pricing, ultimately, determines who gets the loan.

Mr. CLEAVER. Thank you. My follow up question I think Mr. V.—because I am not going to struggle with it—Mr. V and Mr. Chavers, I would like the both of you to deal with the issue and tell me if I am right or wrong.

I don't believe that we have a housing market. I believe that we have two, one for the rich, and then one for the rest of us. Do you disagree or agree and why?

Mr. VALLANDINGHAM. My community bank serves low to moderate income people. I mean, we are in West and West Virginia and very much serve that market and we serve it through the secondary market. And even with loan level pricing adjustments, we are able to price those in and make those loans work.

Typically, where we see barriers to home ownership it comes to either financial education or down payment. Those seem to be the biggest challenges in our marketplace and so when you say that there isn't a market for the low to moderate income buyer, I would say the 60 plus markets that I serve every day are low to moderate income environments that we make secondary market loans in and we are serving those constituents that you are concerned about.

Mr. CLEAVER. OK. I wanted to respond, but Mr. Chavers, my time is going to run out.

Mr. CHAVERS. Congressman, I think your point is well-taken, though I would submit that as you think about housing finance reform it is important to think about it on a holistic basis and that is it is important to not only think about the implications for what loans that have traditionally funneled through the GSE channel, but to also include the FHA, V.A., Ginnie Mae component of the system as part of how you think about the solution.

I had the honor and the pleasure of serving at an earlier time in my career as the president of Ginnie Mae and I know for a fact that the FHA market, for example, tends to disproportionately serve the low to moderate income markets and first-time homebuyers.

I think it is a mistake. However, to look at them in sort of disparate tracks and instead to look at housing finance reform, indeed, on a holistic basis.

I would also submit that both of those markets are supported, ultimately, in the capital markets by the presence of a government guarantee on the securities so that the funding from the global capital markets is somewhat indifferent as to which channel it comes in through the front end.

Mr. CLEAVER. Thank you.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the vice chair of the subcommittee, the gentleman from Florida, Mr. Ross, for 5 minutes.

Mr. ROSS. Thank you, Chairman. And as I talked about in my opening, since 2008 we have seen a recovery from the housing market and we made changes, but yet what we have done in regard to the GSEs is essentially put a veneer over a chasm that exists that is going to probably implode again if we don't do something about it.

And as I pointed out in Mr. Vallandingham's testimony, that Fannie and Freddie have less capital today than were placed in conservatorship 8 years ago in absent of the change in policy are on track to fully deplete their capital by year-end so my questioning goes to capital retention.

Several groups, including the Housing Policy Council, American Bankers Association, Habitat for Humanity, National Association of Homebuilders also a letter on September 21 to Director Watt and Secretary Mnuchin stating, "Key structural reforms must be implemented by Congress before a decision is made regarding the GSEs and capital retention and that Congress should decide the final resolution of the conservatorship."

So my question to each of you is what is your take on capital retention for the GSEs?

Ms. Hughes?

Ms. HUGHES. I believe that the legislative reform should be completed and the capital restrictions or the requirements set and allow the GSEs to work toward those capital requirements.

Mr. ROSS. Mr. Vallandingham?

Mr. VALLANDINGHAM. We too support the recapitalization of the GSEs. When you look at the broader markets and you—

Mr. ROSS. And if they are able to recapitalize, then we can reduce their line of credit, too—

Mr. VALLANDINGHAM. We should.

Mr. ROSS. —Couldn't we?

Mr. VALLANDINGHAM. Absolutely.

Mr. ROSS. OK.

Mr. VALLANDINGHAM. Even as a financial institution, we are required to have capital so it is no different for the GSEs.

Mr. ROSS. Absolutely.

Mr. VALLANDINGHAM. And when you look at the overall function of the market and the international investors, they want to see recapitalization of those GSEs so that we maintain the liquidity and the viability of that market internationally as well.

Mr. ROSS. Ms. Bailey?

Ms. BAILEY. We believe that they need to continually be reformed and then recapitalized specifically highlighting the reforms that we discuss today.

Mr. ROSS. Gotchya.

Mr. Chavers?

Mr. CHAVERS. I think the concern about recapitalization is that it somehow sends a message to the market that it is an adoption of the recapitalization and release proposal which would be problematic in terms of supporting the guarantee, explicit government guarantee at the MBS level.

Whether you recapitalize them in the short term for operating purposes so they don't have to take a draw or whether they take a draw, it is actually sort of left pocket, right pocket.

There is not a material difference. In both instances, right, it is funding to support them on the short-term basis by the taxpayer.

Mr. ROSS. Gotchya.

Mr. Stafford?

Mr. STAFFORD. We fully support and NAFCU fully supports the capitalization of the program modestly, maybe one-quarter worth, but again we truly—

Mr. ROSS. Prudent.

Mr. STAFFORD. Excuse me?

Mr. ROSS. It is just prudent.

Mr. STAFFORD. I think it is prudent. I think it allows them to not have to go to the Treasury as there are changes in their financial condition.

Mr. ROSS. OK, and thank you. And let me follow up on the chairman's earlier question regarding the Mortgage Bankers Association's proposal to create a mortgage insurance fund to provide the government backstop.

Specifically, the DeMarco Bright proposal last year proposed taking Ginnie Mae out of HUD and using Ginnie to provide that government backstop.

Between the two, do any of you have a position between the MBA's proposal for a backstop and the DeMarco Bright?

And Ms. Hughes, I will start with you.

Ms. HUGHES. I have not reviewed either of those plans you just mentioned, so I don't have a real opinion on either of those.

Mr. ROSS. Mr. Vallandingham?

Mr. VALLANDINGHAM. The form of which we take that create the backstop I don't think is as important as doing it and that really points back to the previous question of adding capital back to the GSEs.

Mr. ROSS. Right.

Mr. VALLANDINGHAM. Essentially, that is the same thing so we can talk about doing it in multiple ways. But the reality is we have to form some type of backstop to help deal with credit losses and down in stress markets.

Mr. ROSS. Ms. Bailey?

Ms. BAILEY. I believe a backstop is important.

Mr. ROSS. Mr. Chavers?

Mr. CHAVERS. There is no official statement of position and I don't believe there is actually a difference between the substance of the two approaches. In one instance—

Mr. ROSS. They accomplish the same.

Mr. CHAVERS. They accomplish the same thing and they are, in effect, the same thing just with a different name. They have more in common than they don't.

Mr. ROSS. OK.

Mr. Stafford?

Mr. STAFFORD. NAFCU does not have a formal position.

Mr. ROSS. Mr. Chairman, you talked earlier in your opening about a framework to provide private capital. Could you kind of further expand on what that framework would look like?

I mean, are we looking at front end risk being by the private sector or back end or how would you consider that to be structured?

Mr. CHAVERS. So I think the way to think about the private capital stack that stands in front of the taxpayer is multifaceted. I think it is important to acknowledge that the primary housing markets have largely recovered—

Mr. ROSS. Yes.

Mr. CHAVERS. —So literally the first lost piece of capital is the equity in an individual borrower's home.

You then move to at the instance where that particular borrower has mortgage insurance, you then move to the mortgage insurance, you then transition to whatever the guarantee fee for that particular security.

And then you look to, in the case of backend credit risk transfer, whatever the intermediary is, aggregating and laying off some of that in the capital markets through credit risk transfer, pool insurance, senior subordinated securitization structures or alternatively that aggregator doing sort of front end credit risk transfers. We support both.

Mr. ROSS. I appreciate that analysis. Thank you very much. My time is expired.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Mr. Chairman, every Republican speaker in this committee has always had the debt chart up there and suddenly it disappeared in the same week in which the Republican budget offers us an opportunity to blow another $1.5 trillion, maybe $2 trillion, hole in our deficit so I have taken the liberty of putting up the Republican debt chart in the upper half of that graphic behind our witnesses.

And then I have added the fact that the Republican tax cut adds another $150 billion to $200 billion a year and the abandonment of quantitative easing adds another $80 billion to $100 billion a year to that deficit.

And I might add that getting rid of Fannie and Freddie and spreading them off would also add to that deficit as well. I am told that the regular Republican graphic is somehow technically not available this week, but I invite speakers on both sides of the aisle to choose to have this graphic up during their time as is consistent with the history of this committee particularly this year.

I praise the present system in my opening remarks. It is not a great system compared to what we aspire too. It is a great system when compared to other lending systems that have existed through history.

One of the bad systems that existed in history was the one we had in 2008. It was working well until it didn't. It didn't because we had Fannie and Freddie as government guaranteed private corporations. We need to never go back to that.

And I agree with the chairman that that system failed in 2008. It is the system we adopted since then where Fannie and Freddie are basically government entities that is working very well especially on a historical basis.

The ranking member points out the need for affordable housing and we need to build it both rental and for purchase, but I might also add that proposals to eliminate the property tax deduction and/or the home mortgage deduction raise the cost of homeownership and makes some perspective borrowers, therefore, ineligible for loans.

Mr. Chavers, the homebuyer once I think needs a 30-year fixed rate pre-payable mortgage. Could that possibly be achieved without a government guarantee? I won't say—I overstated it. Is it likely to be achieved in the absence of a government guarantee?

Mr. CHAVERS. I do not believe so, Congressman, not in the scale we currently enjoy.

Mr. SHERMAN. Thank you. Is there anyone on the panel that thinks that we can have 30-year fixed rate pre-payable mortgages in the absence of a guarantee?

Mr. STAFFORD. NAFCU's position to ensure that there is an explicit guarantee.

Mr. SHERMAN. OK. Is there anyone on the panel that wants to argue the other way? The record should report that no one came forward.

On recapitalization, we have this situation where we want to transfer money out of Fannie and Freddie to the Treasury to avoid the capitalize and release that you, Mr. Chavers, brought up, but at the same time we don't want the political embarrassment of Fannie and Freddie ever having to draw on its Treasury line.

What can we do to take away any stigma that and any of it is transferred money to the Treasury year after year for the last several years may occasional draw and then go back?

One way to eliminate that stigma would be to have the money paid in dividends to the Treasury earmarked in the Treasury as a special money received from Fannie and Freddie account and then it would be more obvious if money was drawn from the Treasury that it was coming from money that had previously been deposited in the Treasury.

Mr. Chavers or anyone else, can you think of another way in which we on the one hand make sure that Fannie and Freddie can in a bad year get some of the money that they previously generated, but at the same time prevent the capitalize and release?

Mr. CHAVERS. Congressman, I can't opine on the level of potential political concerns about the draw one way or another. As a practical matter, I think it is very important if there were to be a limited funding of a capital buffer on a limited basis that that is communicated very clearly to the markets that it is not intended to signal the end of the conservatorship.

Mr. SHERMAN. I think you bring that up and that is instead of dealing with the politics of having to draw, deal with the politics of some capitalization and make it plain that capitalization is there to prevent a draw, not to really—

Mr. CHAVERS. And I would suggest the concern there is not, at least not from the markets standpoint, not so much a political one, but one of transparency, such that investors are able to understand in the global capital markets that this does not signal some other type of activity and that, in fact, it is a very limited intended for this purpose recognizing that this market is supported on a global basis and so that will have to be understandable to investors around the world.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the chair of the Subcommittee on Financial Institutions, the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

I thank all of you for being here this morning. An interesting discussion. One of my first questions or concerns is, what are the biggest impediments to getting private capital back in the mortgage market?

We seem to have transitioned to a system where more and more government involvement, more and more government backstops, more and more government rules and regulation, what does it take to get more private capital involved? Anybody?

Ms. Bailey?

Ms. BAILEY. I will answer that. The only time where the market was purely private was at the time leading us up to the housing crash so any private capital that returns to the market has to really be responsible and it can't be toxic private capital that leads us on a chase or excessive profits that puts American taxpayers and homeowners at risk so I will answer in that form.

And I will also remind the committee that FHA and the GSEs played a very important role following the housing crash. They actually sustained the market when private capital withdrew so we have to be very careful as we are making these decisions about house and finance reform to do it in a way that doesn't jeopardize the modest recovery we have experienced.

Mr. LUETKEMEYER. Mr. Chavers, you made a comment long ago about a new system and you have talked and served general terms, but can you get specific of what you would see with a new system what it would look like? What you would see it—how it would transition to what our view would have an idea that it can be down the road?

Mr. CHAVERS. So I think in any new system I think I have indicated it is important if we are going to serve a market with the features and size that is currently served, that is important that there is an explicit government guarantee at the MBS level, at the security level.

I think it is also important that in that transition from current system to any new system that the outstanding existing MBS are, in fact, fungible with the new MBS.

Mr. LUETKEMEYER. OK. Many of you have talked about maintaining government guarantee. What do you mean when you say the government guarantee? Are you going to guarantee the entire loan, 95 percent, 50 percent?

Mr. CHAVERS. Well, actually, Congressman, in fact—

Mr. LUETKEMEYER. Or just the GSE security?

Mr. CHAVERS. It is just the security.

Mr. LUETKEMEYER. What are you—you are talking about the GSE security as a whole.

Mr. CHAVERS. That is correct.

Mr. LUETKEMEYER. Not individual loans.

Mr. CHAVERS. That is correct.

Mr. LUETKEMEYER. OK. So the individual loans would be independent loans that would not be guaranteed individually?

Mr. CHAVERS. I believe that is correct.

Mr. LUETKEMEYER. So security would be guaranteed—

Mr. CHAVERS. The security, the timely payment of principal and interest at the security level would be explicitly guaranteed.

Mr. LUETKEMEYER. OK. I know a number of you talked about the servicing of the assets being important to you. Can you explain why that is important? I know the banking guys and the credit union guys both made a comment on that.

Both of you, if you can give me a response both of you, Mr. Stafford and Mr. Vallandingham?

Mr. STAFFORD. It is absolutely critical in a credit union. Being able to retain the servicing is allowing us to build that relationship and when our members down the road are stressed financially and they need options they come to us. We work with them one-on-one because we have the relationship.

If we didn't retain the servicing, we wouldn't be able to help them. So servicing to us is an absolutely critical component of any future reform.

Mr. LUETKEMEYER. Mr. Vallandingham?

Mr. VALLANDINGHAM. I would echo his comments as well. The relationship is critical and maintaining that relationship with a customer is catamount to our franchise. Ultimately we do a better job, I mean, just flat-out. As a small servicer we have closer relationships with our borrowers.

We better understand the markets in which we serve. And when there is something that happens whether it be a hailstorm or a flood, we have a better understanding how to make that customer correct the situation and make it right, and we serve them better. So at the end of the day it is a win-win for both sides.

Mr. LUETKEMEYER. One of the comments that has been in some discussions that have already been had with regards to capitalization of the GSEs, you know we had Director Watt in here the other day and he is concerned about that. And I think the decision has to be made at some point.

Do the GSEs recapitalize so they can absorb losses or do we continue to just take the profits, funnel it to the Treasury? And whatever a loss occurs just have the Treasury write a check back. I mean can you guys give me some thoughts on that, see where we need to go?

Mr. VALLANDINGHAM. I would say that if we recapitalize and reform then it will build a robust mortgage market that private investors will want to invest in. And you will see the inclusion of private capital at that point, but right now there is a little bit of limbo and that is why you are not seeing the re-entry of private capital.

Mr. LUETKEMEYER. Do you believe that if we had a capital account there that had to be touched, that had to be gone to in order to absorb losses that the GSEs would be more responsible with where they lend money?

Mr. VALLANDINGHAM. Well, obviously having capital is going to help. And maintaining a capital level is going to help them maintain responsibility, and it also directly impacts the size of the balance sheet in which they hold. I mean, you have to have enough capital to support the risk in which they bear. And that is one of the things—

Mr. LUETKEMEYER. That would be the key right there.

Mr. VALLANDINGHAM. —That is one of the things that we didn't do in 2008.

Mr. LUETKEMEYER. I hope everybody listened to that last comment that is key to what is going on here. Holding capital to be able to curtail or to be able to really settle what is going on with a number and an amount of loans that are made. Thank you.

Chairman DUFFY. Gentleman's time has expired.

The chair now recognizes the ranking member of the full committee, the gentlelady from California, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much. I appreciate that and I would like to thank our witnesses for being here today.

As I have sat here listening it appears that everyone on this panel agrees that an explicit government guarantee is a necessary component of housing finance reform. Is that right?

Ms. HUGHES. Correct.

Ms. WATERS. OK. And I would ask you about the PATH Act, but Mr. Chavers has already told us he wishes not to opine in the political aspects of this discussion. So what I will ask you is from each of your perspectives what harms would result if we eliminated the government guarantee? Yes, we can start.

Mr. VALLANDINGHAM. I will be glad to answer first. If you take away the explicit government guarantee the cost to the consumer is going to go up point blank. And so less borrowers are going to be able to afford homes and our housing market is going to decline. I mean it is direct correlation.

Ms. WATERS. All right, everyone agree with that?

Ms. Hughes?

Ms. HUGHES. For us, if that path were to go away we would not be able to serve the number of borrowers that we serve.

So we are a small community bank. We did just under 1,300 loans to mortgages last year. That is a huge amount in our market and without the path that we have we would not be able to deliver that.

Ms. WATERS. Ms. Bailey?

Ms. BAILEY. Yes, the cost of credit would go up, and regions around the country that actually rely on credit like rural communities would definitely not have access to credit.

Ms. WATERS. Thank you.

Mr. Chavers?

Mr. CHAVERS. Congresswoman, yes. I also agree that the cost of credit would go up. You would not be able to support a TBA market which means the size of the 30-year fixed rate freely repayable market would likely be diminished.

Ms. WATERS. Mr. Stafford?

Mr. STAFFORD. I also concur with that. There would be a loss of confidence. Fees would go up and it would detrimentally hurt the rural market that credit unions serve.

Ms. WATERS. Ms. Bailey, I would like to ask you if you have any thoughts on the reform proposal that was put forward by Mr. Gene Sperling, are you familiar with that one?

Ms. BAILEY. I am.

Ms. WATERS. I think Mr. Sperling, Mr. Parrott, Mr. Zandi and Mr. Ranieri and Barry Zigas, and it is also similar to a proposal that I put forward. Could you tell me what is it that you feel is attractive in those proposals? What is it you like about them?

Ms. BAILEY. So we are evaluating every proposal by how it impacts the cost of credit. So we are being very careful to figure out how much additional fees would result from how mortgages are going to be priced. We disagree with that proposal as it is currently written and we have tried to negotiate with them and share some of our perspectives around some of those core concerns.

We have to be very careful not to allow fees that are going to drive up the cost of mortgages that have a disproportionate impact on borrowers of color and that don't firmly speak to our country's affordable housing goals.

We need to be very careful as we are moving the levers of the market not to dry up credit access in important communities all across the Nation and we don't think that proposal, as it is written, will help the borrowers that I mentioned earlier in my testimony access the mortgage market in a more equitable manner.

Ms. WATERS. You are referring to—

Ms. BAILEY. The proposal by Zandi and Mr. Parrott, not your proposal ma'am.

Ms. WATERS. I see. Anyone else familiar with that proposal?

Mr. Chavers?

Mr. CHAVERS. I am, Congresswoman, and actually I would submit that SIFMA and myself evaluates those proposals based on the implications that each have and its ability to be supported by the capital markets. And I would submit that the Zandi proposal as well as your earlier bill from the prior Congress and the mortgage bankers and frankly the Milken Institute proposal have more in common than they do in distinction.

That is they all support an explicit government guarantee, they all support an orderly transition from the current state to the future state, and they all look to the capital markets to provide some support in front of the taxpayer.

And so rather than say opine on one proposal versus the other, the position is to look at their ability to achieve the principal such that the capital markets can support ultimately the primary market.

Ms. WATERS. Do you have any thoughts about fees?

Mr. CHAVERS. I think the fees are more actually dials, if you will. And both policymakers and the implementers have the opportunity to make the adjustments when those fees relative to the amount of risk and where that risk should fall in the system, so how much ultimately falls on the front end in terms of what the borrowers pay, how much gets laid off into the capital markets either through risk sharing or how much gets laid off through mortgage insurance or other forms of credit enhancement.

So I don't have an opinion on a fee specifically, just being sure that the apparatus is in place to appropriately allocate those.

Ms. WATERS. But you do agree that if the fees are disproportionate it could have a negative impact on low income borrowers, right?

Mr. CHAVERS. Yes. So as you adjust the fees up the, now this is me speaking in my individual capacity, I don't think SIFMA has a view, but obviously if you adjust the fees across the ecosystem is has an impact on the eligible universe of borrowers.

Chairman DUFFY. The gentlelady's time has expired.

Ms. WATERS. Thank you.

Chairman DUFFY. The chair recognizes the gentleman from Illinois, Mr. Hultgren, for 5 minutes.

Mr. HULTGREN. Thank you, Chairman. Thank you all for being here. I appreciate your input into these important issues.

I wanted to address my first question to Mr. Vallandingham if I could?

One of the primary tenets I know of your testimony is that any changes to the housing finance system should, and I quote, "preserve equal and direct access to the secondary market to safeguard the role of community banks providing mortgage credit in the communities we serve," end quote. I absolutely agree with that.

Small financial institutions are integral to providing access to mortgage credit across my district and every district in the country, especially the more rural areas where larger lenders do not have a presence.

What do you see as some of the risks for diminishing the role of community banks in the housing finance system and do you have any specific examples or concerns you can sight with any of the proposals that have been discussed here in Washington?

Mr. VALLANDINGHAM. What I see is community banks if they were to become less involved in the housing finance system than those segments of the population, the low to moderate income and the rural communities, would be less served.

And one of the things that we are able to do in our underwriting is really customize the loan and make sure that we understand the property and the marketability and make sure that while it does meet the GSE requirements that it does match the communities in which the property exists.

And a lot of times what you see or what we have experienced as we have dealt with other investors is that larger financial institutions that don't participate in those communities don't really understand the markets and so it is easier to turn that loan down than it is to make that loan work. And what we would see is less availability of credit in those markets and that would be a negative consequence nationwide.

Mr. HULTGREN. Thank you.

Mr. Stafford, I know credit unions play a similar role in rural communities. Do you have any thoughts to add about how credit unions might not be able to as easily participate in the housing finance system if certain changes are made.

Mr. STAFFORD. I would echo many of those comments. Again, many of the rural areas are not served appropriately by the larger financial institutions and so those credit unions need access to the secondary market or liquidity to support those communities. It is at the foundation of what credit unions do.

Mr. HULTGREN. Thanks.

Mr. Chavers if I could address a couple questions to you?

In its June 2017 report on the banks and credit unions the Treasury Department found that the exemption that the GSEs have been granted from the CFPB's qualified mortgage rule has resulted in a concentration of the mortgage market and government supported mortgage programs because the exemption allows the GSEs to securitize loans that private institutions cannot.

As the Treasury Department put it, the exemption creates an asymmetry and regulatory burden for privately originated loans. Do you agree with this assessment and is the exemption an impediment to bringing private capital back to the market?

Mr. CHAVERS. I don't fully agree with that assessment. I think it is part of a larger challenge for return to the private market. That includes concerns about confidence in the infrastructure that supports the private market. That also frankly includes the prevailing economics of the execution of private label securitization. Does the definition contribute to that? Perhaps but it is certainly not the entirety.

Mr. HULTGREN. OK. Also Mr. Chavers, if I could I am supportive of the concept of making significant reforms to our housing finance system that will protect taxpayers without diminishing access to credit.

However given the large role currently being played by Fannie and Freddie, how would you imagine such a transition taking place and what steps should Congress working with FHFA and the administration, what would or should we take to avoid any significant market disruptions?

Mr. CHAVERS. I think a couple of things come to mind. One, assuming that the future system is very clear about maintaining an explicit government guarantee at the MBS level, it is also important that it is communicated that the existing outstanding GSE MBS will be freely fungible with whatever the future state of MBS. That is important.

Number 2, that it be done in a very deliberate fashion and that it be adequately and accurately communicated with full transparency to the marketplace in the transition period and effective date and be very clear about that communication.

Mr. HULTGREN. Thank you. Just have a few seconds left here but Ms. Hughes if I can address quickly page 90 of your testimony points out that the so-called treasury sweep has actually cost taxpayers money because it does not account for the interest obligations of the investments made on behalf of the taxpayers. Isn't this fact on its own enough to justify significant reform?

Ms. HUGHES. Yes. I mean we do need to have significant reform, but loans that are underwritten appropriately and if the capitalization is there the system should work as it needs to.

Mr. HULTGREN. Thank you again.

My time is expired I yield back. Thanks, Chairman.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentlelady from Ohio, Mrs. Beatty, for 5 minutes.

Ms. BEATTY. Thank you, Mr. Chairman, and thank you to our ranking member and certainly to the panelists. Thank you.

In response to a question posed by my colleague and Ranking Member Cleaver, Mr. Vallandingham you stated that two of the biggest barriers to homeownership are financial education, and down payment. Well, let me just say thank you, and I agree with that statement.

And that is why I introduced a bill entitled The Housing Financial Literacy Act which is co-sponsored by more than 20 Members of Congress and even from this committee, Congressman Stivers who sits on the the other side of the aisle.

And what this bill does, it will provide a 25 basis point reduction on the annual mortgage insurance premium paid by FHA borrowers who take a HUD certified home buying financial literacy class. And so I want to urge my other colleagues here on this committee to take a look at that bill.

That is a plug, Mr. Chairman, that I am giving to you. Or maybe I should use a challenge. So thank you for your comment on that, Mr. Vallandingham.

Now, the question I have, first I would like to start with you, Ms. Bailey, and maybe you, Mr. Stafford, in responding to this. The Federal Housing Administration is critically important to first-time homebuyers in minority populations.

In Fiscal Year 2016, first-time homebuyers represented 82 percent of all FHA purchase originations. More importantly, in 2015, while FHA loans were used for 25 percent of all home purchases, it was used for 47 percent of purchases by African American households and 49 percent of home purchases by Hispanic households.

