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National Association of Federally-Insured Credit Unions

April 19, 2021

Federal Housing Finance Agency
Office of the Director
400 7th Street SW
Washington, D.C. 20024

RE: Climate and Natural Disaster Risk Request for Information

Dear Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Request for Information (RFI) issued by the Federal Housing Finance Agency (FHFA) regarding climate change and natural disaster risk to the housing finance system and the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 124 million consumers with personal and small business financial service products. NAFCU and its member credit unions recognize the impacts that climate change is currently having and will potentially have on financial markets, including mortgage markets, especially for properties in special flood hazard areas (SFHAs) and flood-prone areas.

NAFCU encourages the FHFA to work with the other members of the Financial Stability Oversight Council (FSOC), including the National Credit Union Administration (NCUA), to coordinate efforts on climate risk policies to ensure a liquid and stable mortgage market well into the future. The FHFA should adopt a risk-based framework for regulating and supervising the GSEs in the face of climate change and should avoid implementing any policies and requirements for the GSEs that will impede credit unions' ability to sell their mortgages as this may have a negative impact on minority and low- and moderate-income borrowers. NAFCU urges the FHFA to adjust its capital and liquidity requirements for non-bank mortgage sellers and servicers as they pose a substantial risk to the financial system. The FHFA should also closely evaluate its affordable housing efforts to account for climate change risk, specifically for minority and low- and moderate-income borrowers who are disproportionately impacted by climate change, and pursue pilot programs to help borrowers build wealth as well as evaluate the impact any policies may have on the Federal Home Loan Banks' (FHLBs) programs.

General Comments

Climate change has been dubbed a “planetary emergency”¹ and poses risks to our nation’s financial system as well as the global financial system. Climate change is expected to increase the frequency of flooding in SFHAs and elsewhere and contribute to more extreme weather events, such as

¹The Global Risks Report 2020, World Economic Forum (2020), http://www3.weforum.org/docs/WEF_Global_Risk_Report_2020.pdf.

wildfires, that damage homes, negatively impacting a borrower's ability to pay their mortgage loan. A recent extreme weather event was the winter storm in Texas that left millions of homes without power for at least a week, caused pipes to burst and other property damage from the snow and cold, and shut down oil and gas production, food processing facilities, and manufacturing plants.²

Overall, ninety percent of weather-related disasters in the U.S. involve some type of flooding, even outside of SFHAs and floods account for the most property damages from natural disasters.³ The results of new studies that consider sea-level rise, rainfall and flooding along smaller creeks not currently mapped through the Federal Emergency Management Agency (FEMA), show that nearly twice as many properties may be susceptible to flood damage than previously estimated.⁴ These flood risks tend to disproportionately impact minority and low- and moderate-income borrowers.⁵

Most concerning is that extreme weather events could make insurance unaffordable or unavailable for some borrowers, which could lead to a cascade of mortgage defaults if homes become uninsurable over time.⁶ Since the end of fiscal year 2017, the National Flood Insurance Plan (NFIP) has been reauthorized through sixteen short-term funding extensions.⁷ The NFIP is currently authorized through September 30, 2021, but if it is not reauthorized or amended by Congress, the authority to provide new flood insurance contracts will expire and the authority for the NFIP to borrow funds from the Treasury will be substantially reduced. This highlights the need for a longer-term solution to federal flood insurance, so that homeowners remain protected and lenders do not experience losses on mortgage loans. The FHFA should also coordinate with other FSOC members to evaluate the practices of private flood insurance providers and their role in helping to protect borrowers in high-risk areas.

To prepare for and respond to the growing risks posed by climate change, federal financial regulators have recently announced new initiatives. In remarks at a recent FSOC open meeting, Treasury Secretary Janet Yellen announced the formation of a new climate hub at the Treasury to focus on climate finance and support a transition to a net zero carbon economy.⁸ This climate hub is intended to supplement the efforts of the FSOC in developing an appropriate and consistent policy framework for financial markets. The Federal Reserve Board is also establishing a Financial Stability Climate Committee to identify, assess, and address climate-related risks to financial

² Irina Ivanova, *Texas Winter Storm Costs Could Top \$200 Billion—More Than Hurricanes Harvey and Ike*, CBS News (Feb. 25, 2021), <https://www.cbsnews.com/news/texas-winter-storm-uri-costs/>.