So can either one of you, and we will probably have enough time for others to be on deck, can you describe how the reforms of the past act would transform the FHA and its potential impact on minority homeownership?

Ms. BAILEY. The act actually designs to take away and abolish the FHFA housing mortgages, and that would just be a wrong choice for consumers all over the country. As you stated, it is the way most working families enter into the housing finance system. And it is the way that many families have built home equity and wealth over time.

So it would be a very poor choice to take away that option for families. And we need to be mindful that FHA actually rescued the market. It was part of the support to the market when private capital retreated and withdrew from the market. So the FHA and the GSE-insured mortgages actually sustained the market at a time when we actually needed it.

So we have to make sure it is modernized and it has the resources that it needs to fully function and to function well, but we have to be very careful to have a whole total approach and not move in a way that will create real lack of opportunity in the housing sector.

Ms. BEATTY. Thank you.

Mr. Stafford?

Mr. STAFFORD. Tower doesn't officially do FHA mortgages. We actually have another customized program that we use, and they are non-Q.M. loans so we have the option to customize those products specifically for the members.

However with that, as far as the PATH Act, NAFCU doesn't have an official position. I would be more than happy to follow up with one after this hearing.

Ms. BEATTY. OK. Anyone else like to comment?

Thank you, Mr. Chairman, and I yield back.

Chairman DUFFY. The gentlelady yields back.

The chair now recognizes the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Ms. Hughes, in your testimony you discussed the importance of the Federal Home Loan Banks and the role that they can play in providing liquidity in times of crisis. I am certainly familiar with these institutions, especially the Federal Home Loan Bank of Pittsburgh, which is based in my part of the commonwealth.

You expressed concerns that changes to Fannie and Freddie as part of our overall housing finance reform effort may inadvertently impact negatively the FHLB system. You also suggested that the FHLBs may have the potential to play an expanded role in a revised secondary market system.

In your opinion, what is the most appropriate or ideal role for the Federal Home Loan Banks going forward?

Ms. HUGHES. The Federal Home Loan Banks function very well as they are. They are in partnership with their member banks, and we actively utilize them for acquisition of affordable housing programs through their Home Start Grants. We utilize them for delivery of mortgage loans that we service on behalf of the Federal Home Loan Bank. And we obviously use them for advances as needed.

Again, the process that we have with the Federal Home Loan Banks works as it is today.

Mr. ROTHFUS. Let us see, Mr. Stafford, in your testimony you wrote that, quote, "to date we do not believe that any housing finance reform solution suggested in previous Congresses fully accounted for the needs of small lender access." What are some of the major issues that impede participation by smaller institutions?

Mr. STAFFORD. Price and access to the market. Small credit unions in rural areas need unfettered access to the GSEs in the secondary market. That will provide them the appropriate liquidity. They can't hold that type of volume of loans on their balance sheet because of interest rate risk and concentration risk.

So if we can provide in a reformed environment dedicated access, guaranteed access, those are the markets that need it the most.

Mr. ROTHFUS. Mr. Vallandingham, can you comment on that?

Mr. VALLANDINGHAM. Yes. I would also point out that the onslaught of compliance and regulatory burden that came on after the mortgage crisis has eliminated many participants in this market space. The reality is that many financial institutions elected to step away from mortgage lending because they couldn't deal with the compliance costs or the complexities of the compliance that came on after that crisis.

In addition to that, when you look at Q.M. and non-Q.M. loans, the additional litigation risk that hasn't really fully been understood at this point keeps many of those players out of the market and they have decided that it is just much easier to do something else.

Mr. ROTHFUS. Let us talk about Q.M. for a minute, and I want to follow up with Mr. Stafford on the same questions. I know Mr. Stafford expressed concern about Q.M. being the standard for loans eligible for the government guarantee.

Do you have thoughts, Mr. Vallandingham on why that is problematic and can you recommend a more appropriate underwriting standard?

And I am going to get the same answer from Mr. Stafford, or same question.

Mr. VALLANDINGHAM. I will say that community banks, we did it right. We did it right the entire time, and now we are burdened with an additional layer of regulatory oversight and testing and cost, so the actual cost of producing a loan has gone up. The cost of servicing the loan has gone up.

And so when you look at things like Q.M. and ATR, we now have these multiple tests that we go through in the origination process that it takes us longer to produce the loan. And at the end of the day, we weren't the ones that did it.

In fact, if you want to go back, Freddie and Fannie weren't really the cause of this crisis. It was the option ARMs and the interest-onlys and they were all the products, the exotics, that we aren't talking about that really created that.

Now, it snowballed later. I get that.

Mr. ROTHFUS. So Fannie and Freddie didn't buy any Alt-As?

Mr. VALLANDINGHAM. They did buy Alt-As, but those were a part of the affordable housing initiative, and I am not sure that they were necessarily bad credits absent if you had that other portion of the market not occurring. If those didn't occur—

Mr. ROTHFUS. They weren't bad credits. We didn't have to go bail out for Fannie and Freddie?

Mr. VALLANDINGHAM. I am just saying that when it started it started with a lot of the exotics. And had absent those losses, I am not sure the rest of the market would have rolled into that.

Ms. BAILEY. Could I interject?

Mr. ROTHFUS. No. I want to get Mr. Stafford's response on—

Ms. BAILEY. All right.

Mr. ROTHFUS. —On can you recommend a more appropriate underwriting standard than Q.M.?

Mr. STAFFORD. Yes. I can obviously tell you that the regulatory burden is significant. And I will give you one perfect example is we saw that our members were being taken advantage of by title companies. They did not have our members' best interests in mind, so we formed our own title company.

Now, with Q.M. rules, the expense associated with us creating our own title company has to be added to the 3 percent Q.M. rule. It immediately makes that mortgage a non-Q.M. We can no longer sell it. We have to keep it and hold it on our balance sheet.

So even though we had to do what is in our members' best interests, we were actually penalized by the regulation because of the way that you have to calculate the expenses.

Same thing with TRID. This is a pain point for our members of why do they have to wait 3 business days to sign a closing disclosure and then wait for their funds? And if they don't do e-sign it is another 6 days.

So our members are asking why is the government telling me I have to wait 3 or 6 days before I can close a mortgage? Why won't they empower me, the consumer, to waive some disclosures saying I know and understand the rights, and I wish to move forward immediately and not wait 3 or 6 days.

Mr. ROTHFUS. Yield back.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the clapping member from Massachusetts, Mr. Capuano for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Vallandingham, thank you. That is what we have been saying from day one. I don't think anybody has ever said Fannie and Freddie didn't play where they shouldn't have played, but they didn't create it. They simply went in where others went before them, for the reasons, in my opinion, it is human nature.

Fannie and Freddie worked fine when they were government entities, and they worked fine for a long time as non or quasi government agencies, until all of a sudden the greed factor took over with nobody there to regulate them.

They had no choice but to provide good returns for their stockholders and they loved having their pay scales tied to profit. Normal, human nature, should have been foreseen. It wasn't. They participated, played hard and hurt all of us. And I am glad.

I am actually wondering, it seems to me and again correct me if I am wrong, everybody here agrees that we need to do something with the GSEs, specifically preferably explicitly state the government backing of the GSEs. So I think everybody seems to agree on that.

And I think everybody seems to agree that the GSEs, whatever is left after any reform we do, have sufficient capitalization. So if we all agree on that, could somebody tell me what the heck we are doing here?

I mean, you are all very smart and capable people and you have been very good, but all the issues that were brought up today require a lot of details, exactly where the limits are and all that kind of stuff. Those are details. That is not for a public hearing. Those are for discussions to have and push back and forth.

We are having, I don't know, the 400th hearing on housing market, and yet we all agree it has to be done, but we can't get it done. The only bill that this committee has passed out is the PATH Act, and no one here likes it. No one here on this side would have voted for it, and I daresay very few on the other side would have voted for it.

In the 20 years I have been here, I have never seen a committee put out a major piece of legislation that then never made it to the floor, except for the PATH Act, because nobody thought it could work and would destroy the housing market. Thank you for all coming to basically the same exact agreement.

I would also want to ask if any of your banks would have given me a loan and then after I repaid the loan, plus any reasonable amount of interest, you kept taking all my wages? Do you think any of your bankers would not be put in jail? And yet that is exactly what the Federal Government is doing to Fannie and Freddie.

In 2016 $15 billion was taken from homeowners who didn't know it, and taken and put into the general fund every quarter, a total of $15 billion. By the way, I would just like—curious since I don't have too many questions in here, because I am not sure what we are doing here, especially those of you who represent banks.

One of the things I have always been interested in is getting banks back into local mortgages, preferably by incentivizing you to hold the mortgages. My personal opinion is that a held mortgage should be counted toward your capitalization requirements, and maybe a few other incentives.

I like the idea of keeping local banks tied to their communities that they serve having a vested interest in not taking my house because you know me. And because the truth is no small bank, no medium size bank, really is equipped to get rid of a whole bunch of houses. It is not what you want.

So how would you like us to be able to provide you some incentive to hold your mortgages? Would that incentivize your banks to start making their own home mortgage loans in their own communities?

Ms. Hughes?

Ms. HUGHES. We currently service about 5,100 loans, and part of those, about 2,800 of those are on behalf of Freddie Mac, and then we have a small pool for Federal Home Loan Bank. Servicing our own loans is paramount for our ability to serve our consumers' needs.

We actually in our partnership with Freddie Mac on those servicing, because of the constraints under the regulation on how we have to manage those loans if those borrowers go into default, we have actually purchased loans back from the agency because we could work with our borrowers at a deeper level than the regulations allowed.

And back to Sam's point of the regulatory oversight, is pushing community banks out of the market. It is continuing to push the community banks out of the servicing platform. And as we add those additional layers we are adding additional reasons for banks to get out of mortgage lending because it costs—

Mr. CAPUANO. I appreciate that. My time has run out and I would love to hear from all of you, but my chairman is going to knock me out. But at the same time I want to tell you that I don't hate regulation. These are regulations in my opinion that are wrong-ended. And I would love to work with you to straighten those out if we could ever be allowed to do so.

Thank you, Mr. Chairman.

Ms. BAILEY. Community bank profitability is at 95 percent, so it is very important that as we have this discussion that it is rooted in the facts. We had 7.8 million foreclosures in this Nation, and we responded. This Congress responded with sensible rules that provide abilities for lenders and community members to have safety in the market.

So it is very important that as we have this discussion, that it is rooted in the fact that we have actually returned to the levels of lending that we did for our community banks across the country.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentleman from Michigan, Mr. Trott, for 5 minutes.

Mr. TROTT. Thank you, Chairman. I want to thank the panel for their time this morning. I want to also echo some of the comments that have been made regarding the ability to retain servicing. That has got to be part of any solution for the credit unions, the community banks.

And really people don't talk about it much, but the crisis in 2008 was really exacerbated by the inability of large servicers to deal with their borrowers in an appropriate manner.

Communication oftentimes was very poor and really made loss mitigation nearly impossible for a lot of borrowers, which led to quite a bit of frustration and some bad results. So I just want to echo that.

Ms. Hughes and Mr. Chavers, I want to talk about an idea I have because my friend in Massachusetts says this is our 400th hearing on housing finance reform.

I haven't been here that long, so this is probably only my 20th, but one of the reasons why we keep struggling with this is it is hard to get an agreement, not only among Republicans, but in certainly any kind of bipartisan solution on GSE reform.

And one of the issues I have found is, two-thirds of the book of the business for Fannie and Freddie are refis and second home mortgages. Why are they in that business? I agree with Ms. Bailey's comments. The dream of home ownership is an important part of our American values.

Why should Fannie and Freddie be involved in helping someone buy a second home? Why should Fannie and Freddie be involved in helping someone realize a lower interest rate?

I understand one of the concerns would be for low and moderate income folks, but Ms. Hughes, what do you think about simplifying our approach on GSE reform by just getting Fannie and Freddie out of refis and second home mortgages?

Ms. HUGHES. I have really not thought about the second home mortgages.

Mr. TROTT. How simple would that be, right?

Ms. HUGHES. It would be simple, yes. On the investment property space, that is another space that they are actually very active in, and we are limited in what we can deliver to that market. But there are opportunities in the past for loans that are not investors that we could look for other options to make that happen.

Mr. TROTT. Mr. Chavers, what do you think it would do to the rate on a refi if we took them out of that part of the market?

Mr. CHAVERS. Well, Congressman, I am pretty sure that SIFMA has not taken a position on excluding the refi or second home market. and so I would submit that that is a policy determination, obviously best left to the Congress.

I would submit, though, that it is important to recognize any of the downstream implications of the changes that you make. One of the other reasons that I believe as a policy matter we support an orderly housing finance system is its implications for the broader economy.

And typically one of the mechanisms by which we have historically sought to spur economic activity has been through monetary policy and the adjustment of interest rates nationally. And one of the industries that communicates that most directly to the marketplace has historically been the housing market, so just recognizing the implications downstream.

Mr. TROTT. But there would be a way to phase it in over time. And in your earlier comments you said any kind of reform has to have transparency and certainty and adequate notice.

So there would be a way for us to adopt a policy, wouldn't there, such that if Fannie and Freddie were going to get out of the refi market, we could do it and phase it in over time such that the private sector would fill that need and not create any kind of turmoil.

That would be the goal, and we are not great at executing on some of that sometimes, but that would be the goal.

Mr. CHAVERS. Congressman, I was just referring to sort the macroeconomic implications and the implementation of monetary policy and—

Mr. TROTT. Right. I understand.

Mr. CHAVERS. —the housing markets. So in its current configuration with estimates being somewhere between 12 and 15 percent of GDP being impacted by the housing market, taking away the refi or the second home market would have some downstream implications for that impact is all I was suggesting.

Mr. TROTT. Well, a different question for you, sir. What issues would you consider if you were to enhance Ginnie Mae's role in providing a guarantee in the conventional loan space, as proposed in the DeMarco Bright solution?

Mr. CHAVERS. I think a couple of things come to mind, and again, am speaking for myself in this instance because I don't believe that SIFMA has opined on this. As the DeMarco Bright proposal contemplates, there is the need for some administrative reforms at Ginnie Mae.

It has been simplified as being characterized by removing it from the Department of Housing and Urban Development, which I understand placing it on sort of independent footing. But it is important to recognize the strengths of Ginnie Mae is that it is a globally recognized brand in the capital markets. And so the ease of execution is appealing.

The challenges of Ginnie Mae is Ginnie Mae has, at least, probably has less than 200 employees with managing a significant amount of counterparty risk in the marketplace. And it historically has not had the tools to bring in the kind of capacity internally.

What it has been able to do is to leverage it through outside vendors in order to perform its functions. If you were to expand its role, it seems to me that it needs some operational enhancements in order to do so.

Mr. TROTT. Thank you.

I yield back.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentleman from North Carolina, Mr. Budd, for 5 minutes.

Mr. BUDD. Thank you, Mr. Chairman, and thank the panel.

Mr. Chavers, the common securitization platform was originally intended to broaden participation in the securitization market by allowing new entrants to come into the market and compete with the GSEs. However, it seems that the platform's development in recent years has focused on being solely used for Fannie and Freddie.

How important is it that the platform's role in bringing private capital back to the mortgage market?

Mr. CHAVERS. So I believe that the common securitization platform could be expanded to be an option for private market participants to provide standardization and to provide more confidence in that infrastructure.

One of the challenges in the private label market coming out of the crisis is that investors have lost a lot of confidence in the infrastructure having the proper alignment and incentives of the intermediaries between the end investor.

And so the ability to leverage the platform to bring that standardization to provide the sort of marketplace utility merits exploration. Now, I am also mindful, I have heard the comment that the common securitization platform is a bit of a Rorschach test in that everyone sees in it what they hope to see.

And so I don't have any transparency into its current functional application and to appreciate how accessible it would be to sort of migrating to make it a utility for the private market, but it certainly bears exploration.

Mr. BUDD. Thank you. So are you concerned that a platform as it is currently being developed will be used exclusively by the GSEs?

Mr. CHAVERS. I don't know that it gives rise to concern. My understanding is that the way it is currently configured that is the intention. It is also facilitating the transition to the single TBA, which is something that potentially offers additional liquidity, which I think is a desirable objective. So—

Mr. BUDD. So how realistic do you think it is that a platform will be open to other industry participants, aside from Fannie and Freddie, if it continues to be a joint venture of Fannie and Freddie?

Mr. CHAVERS. I don't know that answer. I haven't heard any indication of the intention for it to migrate as we sit today. The focus, as I understand it, has been on it coming fully to market and providing the underpinnings to deliver the single security.

Mr. BUDD. Sure. So a slight variant of that same question, how critical is it for the platform to be spun off from Fannie and Freddie?

Mr. CHAVERS. Excuse me. Congressman, I would like to give that some more thought and—

Mr. BUDD. Certainly.

Mr. CHAVERS. —Get back to you.

Mr. BUDD. Certainly. Thank you.

Mr. Vallandingham, thank you again for being here. Is it your view that the GSE expansion into the single family rental market is consistent with their charter as entities in a conservatorship?

Mr. VALLANDINGHAM. To answer your question, I think that their participation in the investment property and rental market makes homeownership affordable, whether it be through actual ownership or through rental. And so that makes the market—I mean, we had one of the previous commented that the rental market was a disaster and that there wasn't affordable housing in that segment.

Without that investment property avenue, it would be even worse because the cost of financing for those particular properties would go up, which means the cost of rental payments would have to go up in order for that to be a profitable investment.

Same thing with the refinance. So many times I see my borrowers come in and we are shoring up their balance sheet. We are taking equity out of their home and paying off higher cost debt and moving it to lower cost so that their balance sheet is better-positioned and they can withstand problems in their own financial environment.

And if we take that away, I think it would be disastrous, both for the housing market and to the consumer.

Mr. BUDD. OK.

Ms. BAILEY. We think that their increasing involvement there is something to really be critically examined. They have a robust multi-family portfolio that is really designed to impact the rental market space.

And we have to be very careful that as they consider moving into that space that they are not ignoring their obligations to ensure that more homeowners are entering into the single family space so that we can actually expand homeownership, which is part of what those obligations actually speak to.

Mr. BUDD. Thank you, Miss Bailey.

Chairman, I yield back my time.

Chairman DUFFY. The gentleman yields back.

The chair now recognizes the gentleman from New Jersey, Mr. MacArthur for 5 minutes.

Mr. MACARTHUR. I thank you, Chairman. I would like to step back a little bit. You each expressed in your opening remarks some concerns about reforms going too far and maybe disrupting the marketplace, at least that is how I heard it, each from a different perspective.

And I would just like to ask one or two of you to take a stab at what do you see as the primary benefits of the current system? And what do you see as the one or two primary drawbacks of the current system?

Mr. STAFFORD. I can start. The benefits of the current system are numerous; one, its competitive with pricing. There is confidence in the system.

It is an easy flow of liquidity. The technology used by Fannie and Freddie, for example, is significant. And we use it to even hold the loans internally.

So there is a great sense of confidence that the system is working well, at least for credit unions, and we feel comfortable with that.

The things that obviously we are concerned about is conservatorship is temporary. It—by definition. And so we do and are in favor of reforms to remove it from conservatorship.

Mr. MACARTHUR. And one other?

Ms. Hughes?

Ms. HUGHES. For us without the opportunities in the path that exists currently, we would not be able to deliver the number of loans that we deliver to the secondary market. We cannot afford to hold loans on our books at market rate interest rates for our consumers long term.

So that is the definite need that we have for us to continue to be able to service our marketplace.

Mr. MACARTHUR. Yes, and that kind of leads me to my second question.

Mr. Stafford, you mentioned easy flow of liquidity and you are talking about the limitation of holding loans if you can't offload them to a secondary market.

This balance of catastrophic risk and how to deal with that, that is one model, versus I guess what I would call a smoothly flowing market aside from catastrophic risk, just a normal ebb and flow, smooth market that facilitates housing starts and facilitates an orderly real estate market. How would you balance those two issues?

Mr. Vallandingham?

Mr. VALLANDINGHAM. Well, I think that we got away from prudent underwriting standards. And if you do a good job on the front end you are not going to have a repeat of what happened in 2008. And therein lies the basis.

And I think community banks proved that time and time again. I mean, our portfolio has outperformed national averages across the board. And so in reality it is an ounce of prevention is worth a pound of cure.

So in reality I think that we have to be prudent up front and make sure that we do a good job and that we don't allow the non-bank participants, who really, I think in my opinion, created a lot of the problem.

Access to the market and the way that they had it where they were just doing anything they wanted in any way they wanted, and ultimately created the risk that we weren't comfortable with today.

Ms. BAILEY. And I would echo that point, and I would also go back to your original questions about some of the real benefits of the market. One of the things that the market does really well is pool loan risk so that there isn't a specialization where we are only serving borrowers with pristine credit profiles in certain regions of the market.

We actually have a system that allows us to have credit availability because of the duty to serve requirement across the country, specifically in rural areas. And this is really something that the market does well that must be preserved going forward. And the affordable housing goals along with the duty to serve are very critical.

Mr. MACARTHUR. So just balancing those two, and I am going to end, Mr. Chavers, with you because I would like you to sort of look at this from the perspective of those who invest in these securities ultimately.

This balancing of—I agree with you. We need to consider those without pristine credit and making sure that a broad group of Americans can have some hope at the American Dream.

But when that goes too far, which it did in the period in the run up to 2008 where the Federal Government is encouraging people to borrow money that they don't reasonably have a hope of repaying, and I think that was a big part of the run up to the housing crash. How do we reform that?

How do we make sure, Mr. Chavers, that the Federal policy is encouraging lending that is responsible, that there is every hope of it being repaid, that the private market will ultimately want to invest in those loans as they are securitized? What reforms would you see that would allow us to achieve that?

And again, I am out of time, so answer briefly.

Mr. CHAVERS. OK. So Congressman, I think your question runs at the beginning of the continuum, prudent underwriting. And I don't think there is any substitute for prudent underwriting for the product that ultimately goes through the system and ends up in the securitized space.

Now, relative to what we think of as the traditional GSE or TBA market, the benefit of the government guarantee is it opens up the global capital markets, who have no interest, frankly, in taking on credit risk, and bring that capital to support the primary housing market.

As it relates to the private label market, it begins with prudent underwriting and appropriate transparency and intermediaries who act in the ultimate interest of the investor and the borrower and transparency and appropriate disclosure throughout the process.

Mr. MACARTHUR. I thank you. My time has expired. I appreciate all of you being here.

I yield back.

Chairman DUFFY. The gentleman's time has expired.

The chair now recognizes the gentleman from New Mexico, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you all very much for your testimony.

Thank you, Mr. Chairman.

Ms. Bailey, I appreciate the testimony and the work of your group in going in the areas that are very underserved. Second District of New Mexico is 60 percent minority and also one of the poorest districts in the country. 50 percent of the houses are manufactured housing, so I am a little bit familiar with the circumstances they talk about.

Do you hold almost everything or almost nothing in the portfolio on your loans? Or do you sell them to the secondary market?

Ms. BAILEY. We actually have a robust secondary market program that allows us to actually buy loans from banks. So how it is designed is—

Mr. PEARCE. So you are a little bit of a secondary market yourself then?

Ms. BAILEY. Yes. We actually buy certain loans from banks to actually help them make more Community Reinvestment Act loans.

Mr. PEARCE. Do you all have different rates for different borrowers based on credit worthiness?

Ms. BAILEY. I would have to check with our team over at Self-Help to make sure I answer that correctly, so I would—

Mr. PEARCE. OK.

Ms. BAILEY. —Like to get back to you on that.

Mr. PEARCE. Yes, if you wouldn't mind I would appreciate that.

Mr. Vallandingham, do you have any rules of thumb when people are coming in and they are wondering about the 15 or 30-year mortgage that if you have 15 years you pay this much, 30 years? What kind of is that rule of thumb?

Mr. VALLANDINGHAM. In clarification, are you asking about debt-to-income ratio or how we counsel them about the products?

Mr. PEARCE. No. No, I am just talking about if somebody is wanting to know what am I paying over the 15-year for—if I do a 15-year loan versus 30-year loan? Do you have a rule of thumb?

Mr. VALLANDINGHAM. Well, in terms of what their total cost would be?

Mr. PEARCE. Yes, the total cost, that is—

Mr. VALLANDINGHAM. No. I really don't. We provide them with a truth-in-lending statement that shows in that. Generally—

Mr. PEARCE. Just generally I would look at it and I think it is fairly accurate, 15 years you are going to double the price of the house, so a $150,000 house you will pay about $300,000. 30 years you will pay $450,000, about three times. And so—

Mr. VALLANDINGHAM. Well, and I am going to argue that it depends on what rate environment we are in. And one of the things that—

Mr. PEARCE. Yes. I mean, yes, it will.

Mr. VALLANDINGHAM. At the current market and when we ask what it does well, is it brings very low cost financing to the borrowers. I mean, 4 percent over 30 years, that is an incredibly low rate and something that consumers are benefiting from. When I started, and I know I—

Mr. PEARCE. Yes. If I could take my time back here I would appreciate it. So we have heard the statement today many times that the 30-year mortgage will be dead if we don't have the secondary market. What percent—you say in your testimony that many of our banks, community banks, choose to hold their loans in the portfolio.

So by what percent is that? Because we really do want to get a sense of how much we are going to penalize the market if we change this GSE structure?

Mr. VALLANDINGHAM. Well, currently my community bank is $200 million and we service over $600 million in mortgages. We have about a $30 million internal portfolio of loans. We generally use those loans to—

Mr. PEARCE. How much do you put out? In other words, I am more interested in percents than sizes, so what percent do you?

Mr. VALLANDINGHAM. When you say "put out," sir?

Mr. PEARCE. Yes. Yes, so that you put to the secondary market?

Mr. VALLANDINGHAM. Well, not only—

Mr. PEARCE. Thirty of 600? That is what you are telling me? That is all of it?

Mr. VALLANDINGHAM. We portfolio about 30 and we have 600 that we service. Now, in a given year we might have originated a couple hundred million and I would say probably—

Mr. PEARCE. So it is a very small percent is actually held in portfolio?

Mr. VALLANDINGHAM. Yes, sir.

Mr. PEARCE. OK.

So Miss Bailey, the ability to repay rule that CFPB puts out, have you all taken a position on that?

Ms. BAILEY. Yes. We strongly support the ability to pay rule.

Mr. PEARCE. You strongly support the 43 percent, even though that is going to be very punitive on the lower income. You support the 43 percent because I know in our district it is going to be very punitive, but you support it?

Ms. BAILEY. We support it because we think that it gives guidelines for lenders and consumers to have safety in the marketplace. We think Dodd-Frank, like any other piece of legislation or any other regulation, can be fixed, but we think that they present us with a really good starting place for it.

Mr. PEARCE. OK.

Ms. BAILEY. And they return credit to the market.

Mr. PEARCE. I just wanted to know if you support the 43 percent.

So Ms. Hughes, do you all track the—

Ms. HUGHES. We—

Mr. PEARCE. —Underwriting standards of—do you track the underwriting standards of the GSE pretty closely?

Ms. HUGHES. Yes.

Mr. PEARCE. Yes. So when Mr. Johnson began to diminish the underwriting standards, again, I am addressing the fact that the GSEs had no responsibility in 2008. And when I look at it they began to change the underwriting standards dramatically and it began to get loans into the system that probably never were going to be repaid.

If they had never changed the underwriting standards then that great downward pressure in the system probably would not have occurred. And so I accept the fact that there were greedy people out there working in the finance market, but to simply say that underwriting standard in the GSEs have no part in it, is something I just, at the end of the day, won't buy.

I see my time has expired, Mr. Chairman, and thank you very much.

Chairman DUFFY. The gentleman yields back.

Did you want to respond to that?

Ms. HUGHES. I can.

Chairman DUFFY. Sure.

Ms. HUGHES. On the underwriting standards we do follow them very closely. I personally, and I am not speaking on behalf of the ABA, I am personally speaking to you at—the ACR was a non-issue for our institution. We underwrote loans on the borrowers' individual ability to repay from the onset.

So through the housing crisis we had very limited issues against our peers against national averages. We were very low in our defaults because we tried to underwrite them to begin.

Mr. PEARCE. Yes. I was just trying to say that you, even though the underwriting standards deteriorated, you all chose not to internally.

Ms. HUGHES. Right.

Mr. PEARCE. A lot of institutions did not make that choice. If they could go ahead and make the bonuses based on getting rid of the loans, somebody else got the problem, they jumped into that.

But if they could not have gotten rid of the loans because they didn't meet the underwriting standards, then much of the downward pressure in the system wouldn't have occurred.

So I appreciate the fact that you all chose to implement it differently, but my point was actually to the national pressures on those institutions that chose just to walk straight with the underwriting standards, creating an instability in the system.

And that, I think, is a great concept that is a piece of the equation that must be brought into play as we are looking at the entire GSE question.

And again, I yield back Mr. Chairman. Thank you.

Chairman DUFFY. For the second time the gentleman yields back.

I want to thank our witnesses for their testimony and time today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Without objection, this hearing is now adjourned.

[Whereupon, at 11:58 a.m., the subcommittee was adjourned.]

A P P E N D I X

October 25, 2017

Testimony of Ms. Nikitra Bailey

Executive Vice President, Center for Responsible Lending

Before the United States House of Representatives

Committee on Financial Services'
Subcommittee on Housing and Insurance

Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform

October 25, 2017

I. Introduction

Good morning Chairman Duffy, Ranking Member Cleaver, and Members of the House Committee on Financial Services' Subcommittee on Housing and Insurance. Thank you for the opportunity to testify regarding our nation's housing finance system, an issue that profoundly affects American families and is also critical to the overall housing industry, which is nearly 20 percent of the United States economy. I am Executive Vice President of the Center for Responsible Lending (CRL), a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a community development lender headquartered in Durham, NC. Since 1980, Self-Help has provided over $7 billion in financing to 131,000 families, individuals and businesses under-served by traditional financial institutions. It helps drive economic development and strengthen communities by financing hundreds of homebuyers each year, as well as nonprofits, child care centers, community health facilities, public charter schools and residential and commercial real estate projects. Through its credit union network, Self-Help's two credit unions serve over 130,000 people in North Carolina, California, Chicago, Florida and Wisconsin and offers a full range of financial products and services. Learn more at www.self-help.org and www.self-helpfcu.org.

This important hearing provides an opportunity to offer ways that we can build on existing reforms to the nation's secondary market, and repair the parts that are broken without major disruption to the system. We should move forward in a responsible way to incorporate more equitably important market segments – people of color, low-to-moderate income families, and rural residents – that a well-functioning future system depends on. Changes to the system must build upon the significant reforms offered by the Housing and Economic Recovery Act of 2008 (HERA), and the new protections created by the Dodd-Frank Act and the Consumer Financial Protection Bureau. It is imperative that the system serves the full universe of credit worthy borrowers, and provides equal treatment for small lenders, including community banks and credit unions, which often are the only sources of mortgage credit in underserved communities across the nation. Congress must also be careful not to provoke unanticipated harms, which could result in elevated systemic risk. Such risk would result in increases to the cost of mortgage loans and a stifling of the housing market, which has demonstrated modest growth since 2014. Our testimony today draws heavily from our June 29, 2017 remarks delivered before the United States Senate Committee on Banking, Housing, and Urban Affairs.

II. Today's Housing Finance System is Rooted in a Legacy of Discrimination and Exclusion

In an address to Howard University titled "To Fulfill These Rights," President Lyndon B. Johnson offered the following remarks on June 4, 1965:

> You do not wipe away the scars of centuries by saying: Now you are free to go where you want, and do as you desire, and choose the leaders as you please.
>
> You do not take a person who, for years, has been hobbled by chains and liberate him, bring him up to the starting line of a race and then say, "you are free to compete with others," and still justly believe that you have been completely fair.
>
> Thus is it not enough just to open the gates of opportunity. All our citizens must have the ability to walk through those gates.[1]

Regrettably, President Johnson's recommendation did not occur within the nation's housing finance system. Federal housing policies initiated in the twentieth century drafted as seemingly race-neutral solutions to the

[1] Lyndon B. Johnson: Commencement Address at Howard University: 'To Fulfill These Rights.' Accessed October 23, 2017, *available at* http://www.presidency.ucsb.edu/ws/?pid=27021.

Great Depression provided direct affirmative action to white families who descended from European ethnic groups--Germans, Scottish, Irish, Polish, French, Italians, etc. In fact, for decades, federal policies granted white families a monopoly on the ability to build wealth through homeownership, offering whites an unfair economic advantage that has been passed on to future generations through intergenerational wealth transfers. These same federal housing policies overtly excluded families of color, denying them a chance to secure an equal footing in homeownership with whites and the resulting ability to build home equity over time. According to a report by Demos, if homeownership rates were the same for whites and people of color we would see a decrease in the racial wealth gap by 31 percent for African-Americans and 28 percent for Latinos.[2] The current mortgage market was built on discriminatory federal housing policies and has yet to offer an equitable solution forward.

A. *Homeownership is Critical to Reducing the Persistent and Growing Racial Wealth Gap*

Homeownership is the foundation of the American Dream, and is still the primary way that most middle-class families build wealth and achieve economic stability. Wide access to credit is critical for building family wealth, closing the racial wealth gap, and for sustaining the housing market overall—which in turn, contributes significantly to our overall economy. Today, the opportunity to purchase, maintain, and refinance a home has not reached significant portions of low-wealth families and people of color. As a result, these communities lag far behind wealthier and white communities that had a head start due to historic lending inequity supported by our federal government's mortgage policies. These well-documented policies began in 1933 with the underwriting guidelines of the Home Owners Loan Corporation (HOLC) and allowed redlining of African-American and other communities of color, denying them access to mainstream banking services.[3] Examples of the impact of this inequity include the reality that only 2% of Federal Housing Administration (FHA) insured mortgage loans went to homebuyers of color during the first 35 years of the program due to redlining.[4] Further, the administration of the GI Bill loan programs enacted by Congress in 1944 continued this discrimination.[5] In the state of Mississippi alone, just 2 out of 3,229 VA insured mortgages went to African-Americans servicemembers seeking to finance a home or business in the first three years of the program.[6]

Likewise, the lasting impacts of the Great Recession have eroded the modest increase in homeownership rates that African-American and Latino families enjoyed since the passage of the Fair Housing Act in 1968. Evidence from data provided by the Home Mortgage Disclosure Act suggest that communities of color

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[2] Tanvi Misra, Why America's Racial Wealth Gap is Really a Homeownership Gap, Demos, March 12, 2015, *available at* http://www.demos.org/news/why-americas-racial-wealth-gap-really-homeownership-gap.

[3] For a more robust discussion of how federal housing policies benefitted whites while disadvantaging African-Americans and other people of color, see Ta-Nehisi Coates, The Case for Reparations, The Atlantic, *available at* http://www.theatlantic.com/features/archive/2014/05/the-case-for-reparations/361631/ (2014); Bob Herbert, Against All Odds: The Fight for the Black Middle Class, Bob Herbert and Public Square Media, Inc (2016), *available at* http://www.pbs.org/wnet/chasing-the-dream/films/against-all-odds/; James Carr and Nandinee Kutty, Segregation: The Rise Costs for America, Routledge (2008); Ira Katznelson, When Affirmative Action Was White: An Untold History of Racial Inequality in Twentieth-Century America, W. W. Norton & Company (2005); Thomas M. Shapiro, The Hidden Cost of Being African American: How Wealth Perpetuates Inequality, Oxford University Press (2004); Melvin L. Oliver and Thomas M. Shapiro, Black Wealth/White Wealth: A New Perspective on Racial Inequality, Routledge (1997).

[4] DEDRICK ASANTE-MUHAMMAD, ET AL., THE ROAD TO ZERO WEALTH: HOW THE RACIAL WEALTH DIVIDE IS HALLOWING OUT AMERICA'S MIDDLE CLASS 15 (2017), *AVAILABLE AT* https://prosperitynow.org/files/PDFs/road_to_zero_wealth.pdf.

[5] *Id* at. 16.

[6] *Id.*

continue to be underserved by the conventional mortgage market and are more likely than white borrowers to receive FHA loans.[7] At the same time, while FHA remains an important part of the mortgage market, lending backed by Fannie Mae and Freddie Mac is also a critical part of the housing finance system in low-wealth communities, rural communities and communities of color.

The Great Recession exacerbated inequality in wealth distributions. According to the Pew Research Center, in 2012 whites had 13 times the wealth of African-Americans and 10 times the wealth of non-white Hispanics.[8] Specifically, whites had a median wealth of $141,900 compared to $13,700 and $11,000 for non-Hispanic whites and African-Americans respectively.[9] Also, the St. Louis Federal Reserve reports that one in nine whites have less than $1,000 in wealth compared to one in four for Latinos and one in three for African-Americans.[10] Home equity plays a great role in determining a families' wealth and is the furthermost contributor to the racial wealth gap between whites and people of color.[11]

Unfortunately, the decline in homeownership that followed the Great Recession wiped out thirty years of homeownership gains among African-Americans and substantially reduced the homeownership rate among Hispanics (Figure 1). Between 1970 and 2000, African-American homeownership rate increased 5.5% and the Hispanic homeownership rate increased 2.9%. Since 2000, the homeownership rate decreased 6.1% among African-Americans and 1.8% among Hispanics.[12]

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[7] Center for Responsible Lending, New HMDA Data Show Despite Growing Market, African-Americans and Latinos Remain Underserved (2017) *available at* http://www.responsiblelending.org/research-publication/new-hmda-data-show-despite-growing-market-african-americans-and-latinos-remain.

[8] Rakesh Kochhar and Richard Fry, Wealth inequality has widened along racial, ethnic lines since end of Great Recession, Pew Research Center (2014), *available at* http://www.pewresearch.org/fact-tank/2014/12/12/racial-wealth-gaps-great-recession/.

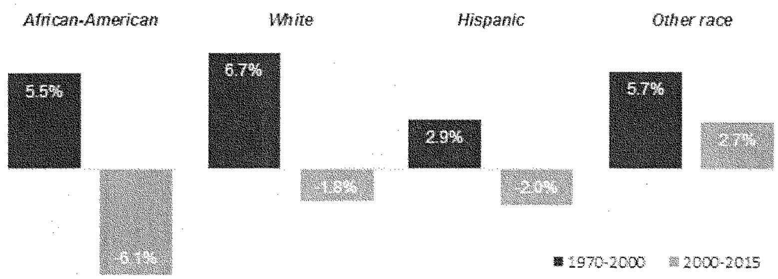
[9] *Id.*

[10] Ray Boshara and William Emmons, Stark Disparities in Wealth Are Key in Discussions on Race in the United States, Washington Post (2014), *available at* https://www.washingtonpost.com/opinions/policies-that-can-bootstrap-the-poor-out-of-the-wealth-gap/2014/12/30/3bf972a6-8f87-11e4-a412-4b735edc7175_story.html?utm_term=.bfc010a14313.

[11] SEE SHAPIRO ET AL., THE ROOTS OF THE WIDENING RACIAL WEALTH GAP: EXPLAINING THE BLACK-WHITE ECONOMIC DIVIDE, INSTITUTE ON ASSETS AND SOCIAL POLICY, (2013).

[12] LAURIE GOODMAN ET AL., ARE GAINS IN BLACK HOMEOWNERSHIP HISTORY? URBAN INSTITUTE (2017), *AVAILABLE AT* https://www.urban.org/urban-wire/are-gains-black-homeownership-history.

Figure 1. All gains in African-American homeownership since the Fair Housing Act have been erased since 2000



Source: Urban Institute. Other race includes Asian Americans, Pacific Islanders, American Indians and Alaska Natives, people who identify as "other," and (starting 2000) people who chose more than one racial identity. Hispanics can be of any race; all other categories are non-Hispanic.

B. *Evidence From 2016 HMDA Data Suggests that the Current Housing Finance System is Underserving Important Market Segments*

The 2016 mortgage data submitted by lenders under the Home Mortgage Disclosure Act (HMDA) shows the mortgage market overall has rebounded slightly from the depths of the Great Recession, but not for all American homebuyers. People of color and low- to moderate-income families continue to face challenges in accessing credit, particularly for loans not provided through government-backed programs.[13] Discrepancies for African-Americans and Latinos persist even as the mortgage market overall has nearly returned to pre-crisis lending volumes. These data reflect how secondary market actors and private lenders are failing to serve the full universe of credit worthy borrowers and the next generation of potential homebuyers (Figures 2 and 3).

[13] Despite Growing Market, African-Americans and Latinos Remain Underserved, Durham, NC, September 2017. See http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-2016hmda-policy-brief-sep2017.pdf.

Figure 2. Mortgage originations and demographic details for purchase mortgages[13]

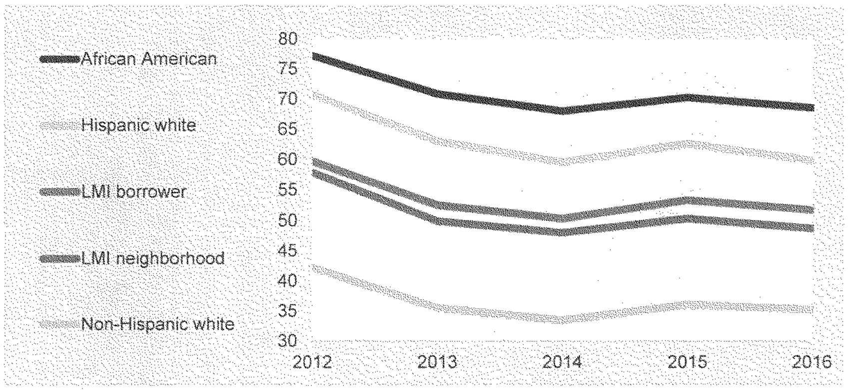
	2016		2015	
	#	%	#	%
Total originations	6,916,000		6,041,000	
Purchase mortgages	3,545,000	51.3%	3,200,000	53.0%
to African-Americans	207,780	6.0%	171,820	5.5%
to Hispanic-whites	304,744	8.8%	259,292	8.3%
to Non-Hispanic whites	2,299,432	66.4%	2,127,444	68.1%
Low- and moderate-income	907,306	26.2%	874,720	28.0%
Refinance mortgages	3,371,000	48.7%	2,841,000	47.0%
to African-Americans	166,850	5.0%	140,500	5.0%
to Hispanic-whites	206,894	6.2%	177,030	6.3%
to Non-Hispanic whites	2,175,724	65.2%	1,888,320	67.2%
Low- and moderate-income	563,953	16.9%	533,900	19.0%

Figure 3. Conventional and Non-conventional purchase mortgage originations, demographic details[14]

	2016		2015	
	#	%	#	%
Conventional (site built)	2,123,000		1,894,000	
to African-Americans	65,451	3.1%	51,202	2.7%
to Hispanic-whites	122,507	5.8%	96,975	5.1%
to Non-Hispanic whites	1,490,032	70.2%	1,361,564	71.9%
Low- and moderate-income	438,229	20.6%	408,494	21.6%
Non-conventional (site built)	1,340,000		1,230,000	
FHA	866,000	64.6%	794,580	64.6%
to African-Americans	142,329	10.6%	120,618	9.8%
to Hispanic whites	182,237	13.6%	162,317	13.2%
to Non-Hispanic whites	809,400	60.4%	765,880	62.3%
Low- and moderate-income	469,077	35.0%	466,226	37.9%

Government-backed mortgages have been a particularly important source of mortgage credit since the start of the Great Recession. This has particularly been true for borrowers of color. As shown in Figure 4, the proportion of these loans for all borrowers has gradually diminished since 2012.

Figure 4. Non-conventional percent of purchase loans for selected borrower groups



Source: Center for Responsible Lending analysis of the 2016 Home Mortgage Disclosure Act Data originally provided by the Federal Reserve Board, available at: https://www.federalreserve.gov/publications/files/2016_HMDA.pdf.

While the overall market share for these programs continues to decline as the market improves, the rate at which people of color rely on these programs has not diminished. Government-insured loans, such as those insured by FHA, have clearly been an important source of credit post-crisis. FHA mortgages are the primary source of credit for African-Americans and Latino home purchasers. However, compared to conventional loans these loans can be costlier over the life of the loan. Further, increasingly, lenders have also been less willing to make these loans. In 2015, large lenders, including Wells Fargo and JP Morgan Chase[14] took steps to pull back from FHA lending and the 2016 data show that more and more FHA loans are being made by non-bank lenders.

These programs are critical and deserve ongoing federal support. The FHA program must be adequately funded and modernized to ensure its viability. However, these data also underscore the urgent need for federal regulators to better enforce fair lending requirements to ensure a more robust conventional mortgage market that serves borrowers of color.

Market indicators highlight how tight lending standards have become, especially for conventional mortgages. These trends help explain the remarkably low levels of conventional loans that made to African-American and Latino borrowers in 2016. As noted, last year only 3.1% of conventional loans were made to African-American borrowers, and only 5.8% were made to Hispanic white borrowers. By contrast, non-Hispanic white borrowers received 70.2% of the conventional loans.

In 2016 the average credit score for all new loan originations fell from its high of 750 in 2013 to stand at 732 in December of 2016. However, the average score remained about 33 pts above the average score a

[14] Kate Berry, JPMorgan Leads Big Banks Out the Door of FHA, National Mortgage News (2015), *available at* http://www.nationalmortgagenews.com/news/compliance-regulation/jpmorgan-leads-big-banks-out-the-door-of-fha-1062309-1.html.

decade before.[15] At the same time, market-level credit availability indices continue to show that lenders have a very low tolerance for taking reasonable risk for new loans.[16] Recent vintages of new mortgages (loans originated from 2011-2015) have had near zero rates of default.[17]

These tight credit standards are preventing homeownership opportunity for credit worthy borrowers of color and low- to moderate-income borrowers. Recent data released by Fannie Mae show that loans to low-income borrowers originated from 2010-2015 had a default rate of just 0.3 percent, approximately equal to that of loans to high-income borrowers originated from 2002-2004.[18] There is ample opportunity in the mortgage market to expand lending to borrowers while still offering responsible loans that borrowers can successfully repay.

C. *The GSEs and Ginnie Mae Provide Important Access to Mortgage Credit in Underserved Communities*

Both the GSEs and Ginnie Mae continue to provide critical mortgage capital to underserved communities. The GSEs purchased over 2 million home purchase and refinance mortgage loans in 2015, including nearly a half a million loans to low- and moderate-income borrowers, nearly 400,000 loans to borrowers of color and over 300,000 loans to borrowers living in rural areas. At the same time, smaller financial institutions (those with assets less than $2 billion) relied on loans sold to the GSEs to meet the credit needs of nearly 200,000 borrowers seeking mortgage credit in rural communities. Loans backed by Ginnie Mae also continue to play a significant role in serving borrowers whose credit may warrant additional enhancement or who have limited resources for a down payment. Government-backed lending cannot and should not be sole source of mortgage lending in these communities.

To better understand the GSE market share among low- and moderate-income borrowers, borrowers of color, rural borrowers and among community banks and credit unions, CRL analyzed over six million home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes (including manufactured homes) reported under the Home Mortgage Disclosure Act in 2015 (referred to as purchase lending and refinance lending going forward). Of these loans, 34.2 percent were sold to Fannie Mae, Freddie Mac or Farmer Mac (collectively, the GSEs) and 16.2 percent were loans guaranteed through Ginnie Mae (see Figure 5).

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[15] LAURIE GOODMAN ET AL., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK (2017), *AVAILABLE AT* https://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-march-2017/view/full_report.

[16] *Id.*; Mortgage Bankers Association, Mortgage Credit Availability Index (2017), *available at* https://www.mba.org/newsresearch-and-resources/research-and-economics/single-family-research/mortgage-credit-availability-index.

[17] Laurie Goodman, Squeaky Clean Loans Lead to Near-Zero Borrower Defaults – And That is Not a Good Thing, Urban Institute (2016), *available at* http://www.urban.org/urban-wire/squeaky-clean-loans-lead-near-zero-borrower-defaults-and-not-good-thing.

[18] Fannie Mae 2016 Annual Housing Activities Report and Annual Mortgage Report, chart at page 19, *available at* https://www.fhfa.gov/PolicyProgramsResearch/Programs/AffordableHousing/Documents/Fan_M_Goals/2017/Fannie-Mae-2016-AHAR-AMR-FINAL.pdf.

Figure 5. 2015 purchase and refinance loans by purchaser

	All loans		Loans to LMI borrowers		Loans to borrowers of color	
	#	%	#	%	#	%
GSEs	2,065,978	34.2%	457,450	31.3%	374,133	30.0%
Ginnie Mae	976,119	16.2%	235,514	16.1%	262,773	21.1%
Not sold in 2015	1,245,698	20.6%	275,054	18.8%	225,453	18.1%
Other	1,752,868	29.0%	493,318	33.8%	382,781	30.7%
Total	**6,040,663**		**1,461,336**		**1,245,140**	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data, home purchase and refinance mortgages for first-lien, owner-occupied, 1-4 family homes, including manufactured homes. GSEs refers to all loans sold to Fannie Mae, Freddie Mac or Farmer Mac in 2015 calendar year. Other category includes loans acquired by an affiliate institution, commercial bank, savings bank, savings association, life insurance company, credit union, mortgage bank, finance company or private securitization.

i. *The GSEs and Ginnie Mae Provide Important Credit Access for Low- and Moderate-Income Borrowers and Borrowers of Color*

In 2015, GSEs purchased 457,450 purchase and refinance loans made to low- and moderate-income borrowers making up 31.3 percent of purchase and refinance mortgage lending to LMI borrowers, or borrowers with incomes less than 80 percent of the area median income. Likewise, Ginnie Mae guaranteed 235,514 purchase and refinance loans to LMI borrowers making up 16.1 percent of all purchase and refinance lending to low- and moderate-income borrowers (Figure 5).

During the same year, the GSEs purchased 374,133 loans to borrowers of color, or 30.0 percent of all loans to these borrowers and Ginnie Mae guaranteed 262,773 FHA loans to borrowers of color—a 21.1 percent market share.

ii. *GSE Market Share Exceeds Ginnie Mae Market Share in Rural Communities*

The GSEs also provide an important source of mortgage capital in rural communities, where they purchased nearly one out of every three new mortgages in 2015. In 2015, lenders made over one million purchase and refinance loans in rural areas.[19] The GSEs also purchased 76,661 purchase and refinance loans to LMI borrowers in rural areas and 20,504 loans to rural borrowers of color, a 26.2 percent and 21.9 percent market share, respectively (Figure 6).

In comparison, Ginnie Mae guaranteed 196,963 FHA loans in rural areas, including 52,876 loans (18.1 percent) to LMI borrowers and 24,234 loans (25.9 percent) to rural borrowers of color.

[19] Census tracts, which were classified as either urban or rural areas based on the 2017 definition of rural area at 12 CFR 1282.1, and *available at* https://www.fhfa.gov/DataTools/Downloads/Pages/Duty-to-Serve-Data.aspx.