³ Clare Cannon, et al., *The Climate Change Double Whammy: Flood Damage and the Determinants of Flood Insurance Coverage, the Case of Post-Katrina New Orleans*, *Climate Risk Management*, Vol. 27, (2020), <https://doi.org/10.1016/j.crm.2019.100210>.

⁴ Christopher Flavelle, et al., *New Data Reveals Hidden Flood Risk Across America*, *The New York Times*, June 29, 2020, <https://www.nytimes.com/interactive/2020/06/29/climate/hidden-flood-risk-maps.html>.

⁵ *Id.*

⁶ *The Global Risks Report 2020*.

⁷ Congressional Research Service, *What Happens if the National Flood Insurance Program (NFIP) Lapses?* (Oct. 2, 2020), <https://fas.org/sgp/crs/homesec/IN10835.pdf>.

⁸ Remarks by Secretary Janet L. Yellen at the Open Session of the meeting of the Financial Stability Oversight Council, Mar. 31, 2021, <https://home.treasury.gov/news/press-releases/jy0092>.

stability from a macroprudential perspective.⁹ Despite these efforts, responses across the financial markets remain fragmented and until a cohesive approach is adopted, the FHFA should err on the side of caution before adopting a supervisory approach for the GSEs or any policies that may have ripple effects across the mortgage markets.¹⁰

Before the FHFA makes any decisions on mortgage purchase policies or supervision of the GSEs, Congress should appropriate more resources to FEMA and FEMA should coordinate with state and local authorities to initiate an effort to update flood maps and determine the most accurate flood risks. A 2017 report from the Department of Homeland Security found that FEMA is unable to “provide members of the public with a reliable rendering of their true flood vulnerability or ensure that NFIP rates reflect the real risk of flooding.”¹¹ That same report determined that approximately 60 percent of FEMA’s flood maps have not been updated in the last 5 years. A 2017 Congressional Budget Office report also found that half of the 166 counties with the highest flood risk relied on flood maps that were over 5 years old and 42 of those counties used maps that had not been updated in over 10 years.¹² This alarming reality emphasizes the point that before federal policy decisions are made on the appropriate methods for assessing climate risk, more federal coordination with state and local authorities is needed to determine the true flood risks presented to homeowners across the country. Moreover, there should be a coordinated effort among FSOC members regarding supervisory efforts to manage climate and natural disaster risk.

Coordination that Recognizes the Unique Nature of Credit Unions

The federal and state and local coordination outlined above should recognize the unique nature of the credit union industry and field of membership restrictions that may result in concentration of climate-related impacts. As NAFCU continues to advocate for modernization of credit unions’ field of membership rules to allow credit unions to better adapt to population shifts and changing market conditions, we caution the FHFA not to adopt policies that may have the effect of penalizing some credit unions based solely on the communities they serve. It is critical that climate and natural disaster risk policies do not disrupt credit unions’ ability to sell their mortgages to the GSEs and access the secondary market.

Ultimately, a diverse set of national strategies will be necessary to effectively address climate risks in the future, but in the meantime, it is paramount that policies aimed at mitigating financial sector exposures are incrementally calibrated to reflect the rate and severity of climate change rather than developed in response to purely hypothetical scenarios. Imposing artificially high capital or

⁹ Speech by Governor Lael Brainard, *Financial Stability Implications of Climate Change*, Board of Governors of the Federal Reserve System, <https://www.federalreserve.gov/newsevents/speech/brainard20210323a.htm>.

¹⁰ President Biden intends to sign an executive order this week to combat climate-related financial risks, which would require FSOC to assess risks to the financial system and the U.S. and deliver a report within 180 days. See Lorraine Woellert, *Biden Prepares Sweeping Order on Climate-Related Risks*, Politico (Apr. 15, 2021), <https://www.politico.com/news/2021/04/15/biden-climate-risks-executive-order-481962>.

¹¹ Department of Homeland Security Office of Inspector General, OIG-17-110, *FEMA Needs to Improve Management of its Flood Mapping Programs* (2017).