Figure 6. 2015 purchase and refinance loans by purchaser in rural areas

	All rural loans		Loans to rural LMI borrowers		Loans to rural borrowers of color	
	#	%	#	%	#	%
GSEs	320,525	30.0%	76,661	26.2%	20,504	21.9%
Ginnie Mae	196,963	18.4%	52,876	18.1%	24,234	25.9%
Not sold in 2015	271,145	25.3%	77,405	26.4%	22,872	24.4%
Other	281,233	26.3%	85,999	29.4%	25,982	27.8%
Total	1,069,866		292,941		93,592	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

The GSEs also provide a critical source of mortgage capital for smaller lenders, those with assets of less than $2 billion in 2015. The GSEs purchased 177,028 purchase and refinance loans from smaller lenders lending in rural areas, or 25.1 percent of the market. Ginnie Mae guaranteed 139,792 purchase and refinance loans made by small lenders in rural areas that same year—a 19.8 percent market share (Figure 7).

Figure 7. 2015 purchase and refinance loans originated by small lenders by purchaser in rural areas

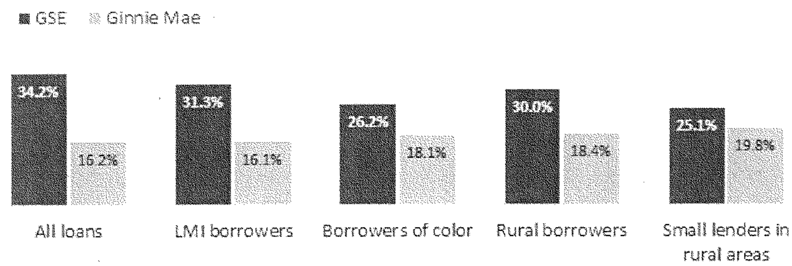
	Purchase loans		Refinance loans		Total	
	#	%	#	%	#	%
GSEs	73,564	18.5%	103,464	33.4%	177,028	25.1%
Ginnie Mae	70,417	17.8%	69,375	22.4%	139,792	19.8%
Not sold in 2015	86,709	21.9%	71,089	22.9%	157,798	22.3%
Other	165,920	41.8%	66,122	21.3%	232,042	32.8%
Total	396,610		310,050		706,660	

Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

In all, the GSE market share exceeds the market share of Ginnie Mae among low- and moderate-income borrowers, borrowers of color and rural borrowers. The GSEs also purchase one out of every four loans issued by smaller lenders in rural areas, exceeding the market share of loans guaranteed by Ginnie Mae and even exceeding the market share of loans that are originated but not sold to other institutions or the secondary market (Figure 8).[20]

[20] FHA operations have been hampered in recent years due to a variety of challenges including excessive uncertainty regarding lending liability, structural defects in its servicing process and outdated and under resourced technology and operations infrastructure. See, The Federal Housing Administration Can Do More With More, April 2017, *available at* https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/.

Figure 8. Market share of GSEs and Ginnie Mae



Source: CRL analysis of 2015 Home Mortgage Disclosure Act data

In addition to support for homeownership, the GSEs also play a vital role in supporting affordable rental housing, which is essential for many working families. These programs have performed well, even through the recent financial crisis, and should be continued going forward.

D. *The Future of the Market Depends on Mortgage Providers Meeting Their Duty-to-Serve Obligations*

Existing homeowners, especially older Americans, will need buyers when they want to sell, and new families need access to affordable mortgage credit to buy their homes. In the future, homebuyers will be more racially and ethnically diverse than they have been in the past. Harvard's Joint Center for Housing Studies found that non-whites accounted for 60 percent of household growth from 1995-2015 and predicted that half of millennial households by 2035 will be non-white.[21] The mortgage market will need to find ways to serve borrowers of color and lower-wealth borrowers to sustain a robust market in the coming years.

Responsible and affordable refinance loans are also crucial to allowing borrowers to preserve homeownership. Recent history shows this to be the case, as toxic refinance loans helped spur the housing crisis. In fact, 90 percent of borrowers who took out subprime loans from 1998 to 2006 were already homeowners.[22] Yet, discrepancies persist in access to refinance mortgages as well as purchase mortgages. In fact, while very modest gains were made in 2016 in the access of borrowers of color to purchase mortgages, these gains did not carry over for African-American and Hispanic white borrowers, relative to the growing refinance market. In addition to making loans broadly available for home purchase, responsible and affordable refinance mortgages need to be broadly available to support sustained homeownership.

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[21] Joint Center for Housing Studies of Harvard University, State of the Nation's Housing 2017, (2017), *available at* http://www.jchs.harvard.edu/research/state_nations_housing.
[22] Maura Reynolds, Refinancing spurred subprime crisis, Los-Angeles Times (2008), *available at* http://articles.latimes.com/2008/jul/05/business/fi-refi5; Amir Khandani, Andrew Lo, and Robert Merton, Systemic Risk and the Refinancing Ratchet Effect, National Bureau of Economic Research Working Paper No. 15362 (2009), *available at* http://www.nber.org/papers/w15362.

III. Congress Has Already Substantially Reformed the Housing Finance System with HERA and New Mortgage Protections

In response to the financial crash, Congress took action to strengthen and improve the regulatory structure of the housing market. The Housing and Economic Recovery Act of 2008 (HERA), The Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), and Consumer Financial Protection Bureau (CFPB) regulations have reformed the housing market and made it safer for all market participants. As we pursue further reform, we should build upon the current market and regulatory structure.

HERA substantially changed the regulatory landscape of the housing finance system.[23] In fact, after the passage of HERA, substantial GSE reform has already been implemented, and these reforms should be continued, expanded, and made permanent.

A. HERA's Reforms Should Be Maintained

Congress' creation of the Federal Housing Finance Agency (FHFA) was a central reform of the housing finance system. HERA abolished the Office of Federal Housing Enterprise Oversight (OFHEO) and the Federal Housing Finance Board, and established FHFA – a strong independent regulator with the legal authority and tools required to supervise the full activities of the GSEs. Prior to HERA, oversight of the GSEs was split between OFEO and the Secretary of HUD. The absence of a primary and comprehensive regulator resulted in the lack of robust and efficient enforcement. OFHEO, an independent agency within HUD, was the safety and soundness regulator, and the Secretary of HUD was the mission regulator. The affordable housing goals were under the Secretary of HUD's purview. This regime was problematic for many reasons, but the most significant issue was that OFHEO did not possess the legal authority necessary to adequately supervise the GSEs or enforce the law. As FHFA's General Counsel stated in congressional testimony in 2013, "At OFHEO much had to be done with implied authorities; HERA corrected that, providing explicit authorities and language regarding 'incidental authority.'"[24]

OFHEO's authority over the GSEs was weak and not comparable to other financial regulators. The agency did not have sufficient authority to establish prudential standards, including internal controls, audits, risk management, and management of the portfolio. In contrast, HERA empowered FHFA with the legal authority to comprehensively and robustly regulate the GSEs. FHFA has the tools to ensure adequate capital,[25] establish prudential standards,[26] review and approve new product offerings,[27] place a regulated entity into receivership,[28] and closely supervise the full activities of the GSEs.

Furthermore, OFHEO did not hold adequate enforcement authority. OFHEO had to rely on the Attorney General to sue on the agency's behalf. HERA provided FHFA with a broad range of administrative enforcement tools, including cease and desist orders, civil money penalties, debarment of officials, and the ability to act against entity-affiliated parties.[29] FHFA may also access the courts through its independent

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[23] 12 U.S.C. § 4501 et. seq.
[24] Housing Finance Reform: Powers and Structure of a Strong Regulator, Statement of Alfred M. Pollard before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (2013), *available at* https://www.fhfa.gov/mobile/Pages/public-affairs-detail.aspx?PageName=Housing-Finance-Reform-Powers-andStructure-of-a-Strong-Regulator.aspx.
[25] 12 U.S.C. §§ 4611-4613.
[26] 12 U.S.C. § 4513b.
[27] 12 U.S.C. § 4541.
[28] 12 U.S.C. § 4617
[29] 12 U.S.C. §§ 4581, 4631.

litigation authority.[30] Additionally, while OFHEO funded operations through assessments on the GSEs, it could only collect the assessments when approved through appropriations. Consequently, OFHEO was perpetually underfunded. HERA corrected this so FHFA would not be subject to the appropriations process and the politics accompanying it.[31]

In addition, HERA corrected the bifurcated authority issue that OFHEO experienced. On the mission side, HERA provided FHFA with authority over the affordable housing goals and established a duty to serve underserved markets requirement. The duty to serve rule's purpose is to increase the liquidity of mortgage investments and improve the distribution of investment capital available for mortgage financing for very low-, low-, and moderate-income families in manufactured housing, affordable housing preservation, and rural markets.[32] FHFA's authority to administer the duty to serve requirement and the affordable housing goals should be applied robustly to expand affordable homeownership opportunity.

Congress should continue to build upon HERA's important reforms to the housing finance system. For instance, FHFA has required reinsuring of credit risk and it has greatly shrunk portfolios to reduce taxpayer exposure. The ban on lobbying and campaign activity should be made permanent, portfolios should be further reduced and limited to necessary business purposes (such as modifying loans), and capital standards should be set and achieved. Utility regulation and rules regarding returns for the GSEs would further prevent excessive risk taking. Much authority already exists to continue advancing this reform while Congress considers GSE legislation.

Furthermore, the GSEs' affordable housing goals – particularly the purchase of single-family loans from low and very low-income borrowers – are essential to encourage affordable homeownership opportunities. Contrary to the unfortunate myth, the affordable housing goals and the Community Reinvestment Act (CRA) did not cause the mortgage meltdown.[33] According to the Financial Crisis Inquiry Commission (FCIC), the housing goals only contributed marginally to Fannie Mae and Freddie Mac's participation in risky mortgages.[34] The GSEs could have met their housing goals without any purchases of Alt-A or subprime securities. Furthermore, lenders made few subprime loans to meet their CRA requirements. A Federal Reserve study found that banks and thrifts only made 6 percent of higher-cost loans to low- or moderate-income borrowers or in low- or moderate-income neighborhoods that were covered by the CRA.[35] The remaining 94 percent of high-cost loans were made by CRA-covered institutions that did not receive CRA credit for the loans, or were made by lenders not covered by the CRA.[36] Other research corroborated these conclusions.[37]

In fact, evidence shows that borrowers perform well when they receive safe and responsible loans. For example, a report on Self-Help Credit Union's Community Advantage Program from the University of North Carolina's Center for Community Capital, showed that borrowers amassed a net worth of $38,000,

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[30] 12 U.S.C. § 4635.
[31] 12 U.S.C. § 4516.
[32] 12 U.S.C. § 4565; 12 C.F.R. 1282, Subpart C.
[33] The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (2011), at xxvii, *available at* https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.
[34] *Id.*
[35] *Id.* at 220.
[36] *Id.*
[37] *Id.*

compared with renters' $266, even as housing values plunged during the crisis.[38] The Community Advantage Program securitized mortgages for more than 50,000 families in 48 states.

B. Dodd-Frank Act Mortgage Protections Made the Market Safer

Additionally, the Dodd-Frank mortgage protections and CFPB regulations – such as the Ability-to-Repay (ATR) and Qualified Mortgage (QM) rules – are needed to protect consumers, small businesses, taxpayers, and the nation's economy. These protections have not negatively impacted lending, but have made the market safer.

QM and ATR define bright line standards to move the market away from high-risk, unsustainable loans and ensure borrowers have an ability to repay the loans they receive. QM and Ability-to-Repay promote product features that are reorienting the housing market back toward safe, sustainable lending for all borrowers. All financial institutions benefit from the underlying purposes of financial regulation: protecting consumers, ensuring the safety and soundness of institutions, protecting community financial institutions from unfair competition, and defending the nation's financial market from systemic risk.

Contrary to theories that the Dodd-Frank Act has stifled growth, the financial sector has had record profits. In 2016 U.S. financial institutions had total annual profits of $171.3 billion, the highest level since 2013.[39] While this profit level is slightly lower than the profit level in the peak of the false housing boom in the years immediately prior to the financial crisis (2004-2006), it remains higher than inflation-adjusted financial sector profits for any other time period since World War II.

Community bank profitability has also rebounded strongly and meets pre-recession levels. In 2010, less than 78 percent of community banks were profitable. By the end of 2015, over 95 percent of community banks were profitable.[40] The most recent FDIC report from the 2016 third quarter notes that the percentage of unprofitable community banks sunk to 4.6 percent, which is the "lowest percentage since the third quarter of 1997."[41] Full year earnings were up 9.7 percent in 2015, which is a higher figure than the overall increase of 7.5 percent for all banks.[42]

Moreover, according to CRL's 2016 HMDA analysis, for the third straight year, mortgage lending volume overall has not been affected by ATR and QM. Instead, lending trends show incremental increases signaling modest growth in 2014, 2015, and again in 2016. In 2016, 2,123,000 conventional loans were approved. An additional 866,000 non-conventional loans were also made last year.[43]

Furthermore, although access to credit persists as problem in today's market, it is lender overcorrections in the post- crises market, not Ability-to-Repay/QM that explain constrained lending patterns. This

[38] Allison Freeman, UNC Center for Community Capital, The Continuing Importance of Homeownership: Evidence from the Community Advantage Program (2014), at 9, *available at* http://www.frbsf.org/community-development/files/ci_vol26no2-Continuing-Importance-of-Homeownership.pdf.
[39] Wall Street Journal, U.S. Banking Industry Annual Profit Hit Record in 2016 (2017), *available at* https://www.wsj.com/articles/u-s-banking-industry-annual-profit-hit-record-in-2016-1488295836.
[40] Federal Deposit Insurance Corporation, Core Profitability of Community Banks 1985-2015 1 (2016), *available at* https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/article1.pdf.
[41] Federal Deposit Insurance Corporation, Quarterly Banking Profile: Third Quarter 2016 I, *available at* https://www.fdic.gov/bank/analytical/quarterly/2016_vol10_4/fdic_v10n4_3q16_quarterly.pdf.
[42] *Id.*
[43] Center for Responsible Lending, New HMDA Data Show Despite Growing Market, African-Americans and Latinos Remain Underserved (2017), *available at* http://www.responsiblelending.org/research-publication/new-hmda-data-show-despite-growing-market-african-americans-and-latinos-remain.

environment is most harmful to lower-wealth households with lower FICO scores, and fewer resources for a down payment.[44] Evidence of tight credit standards includes:

- The median credit score on new origination currently stands at 729, up 25 points from 2001. The lower bound, 10th percentile, rose from the low 600s to 645 over this same time period.[45]
- The Urban Institute's Credit Availability Index remains low, standing at 5.2 for the fourth quarter of 2016 (the most up to date value). It was near 10 in 1998, rose to over 16 in 2006 and 2007 and fell precipitously in 2008.[46]
- The MBA's Mortgage Credit Availability Index, most recently valued at 183 in April 2017, is half the value in June 2004.[47]
- Mortgage default rates on recently originated loans are near zero. The default rate for loans originated from 2011 to 1Q2016 was 0.2% for Fannie Mae loans and 0.1% for Freddie Mac loans through 4Q2016.[48]

Ultimately, millions of loans that could be responsibly made have not been due to these unnecessary credit constraints. Lack of access to credit in today's mortgage market is particularly problematic because QM rules ensure that the loans available today are safe. The Ability-to-Repay standard provides borrowers and lenders much more certainty that the loan is affordable. The elimination of products like option adjustable rate mortgages (ARMs) and teaser rate loans means borrowers receive clear information about what they will owe monthly. Additionally, overall interest rates remain low and house prices are still rebounding, resulting in affordable homebuying opportunities in many markets. The Urban Institute's maximum affordable home price ($311,453) remains well above the median sales price ($278,745).[49] Lack of access to responsible loans in this market can and should be addressed.

Today's housing market is safer due to legislative reform, like HERA and Dodd-Frank, as well as through CFPB regulations. These reforms have substantially changed the regulatory landscape of the housing finance system. As we pursue further reform we should build upon the current market and regulatory structure and be particularly mindful of how policies affect access to responsible mortgage credit.

IV. FHA is a Critical Component of the Housing Finance System and Along with the GSEs Saved the Market from Total Collapse. To Remain Effective and Achieve its Goal of Promoting Homeownership, it Must be Reformed and Modernized.

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[44] Jim Parrot and Mark Zandi, Opening up the Credit Box (2013), *available at* http://www.urban.org/UploadedPDF/412910-Openingthe-Credit-Box.pdf., see also LAURIE GOODMAN ET AL., TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014 (2016), *AVAILABLE AT* http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009- and-2014.
[45] LAURIE GOODMAN ET AL., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK (2017) 14, *AVAILABLE AT* http://www.urban.org/research/publication/housing-finance-glance-monthly-chartbook-june-2017/view/full_report.
[46] *Id.* at 13.
[47] Mortgage Bankers Association, Mortgage Credit Availability Index (2017), *available at* https://www.mba.org/newsresearch-and-resources/research-and-economics/single-family-research/mortgage-credit-availability-index.
[48] LAURIE GOODMAN ET AL., *supra* note 45.
[49] Id. at 16.

A. *When Considering Legislative Changes to the Housing Finance System, it is Crucial to Start by Recognizing the Central Role that the GSEs and FHA Play in the Nation's Housing Market Recovery*

The GSEs and FHA ensured that stable and affordable mortgage credit was available across the country and throughout the economic downturn. Currently, they hold mortgages worth $6.17 trillion with Fannie Mae at 44.2 percent, Freddie Mac at 27.5 percent, and Ginnie Mae at 28.3 percent.[50] The GSEs were created by Congress in the 1930s to provide stability to the capital markets and to increase the availability of mortgage credit throughout the United States following periods of significant economic instability. The GSEs have a mandate to serve all credit markets at all times, which guarantees broad credit availability in all regions of the nation. The charters of the GSEs state that they must "promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing."[51] By pooling and securitizing mortgages, backed by an implied federal government guarantee, the GSEs have ensured the flow of credit to all parts of the nation. We now have a national mortgage market, investor confidence, increased loan volume, and widespread use of the 30-year fixed rate mortgage.

B. *Following the Financial Crash, GSE and FHA Lending Saved the Market from Complete Shutdown*

Private capital withdrew from the market during the housing crash. The countercyclical nature of the GSEs and FHA insured mortgage credit sustained the market. Private label lending peaked in 2006 with approximately 40 percent of all mortgage originations.[52] It began to decline in 2007 and virtually stopped by 2008.[53] With record levels of defaults and foreclosures occurring alongside sharp declining prices nationwide, overall mortgage lending quickly dried up.

Credit would not have been available for most mortgagees if not for government support during the financial crisis. Backed by government guarantees, the GSEs under Federal Housing Finance Administration conservatorship beginning in September 2008 and FHA continued to ensure the availability of credit. GSE lending jumped to over 65 percent of all mortgage originations in 2008.[54] FHA lending also played a key role as its involvement increasing rapidly.[55] Since then, FHA purchase loans have dropped steadily and returned closer to the normal levels of the early 2000s (Figure 9).[56] Moody's estimated that FHA's contribution prevented a second collapse in the housing market, which could have sent the U.S. economy

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[50] LAURIE GOODMAN ET AL., HOUSING FINANCE AT A GLANCE: A MONTHLY CHARTBOOK 6-7 (2017), *AVAILABLE AT* http://edit.urban.org/sites/default/files/publication/90451/may_chartbook.pdf.

[51] Fannie Mae's charter is in Title III of the National Housing Act, 12 U.S. Code § 1716 et. seq. Freddie Mac's charter is in 12 U.S.C. §1451 et. seq.

[52] LAURIE GOODMAN ET AL., *supra* note 50.

[53] Id.

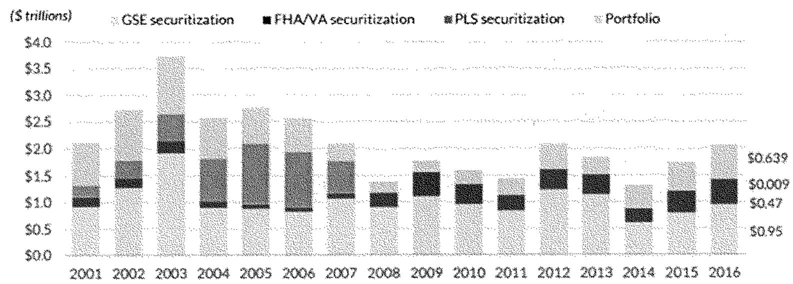
[54] Id.

[55] John Griffith, "The Federal Housing Administration Saved the Housing Market" (Washington: Center for American Progress, 2012), *available at* https://www.americanprogress.org/issues/housing/report/2012/10/11/40824/the-federalhousing-administration-saved-the-housing-market/. This report cites data estimates from Moody's Analytics in October 2010.

[56] US Department of Housing and Urban Development, Annual Report to Congress Regarding the Financial Status of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2010, at 2 (2010), *available at* https://portal.hud.gov/hudportal/documents/huddoc?id=report_to_congress.pdf; See also US Department of Housing and Urban Development, Federal Housing Administration Annual Report to Congress, The Financial Status Of the FHA Mutual Mortgage Insurance Fund Fiscal Year 2016, at 8 (2016), *available at* https://portal.hud.gov/hudportal/documents/huddoc?id=2016fhaannualreport1.pdf.

into a double-dip recession and caused the economy to shed another 3 million jobs and the unemployment rate to rise an additional 1.6 percent.[57]

Figure 9. First lien origination volume



Source: Inside Mortgage Finance and Urban Institute, last updated February 2017

C. *Modernizing the FHA is Critical to Ensure It Carries Out its Mission to Promote Homeownership and Ensure Access to Credit*

The FHA is one of the main pillars of the nation's housing finance system. The program creates an entry point for millions of first time home buyers. As noted above, FHA was central to the nation's economic recovery after the financial crash by continuing to insure mortgage loans when private capital dried up. However, the program would benefit tremendously from both funding and statutory reform.

i. *The False Claims Act*

Lender liability under the False Claims Act has been the subject of a variety of proposed reforms. There is a recognized need to clarify what types of errors can trigger liability under the Act. The statute imposes treble damages against anyone who submits a false claim to the government, including FHA insurance payments. Because these treble penalties can cost a far greater amount than the loan itself, this has the potential to decrease the appetite for making FHA insured loans that have only a modest risk of defaulting.[58] This has potential negative effects on access to mortgage credit, especially for those borrowers that rely on FHA to secure mortgage loans. The False Claims Act can be a strong tool to curb fraud in the mortgage lending space, and should be reformed to clarify the liability provisions so it can bolster access to credit.

ii. *Program Funding*

FHA loan volume plummeted during the subprime mortgage lending boom. In 2015, FHA lending somewhat recovered, but while the increase in lending volume has bolstered FHAs capital levels it has

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[57] John Griffith, *supra* note 55. This report cites data estimates from Moody's Analytics in October 2010.
[58] See, Michael D. Calhoun, *The Federal Housing Administration Can Do More With More*, Brookings (2017), *available at* https://www.brookings.edu/research/the-federal-housing-administration-can-do-more-with-more/.

counterintuitively negatively impacted FHA's operations.[59] Under statute the entirety of FHA's revenue is sent to the Mutual Mortgage Insurance Fund (MMIF) and cannot be used for FHA's operations, regardless if that funding could significantly improve operational or program efficiency. For example, FHA attempted to address the false claims act ambiguity by establishing which errors would and would not trigger liability, but this effort was abandoned due to lack of funding.[60] Additionally, FHA loan servicing for modifications for troubled loans is expensive and risky, so servicers will be constrained in their ability to provide payment relief for borrowers without programmatic changes.

FHA has made attempts to secure additional funding to address these (and more) complications, but has been met with resistance. One of these proposals was legislation authorizing a 4 basis point ongoing fee on FHA loans. Additionally, HERA authorized $25 million a year for 5 years out of a "negative credit subsidy", proceeds from the MMIF, to target system upgrades and quality control.[61] These upgrades would substantially advance FHA's role in the housing market, protecting taxpayers, and support the overall economy.

V. Access and Affordability are Central Tenants to the Future of the Housing Finance System

Despite historical inequities in access to mortgage credit, the future of the market depends on often-excluded borrowers including people of color and LMI families. As stated above, these borrowers have less wealth, which has translated into lower credit profiles and an inability to make large down payments on mortgage loans.[62] Therefore, a future well-functioning system must serve all credit worthy borrowers.

A. *Serve all credit worthy borrowers*

Rural borrowers, new emerging households, LMI borrowers and borrowers of color all face obstacles to receiving competitive and affordable mortgage loans. Current statutory provisions governing the GSEs include important measures to further service of these markets: the mandate to serve the broad market, even at a lower rate of return; affordable housing goals; the duty to serve under-reached markets; and the affordable housing funds. These were all included in or reaffirmed by HERA, which passed with strong bipartisan support. These bipartisan compromises, worked out over nearly a decade, must be preserved and expanded in order to meet the current and future mortgage market, which will include large proportions of these borrowers. Equally important, credit risk transfers must continue to be done by the issuer-guarantors through mechanisms that do not price these borrowers or small lenders out of the market. This means credit

[59] Id.

[60] Id.

[61] 12 U.S.C. § 4501 et. seq.; Section 2126 authorized $25m negative subsidy (This funding was dependent on FHA's meeting its statutory capital ratio, and FHA has been below this standard for several years before present day, so this provision was never implemented.)

[62] See The State of the Nation's Housing, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make down payments. For example, among renters aged 25–34 in 2010, the median net wealth was only $1,400 for blacks and $4,400 for Hispanics, compared with $6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-down payment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.")

risk transfers must be executed through reinsurance structures that permit pooling of loans and risk, and not through deeper upfront risk transfers.

B. *Pricing Practices Should Expand Mortgage Access*

The GSEs and FHA today have an affirmative duty to serve all markets which incentivizes them to set prices in a way that balances risk and access.[63] These participants in today's housing finance system are incentivized to pool risk and price credit risk on a pooled basis. Unfortunately, recent proposals for legislative housing finance reform share a common feature that undermines this pricing approach. Deep upfront credit risk transferred to private capital would incentivize actors to segment, rather than pool, credit risk and prices. Segmented pricing puts mortgage credit out of reach for too many credit worthy borrowers.

The total amount borrowers pay to cover credit risk is a function of modeled losses, capital standards and the required rate of return on capital.[64] Modeled losses are largely independent of system structures.[65] Capital requirements and required rates of return on capital are dependent on the structure of a future system, and function to increase or decrease the overall total amount to be held to guard against losses.

It is the policies of participants in the housing finance system that translate predicted credit losses into borrower prices and distribute prices for borrowers with different characteristics. Importantly, the degree to which costs are pooled or distributed is determined by the structure of the housing finance system. For example, FHA charges the same insurance premium to borrowers regardless of credit score,[66] whereas private mortgage insurers charge widely different fees to borrowers with different credit scores and/or levels of down payment (Figure 10).

[63] CRL continues to work with FHFA to encourage changes which could further open access to credit. For example, eliminating the loan level price adjustments (LLPAs) that were put in place after the crisis.
[64] For a more detailed discussion of the levers that affect pricing and the distribution of pricing for credit risk see Calhoun, M. and Wolff, S. Who Will Receive Home Loans, and How Much Will They Pay? (2016), *available at* http://www.urban.org/policy-centers/housing-finance-policy-center/projects/housing-finance-reform-incubator/mike-calhoun-and-sarah-wolff-who-will-receive-home-loans-and-how-much-will-they-pay.
[65] System structure could introduce new risks. For example, if a future system made it very difficult or costly for first-time homebuyers to purchase a home, then existing homeowners would have a difficult time selling their homes. This could depress housing prices or limit liquidity in the housing system overall, which could result in a downturn and create losses in the system above what would be predicted by current models.
[66] FHA premium rates *available at* https://portal.hud.gov/hudportal/documents/huddoc?id=17-07ml.pdf.

Figure 10. Private mortgage insurance pricing, 2017

	97-95.01% LTV 35% Coverage	95-90.01% LTV 30% Coverage	90-85.01% LTV 25% Coverage	85% LTV and under 12% Coverage
>=760	55	41	30	19
740-759	75	59	41	20
720-739	95	73	50	23
700-719	115	87	60	27
680-699	140	108	73	32
660-679	190	142	100	41
640-659	205	150	105	43
620-639	225	161	110	45

From online published rate sheets for Borrower Paid Mortgage Insurance from private mortgage insurers Genworth (https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf) and Radian (http://www.radian.biz/sfc/servlet.shepherd/version/download/068C0000002osy9IAA)

Underwriting structures determine if borrowers are credit worthy, but pricing structures determine if a credit worthy borrower can afford a mortgage. Differential pricing creates an additional barrier to mortgage credit by increasing the price, sometimes significantly, for some borrowers relative to others. There is evidence of price acting as a barrier even in today's mortgage market. For example, although Fannie Mae's guidelines allow the GSE to purchase loans with credit scores down to 620 and loan-to-value (LTV) ratios of up to 97 percent, very few loans purchased by the GSE have these characteristics.[67] One reason is that risk-based pricing by both the GSEs and private mortgage insurers add significantly to the cost of loans for borrowers with lower scores and less wealth for a down payment. For example, the combination of loan-level price adjustments (LLPAs) and mortgage insurance (MI) premiums adds over 300 basis points to the cost of a mortgage for a borrower with a credit score of 620 and an LTV of 97 percent.[68]

The GSEs, though, currently set prices based on a more consolidated set of borrower characteristics than private actors like private mortgage insurers. They lay off credit risk largely through back-end credit risk transfer mechanisms which allows for pooling of loans and risk. Ultimately, these policies limit the degree to which loan pricing is highly segmented.[69]

Comparing the GSE guarantee fee structure to the MI pricing structure reveals the private market's tendency to create finely defined bands. GSE guarantee fee pricing[70] breaks up credit scores into three bands: >=740, 700-739, and 620-699. From December 2013 to April 2016, MI companies broke up this same range into four bands: >=760, 720-759, 680-719, and 620-679. The most recent set of MI pricing, released in April 2016,[71] breaks this same range of credit scores into eight different bands: >=760, 740-759, 720-739, 700-719, 680-699, 660-679, 640-659, and 620-639.

[67] See p. 6 of *2017 First Quarter Credit Supplement*, Fannie Mae, May 5, 201, *available at* http://www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2017/q12017_credit_summary.pdf.
[68] 350/4+225=312.5 basis points. Fannie's Mae's LLPA for this combination of credit score and LTV is a one-time fee of 350 basis points (see page 2: https://www.fanniemae.com/content/pricing/llpa-matrix.pdf), we assumed a LLPA multiple of 4 to convert this upfront fee to an ongoing cost comparable to the MI premium. Borrower paid MI from Genworth for this combination of credit score and LTV is a continuing fee of 225 basis points (see: https://mortgageinsurance.genworth.com/pdfs/Rates/11370775.Monthly_Natl.FIXED.0616.pdf).
[69] Through the LLPAs the GSEs also have differential pricing, which limits their reach to underserved borrowers.
[70] As described in Fannie Mae and Freddie Mac Guarantee Fees: Request for Input, FHFA (2015), *available at* https://www.fhfa.gov/policyprogramsresearch/policy/documents/gfeerfi060514f.pdf.
[71] Shown in Figure 11.

Finely defined pricing frameworks produce more extreme pricing. Figure 7 below shows the change in basis points borrowers with a given credit score experienced when PMI pricing changes were implemented in April 2016. Some borrowers, those with credit scores above 740, enjoyed a reduction in fees whereas others, almost all borrowers with scores below 680, experienced increases. The cells highlighted in dark green saw a decrease of more than 30 basis points. The cells highlighted in dark orange saw an increase of more than 30 basis points (Figure 11).

Figure 11. Change in MI pricing by credit score and LTV December 2013 to April 2016

	97-95.01% LTV 35% Coverage	95-90.01% LTV 30% Coverage	90-85.01% LTV 25% Coverage	85% LTV and under 12% Coverage
>=760	-50	-13	-9	-4
740-759	-35	-3	-3	-7
720-739	-15	11	6	-4
700-719	-16	-2	3	-6
680-699	9	19	16	-1
660-679	42	27	29	2
640-659	57	35	34	4
620-639	77	46	39	6

From online published rate sheets for Borrower Paid Mortgage Insurance from private mortgage insurers Genworth and Radian for December 2013 and April 2016.

Proposed housing finance systems that rely on deep, upfront private capital to cover credit risk do not provide a countervailing pressure to market incentives to finely and differentially price credit risk. Even in the current system, in which the GSEs have incentives for risk and price pooling, troubling pricing differences prevent credit worthy borrowers from getting mortgages. Unfortunately, the legislative proposals further erode incentives for pooling and are likely to result in even greater differential pricing. This will make it even harder and costlier for credit worthy borrowers of modest means to afford a mortgage.

C. *Community Banks and Other Small Lenders Must Be Supported in Housing Finance Reform*

Community banks, credit unions and other small lenders play a critical role in providing mortgages and other financial services on a local basis to American families, and they must be supported by the housing finance system. The current system has many provisions to do this, and these should be continued and expanded. Some proposals for changes in housing finance, though, would strongly tilt the system against these institutions.

Community banks, credit unions, and other small financial institutions deliver mortgages to their customers, along with other essential financial services, in the communities where they are located. As has been noted by many, these institutions have a different business model than larger institutions, often serving local markets and having close relationships with their customers. In rural areas, these institutions play a particularly important role. In many rural communities, community banks and credit unions are the only financial institutions providing retail branches and services in the community. These institutions also focus on traditional banking services and do not engage in many of the complex lines of business that larger institutions do, such as securities issuance, credit default swaps, or proprietary trading.[72] Disruptions to the traditional banking services, such as mortgages, cannot be offset with other products and lines of service. As a result, stress on community banks and their mortgage lending would be felt elsewhere. For example, community banks provide almost half of small business lending, and that is dependent on the overall sustainability of the institutions.

The GSEs provide a number of features that are essential for community banks. First is the GSEs' cash window, which provides lenders the option of selling individual loans. This means that smaller institutions do not have to trade their loans for securities or sell their loans to other large banks. Although many larger lenders trade their loans for GSE securities, this is difficult for small lenders. The securities carry the interest rate risk of the underlying loans and, as a result, can change substantially in value if market interest rates change. An increase in market interest rates would significantly reduce the value of the securities and create a loss for the bank holding the security. Larger institutions can purchase interest rate swaps to hedge this risk, but this is much harder for small lenders to do.

Another advantage of the current cash window is that the GSEs purchase these loans without requiring the transfer of the servicing of the loans to a third party. This enables the community banks and credit unions to continue the relationship with the customer during the life of the loan rather than having the loan serviced by a third party or even a competitor. Private loan purchasers and aggregators often require the seller to transfer the loan servicing to the purchaser. Keeping loan servicing in the hands of the community based financial institutions usually results in better consumer outcomes in terms of customer service and loan performance.

The current cash window also provides comparable pricing to trading for securities. This is critical, as options such as the cash window are viable only if the pricing is at a level that permits community banks to be competitive in the mortgage market. Overall, the mortgage market favors larger lenders and larger transactions, particularly for securities. Sales of large pools of loans are more attractive to buyers of the loans and buyers of the securities backed by the loans. Absent safeguards, large lenders can leverage the government support to use these structural advantages to squeeze community banks and other small lenders out of the market. These important features of the cash window option, which are not available for FHA loans, are a reason that the FHA program, while vitally important, is not a substitute for community banks having access to conventional lending for their full spectrum of customers.

Given the importance of these provisions in the current housing finance system, they should be continued and expanded. However, some of the proposals for housing reform have provisions that would tilt the government supported mortgage market heavily against community banks. While most options preserve some form of a cash window, they do not have the supporting protections that make it workable. Most important is pricing parity with the securities option. If securities trade at a better price, it greatly diminishes the value of the cash window. This is true even if there is a provision that prohibits volume pricing or discounts. If all cash transactions are disfavored to securities, the lack of discounts in either market are of little consolation to community banks who are disproportionately dependent on the cash window transactions. To provide this pricing parity, the guarantor/issuer must have the ability to pool costs across the market. This makes it essential that guarantor/issuers serve a national market and have a duty to equitably serve all lenders. Otherwise, if some guarantors/issuers can choose to cream the market, serving only the large lenders and the most lucrative markets, the remaining guarantors will not have sufficient

[72] These distinctions have been recognized by the CFPB, which created a number of special provisions for these lenders in the mortgage regulations, exempting smaller lenders from many requirements and providing additional flexibility for underwriting and servicing of loans.

loans from the full market to be able to provide pricing parity to small lenders and still compete in the overall market. In order to provide this parity, the guarantor/issuers also must be able to pool the credit risk that they hold and reinsure. If all but the catastrophic credit risk is transferred before the loans are purchased by the guarantor/issuers, there is insufficient revenue remaining for the guarantors/issuers to pool the costs and provide viable pricing to small lenders. If substantially all of the credit risk is sold and priced before the loans are acquired by the guarantor/issuer, then these other parties control the access and pricing and they will favor the larger lender transactions, which will be more profitable.

Provisions for a small lender security or issuer are offered in some plans to address this problem, but they are inadequate. Securities resulting from small groups of loans from many lenders will be measurably more expensive to assemble. They would also still lack the size to create enough loans to provide the large volume of securities for the economies of scale and liquidity that investors in securities desire, and would also reduce the price community banks received for the mortgages.

Other aspects of the mortgage market already have headwinds for community lenders. Many components of the production of mortgages favor large lenders due to their market size. These larger lenders can demand lower prices for many of the third-party services provided to lenders, and overall they have the advantage of economies of scale over smaller lenders. These conditions make it all the more important that the government elements of the mortgage provide a level playing field and not contribute to the squeezing out of community bank mortgage lending.

D. *Preserve Duty to Serve and the Affordable Housing Goals for All Market Participants*

The duty-to-serve requirements ensure broad availability of mortgage credit throughout the business cycle, which ensures that no region of the nation is left out of the housing finance system. Congress created the obligation within the actual charters of the GSEs, and they state that the GSEs must "promote access to mortgage credit throughout the nation (including central cities, rural areas, and underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.[73] These obligations continue through the Fair Housing Act of 1968, which Congress passed immediately following the death of Dr. Martin Luther King, Jr. who spent a crucial portion of his life working to address housing discrimination.[74] They are carried forward in the Equal Credit Opportunity Act of 1974 (ECOA), and are implemented through the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (FHEFSSA) and Housing and Economic Recovery Act in 2008 (HERA).[75] They represent Congress' long-term view that all secondary mortgage market participants have an affirmative duty to further fair lending.

Congress also created the Affordable Housing Goals in 1992 with FHEFSSA, and carried them forward in 2008 with HERA to help expand credit access for underserved groups, ensure liquidity in the financial markets, and further fair lending goals.[76] Originally, the goals advanced lending opportunities to low-income families in underserved areas, which resulted in mortgage originators making more affordable loans. The affordable housing goals made a tremendous impact on helping credit worthy borrowers purchase homes. From 2003 through 2012, the National Community Reinvestment Coalition reported that more than 25 million hard-working families nationwide were able to become homeowners due to the

[73] 12 U.S.C. § 1716; 12 U.S.C. § 1451 note.
[74] 42 U.S.C. § 3601 et seq.
[75] 15 U.S.C. § 1691 et seq; 12 U.S.C. 4501 et seq; Pub. L. 110-289 (July 30, 2008).
[76] 12 U.S.C. § 4562 (single-family housing goals).

goals.[77] Now, they are a metric for accountability by the GSEs' conservator, the FHFA, to address underservice to important, and often excluded, market segments such as low-and moderate-income families, rural communities, and people of color.

Thus, the goals must be strengthened and fully enforced to ensure that their true purpose is realized. They can be a tool for helping to strengthen household wealth in a safe and sound manner while also shoring up economic growth. Further, Congress should continue to require that all participants within the secondary mortgage market be subject to the duty-to-serve mandate and affordable housing goals.

E. *Housing Finance Reform Must Address Prior Discrimination in the System*

Discrimination within the nation's housing finance system is well documented and a significant contributor to the current racial wealth gap that plagues our nation today. This discrimination harms the market by curtailing credit worthy borrowers from accessing loans in a marketplace that is safer; has historically low interest rates; and relatively lower housing costs than the times leading up to the Great Recession. Action is needed now to reduce unnecessary restrictions on mortgage credit access such as excessive risk-based pricing. Thus, the FHFA's loan level price adjustments (LLPAs) must be eliminated.

i. *The Federal Housing Finance Agency Must Eliminate Loan Level Price Adjustments*

Following the mortgage crisis of 2008, which was found to be caused by Wall Street's appetite for excessive profits, market overcorrections emerged that led to excessive pricing of risk in the system. FHFA instituted loan level price adjustments (LLPAs) to offset risk from borrowers with lower credit profiles and smaller down payments, despite compelling evidence that when provided with safe and affordable mortgage loans, these borrowers perform well. Further, these increased fees disproportionately impact potential homebuyers of color and low-to-moderate income families whose ability to save for down payments and credit profiles have been negatively impacted by discrimination and lack of opportunity in the mortgage market that has been previously been discussed.[78]

Moreover, families of color and low-and moderate-income communities have been deeply harmed by irresponsible lending in the last decade. Predatory mortgage lending dominated formerly redlined communities and, the brunt of the impact was experienced in communities of color across the nation. The Center for Responsible Lending's research on the effects of subprime lending found that a disproportionate number of foreclosures occurred in communities of color — even when these borrowers qualified for less expensive and sustainable mortgage loans.[79] Core Logic reports that 7.8 million foreclosures have been completed.[80] The post foreclosure spillover costs within communities of color totaled $1 trillion dollars.[81]

[77] National Community Reinvestment Coalition, Nationwide Benefits from the Affordable Housing Goals, *available at* http://www.ncrc.org/images/PDFs/ahg/nationwide%20ahg.pdf.
[78]For a more detailed discussion of how discrimination contributes to lower credit scores for borrowers of color see, Racial Justice Project of the National Consumer Law Center, Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination (2016), *available at* https://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.
[79] DEBBIE GRUENSTEIN BOCIAN ET AL., FORECLOSURES BY RACE AND ETHNICITY: THE DEMOGRAPHICS OF A CRISIS (2010), *AVAILABLE AT http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf*
[80] CoreLogic Issues US Residential Foreclosure Crisis Decade in Review, *available at* http://www.corelogic.com/about-us/news/corelogic-issues-us-residential-foreclosure-crisis-decade-in-review.aspx.
[81]DEBBIE GRUENSTEIN BOCIAN, ET AL., COLLATERAL DAMAGE: THE SPILLOVER COSTS OF FORECLOSURES (2012), *AVAILABLE AT* http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/collateral-damage.pdf.

These losses were not to homeowners who actually suffered a foreclosure but to their neighbors who lived in close proximity to homes that had been foreclosed upon.

Today, rather than remediate the damage done by abusive subprime lending and its disproportionate impact on communities of color, lenders and FHFA responded by closing off lending options for these communities. The Urban Institute reports that from 2009-2014 there were 5.2 million mortgage loans missing from the secondary market system due to unnecessarily overly tight credit restrictions put in place by the GSEs.[82]

ii. *Maintain Flexibility in Determining Down Payments and Creating Initiatives to Fuel Lending*

Removing regulator flexibility in establishing down payments in housing finance reform and mandating down payments would unnecessarily restrict access to credit for lower-wealth families. As an initial matter, these mandates overlook the fact that borrowers must also save for closing costs – roughly 3 percent of the loan amount – on top of any down payment required. And, the mandates would increase the number of years that borrowers would need to save for a down payment. An analysis by the Center for Responsible Lending demonstrates that it would take the typical family 17 years to save for a 10 percent down payment and 11 years to save for a 5 percent down payment.[83] This time frame is greatly expanded for African-American and Latino borrowers. Considering that many of these households have limited wealth, down payment mandates could significantly reduce the number of future first-time homebuyers.[84] This reduced pool of buyers could lead to lower home prices, more difficulty selling an existing home, and even some existing borrowers defaulting on their mortgage.

Not only is there a huge cost to legislatively mandating down payments, but there is also a limited benefit in terms of reducing default rates. When looking at loans that already meet the product requirements for a Qualified Mortgage, a UNC Center for Community Capital and CRL study shows that these requirements

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[82] LAURIE GOODMAN ET AL., TIGHT CREDIT STANDARDS PREVENTED 5.2 MILLION MORTGAGES BETWEEN 2009 AND 2014 (2016), *AVAILABLE AT* http://www.urban.org/urban-wire/tight-credit-standards-prevented-52-million-mortgages-between-2009- and-2014.

[83] CRL years-to-save calculations are based on purchase of a 2011 median priced house ($173,600) by borrower with median income in 2011 ($50,502). Assumes an annual savings rate dedicated for down payment of 2.6%. Median income for 2011 is from American Community Survey. Savings rate assumption is derived from the Bureau of Economic Analysis's (the 1-year average of the BEA's personal savings rate from July 2012-July 2013 is 4.9 percent; the 20-year average was 5.0 percent). However, the BEA's the BEA's rate is based on take home, not gross, income, and therefore, a 5.0 personal savings rate translates to a 3.6 percent rate for gross income, assuming a combined federal, state and local tax rate of 28 percent (see effective tax burden for the middle http://www.nytimes.com/2012/11/30/us/most-americans-facelower-tax-burden-than-in-the-80s.html?pagewanted=all&_r=2&). Assumes that, of this 3.6 percent, 1 percentage point must be used by families for retirement, college, and emergencies, leaving 2.6% available for homeownership savings.

[84] See The State of the Nation's Housing, Joint Center for Housing Studies, at 3 (2013) (stating that "[m]inorities—and particularly younger adults—will also contribute significantly to household growth in 2013–23, accounting for seven out of ten net new households. An important implication of this trend is that minorities will make up an ever-larger share of potential first-time homebuyers. But these households have relatively few resources to draw on to make downpayments. For example, among renters aged 25–34 in 2010, the median net wealth was only $1,400 for blacks and $4,400 for Hispanics, compared with $6,500 for whites. Even higher-income minority renters have relatively little net wealth, with both blacks and Hispanics in the top income quartile having less than half the average net wealth of whites. Proposed limits on low-downpayment mortgages would thus pose a substantial obstacle for many of tomorrow's potential homebuyers.").

cut the overall default rate by almost half compared with loans that did not.[85] Layering on a down payment requirement on top of these protections produces a marginal benefit.[86] This makes sense, because risky product features and poor lending practices caused the crisis by pushing borrowers into default, and the Dodd-Frank Act reforms address these abuses. The Qualified Mortgage and Ability-to-Repay reforms restrict risky features such as high fees, interest-only payments, prepayment penalties, yield-spread premiums paid to mortgage brokers, lack of escrows for taxes and insurance for higher priced mortgage loans, teaser rates that spiked to unaffordable levels even with constant interest rates, and outlawing no-doc loans. These reforms address the unaffordable and abusive loan products that caused the crisis.[87]

iii. ***The U.S. Commission on Civil Rights Should Convene Hearings to Investigate the Impact of Mortgage Discrimination Within the Nation's Housing Finance System on Families of Color***

Throughout these remarks, the federal government's role in furthering housing discrimination within the mortgage market has been described. Now, is the appropriate time to fully investigate the impact of those discriminatory practices on the ability of families of color to build wealth through homeownership in an equitable manner with whites. According to recent research by Prosperity Now, it will take 228 years for the average African-American family to reach the level of wealth white families own today.[88] For the average Latino family, matching the wealth of white families will take 84 years.[89] The U.S. Commission on Civil Rights should convene hearings to probe and complete an official record of this discrimination similar to work done by the Financial Crisis Inquiry Commission following the Housing Crash of 2008. Once an official record is completed, Congress should request that the Congressional Budget Office issue a report on the economic impact of the discrimination and offer legislative action that directly addresses this discrimination.

VI. Conclusion

In 2018, America will commemorate 50 years of the passage of the Fair Housing Act of 1968. Many of the promises of that important legislation have yet to be realized, especially within the nation's housing finance system. Congress has a unique opportunity to reform the secondary mortgage market in a more equitable manner. Such action will allow far more American citizens the opportunity to thrive and keep smaller lenders on equal footing with large national banks. Congress must also act with extreme care and build upon existing reforms that have stabilized the marketplace and made it safe for consumers and lenders alike.

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[85] ROBERTO G. QUERCIA, ET AL., BALANCING RISK AND ACCESS: UNDERWRITING STANDARDS FOR QUALIFIED RESIDENTIAL MORTGAGES, CENTER FOR RESPONSIBLE LENDING AND UNC CENTER FOR COMMUNITY CAPITAL (Revised 2012), stating that "[l]oans consistent with the QM product features—which include both prime and subprime loans—have fared extremely well, with just 5.8 percent of loans either 90+ days delinquent, in the foreclosure process, or foreclosed upon as of February 2011. In comparison, the default rate for prime conventional loans in our sample was 7.7 percent, nearly two percentage points higher…[T]he rates for the subprime and Alt-A market segments [were] 32.3 and 22.3 percent, respectively." *AVAILABLE AT* http://www.responsiblelending.org/mortgage-lending/researchanalysis/Underwriting-Standards-for-Qualified-Residential-Mortgages.pdf).

[86] *Id.* at 18.

[87] SEE DEBBIE GRUENSTEIN BOCIAN, ET AL., LOST GROUND, 2011: DISPARITIES IN MORTGAGE LENDING AND FORECLOSURES, CENTER FOR RESPONSIBLE LENDING AND UNC CENTER FOR COMMUNITY CAPITAL (2011), *AVAILABLE AT* http://www.responsiblelending.org/mortgagelending/research-analysis/Lost-Ground-2011.pdf).

[88] DEDRICK ASANTE-MUHAMMAD, ET.AL., THE ROAD TO ZERO WEALTH: HOW THE RACIAL WEALTH DIVIDE IS HOLLOWING OUT AMERICA'S MIDDLE CLASS, PROSPERITY NOW, 5 (2017), *AVAILABLE AT* https://prosperitynow.org/files/PDFs/road_to_zero_wealth.pdf.

[89] *Id.*

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Written Testimony of Kevin G. Chavers

Managing Director, BlackRock

on behalf of the

Securities Industry and Financial Markets Association

before the U.S. House of Representatives

Committee on Financial Services

Subcommittee on Housing and Insurance

Hearing entitled "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform"

October 25, 2017

Chairman Duffy, Ranking Member Cleaver and members of the Subcommittee, thank you for the opportunity to testify today on the important topic of housing finance reform. My name is Kevin G. Chavers, and I am a Managing Director at BlackRock focusing on public policy issues, testifying today both on behalf of BlackRock and the Securities Industry and Financial Markets Association (SIFMA) [1]. BlackRock manages assets on behalf of individual and institutional clients across equity, fixed income, real assets, and other strategies. Our clients include pension plans, charities, foundations, endowments, official institutions, insurers and other financial institutions, as well as individual savers around the world. The assets we manage represent our clients' futures and the investment outcomes they seek, and it is our responsibility to help them better prepare themselves and their families to achieve their financial goals.

SIFMA and its member firms, BlackRock included, appreciate the attention being paid to housing finance reform and believe it is timely for Congress to move forward with meaningful reforms that protect taxpayers, ensure access to affordable housing, and maintain deep and liquid markets, including the preservation of a highly liquid To-Be-Announced Market (TBA).