¹² Congressional Budget Office, *Age of Flood Maps in Selected Counties That Account for Most of the Expected Claims in the National Flood Insurance Program: Supplemental Material for The National Flood Insurance Program: Financial Soundness and Affordability* (2017).

liquidity requirements for the GSEs in anticipation of a worst-case scenario could actually undercut the economic support necessary for effective climate adaptation and harm credit union members in the process, particularly if the credit union's membership resides in an area projected to have greater climate-related risks. In other words, preemptive efforts to address climate change should be tailored to accommodate the unique lending activity of credit unions who cannot realistically diversify their geographic footprint when bound by field of membership constraints.

Identifying and Assessing Climate and Natural Disaster Risk

As a threshold matter, the FHFA should evaluate various definitions of climate and natural disaster risk before considering how it will supervise the GSEs because this definition will dictate the scope of future policymaking and the impact on credit unions. The FHFA and other members of the FSOC should adopt a substantially similar definition to promote uniformity and ease compliance burdens in the financial markets. To accomplish this objective, FSOC members should conduct a series of open meetings with climate and environmental experts.

Although this RFI may be helpful in gathering initial feedback and NAFCU encourages the FHFA to continue to solicit stakeholder feedback on climate change, preliminary discussion with climate experts to define, identify, and clarify climate risks to the mortgage markets could generate more meaningful engagement from financial sector stakeholders that may not have a complete understanding of the analytical methods used to assess climate risk. The FHFA should transparently partner with organizations or groups that study climate and natural disaster risk management to facilitate a more robust policy discussion with stakeholders in future listening sessions and RFIs. The FHFA should also partner with regional organizations and establish state and local efforts to better understand the different climate risks facing communities and lenders across the country, whether it is wildfires, hurricanes, or other natural disasters that threaten the mortgage markets and how those risks may impact urban and rural communities differently.

Credit Union Efforts to Identify and Assess Climate and Natural Disaster Risk

Credit unions utilize various risk management strategies to address climate and natural disaster risk. These risk management strategies include (1) monitoring properties in a SFHA; (2) requiring NFIP insurance or private flood insurance, (3) engaging in loss mitigation efforts to help borrowers afford their loan payments after a natural disaster impacts the borrower's financial condition; (4) and conducting risk assessments after a disaster. Post-disaster risk assessments include determining the disaster's effect on asset quality and explaining the disaster's implications on the credit union's earnings and capital, as well as the effects on funding, liquidity, operations, and sensitivity to market risk.¹³

Credit unions are also required to maintain a process for identifying all loans and investments affected by a natural disaster and any potential loss exposure as well as track information on the

¹³ Interagency Supervisory Examiner Guidance for Institutions Affected by a Major Disaster, Dec. 2017, <https://www.ncua.gov/files/press-releases-news/SL-17-02-examiner-guidance-institutions-affected-major-disaster-enclosure.pdf>.

condition of affected collateral and the collectability and timing of insurance proceeds.¹⁴ A credit union must also anticipate weather-related risks to its own branches and other facilities when developing a security and record preservation program. This may be particularly relevant if a credit union facility is in an at-risk community and its broader mortgage portfolio is particularly exposed to climate risk. Collectively, these compliance requirements ensure that the credit union system remains safe and sound by requiring institutions to prepare, monitor, and assess risks posed by natural disasters that may be a result of climate change.

Non-bank Servicers Pose a Risk to the GSEs' Management of Climate and Natural Disaster Risk

As NAFCU recently wrote in response to the FHFA's Enterprise Liquidity Requirements rule, in a letter dated March 8, 2021, non-bank mortgage servicers pose not only a risk to the GSEs but also a systemic risk to the financial system. With respect to climate change and natural disaster risk, one of the most critical elements in determining preparedness and appropriate disaster response is an institution's liquidity and capital condition. Considering the FHFA's financial eligibility requirements for non-bank mortgage sellers and servicers are woefully inadequate to handle catastrophic losses at several of the largest servicers, the increased frequency and severity of extreme weather events due to climate change will only amplify risks to the GSEs and the mortgage markets. Ultimately, it is the borrowers working with these non-bank sellers and servicers, many of whom are minority and low- and moderate-income borrowers, that will be negatively impacted by the failure of or financial losses at these non-bank sellers and servicers. The credit unions that originated the mortgage loans will also face increased burdens and risks due to such failures or losses.