Over the past nine years, there have been significant changes in the housing and securitization markets, as well as critical changes to Fannie Mae and Freddie Mac (collectively, the GSEs). These changes include:

- significant reductions in the size of the GSEs' portfolios,
- enhanced underwriting guidelines,
- increased guarantee fees,
- innovative structures for introducing private sector credit enhancement including a new Credit Risk Transfer (CRT) market,
- revised representation and warranty requirements,
- the ongoing implementation of a Common Securitization Platform and
- the development of a common form of mortgage-backed security that could be traded with a single TBA contract.

Further, the environment for the housing market and housing finance has changed dramatically during the post-Crisis period, and relative to the previous Congressional attempts at reform. Housing prices in most markets across the country have recovered, with some exceptions. The Consumer Financial Protection Bureau introduced new regulations that address both underwriting standards and mortgage servicing geared toward protecting borrowers. Rating agencies have significantly revised their ratings criteria and methodologies. In light of the current environment, this backdrop is more conducive to pursuing housing reform than at any time since the Crisis.

Since the financial crisis, policymakers have contemplated an array of proposals for what the next iteration of the housing finance system could look like. While SIFMA believes that some of these proposals are worthy of consideration in whole or in part, we would like to take this

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

opportunity to discuss the key principles SIFMA believes Congress should consider when developing any housing finance reform legislation. At a high level, our guiding principles for reforming housing finance are: (i) the need for a clearly defined and limited government role to facilitate liquidity, yet protect taxpayers, (ii) transparency at all levels, and (iii) a framework to attract private capital. A sustainable proposal needs to be comprehensive in considering the roles and structures of Fannie Mae, Freddie Mac, the Federal Housing Administration (FHA), and Ginnie Mae, as well as their regulatory regimes.

Specifically, these principles are as follows:

1. Any conversation on housing finance reform should begin with a discussion of its potential impact on borrowers and the availability of long-term fixed-rate credit products.
2. Any legislation should articulate a clearly-defined government role in the mortgage market that focuses on ensuring uninterrupted liquidity in secondary markets for mortgage-backed securities (MBS).
3. SIFMA and its members believe that, to retain the high levels of liquidity in today's marketplace and protect and preserve the TBA market, any housing finance legislation should establish an explicit and appropriately-priced government guarantee for qualifying MBS.
4. A government guarantee should be structured to protect taxpayers from an undue amount of risk through private-sector risk sharing arrangements.
5. Congress should establish a clear and limited role for well-capitalized intermediaries to support a deep and liquid market.
6. In addition, to further reduce taxpayer risk over the long-term, Congress should encourage the return of additional private capital to the mortgage market through the establishment of policy certainty and a well-functioning infrastructure with proper alignment of incentives.
7. Finally, any legislative reforms to the housing finance systems should be undertaken in a deliberate and thoughtful way, including an orderly transition from the current system to the new system and fungibility of existing GSE MBS with any future MBS.

We will now discuss each of these principles in more detail.

Any conversation on housing finance reform should begin with a discussion of its potential impact on borrowers and the availability of long-term fixed-rate credit products. For most Americans, the purchase of a home is the most significant purchase they will undertake over the course of their lives and for the vast majority, a 30-year fixed-rate mortgage may make the most sense. As such, SIFMA and its members believe that preserving broad access to an affordable 30-year fixed-rate mortgage should underpin any legislative effort to reform our housing finance system. It should be noted, however, that 30-year fixed-rate mortgages pose significant interest rate and other risks to lenders and investors due to the long maturity period, the possibilities of both default and prepayment, and borrower refinancing stemming from changes in interest rates. It is important that the secondary market architecture help lenders and investors manage these risks, because without mechanisms to manage them, many lenders would be unwilling to originate 30-year fixed rate loans and might exit the market for long-term mortgages completely.

The primary focus of SIFMA has been and will continue to be the preservation of a highly liquid TBA market, which provides a number of important benefits to consumers, lenders, and the economy. The TBA market is a roughly $5 trillion market that helps borrowers by facilitating the advance sale of conforming loans. The forward nature of this market allows originators to offer borrowers interest rate locks well in advance of closing. The TBA market is a national market so regional differences in credit availability are smoothed by the geographic diversity of mortgages underlying a MBS. The TBA market also benefits end investors, including 401(k) plans, pensions, and mutual funds, by allowing them to buy MBS with clear, predictable terms on a regular basis to meet their own portfolio diversification needs. And because the TBA market is so liquid – over $200 billion of securities traded on an average day in 2016 – end investors do not demand steep liquidity premiums, further driving down the costs to borrowers.

Homogeneity is what makes the TBA market succeed. Because securities are sold in advance, buyers and sellers agree on certain terms of a trade, but buyers do not know – and do not need to know – all the characteristics of the security they have purchased. Instead, buyers receive information about the security two days before the trade settles. Today, mortgage origination terms are standardized through the GSEs. GSE-mandated standards help create homogeneity in terms of form (structure and payment dates) and underlying contractual provisions (documentation, pooling, servicing, and disclosure). These standards mean that investors can purchase MBS in the TBA market with confidence that these securities will meet a certain minimum standard of quality regardless of who originates the mortgages.

Any legislation should articulate a clearly-defined government role in the mortgage market that focuses on ensuring uninterrupted liquidity in secondary markets for MBS. A vibrant secondary market will benefit all market participants – borrowers, originators, lenders, investors, and intermediaries – and clarity on the government's role will allow all market participants to hedge the risks that accompany their position in the market, and for the private sector to develop around it. A clearly-defined government role will also help attract private capital to the mortgage market and help rebuild the market for private-label MBS.

SIFMA and its members believe that, to retain the high levels of liquidity in today's marketplace and protect and preserve the TBA market, any housing finance legislation should establish an explicit and appropriately-priced government guarantee for qualifying MBS. The TBA market is enabled by a government guarantee on the principal and interest payments of qualifying MBS. This guarantee promotes homogeneity by allowing investors to look beyond idiosyncratic credit risk and instead focus on the risk that loans will prepay at a faster or slower rate than expected, behavior in large part driven by changes in the interest rate environment. These investors, so-called "rates investors", may not have an interest in or appetite for the credit risk that is required for investments in, for example, the non-agency MBS market. Without a guarantee, large swaths of investors, both U.S.-based and global, would look to other products for their investments.

This explicit and appropriately priced guarantee will maintain liquidity and confidence in the secondary market, reduce interest rates for borrowers, and encourage investors to supply credit by allowing them to focus on prepayment and interest rate risks. Absent a government guarantee, the market will be required to price credit risk –including catastrophic credit risk – into mortgage interest rates, which will reduce the availability of credit and weaken investor appetite for even the safest MBS. The guarantee will also provide critical countercyclical support for the market in times of crisis, and allow investors to fund mortgage credit creation during contractions of private capital availability. In 2008, as the private-label MBS market receded and banks withdrew, the GSE and FHA markets continued to facilitate loans. If the GSE and FHA markets had not been able to step into the downturn, mortgage credit would have completely dried up and many Americans would have effectively been unable to purchase homes.

A government guarantee should be structured to protect taxpayers from an undue amount of risk through private-sector risk sharing arrangements. The government should require that for a MBS to qualify for a guarantee, it must have levels of private capital in front of the guarantee to protect taxpayers, including borrower equity and fees paid by lenders to obtain a guarantee. Additionally, intermediaries should be required to conduct CRT to ensure that taxpayer exposure is focused on catastrophic risk, not first-loss risk. We believe the adoption of both front and back-end CRT by the GSEs has been an important step towards a safer secondary market. Congress should encourage existing CRT practices as well as continued innovation in the transfer of credit risk. We believe that innovation is still to be encouraged in this regard – various forms of risk sharing have their benefits and risks, and it is not yet time to call the markets mature and pick a winner. Additionally, we believe that policymakers can take steps to improve their liquidity by eliminating roadblocks to new structures, such as commodity pool regulations; broadening the investor base for CRT by making CRT more attractive to mortgage REITs; and making capital requirements for the securities less punitive for banks, among other things. Investors prize liquidity in the markets in which they invest – more liquidity will bring more investors, lowering the cost of CRT.

It is also important that any credit risk sharing not have a pro-cyclical impact on the availability of credit. Requiring fixed levels of risk sharing or setting mandatory amounts of CRT for intermediaries to conduct for a given security could cause insurance premiums to rise in periods of market stress, hurting the availability of credit at the worst possible time. Instead, targeted levels of risk sharing should include off-ramps and provisions that allow regulators to temporarily adjust or suspend requirements should market conditions dictate this. Congress should also try to gradually increase the exposure of private capital to credit risk in the housing market, and be cognizant that investor appetite for first-loss positions in MBS, however secure, will have limits. Additionally, to preserve the functioning of the TBA market, Congress should continue to allow CRT to be conducted after a loan is bundled into a security.

Congress should establish a clear and limited role for well-capitalized intermediaries to support a deep and liquid market. There have been several thoughtful proposals in recent years about intermediary entities that are worthy of consideration, SIFMA believes that whatever entity stands between originators and the taxpayers should be a) well capitalized and b) dedicated to its securitization and standard-setting mission to ensure that the market for origination remains competitive.

Today, Fannie Mae and Freddie Mac play this role, aggregating mortgages into securities including through their cash window – an important feature for smaller lenders to access the securitization market. Absent this cash window, small lenders, including community banks and credit unions, would face a steep, and potentially insurmountable disadvantage when accessing the secondary market. Intermediaries will likely need small, limited portfolios to maintain a cash window and small portfolios may be needed for credit risk transfer facilitation. In either case, they should not be able to leverage portfolios as proprietary investment vehicles. Intermediaries also have an important role to play in setting industry-wide standards, much as they do today. Standardization of loan documentation, data, and other processes has been one of the key benefits of the current system.

While the GSEs have been in conservatorship for nine years, the enterprises and FHFA have undertaken important administrative actions that have improved the soundness of the entities and the durability of the housing finance system broadly. We believe these reforms – or some equivalent version of these reforms – should be preserved under any new system and applied to or used by future intermediaries. We have already mentioned the CRT program, and the GSEs have begun modernizing their securitization infrastructure, which was needed given the age of existing GSE systems. This Common Securitization Platform will likely be a valuable asset in any future system.

In addition, to further reduce taxpayer risk over the long-term, Congress should encourage the return of additional private capital to the mortgage market through the establishment of policy certainty and a well-functioning infrastructure with proper alignment of incentives. Today, private-label securities are but a small corner of the market. We believe that in the long-term, this situation is suboptimal and must improve. Creating the conditions for a well-functioning private label market is an important component of housing finance reform. Housing finance legislation should aim to involve new sources of private capital while being careful not to repel private actors or generate uncertainty for investors. Regulatory policies that recognize and respect the rights of investors are critical to attracting private capital to the housing markets. Creating policy certainty should be a primary goal of housing finance reform, as the lack of certainty has been a core driver of the weakness of the non-government MBS markets post-crisis.

We believe there are a few key principles here:

- Investors in private label MBS need to understand what they are buying, through clear and transparent disclosure and clearly defined rights and obligations of transacting counterparties that is as standardized as is reasonable, and through the establishment of more nationally uniform rules around activities such as mortgage servicing as opposed to the hodgepodge of rules that exist today at the national, state, and local levels.
- Investors need to trust that rules of the game will not change after the fact; for example, that their rights will be respected in policy actions including legal and regulatory settlements, or that their investments will not be threatened by irresponsible abuse of eminent domain.
- Investors need to believe that policymakers share the goal over the long term of creating a vibrant and liquid non-government mortgage securitization market. Investors will not return in size to these markets unless they believe the markets will be around for the long term.

Finally, any legislative reforms to the housing finance systems should be undertaken in an orderly and thoughtful way, including an orderly transition from the current system to new system and fungibility of existing GSE MBS with any future MBS. There is tremendous downside risk of a disorderly transition, and turmoil in the housing market would penalize Americans in the market for a home. In our view, policymakers focused on creating a new system should be just as mindful of how we transition to the new system as they are on what the new system will look like. There is currently over $4 trillion in outstanding Fannie Mae MBS and Freddie Mac participation certificates held by investors globally. There are hundreds of billions of dollars of newly originated securities issued by the GSEs each year. It is imperative to avoid disruption to the housing finance market and to ensure the continuity of liquidity that the market currently supports. This requires clear and simple fungibility between current securities and any new securities, if they take on a different form; a full faith and credit guarantee on the current securities; and an appropriate transition time.

In the secondary market, the best way to ensure a safe and orderly transition is to assure investors that existing GSE MBS will be fungible with any future MBS. Abandoning outstanding securities could irreparably harm confidence by investors for new securities, and any security would launch with no liquidity – a dangerous outcome for all market participants, including borrowers. It is possible that the transition period is necessarily a lengthy one, but we believe that to ensure the smooth functioning of our markets, it is better that the transition be long and cautious, as missteps could harm investor confidence in the new system and create serious distortions in the housing market.

In conclusion, the current circumstances are very different from 2008 when the GSEs were first placed into conservatorship, and we are now in a better place. The housing markets have largely recovered, the financial conditions of the GSEs has stabilized, and the GSEs have undertaken a number of important reforms. That said, Fannie Mae and Freddie Mac remain in an uncertain state of conservatorship. SIFMA and its members believe the time for reform is now and we stand ready to assist the Committee in this undertaking.

October 25, 2017

Testimony of

Brenda Hughes

On behalf of the

American Bankers Association

before the

Subcommittee on Housing and Insurance

of the

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Chairman Duffy, Ranking Member Cleaver and Members of the Subcommittee, my name is Brenda Hughes. I serve as Senior Vice President and Director of Mortgage and Retail Lending for First Federal Savings of Twin Falls, Idaho. I have been with First Federal for over twenty years. First Federal is a $607 million asset bank which was established in 1915. We currently have 11 branches and one production office and have 247 employees. We are the largest lender in our assigned lending area and have originated over $1 billion in mortgage loans in the last 10 years.

I am pleased to be testifying on behalf of the American Bankers Association on the important topic of GSE reform and community bank access. The ABA is the voice of the nation's $17 trillion banking industry, which is composed of small, mid-size, regional and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits and extend more than $9 trillion in loans.

In addition to my role at First Federal Bank, I served on Freddie Mac's Community Advisory Board from 2005 to 2016, chaired the ABA's Mortgage Markets committee from October of 2012 until September of 2014, and currently am vice chair of the ABA's GSE Policy Committee. I also currently serve on the CFPB's Community Bank Advisory Council.

First Federal actively delivers loans directly to Freddie Mac and to the Federal Home Loan Bank of Des Moines and we retain servicing on these loans. We also work with a handful of other market investors to whom we sell loans with servicing released. We currently service approximately 5,000 loans. Like so many banks, both large and small, access to the secondary market in general, and through the federally guaranteed secondary market enterprises (GSEs) in particular, is essential to our ability to meet the mortgage needs of our customers.

The American Bankers Association, through input and deliberation from banks of all sizes and from all parts of the country, has developed a set of principles to guide the reform of Fannie Mae and Freddie Mac, which, as you know, have been in conservatorship since 2008. We appreciate the work this committee has done thus far, as well as the opportunity to share our views with you today.

On GSE reform, and on the importance of preserving access for lenders of all sizes and in all regions of the country, ABA believes that:

- Key shared principles should guide reform efforts;
- Without legislative reform, past abuses may be repeated, or new ones may arise which imperil the mortgage markets and put taxpayers at risk; and
- Reform need not be radical or extreme, but should be comprehensive.

I will elaborate on each of these in turn.

I. Key Shared Principles Should Guide Reform Efforts

ABA has (during the many years that Fannie Mae and Freddie Mac have been in conservatorship) worked with bankers from institutions of all sizes and from all parts of the country to develop principles which should guide reform of the GSEs. For the purposes of this testimony, we highlight the following principles, and note that many of these are widely shared among various other trade and industry associations.

We believe that these principles should form the basis for legislative reform efforts.

1. **The GSEs must be strictly confined to a secondary market role of providing stability and liquidity to the primary mortgage market for low- and moderate-income borrowers and must be strongly regulated, thoroughly examined and subject to immediate corrective action for any violation.**

A reformed system must ensure that the GSEs or their successors stay focused purely on advancing stable, affordable and readily available secondary market access to the primary market. Shareholder returns or other investment goals cannot be allowed to drive their behavior. While a certain level of competition is desirable to ensure innovation and responsiveness to the market, competition cannot be allowed to spin out of control and take the GSEs into other businesses or investment areas. For this reason some have suggested that a public utility or member-owned cooperative model may be a desirable evolution for the GSEs. We note only that while ownership structure is one way to limit and direct activities, strong regulation will also be necessary to keep GSEs or their successors focused on their defined role, regardless of what ownership structure is ultimately chosen.

2. **In return for the GSE status and any benefits conveyed by that status, these entities must agree to support all segments of the primary market, as needed, in all economic environments and to provide equitable access to all primary market lenders.**

The GSEs or their successors, including any potential new competitors that may be chartered, will benefit from a defined market available only to them and with a government guarantee on the securities that are issued. To ensure that those benefits are available to all, GSEs must be required to provide access to all primary market lenders on an equitable basis.

3. **Access must also include preservation of the "To Be Announced" (TBA) market and both servicing retained and sold options.**

The To Be Announced market, also known as the Cash Window, allows originators to sell loans on an individual basis to the GSEs. This option must be preserved to ensure access to the secondary market for lower volume lenders or those who choose for business purposes to sell individual loans. Similarly, to ensure that originators may continue to service loans consistent with their chosen business model, flexibility to sell loans servicing retained or servicing released must be preserved in any reformed system.

4. **Mortgage Backed Securities issued by the GSEs should carry an explicit, fully-priced and fully transparent guarantee from the federal government.**

The key benefit conveyed by the GSEs to the primary market is access to long-term affordable liquidity for mortgage lending. To preserve that liquidity, the government guarantee is necessary, but taxpayers need to be fully compensated for the risks they bear in providing that guarantee. Fees necessary to support the guarantee must be charged, and must be transparent so that they reflect the true cost of the guarantee, and only that cost. Fees should not be assessed to offset other government spending or priorities. It may be desirable to establish a segregated insurance fund to cover potential losses in the event that the guarantee is tapped in a crisis. Further, to ensure equitable access, the fees must be assessed equally on all lenders on a cost averaging basis.

5. **The GSEs or their successors must be capitalized appropriately to the risks borne and regulated to ensure that they remain so in all market conditions.**

Currently, Fannie Mae and Freddie Mac are operating under conservatorship, with little capital and with all profits being swept to the U.S. Treasury as compensation for the federal investment and risks borne of behalf of taxpayers. It will be essential that going forward the GSEs or their successors have adequate capital to withstand market downturns, especially as they will be monoline businesses whose risks therefore may be concentrated in certain circumstances. Capital support for the guaranteed secondary market can come from a variety of sources, including indirectly from credit risk transfers, and investment of new capital from new member/owners/users of the GSEs or their successors (depending upon the model ultimately chosen by Congress).

Recently concerns have been raised that with no capital buffer the quarterly sweeps to Treasury could require one or both of the GSEs to take a draw from their line of credit. Some have urged that the GSEs be allowed to rebuild capital to avoid this, even absent reform. ABA strongly believes that recapitalization must be coupled with necessary reforms. A draw can likely be avoided by altering the terms of the sweep to annual rather than quarterly payments, and even if a further draw on the line of credit is needed it would be consistent with the terms of the conservatorship and not a cause for undue concern.

6. **Regulation of the GSEs must include establishment of sound and fair underwriting standards for the loans they purchase, and must be based upon and coordinated with underwriting standards applicable to the primary market.**

Significant underwriting requirements imposed under the Dodd-Frank Act, most notably Ability to Repay (ATR) and Qualified Mortgage (QM) rules, while less than perfect, have significantly strengthened mortgage underwriting in the primary market. Going forward we believe it desirable that these primary market underwriting requirements serve as a basis that supports all secondary market activity, regardless of whether residential mortgages are sold to the GSEs or their successors or to private label purchasers. As a general matter, mortgages sold into the secondary market with government guarantees should meet QM standards, whereas private label securitizations will only require the less stringent ATR standard as a baseline, although investors may establish additional standards at their discretion.

For the primary market, loans originated and held in portfolio should automatically be granted QM status so long as they meet basic Ability to Repay requirements and do not run afoul of safety and soundness regulations. Such loans are inherently conservatively underwritten as portfolio lenders hold 100 percent of credit risk and thus will only make loans that have a high degree of ability to be repaid.

For the secondary market, the so-called GSE Patch currently in place effectively allows Fannie Mae and Freddie Mac to confer Qualified Mortgage status to any loan they are willing to purchase. As a result, Fannie Mae and Freddie Mac define the nature and extent of risks to which taxpayers are exposed. This was a necessary but flawed mechanism to ensure that the new rules did not overly restrict mortgage credit when regulations in 2014 subdivided ATR mortgages into QM and non-QM categories, and was deemed to be manageable as long as the GSEs were in conservatorship. However, the GSE Patch is designated to expire when conservatorship of the GSEs ends, creating the necessity and opportunity to revise the QM/ATR rules so that the GSEs or their successors are not permitted to define what is QM without restriction. Whatever regulatory definition replaces the open-ended GSE patch, GSE guarantees should be limited to loans that have well-defined and fixed criteria, and transition to a revised QM designation should be managed to avoid constricting credit availability. A properly designed QM requirement to "earn" a federal guarantee is essential to protect taxpayers, and will help to guide non-QM mortgages to a private label secondary market without taxpayer exposure.

7. **Credit Risk Transfers required by FHFA should be continued and expanded. Credit risk transfer must be a real transfer of risk and must be economically viable for the GSEs and the lenders they serve.**

Several mechanisms for credit risk transfers have been critically important innovations introduced to the GSE model in recent years. They have helped to bring private market participation back to the mortgage markets, and have had a real impact on reducing taxpayer exposure to GSE risks. They should become a permanent feature of secondary market financing. However, they must continue to be developed in ways that make economic sense for the GSEs, investors, primary market lenders, and for the borrowers they serve. They must also truly transfer credit risk in a permanent fashion to ensure taxpayer protection. To that end, FHFA (or its successor) must vigorously regulate, examine and enforce credit risk transfer requirements.

8. **Any reform of the secondary mortgage market must consider the vital role played by the Federal Home Loan Banks and must in no way harm the traditional advance businesses of Federal Home Loan Banks or access to advances by their members.**

The Federal Home Loan Banks (FHLBs) have provided mortgage financing in the form of collateralized advances to their member/owners for over 80 years. They have performed as intended, ensuring liquidity even in times of market crisis. Their crisis performance is traceable in part to mutual ownership status, relatively high statutory capital requirements and fully-collateralized lending. Changes to Fannie and Freddie may affect the FHLBs, even if unintended or indirect, and potential effects must be considered, accounted for, and preferably avoided. Additionally, the FHLBs may have the potential to play an expanded role in a revised secondary market system, but any expanded role must be separately capitalized and regulated in such a manner that it does not put at risk the traditional advance business of the FHLBs.

9. **Affordable housing goals or efforts undertaken by the GSEs to expand the supply of affordable rental housing should be delivered through and driven by the primary market, and should be structured in the form of affordable housing funds available to provide subsidies for affordable projects.**

The bright line between the primary and secondary market in the single family housing finance area should also broadly apply to the affordable housing and multifamily market. Primary market lenders should be the originators of these loans supported by access to stable, long term liquidity from the GSEs. Only in complex originations where the primary market lacks capacity should the GSEs be involved in direct financing, and strong regulation and oversight should be employed to ensure that there is no "cherry picking" of deals by the GSEs from the primary market.

We believe the Federal Home Loan Bank Affordable Housing Program (AHP) provides a good model for other GSE affordable housing programs. The AHP is a competitive grant program created by Congress in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 and began operations in 1990. The AHP is designed to address local housing needs. It is administered regionally by each Federal Home Loan Bank, working through its financial institution members and those members' community-based partners. Such community-based partners are working at the grass roots level and most closely understand the housing needs of their communities. To further ensure that AHP-funded projects serve local housing needs, each Federal Home Loan Bank is advised by an Advisory Council made up of community and nonprofit affordable housing and economic development organizations from within the Federal Home Loan Bank's district.

This model helps to ensure that affordable housing funds are directed by actual needs in a community as identified by community groups and private market lenders in that community. The participation and guidance of local partners is a powerful tool when combined with the resources that can be made available through any GSE-based affordable housing fund or program. To date, the Federal Home Loan Bank AHP has awarded more than $5.4 billion that has assisted in the purchase, construction or rehabilitation of more than 827,000 units of affordable housing across our nation.

Without Legislative Reform, Past Abuses May Be Repeated

Prior to conservatorship, Fannie Mae and Freddie Mac existed as hybrid companies, in a duopolistic system. They had private shareholders who profited from risks taken with the implied guarantee of the federal government. Changes to the charters of the institutions must be undertaken in legislation to remove this private profit/public risk model. The GSEs should be transformed into cooperatively owned public utilities or other similar limited purpose, well-regulated entities.

Early in the conservatorship, Fannie Mae and Freddie Mac were unable to pay the 10 percent required interest rate on over $180 billion injected by U.S. taxpayers to prevent their collapse. As a result, the two were de facto nationalized with profits, if any, being swept to the U.S. Treasury. Under this arrangement, the interest payments on government bailout funds has been waived. The GSEs operate with little and shrinking capital and are, under terms of the conservatorship, expected to go to zero capital by 2018.

Since returning to a positive cash flow in recent years, the terms of the conservatorship as amended have remained in place. Though funds swept to Treasury have been substantial, the amount falls substantially short of the taxpayers' direct investment plus the waived interest obligations on that investment. The terms of the conservatorship do not provide for a cutoff of payments (or for the debt incurred to be considered repaid) and do not allow for the GSEs to retain earnings to build capital.

Some have suggested that the GSEs simply be recapitalized and released back to the private market, with limited changes to their charters, noting that reforms to the entire mortgage market have addressed many of the problems that lead to the financial crisis and the insolvency of the GSEs.

We reject that approach, as it would return us to the untenable situation of public risk-taking to the benefit of private investors. Even with current reforms in place it would encourage future abuses and undue risks to U.S. taxpayers. Instead, legislation should establish directed and limited activities, strong capital standards and a clear set of benchmarks for implementing and meeting those standards.

It will also be essential for legislation to firmly establish a mandate that the GSEs provide equitable access to all primary market participants, regardless of size or geographic location. As cited in principle 2 above, in return for the GSE status, these entities must be willing to serve all primary market participants on an equitable basis in all market conditions. That includes access to the TBA market (also known as the "Cash Window") with the ability to sell individual or groups of loans.

In recent years, and primarily as a result of a mandate by the FHFA, the GSEs have moved to standardized Guarantee fees (G-fees) for all primary market originators selling to the GSEs. Going back to the early 2000's, however, great pricing differentials existed, with the GSEs giving large volume discounts and other preferential pricing to some institutions. This un-level playing field severely hampered community banks' ability to compete and serve their communities.

Going even further back, some community banks found it difficult to do business with the GSEs at all, as their pricing and other policies were geared toward higher volume lenders and the GSEs showed little interest in working with smaller, lower volume banks.

It will be necessary to incorporate into statute the mandate that the GSEs serve all primary market participants equitably in order to avoid the potential for backsliding.

Some will argue that this can be accomplished via regulation, and indeed, FHFA has done an admirable job in recent years ensuring equitable treatment. However, regulators and regulatory approaches can change over time. While a strong regulator must be part of reform, so too must be clear statutory guidance in this area.

II. Reform Need Not Be Radical or Extreme, But Comprehensive in Effect

Separate legislative efforts considered by the Senate Banking Committee in the last Congress and by the House Financial Services Committee earlier envisioned a complete restructuring of the secondary mortgage market system. Those legislative approaches were ultimately not able to gain approval at least in part over concerns that they were too complex and untested, and that the transition from the current system to those envisioned by either approach would be too disruptive to the housing finance system.

Still, those legislative efforts were helpful in focusing attention on the key services provided by the GSEs, the need for those services, and in delineating how some of those services could be separated into component parts, and reassigned in a new system to reduce risk and create opportunity for greater competition.

Consensus is forming around the view that a limited and controlled government involvement in the secondary mortgage market is needed to ensure the availability of stable, affordable long term financing for mortgage finance.

Legislation need not recreate the entire secondary market structure from scratch. In fact, guided by the principles detailed above, and incorporating key elements laid out here, we believe that relatively tailored legislation that takes a surgical but comprehensive approach to making necessary alterations to the current system is both desirable and achievable.

In addition to changes to the charters and ownership structure of the GSEs, the creation of clear, achievable and strict capital requirements, and the mandate to serve all primary market participants equitably, these changes should also include creation of an insurance fund to backstop the GSEs capital to protect taxpayers further from again having to bailout the GSEs. While the government will stand behind the securities issued by the GSEs, the insurance fund should stand in front of the explicit government guarantee to protect taxpayers to in the event that the guarantee is ever drawn upon. The fund should be actuarially sound and modeled on the FDIC insurance fund.

Conclusion

Americans have relied on long-term, fixed-rate mortgages for affordable mortgage finance for 70 years. Fannie Mae and Freddie Mac have facilitated access to this product by providing access to the capital markets for primary market lenders. Absent aggregation and securitization provided through the TBA market, access to long-term, lower-rate funding would be far more difficult to come by for most primary lenders. The government guarantee provided to mortgage backed securities issued by the GSEs makes them attractive to the capital markets, ensuring liquidity. All of these elements must be preserved and remain available to all primary market participants regardless of size or geographic location.

Congress has an essential role in providing the certainty necessary to ensure long-term stability of the housing finance system. Just as the federal debt market provides the bellwether that makes all private debt markets more efficient and liquid, an explicit, fully priced, fully paid-for federal guarantee for a targeted portion of the mortgage market will be a catalyst for broader market growth and development. Congress should not defer action any longer. Nine years of conservatorship is more than enough.

Thank you for the opportunity to share our views with the committee. The American Bankers Association stands ready to work with members of the committee to advance this important set of issues.

NAFCU

Testimony of

Richard Stafford

President/CEO Tower Federal Credit Union

On behalf of

The National Association of Federally-Insured Credit Unions

"Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform"

Before the

Subcommittee on Housing and Insurance

United States House Financial Services Committee

October 25, 2017

Introduction

Good morning, Chairman Duffy, Ranking Member Cleaver, and Members of the Subcommittee. My name is Rick Stafford and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). I appreciate the opportunity to share NAFCU's views on housing finance and the importance of maintaining secondary market access for small lenders. In addition to our testimony, NAFCU member credit unions look forward to continuing to work with you beyond today's hearing to ensure access to the secondary mortgage market for credit unions and their 110 million members.

I currently serve as the President and CEO of Tower Federal Credit Union (Tower) in Laurel, Maryland. Tower Federal Credit Union is a $3 billion institution serving nearly 170,000 members with 16 branches in the Baltimore-Washington corridor. Tower was originally chartered in August of 1953 to serve a national security component of the Department of Defense. Today, we serve the defense and intelligence sectors, along with several associations and select employers. We offer our employer groups a full range of financial products and services, including checking accounts, deposit accounts, credit cards, auto loans, mortgages, and home equity loans. We also provide a suite of ancillary services including wealth management, residential real estate brokerage services and car buying services.

I have over 30 years of senior management experience in the financial services industry, including leading mortgage lending for community-based financial institutions. I am a graduate of Adrian College, and earned a Masters from Walsh College of Accounting & Finance. I also am a graduate of the School of Banking at Georgetown University. My number one priority every day at Tower is to manage the organization in a safe and sound manner. No exceptions. My second priority is to add value back to our members-owners by managing an incredible workforce focused on listening to member's needs, providing solutions to improve their financial well-being while delivering exceptional service.

NAFCU's Perspective on the Emerging House Debate

NAFCU applauds the Committee leadership for their continued attention to housing policy as the Committee pursues housing finance reform ideas from stakeholders. NAFCU is the only national organization exclusively representing the interests of the nation's federally-insured credit unions. NAFCU-member credit unions collectively account for approximately 69 percent of the assets of all federally-chartered credit unions. My testimony today will cover the longstanding and vital relationship between credit unions and the government-sponsored enterprises (GSEs) and how important it is for credit unions to continue to have unencumbered access to the secondary market with fair pricing based on loan quality, instead of volume.

We thank you for your thoughtful approach to housing finance reform, and urge the committee to carefully consider the practical implications of any potential changes. As the Committee considers reform, NAFCU and its member credit unions would urge you to narrowly tailor changes. At Tower, our business relationship and loan delivery/loan sale process with the GSE we use – Fannie Mae – is working just fine. With technologies deployed by Fannie Mae in recent years, it is easier in some ways today for credit unions to sell a loan than it was just 5 years ago. The current system is working for credit unions. However, we recognize the challenges to the current model that exist and appreciate this opportunity to offer our thoughts on reform.

Although we have not endorsed any particular plan at this time, we appreciate that the committee is holding this hearing today and has sought stakeholder input on reform. We have outlined several housing finance reform principles that should be included in any reform effort in order to guarantee the continued safety and soundness of the credit union industry. I will discuss those principles shortly.

If Congress opts to create a new system, we believe that funding of a new system should be done so as to limit the cost to smaller financial institutions as much as possible. High cost of entry into, or establishment of, a new system, could be a major barrier for small lenders. To date, we do not believe that any housing finance reform solution suggested in previous Congresses fully accounted for the needs of small lender access.

One of the first steps in housing finance reform should be to ensure that the GSEs are in a safe and sound condition. NAFCU supports recapitalization of the GSEs as part of a bigger reform discussion.

NAFCU would also like to stress the importance of large institutions not being given control of the market. Even though large institutions play an important role, including serving as loan purchasers for small lenders, their market dominance would have negative consequences for smaller institutions. In many instances, they compete for mortgage business with small lenders. Although they may be willing to buy and package small lender loans during good economic times, thereby ensuring liquidity for those small lenders, in an economic downturn, they may limit this activity, drying up liquidity for small lenders and reducing competition on the front-end. In that scenario, the consumers and communities that those small lenders serve lose access to mortgage credit. Congress must prevent such a scenario in a reformed housing finance system.

Credit Union Principles in Housing Finance Reform Efforts

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

- **A healthy, sustainable and viable secondary mortgage market must be maintained.** Credit unions must have unfettered, legislatively-guaranteed access to the secondary mortgage market. In order to achieve a healthy, sustainable and viable secondary market, there must be vibrant competition among market participants in every aspect of the secondary market. Market participants should include, at a minimum, at least one GSE, the Federal Home Loan Banks (FHLBs), Ginnie Mae, and private entities.

- **The U.S. government should issue an explicit government guarantee on the payment of principal and interest on mortgage-backed securities (MBS).**
  The explicit guarantee will provide certainty to the market, especially for investors who will need to be enticed to invest in MBS, and facilitate the flow of liquidity through the market.

- **The GSEs should be self-funded, without any dedicated government appropriations.**
  Although the U.S. government should be involved in the secondary mortgage market, the GSEs should not be government-funded mortgage programs. The GSEs' fees should provide the revenue necessary for sustained independent operation. Those fee structures should, in addition to size and volume, place increased emphasis on the quality of loans. Risk-based pricing for loan purchases should reflect that quality difference. Credit union loans provide the high quality necessary to improve the salability of the GSEs' securities.

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

- **The GSEs should be allowed to rebuild their capital buffers.**
  Rebuilding capital buffers ensures the safety and soundness of the GSEs, maintains investor confidence, prevents market disruption, and reduces the likelihood of another taxpayer bailout in the event of a future catastrophic market downturn. The GSEs should be permitted to begin rebuilding capital slowly over a period of several years.

- **The GSEs should not be fully privatized at this time.**
  There continues to be serious concerns that in a fully privatized system, in which the GSEs are sold off to the secondary market, small, community-based financial institutions could be shut out of the secondary market. Any privatization efforts should be gradual and ensure that credit unions have continued access to the GSEs and the secondary mortgage market.

- **The FHLBs must remain a central part of the mortgage market.**
  The FHLBs serve an important function in the mortgage market as they provide their credit union members with a reliable source of funding and liquidity. Housing finance reform must take into account the consequence of any legislation on the health and reliability of the FHLBs.

- **Credit risk transfer transactions should be expanded and the Common Securitization Platform (CSP) and Single Security retained.**
  Although there are concerns regarding credit unions' ability to participate in certain credit risk transfer (CRT) transactions, the GSEs should continue to expand CRT as well as initiatives to create deeper mortgage insurance to further disperse risk among private investors. Credit unions should be permitted to participate in transactions such as front-end CRTs through a special purpose vehicle, such as a credit union service organization or the FHLBs. The CSP and Single Security have the potential to simplify the sale of loans to the GSEs and allow greater, more affordable access to the secondary mortgage market.

- **The FHFA or its successor should continue to provide strong oversight of the GSEs and the new system, whatever it may look like.**
  A strong, reliable single federal regulator helps to provide consistency and focus to the GSEs so they can stay on track with their core missions and objectives. The FHFA helps maintain safety and soundness in the secondary mortgage market. A new system should also utilize the current regulatory framework and GSE pricing and fee structures.

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

Background on Credit Unions and Credit Union Mortgage Lending

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 § USC 1752(1)). Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 110 million Americans. Despite the passage of over 80 years 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:

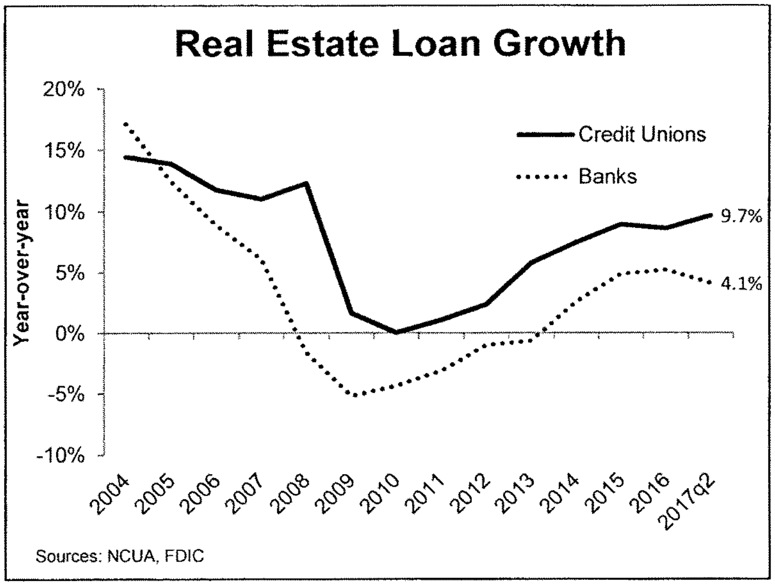
- Credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism. Credit unions are not banks.

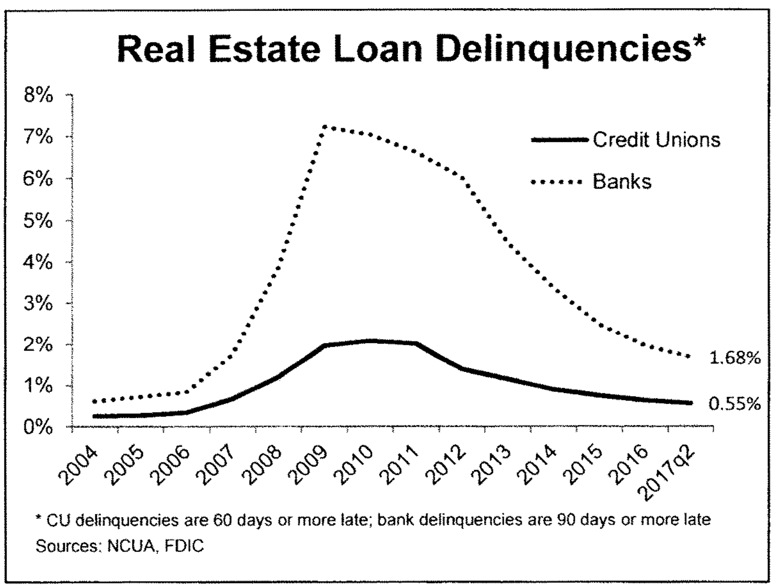
The nation's approximately 5,700 federally-insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions, united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

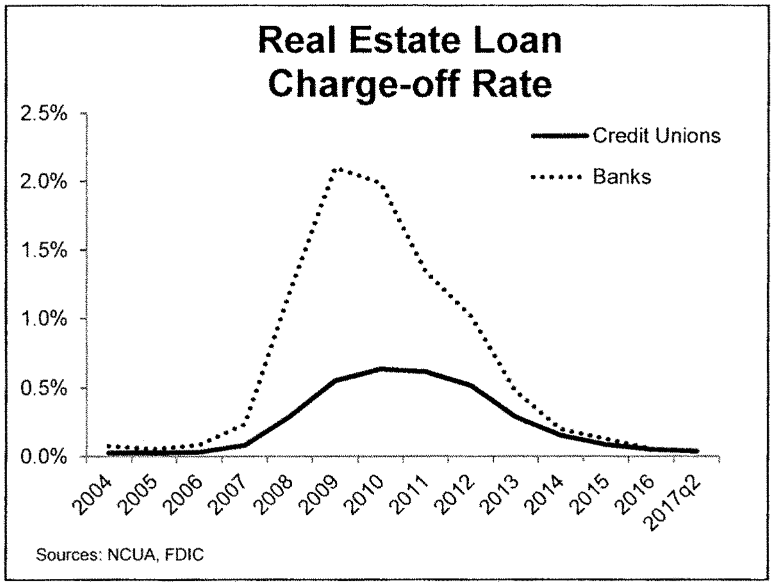
Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. Since the financial crisis of 2008, consolidation of the commercial banking sector has progressed at an increasingly rapid rate. With the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost of those services. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

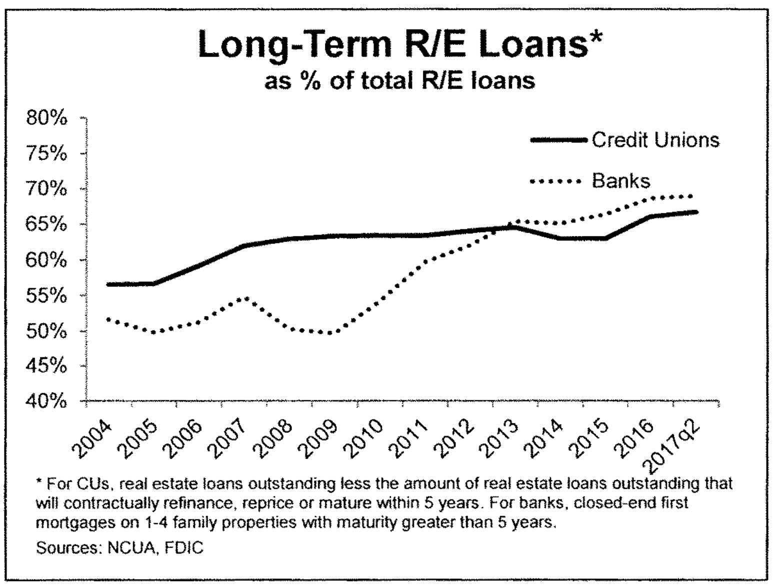
As has been noted by Members of Congress across the political spectrum, credit unions were not the cause of the economic crisis, and an examination of their lending data indicates that credit union mortgage lending outperformed bank mortgage lending during the recent downturn. This is partly because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

As the housing market continues to recover from the financial crisis, and Congress works to put into place safeguards to ensure such a crisis never happens again, credit unions continue to focus on providing their member-owners with the basic financial products they need and demand. The graphs below highlight how credit union real estate loan growth has outpaced banks since the downturn and how credit unions have fared better with respect to real estate delinquencies and real estate charge-offs. It is with this data in mind that NAFCU urges members of the Committee to recognize the historical performance and high quality of credit union loans as housing finance reform moves forward.

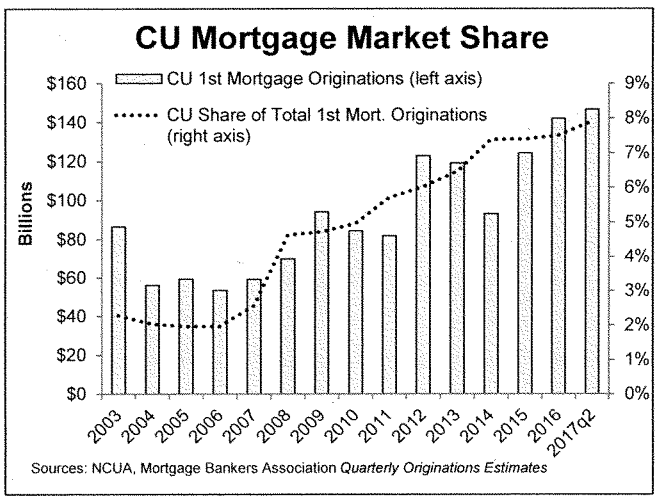

Real Estate Loan Growth
20%
15%
10%
5%
0%
-5%
-10%
Year-over-year
Credit Unions
Banks
9.7%
4.1%
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017q2
Sources: NCUA, FDIC


Real Estate Loan Delinquencies*
8%
7%
6%
5%
4%
3%
2%
1%
0%
Credit Unions
Banks
1.68%
0.55%
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017q2
* CU delinquencies are 60 days or more late; bank delinquencies are 90 days or more late
Sources: NCUA, FDIC


Real Estate Loan
Charge-off Rate
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
Credit Unions
Banks
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017q2
Sources: NCUA, FDIC

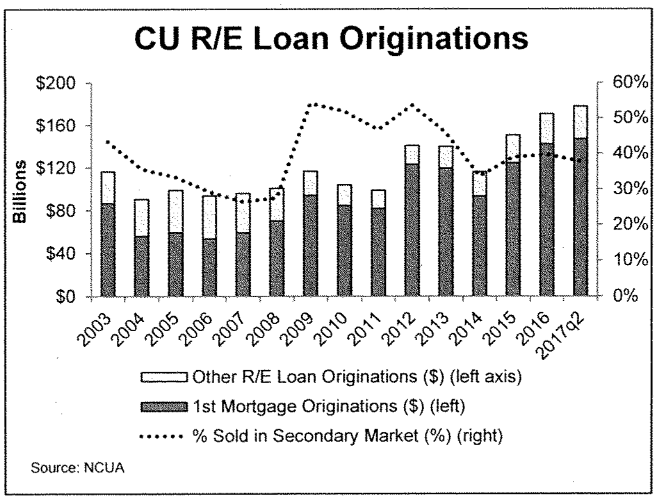

Long-Term R/E Loans*
as % of total R/E loans
80%
75%
70%
65%
60%
55%
50%
45%
40%
Credit Unions
Banks
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017q2
* For CUs, real estate loans outstanding less the amount of real estate loans outstanding that will contractually refinance, reprice or mature within 5 years. For banks, closed-end first mortgages on 1-4 family properties with maturity greater than 5 years.
Sources: NCUA, FDIC

A primary concern of credit unions is continued, unencumbered access to the secondary mortgage market. This includes adequate transition time to any new system. A second concern, which is equally as important, is the GSEs' recognition of the quality of credit union loans through a fair pricing structure. Because credit unions originate a relatively low number of loans compared to others in the marketplace – federally-insured credit unions had less than 8 percent of first mortgage originations in 2017 through the second quarter (see chart below). NAFCU's member credit unions are opposed to any pricing structure based on loan volume, institution asset size, or other geopolitical issues that could lead to discrimination and disadvantage their member-owners. As such, credit unions should have access to pricing focused on quality, not quantity.



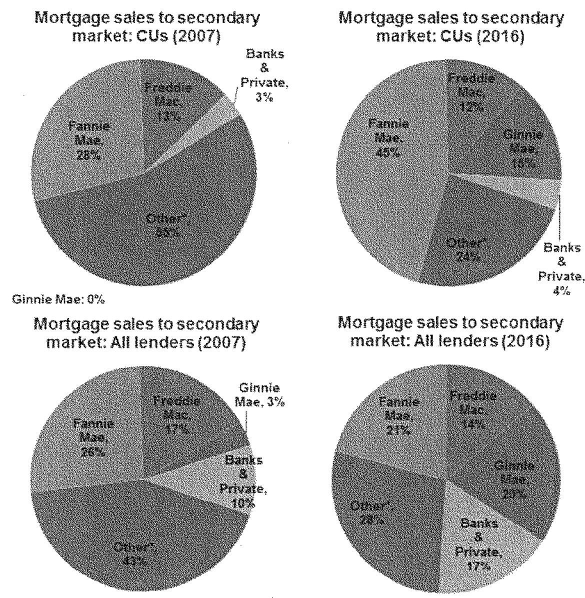
Recent trends in asset portfolios, coupled with the current interest rate environment, present a unique challenge to credit union management. Until recently, interest rates had fallen to record lows, credit unions experienced vigorous share growth, and credit union participation in the mortgage lending arena increased to historic heights. Even though interest rates have started rising again, credit union first mortgage originations have continued to grow. Between 2007 and

2017, the credit union share of first mortgage originations expanded from 2.6 to 7.9 percent. The portion of first mortgage originations sold into the secondary market increased overall from 26 percent in 2007 to 38 percent in 2017, according to National Credit Union Administration (NCUA) call report data (see chart below).



Credit unions hedge against interest rate risk in a number of ways, but selling products to be securitized and sold on the secondary market remains a key component of safety and soundness. Lenders must have guaranteed access to secondary market sources including Fannie Mae, Freddie Mac, Ginnie Mae and the FHLBs because they are valuable partners for credit unions that seek to sell their fixed-rate mortgages. Not only does the selling of mortgage loans allow credit unions to better manage their risk, but it also means they are able to reinvest those funds to provide new loan products and additional financial services for their members. A 2015 NAFCU real estate survey highlights the growing utilization of the 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 40 percent of total loans. Without these critical relationships, credit unions would be unable to provide the services and financial products their memberships demand and expect.

Home Mortgage Disclosure Act data also shows how heavily credit unions have come to rely on the GSEs. Between 2007 and 2016, the portion of credit union first mortgages that were sold to Fannie Mae grew from 28 percent to 45 percent. The portion sold to Freddie Mac fell slightly from 13 percent to 12 percent over the same period. In 2015, 57 percent of all credit union first mortgages sold to the secondary market were initially sold to the GSEs. The total market for mortgage resales is also heavily dependent on the GSEs.



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

Source: FFIEC Home Mortgage Disclosure Act (HMDA) data

Mortgage Lending at Tower

The ability to sell to Fannie Mae on the secondary market is very important to Tower. Without selling to a GSE, we would not have been able to originate a number of loans and would not have been able to serve the needs of our membership. We currently sell approximately 80% of our loans to Fannie. In the last 5 years, this is a total of $1.2 billion in funding, assisting 2,700 members in our community.

Tower, like many credit unions, never participated in the type of risky mortgage lending that contributed to the economic downfall of 2008 and 2009. We did not get into negative amortizing ARMs, ALT-A loans, subprime loans, or "no income, no job, no assets (NINJA)" loans. The demand existed. We had members who asked for these types of loans, but we took our fiduciary responsibility to our members seriously and refused to put them into a home they could not realistically sustain.

We sell our loans directly to Fannie Mae because they offer competitive pricing for affordable lending to our members, as well as diverse mortgage products and the ability to maintain a servicing relationship with our members. To us, these are more than just loans. Each one represents a family in a home, and each mortgage application is a new opportunity to help make a family's dream of home-ownership come true. Even though most of our mortgage business is within Maryland, we do originate loans for our members across the country.