NAFCU urges the FHFA to enhance its liquidity and capital requirements for non-bank sellers and servicers to better protect the mortgage markets and the borrowers that would be impacted by failures at these servicers. Moreover, the FHFA should support legislation to establish a heightened federal regulatory and supervisory structure for non-bank sellers and servicers as they are not currently subject to federal safety and soundness oversight. As the risks posed by climate change continue to grow, the FHFA should recognize that the largest risk to the GSEs' portfolios comes not from already well-regulated financial institutions that are subject to stringent capital and liquidity standards and federal safety and soundness supervision, but rather those non-bank mortgage sellers and servicers that are not.

Housing Affordability and Minority and Low- and Moderate-Income Borrowers

Generally, minority communities and low- and moderate-income communities are more susceptible to certain climate-related impacts because their homes may be in SFHAs or flood-prone areas and higher-income communities see greater investment in flood protection efforts. As climate risk grows, it is critical that the FHFA and other federal agencies partner with state and local authorities to develop comprehensive solutions that do not further exacerbate these racial and

¹⁴ *Id.*

wealth disparities. Some of these solutions may include programs to incentivize investments in floodproofing of homes and expanding access to affordable insurance.¹⁵

Additional efforts should focus on promoting the development of and investment in affordable housing options in safer geographic areas that are less prone to flooding.¹⁶ These climate-related affordable housing efforts should be incorporated into the GSEs' Duty to Serve requirements and annual housing goals. To further mitigate the adverse effects on minority and low- and moderate-income borrowers exposed to climate and natural disaster risk, the GSEs should consider establishing pilot programs to help borrowers build wealth. As NAFCU has consistently advocated, such a pilot program should focus on purchasing low- or zero down payment, 15- or 20-year fully amortizing loans with either a fixed interest rate or a two-step rate structure. With this type of mortgage loan, borrowers would be less at-risk of delinquencies and default as they are building wealth at a faster rate.

The FHFA should also closely consider the impact that any policy changes will have on the FHLBs as credit unions rely on the FHLBs for liquidity to continue serving their members, including minority and low- and moderate-income members. For example, credit unions utilize the FHLBs' Affordable Housing Programs (AHP) to assist in community development and providing access to credit for minority and low- and moderate-income borrowers. Any policy changes that alter the valuation of collateral used for FHLB advances, changes in the eligibility standards on collateral for those advances, changes to the eligibility standards for mortgages purchased through the FHLBs' Acquired Member Assets programs, or any reduction in liquidity or funding options for the AHP could have a substantial impact on credit unions and their members. Such changes should be aligned with risk assessments and policy changes made by other financial regulators to address climate change and natural disaster risk and should only be adopted after notice and comment rulemaking to ensure a transparent process and opportunity for stakeholder feedback.

Conclusion

Climate change poses a substantial existential risk and carries significant challenges for lenders and the mortgage markets, but the FHFA should be careful not to impose policies that may negatively impact credit unions' ability to sell their mortgage loans into the secondary market. NAFCU encourages the FHFA to continue its collaboration with the FSOC and the NCUA to understand the efforts credit unions are taking to manage risks posed by climate change and natural disasters. Understanding the unique nature of credit unions is critical to properly calibrating any risk assessments and policies that will impact the industry.

One of the biggest risks to the mortgage market is the lack of federal safety and soundness regulation and oversight of non-bank sellers and services, so in considering climate change risks, the FHFA should adjust its capital and liquidity requirements for these institutions. The FHFA should also evaluate its affordable housing efforts, take steps to promote wealth building home

¹⁵ Rachel Cleetus, *The FHFA Begins to Reckon with Climate Risks to the Housing Market*, Union of Concerned Scientists, Mar. 5, 2021, <https://blog.ucsusa.org/rachel-cleetus/fhfa-begins-to-reckon-with-climate-risks-to-housing-market>.

¹⁶ *Id.*

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loan options, and consider the impact any policies may have on the FHLBs and credit unions' ability to provide credit to their communities, specifically minority and low- and moderate-income borrowers.

Thank you for the opportunity to provide comments on this RFI. NAFCU looks forward to working with the FHFA, NCUA, and the Administration to assess climate change risk in a manner that does not impact credit unions' ability to keep serving their communities. If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2212 or akossachev@nafcu.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Ann C. Kossachev". The signature is fluid and cursive, with the first letters of the first and last names being capitalized and prominent.

Ann C. Kossachev
Director of Regulatory Affairs