Tower firmly believes that access to affordable credit for homebuyers is essential to the financial well-being of working-class Americans. Without the GSEs, our capacity to lend would be outstripped by demand. The GSEs also benefit consumers because access to the secondary market and access to capital provides us with additional lending capacity. Our ability to sell loans, as opposed to keeping them on our balance sheet, also mitigates our long-term interest rate risk, reduces concentration risk, and keeps rates competitive overall. If not for access to the GSEs, our capacity to meet local demand would be greatly diminished, and local consumers would suffer from higher rates and fees, more stringent credit requirements and overall fewer options. NAFCU urges you to keep this in mind as you consider the important business of housing finance reform.

Key Elements of the Current System

Our partnership with Fannie Mae is critical to Tower's mortgage lending function. We use Fannie's Desktop Underwriter® platform to underwrite all mortgage loans that we originate. This ensures conformity and consistency across our portfolio, whether we sell the loan or not.

Using Desktop Underwriter® provides Tower with a level of efficiency that we might not otherwise achieve. Additionally, it enhances the member experience by automating and expediting parts of the loan process. If comprehensive housing finance reform includes any significant changes to the Desktop Underwriter® platform, it would have widespread effects on our operations. In general, the use of the GSE underwriting platform and parameters create conformity for the industry as a whole.

If and when Congress considers reform, access to such technology must be preserved in any new model. The GSEs' tools provide critical benefits to small lenders. Desktop Underwriter® is an important tool for Tower and we want to ensure continued utilization. There are some opportunities for improvement, including updating the Agency's antiquated credit risk scoring platform, which would subsequently lessen some punitive results in loan level pricing adjustments borne by the consumer.

Consequently, we are wary of efforts to eliminate the GSEs. The current aggregation model at the GSEs has had benefits for credit unions. We do not want to see a regression to the previous aggregation model used before conservatorship - where market share agreements with the largest lenders created underwriting exceptions and lower guarantee fees based on volume, not on the underlying loan risk. This priced out smaller lenders and forced them to sell to larger lenders, instead of directly to Fannie Mae. These practices created huge volumes of underpriced risk that were a part of the predatory culture that precipitated the financial crisis. We want a system that ensures equal market access for lenders of all sizes and business models and maintains a deep, liquid market for long-term options. Furthermore, even though Tower is not currently using it, the function of the cash window at the GSEs as a single loan execution process and best-efforts loan commitments are also vital to credit unions moving forward. The cash window serves as a quick and efficient means of liquidity for credit unions that would otherwise be unable to sell to the GSEs.

Transition to a New Housing Finance System

If Congress acts to bring broad reforms to the nation's housing finance system, getting the transition right will be critical. It is of the utmost importance to ensure a smooth transition to a reformed system because credit unions need certainty that changes outlined in legislation and accompanying regulation will function as intended. Credit unions must be kept up-to-date during this transitional period and lawmakers should build flexibility into the transitional period to account for unforeseen implementation challenges. NAFCU and its member credit unions believe that Congress should first agree on a set of reforms and then, based on the nature and complexity of the reforms, establish a timeframe for transition. Arbitrarily pledging to adhere to a transitional timeframe before finalizing reforms could create otherwise avoidable issues for the GSEs or their successor(s) as well as outside stakeholders.

If a new system is established, and in order to ease the transition, Congress should consider moving currently approved Fannie and Freddie lenders into a new system en bloc and giving them an expedited certification. This could reduce confusion and, if executed properly, could make the process run more smoothly for all involved. It can take time for lenders to be certified with the GSEs, and this time should be factored in to the transition time.

NAFCU and its member credit unions also believe it is important that a new system be up and running before Fannie Mae and Freddie Mac's ability to securitize MBS is shut down. One way to accomplish this may be slowly winding down the two entities throughout the early stages of a new system.

The Importance of Servicing Rights to Credit Unions

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

At Tower we retain servicing rights on all of our loans. This was especially beneficial during the economic crisis, as it allowed our members to approach us when they got in trouble and allowed us to work closely with them to help keep them in their home. In addition, maintaining the servicing rights for the life of the loan ensures no disruption to our members. This ability to retain servicing rights must be kept in any new housing finance system. If national servicing standards are created, they should be done in such a way as to not create new burdens on credit unions.

Underwriting Criteria in Any New System

NAFCU has concerns about using the "Qualified Mortgage" (QM) standard as the standard for loans eligible for the government guarantee, as some have proposed. We believe underwriting standards should not be statutorily established and are best left to the FHFA or its successor. This would allow the regulator to adapt to changing market conditions and act in a counter-cyclical manner if necessary.

Furthermore, given credit unions' unique member-relationship, many credit unions are making good loans that work for their members but do not fit into all of the parameters of the QM box. At Tower, we are comfortable making credit worthy non-QM loans, but not all credit unions are. Using the Consumer Financial Protection Bureau's (CFPB) QM standard for the guarantee, as some have proposed in the past, could discourage many credit unions from making non-QM loans.

NAFCU would also like to caution Congress against perpetuating of the use of just one brand of credit-scoring model. Both Fannie Mae and Freddie Mac require loans that are underwritten using FICO scoring models. A new housing finance system should be open to alternative credit scoring models as well. NAFCU supports legislation that would allow alternative credit scoring models to be used.

Regulatory Relief and Mortgages

As Congress considers housing finance reform, we urge you to look for ways to provide community institutions such as credit unions relief from overly burdensome regulatory restrictions on mortgages that can serve to constrain mortgage credit. We were pleased to see a number of provisions to provide relief in Title IV of the *Protecting American Taxpayers and Homeowners* (PATH) *Act*, which was passed by the Committee in 2013.

NAFCU supports certain changes to the QM standard to make it more amenable to the quality loans credit unions are already making. We would like to highlight the following recommended changes:

Loans Held in Portfolio

NAFCU supports exempting mortgage loans held in portfolio from the QM definition as the lender, via its balance sheet, already assumes risk associated with the borrower's ability-to-repay. The following is a real-life example of a loan we would have approved to hold in portfolio but would not approve now:

- Non-conforming loan (jumbo)
- 53% LTV
- Existing long relationship
- Substantial deposit relationship
- 810 FICO score
- DTI is above 43% creating a non-QM loan

Debt-to-Income Ratio

NAFCU supports Congress directing the CFPB to revise the aspect of the 'ability-to-repay' rule that dictates that a consumer have a total debt-to-income (DTI) ratio less than or equal to 43 percent in order for that loan to be considered a QM. This arbitrary threshold prevents otherwise healthy borrowers from obtaining mortgage loans and has a particularly serious impact in rural and underserved areas where consumers have a limited number of options. The CFPB should either remove or increase the DTI requirement on QMs.

Inclusion of Affiliate Fees in the 3% QM Points/Fee Test

After witnessing our members being charged exorbitant fees, Tower started a wholly-owned title company, which, by regulation is defined as an affiliate, to provide better services and more affordable benefits to our members. On occasion, when these fees are added to the Tower loans points/fees they exceed 3%. When this happens, the loan becomes ineligible for sale to Fannie and we have to portfolio the loan. This means Tower has diminished capacity to provide more loans and services to its members. The same or perhaps worse fee structure by an independent title company under the same scenario would not be counted towards the 3 percent. Thus lenders are penalized for having affiliated title companies even though they provide a benefit to borrowers.

TRID Reforms

Tower also supports changes to the TILA/RESPA requirements, such as removing the requirement to deliver the Closing Disclosure (CD) 3 business days prior to closing. There are myriad reasons why this issue creates hardship for all involved. A "real-life" situation includes a final property inspection triggering "last minute" changes to the contract, which are in the best interest of the borrower. Because of the rigid, mandatory, "no exception" nature of the CD requirement, these examples "re-start" the timer and push back closing, which affects the borrower's moving schedule, utility setups, and other important events. There are also examples where a borrower may be able to get better terms on rates, but cannot afford to move the closing and cannot waive this requirement. Tower finds this requirement is especially frustrating to our members who do not understand why it is a requirement that penalizes them. At a minimum, consumers should be given some freedom to waive the requirement.

Another frustration relates to third party fees. The lender is required to know exactly what third parties will charge and if the actual invoice exceeds the tolerance, the lender must pay the difference. Situations arise where an inspection or appraisal may be more involved than originally thought and vendors may justifiably incur more expenses to perform the work. Again, the rigidity of the rules requires credit unions to absorb these amounts, which impacts their bottom line and makes it harder to offer additional loans and services to their members.

Finally, there may be specific provisions in the *Federal Credit Union Act* that would have to be amended to ensure a new housing finance system works for credit unions. One example is the limitation on credit union investments that could hinder the ability of credit unions to participate in a new system. NAFCU welcomes the opportunity to work with the Committee on potential changes that may be needed as part of any housing finance reform effort.

Conclusion

NAFCU appreciates the Subcommittee's attention to this important issue. The current system works for credit unions and we urge you to move cautiously with any reforms. As you consider housing finance reform, we urge you to adhere to the credit union principles outlined in my testimony. Whatever approach is taken to reform the system, it is vital that credit unions continue to have unfettered access to the secondary market and get fair pricing based on the quality of their loans. The government must also continue to play a role by providing an explicit government guarantee to help stabilize the market.

Thank you for the opportunity to provide our input on this important issue. NAFCU and its member credit unions look forward to working with you as housing finance reform legislation moves forward.

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

INDEPENDENT COMMUNITY
BANKERS of AMERICA

Testimony of

Samuel A. Vallandingham
President and CEO
Of
The First State Bank
Barboursville, WV

On behalf of the
Independent Community Bankers of America

Before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Housing and Insurance

Hearing on

"Housing Finance: Private Sector Perspectives on Housing Finance Reform"

October 25, 2017
Washington, D.C.

Opening

Chairman Duffy, Ranking Member Cleaver, and members of the Subcommittee, I am Samuel Vallandingham, President and Chief Executive Officer of First State Bank, a $200 million community bank in Barboursville, West Virginia. I am pleased to be here today on behalf of the Independent Community Bankers of America and the nearly 5,700 community banks we represent. Thank you for convening this hearing titled: "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform."

Community bankers and their customers have a great deal at stake in the future of housing finance. Any changes to housing finance must preserve equal and direct access to the secondary market to safeguard the role of community banks in providing mortgage credit in the communities we serve. It is critically important to borrowers and the broader economy that the details of any reform are done right. We look forward to working with the Committee and providing ongoing input into the reform process from the community bank perspective.

Community Banks and the Housing Market

Community bank mortgage lending is vital to the strength and breadth of America's housing market. Community banks represent approximately 20 percent of the mortgage market, but more importantly, our mortgage lending is often concentrated in the rural areas and small towns of this country, which are not effectively served by large banks. For many rural and small-town borrowers, a community bank loan is the only option to help families buy a home.

A vibrant community banking sector makes mortgage markets everywhere more competitive and fosters affordable and competitive interest rates and fees, better customer service, and more product choice. The housing market is best served by a diverse group of lenders of all sizes and charter types. Nearly eight years after the financial crisis, an already concentrated mortgage market has become yet more dangerously concentrated. We must promote beneficial competition and avoid further consolidation and concentration of the mortgage lending industry.

First State Bank was founded by my great grandfather in 1905 and has survived the Great Depression and numerous recessions since that time, including the most recent financial crisis, by practicing conservative, commonsense lending and serving our community through good times and bad. I'm proud to note that First State Bank was awarded SBA Lender of the Year in 2001 and SBA Community Bank of the Year in four consecutive years: 2005, 2006, 2007, and 2008. We emerged from the crisis well-capitalized and our lending has supported the recovery.

Many American community banks have similar stories. And with meaningful regulatory relief, particularly in the mortgage lending area, I fully expect the community bank business model will thrive in the future, to the benefit of consumers, communities, and the broader economy.

Residential mortgage lending has been an important component of First State's business since its early years and has grown more important over the years. Today, we have a nearly $600 million portfolio consisting of approximately 5,500 loans. Most of these loans are held by Freddie Mac, and a smaller number are held by Fannie Mae. First State Bank and our customers depend on our access to Fannie Mae and Freddie Mac. Many of First State Bank's mortgage loans come from other smaller community banks that depend on my bank for access to the secondary market.

Fair Access to the Secondary Market

Secondary market sales are a significant line of business for many community banks. According to an ICBA survey, nearly 30 percent of community bank respondents sell half or more of the mortgages they originate into the secondary market.[1] When community banks sell their well-underwritten loans into the secondary market, they help to stabilize and support that market. Community bank loans sold to Fannie Mae, Freddie Mac, and the Federal Home Loan Banks ("the GSEs") are underwritten as though they were to be held in the bank's portfolio. Selling loans to the GSEs allows the community bank to retain the servicing on those loans, thereby keeping their relationship with that borrower. Loans that are serviced by locally based institutions tend to lead to better outcomes for borrowers and their communities. Many non-GSE secondary market investors require transfer of servicing when they purchase a loan.

While community banks choose to hold many of their loans in portfolio, it is critical for them to have robust secondary market access to support lending demand with their balance sheets. Selling mortgage loans into the secondary market frees up capital for more residential mortgages or other types of lending, such as commercial and small business lending, which support economic growth in our communities.

Even those community banks that hold nearly all of their loans in portfolio need to have the option of selling loans in order to meet customer demand for long-term fixed rate loans. Meeting this customer demand is vital to retaining other lending opportunities and preserving the relationship banking model. As a community bank, it is not feasible for me to use derivatives to offset the interest rate risk that comes with fixed rate lending. Secondary market sales eliminate this risk. The ability to sell a single loan for cash, not securities, is critical to my bank because I don't have the lending volume to aggregate loans and create mortgage backed securities, before transferring them to Fannie Mae or Freddie Mac. In addition, I'm assured that the GSEs won't appropriate data from loans I've sold to solicit my customers with other banking products.

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[1] ICBA Mortgage Lending Survey. September 2012.

Key Features of a Successful Secondary Market

The stakes involved in getting housing-finance market policies right have never been higher. Housing and household operations make up 20 percent of our economy and thousands of jobs are at stake.

ICBA's approach to GSE reform is simple: use what's in place today and is working and focus reform on aspects of the current system that are not working or that put taxpayers at risk. If reform is not done right, the secondary market could be an impractical or unattractive option for community banks. Proposals that would break up, wind down, sell or transfer parts of the GSEs' infrastructure to other entities would end up further concentrating the mortgage market in the hands of the too-big-to-fail players, putting taxpayers and the housing market at greater risk of failure. Further, they run the risk of disrupting liquidity in the $5 trillion housing market that community banks and homebuyers depend on.

As stated earlier, my bank provides secondary market services to smaller community banks, and I depend on direct access to Fannie and Freddie to provide the liquidity and interest rate protection that I pass on to my community bank clients and our borrowers. My business model would not survive if the GSEs were gone and my only access to the secondary market was through Wells Fargo or Wall Street. If that were the case, many community banks would exit the business and many communities would lose local mortgage lenders.

Below are some of the key principles community banks require in a first-rate secondary market.

- ***Lenders should have competitive, equal, direct access on a single-loan basis.*** The GSE secondary market must continue to be impartial and provide competitive, equitable, direct access for all lenders on a single-loan basis that does not require the lender to securitize its own loans. Pricing to all lenders should be equal regardless of size or lending volume.

- ***An explicit government guarantee on GSE MBS is needed.*** For the market to remain deep and liquid, government catastrophic loss protection must be explicit and paid for through the GSE guaranty fees, at market rates. This guarantee is needed to provide credit assurances to investors, sustaining robust liquidity even during periods of market stress.

- ***The TBA market for GSE MBS must be preserved.*** Most mortgage lenders are dependent on a liquid to-be-announced (TBA) market that allows them to offer interest rate locks while hedging interest rate risk with GSE mortgage-backed securities (MBS) that will be created and delivered at a later date. Creating new GSE MBS structures, or using customized capital markets structures that provide front end credit risk transfers, generally makes the resulting MBS "non-TBA."

- ***Strong oversight from a single regulator will promote sound operation.*** Weak and ineffective regulation of the GSEs enabled them to stray from their primary mission as aggregators, guarantors, and securitizers. As required by HERA, the FHFA must ensure the secondary market operates in a safe and sound manner so taxpayers are not put at risk. It is incumbent upon FHFA to ensure the GSEs are adequately capitalized commensurate with their risks and compliant with their primary mission.

- ***Originators must have the option to retain servicing, and servicing fees must be reasonable.*** Originators must have the option to retain servicing after the sale of a loan. In today's market, the large aggregators insist that lenders release servicing rights along with their loans. Transfer of servicing entails transfer of customer data which can be used for cross-selling. While servicing is a low-margin business, it is a crucial aspect of the relationship-lending business model, giving originators the opportunity to meet the other lending or financial services needs of their customers. Additionally, in general, consumers receive better service when their loans are serviced on a local level than when they are serviced by entities that did not originate their loan and are located out of their market area.

- ***Complexity should not force consolidation.*** Under the current GSE model, selling loans is relatively simple. Sellers take out commitments to sell loans on a single-loan basis and are not required to obtain complex credit enhancements, except for private mortgage insurance for loans exceeding 80 percent loan-to-value or other guarantees. Any future secondary market/GSE structure must preserve this relatively simple process for community banks and other small lenders that individually do not have the scale or resources to obtain and manage complex credit enhancements from multiple parties.

- ***The GSEs must be allowed to rebuild their capital buffers.*** ICBA believes the first step in GSE reform must be restoring the GSEs to a safe and sound condition. Regardless which approach or structure reform takes, the existing system must be well capitalized to prevent market disruption or additional taxpayer support in the event of one or both GSEs requiring a draw from the U.S. Treasury during what's likely to be a lengthy debate and transition period to any new structure or system.

- ***GSE shareholder rights must be upheld.*** Any reform of the housing finance system must address the claims of GSE shareholders and respect the rule of law that governs the rights of corporate shareholders.

ICBA's Way Forward

ICBA's approach to GSE reform is simple: use what is in place today and is working, and address or change the parts that are not. Our approach has two parts: reforms that can be accomplished administratively by FHFA within HERA, and reforms that will require Congressional action.

Administrative Reforms

- FHFA should end the net worth sweep of revenues to Treasury and, following HERA, require both GSEs to develop capital restoration plans. These plans would include continued use of credit risk transfers, provided they meet a targeted economic return threshold that balances GSE revenue and capital building needs with prudent credit risk management standards.

- FHFA should review and approve those capital plans, establish prudent risk based capital levels as required by HERA, and set reasonable timeframes and milestones for achieving re-capitalization goals.

- FHFA should monitor the GSEs' performance against their respective plans and release each GSE from conservatorship as they become well-capitalized.

- The GSEs should complete construction of the Common Securitization Platform and issue their respective MBS from the platform. Ownership/management of the CSP should remain with the GSEs through the current LLC structure. Expanding access to the CSP to other entities should be up to Common Securitization Solutions, LLC (CSS) board, with final approval by FHFA.

- Launch of the Uniform Mortgage Backed Security (UMBS) should be deferred until both GSEs are recapitalized and released from conservatorship.

Legislative Reforms

- Congress should create a catastrophic mortgage insurance fund to be administered by the FHFA which would be funded through GSE guaranty fees. The size of the fund should be determined based on actuarial standards and should be similar to the FDIC's deposit insurance fund. The fund would stand behind the explicit U.S. government guarantee of the GSE MBS.

- Congress should change the GSE corporate charters from the current government-chartered, shareholder-owned, publicly traded companies, to regulated financial utilities that are shareholder owned. All current shareholders should be able to exchange common and junior preferred GSE shares for a like amount of shares in the new structures. The Treasury should exercise its warrants for senior preferred shares of GSE stock and convert those shares to stock in the new structure. No dividends should be paid to any shareholders until the company is deemed well capitalized per its recapitalization plan by the FHFA. The Treasury should be required to divest itself from its shares once a company is well capitalized.

The worst outcome in GSE reform would be to allow a small number of mega-firms to mimic the size and scale of Fannie and Freddie under the pretense of creating a private sector solution strong enough to assure the markets in all economic conditions. Moral hazard derives from the concentration of risk, and especially risk in the housing market because it occupies a central place in our economy. Any solution that promotes consolidation is only setting up the financial system for an even bigger collapse than the one we've just been through.

The GSEs must not be turned over to the firms that fueled the financial crisis with sloppy underwriting, abusive loan terms, and an endless stream of complex securitization products that disguised the true risk to investors while generating enormous profits for the issuers. These firms must not be allowed to reclaim a central role in our financial system.

ICBA is pleased to see a robust debate emerging on housing finance reform. A number of serious proposals have been put forth to date – both from within Congress and from outside – all of which combine promising features with others that warrant additional consideration and reworking.

Recapitalization of the GSEs Cannot Wait

Finally, I would like to highlight for this committee an immediate risk facing the GSEs, the mortgage market, and taxpayers.

Though Fannie Mae and Freddie Mac have returned to profitability and have resolved the majority of their defaulted loans, the quarterly sweep of their earnings to the Treasury – some $265 billion in eight years – has seriously depleted their capital buffers. In fact, Fannie Mae and Freddie Mac have less capital today than when they were placed in conservatorship eight years ago and, absent a change in policy, are on track to fully deplete their capital by year-end. When this happens, one or both companies are likely to require a draw from the Treasury. This in turn could trigger a market disruption that spikes interest rates and freezes home purchases and refinancing. This self-inflicted crisis can and must be avoided. We urge this committee to support the efforts of FHFA and the Treasury to protect taxpayers from another bailout.

Relief from Burdensome and Costly Mortgage Regulation

We appreciate the focus of this hearing on the critical issue of housing finance reform and the secondary markets. I must also mention the urgency of reforming burdensome mortgage regulations that risk driving community banks from the mortgage market. ICBA thanks this committee for passing bills that will provide relief from the Consumer Financial Protection Bureau's (CFPB's) "qualified mortgage," escrow, small servicer, and Home Mortgage Disclosure Act (HMDA) rules.

We are urging the Senate to take up and pass these bills expeditiously. However, with implementation of new HMDA rule rapidly approaching on January 1, 2018, we request that Congress pass legislation that would delay implementation, as recommended by the Treasury Department's June 2017 report, "A Financial System That Creates Economic Opportunities."

Community banks rely on third party vendors to overhaul their systems for compliance with the new rule. Unfortunately, we do not believe vendors are prepared for the January 1 compliance date in large part because the CFPB has continued to revise and retool its guidance in response to lender comments. There is an enormous risk of compliance failure on January 1 and in the following months and a disruption in the flow of mortgage credit in our communities.

We appreciate this committee's support for a delay in the TILA-RESPA Integrated Disclosure rule, and urge you to enact a similar delay in the HMDA rule for one year.

Closing

Thank you again for the opportunity to testify today. It is critically important the details of reform are done right to ensure community banks and lenders of all sizes are equally represented and communities and customers of all varieties are served.

Rick Stafford Response

Question for the Record

Financial Services Housing and Insurance Hearing "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform"

October 25, 2017

Question for Samantha Vallandingham, President and CEO, First State Bank and Rick Stafford, President and CEO, Tower Federal Credit Union:

One of the more overlooked but important aspects that Fannie and Freddie bring to the current market is product and process standardization. This includes standards for things like loan documents, underwriting guidelines, appraisals, and title insurance that are included in Fannie and Freddie's selling and servicing guides. These standards help promote competition by ensuring that a mortgage made by a community bank has the same general features as a loan made by a national lender. This also means that community bank loans can be sold in the same market for the same price as loans made by larger lenders.

- If we bring more private capital into the system or add additional securitizers how do we ensure that the uniformity and standards developed by the GSEs are not lost?

A: Maintaining product and process consistency and uniformity across the GSEs or other securitizers is essential for credit unions to continue to have equal and unfettered access to the secondary market. Without standardization, chaos will surely ensue in terms of control, risk mitigation, and efficiency initiatives. In a new system, it is crucial that the FHFA or its successor continue to provide strong oversight of the GSEs or other securitizers to guarantee consistency and ensure that all securitizers stay on track with their core missions and objectives. Additionally, in my written testimony, I outline the importance of preserving current technologies that help to standardize the process for lenders, in particular, the common securitization platform (CSP). Retaining the CSP is the key to creating uniformity and simplicity in a new system. We also believe that establishing an FHFA board of advisors, on which credit unions are represented, would provide an avenue for direct lender feedback to help the FHFA or its successor find ways to maintain product and process standardization as well as provide increased transparency in the mortgage lending industry.

Congressman Brad Sherman
Question for the Record
Financial Services Housing and Insurance Hearing "Sustainable Housing Finance: Private Sector Perspectives on Housing Finance Reform"
October 25, 2017

Question for Samuel Vallandingham, President and CEO, First State Bank and Rick Stafford, President and CEO, Tower Federal Credit Union:

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- If we bring more private capital into the system or add additional securitizers how do we ensure that the uniformity and standards developed by the GSEs are not lost?

Response from Samuel Vallandingham:

It would depend on the form that private capital takes. If it's in the form of real equity capital raised through public offerings to capitalize the GSEs and protect taxpayers, then there would not be any erosion of standardization, which could lead to a situation similar to what happened in the run up to the financial crisis. Additionally, back-end credit risk transfers which are currently being done by both GSEs do not erode the standardization of the market. However, proposals to increase the number of guarantors that could access the federal guaranty on MBS would lead to an erosion of underwriting standards as those entities attempt to compete and take market share from the GSEs and each other. This would put additional stress on capacity of the FHFA to properly oversee the market and supervise those entities to protect market liquidity. Additionally, the proliferation of certain types of front-end credit risk transfers, such as many of those executed by the largest aggregators and banks, while putting those institutions capital at risk, could (if not monitored) result in an erosion in credit standards and standardization as those institutions seek to maintain a competitive advantage.