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NAFCU | Your Direct Connection to Advocacy, Education & Compliance

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Naa Awaa Tagoe
Senior Associate Director
Office of Financial Analysis, Modeling and Simulations
Division of Housing Mission and Goals
Federal Housing Finance Agency
400 7th St., S.W.
Washington, D.C. 20019

RE: Single-Family Credit Risk Transfer

Dear Ms. Tagoe:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing in regard to the Federal Housing Finance Agency's (FHFA) recent Request for Input on single-family credit risk transfer and proposals to adopt additional front-end credit risk transfer structures. NAFCU and its member credit unions support the FHFA's efforts to reduce overall risk at Fannie Mae and Freddie Mac (the GSEs), but have also identified three primary areas of concern with the proposals and principles outlined by the FHFA:

1. Limiting front-end credit risk transactions to only those that are "economically sensible" has the potential to force credit unions out of the mortgage market;
2. Requiring public disclosure of the details of transactions for loans sold to the GSEs will impose burdensome expenses on credit unions; and
3. Establishing a level playing field for all lenders must include consideration of the unique structure and constraints of credit unions so they are not disadvantaged against larger lenders.

In light of these apprehensions, NAFCU would love the opportunity to set up an in-person meeting to discuss the FHFA's proposals and further elaborate on the credit union perspective.

General Comments

In 2012, the Federal Housing Finance Agency began working on developing a strategic plan for Fannie Mae and Freddie Mac to pilot a program for reducing overall credit risk by sharing that risk with private investors. Another objective of the program is to increase consumer access to mortgage credit with low down payment loans from lenders of all sizes and provide extensive national secondary market liquidity for residential mortgage financing, especially for single-family mortgages. The GSEs have developed various transaction structures to achieve these goals, but have mostly engaged in debt issuances: Connecticut Avenue Securities (CAS) for Fannie Mae and Structured Agency Credit Risk (STACR) for Freddie Mac. CAS and STACR debt transactions are examples of back-end transactions. In the *2016 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions,* FHFA announced the analysis of additional front-end credit risk transfer structures as one of its conservatorship priorities, specifically collateralized recourse agreements. Such transactions would require the lender to reimburse the GSEs for a certain percentage of potential credit losses on loans sold to them (usually three to six percent of the loan balance). These loans would come with a mortgage coupon for the full guarantee fee and, as a result, the GSEs either pay a fee to the lender or offer a concession on the guarantee fee they charge to the lender for taking the credit risk. The FHFA is also working on ideas for deeper mortgage insurance structures.

NAFCU supports the goals of increasing consumer access to mortgage credit because credit unions care deeply about their members' financial well-being and believe that they should have access to affordable mortgages. Credit unions will, however, be unable to provide the most affordable mortgages if they are effectively priced out of front-end credit risk transactions or otherwise unable to participate without a user-friendly systems-supported platform. The FHFA has identified nine principles of credit risk transfer, including: engaging in transactions that are economically sensible, creating transparency through the public disclosure of transaction information, and creating a level playing field for all lenders. NAFCU believes that considering these principles in the context of front-end credit risk transactions, the FHFA must more seriously evaluate the effect such transactions may have on credit unions.

"Economically Sensible" Transactions

First and foremost, credit unions must be educated in the credit risk transfer process and understand how to manage their portfolio lending within such a framework. This learning process will take time. The FHFA should be cognizant of this as well as the fact that NCUA must first approve any aggregation procedures that would allow credit unions to participate in front-end credit risk transactions. Moreover, the credit union industry provides stellar loan products to our nation's consumers. A credit risk transfer is essentially an analysis of loan quality, so, in exchange for selling high quality loans, credit unions should perhaps be entitled to a greater guarantee fee concession or a portion of the premium received by the loans they originate. The GSEs benefit from the quality of loans provided for credit risk transfer transactions, so NAFCU urges the FHFA to hold off on expanding the use of front-end transactions until credit unions can meaningfully participate.

Notwithstanding, several of NAFCU's member credit unions are concerned that front-end credit risk transactions will inflict harm on their business models and add costs to their members. Front-end credit risk transactions will require smaller lenders, including credit unions, to hold more capital against projected losses to ensure that they can participate. Additionally, credit unions may not be well equipped to handle the larger "pipeline risk" that is transferred to the lender in front-end transactions, putting them at a significant disadvantage in the mortgage market. Such risk may not be a huge burden for big banks, but credit unions may suffer under this transaction structure.

If the FHFA is requiring the GSEs to restrict credit risk transfer transactions to only those that are "economically sensible," then the GSEs may be less willing to acquire mortgage loans from credit unions that come at a higher cost. Furthermore, front-end credit risk transactions may make loans more costly to sell to the GSEs. Under this model, in order to continue to sell loans to the GSEs, credit unions will be forced to pass on the additional expense to their members, thereby placing credit unions at a competitive disadvantage in the communities they serve.

NAFCU urges the FHFA to consider expanding its definition of "economically sensible" transactions so that credit unions will not be excluded from participating in front-end credit risk transactions. Broadening the definition of this principle will allow credit unions that provide high quality loans to participate in front-end transactions so as to not be disadvantaged in the markets they service. It is equally as important, however, that the FHFA evaluate ways to protect credit unions as they attempt to take part in front-end transactions.

Public Disclosure Requirement

NAFCU strongly supports increased transparency in the regulatory environment. In the realm of front-end transactions, transparency is likely in the best interest of investors, the FHFA, credit unions, and the public at large because it provides awareness of the market pricing of mortgage credit risk and allows all parties to better evaluate credit risk transfer programs. Nonetheless, requiring credit unions to provide public disclosure of the details of transactions for loans sold to the GSEs, without supporting the development of systems to do so at little to no cost for credit unions, will create immense difficulties.

Asking credit unions to provide public disclosures will not only create additional compliance requirements, but will also impose burdensome administrative processes and related expenses. Furthermore, there is the larger concern of potential reputational and privacy risks for both credit unions and their members. Privacy of personal financial information is of utmost importance and credit unions strive to maintain such privacy in all the services they provide and transactions in which they participate.

NAFCU requests that the FHFA further explain this principle and how it would play a role in the front-end credit risk transfer transactions. All information sharing, especially if it is shared with the general public must be appropriately redacted to protect the identity and personal financial information of consumers. Therefore, NAFCU would like to know what safeguards the FHFA and other parties to the credit risk transfer process intend to use to ensure that credit unions and their members will not be exposed to reputational and privacy risks.

Creating a Truly Level Playing Field

The FHFA seeks to establish a front-end credit risk transfer program that does not provide an advantage to larger mortgage originators over small ones, but the very structure of the front-end credit transactions favors larger lenders. Collateralized recourse agreements require the lender to take on credit risk before or at the same time as the loan is acquired by the GSEs; and that is a huge undertaking for credit unions because they are not structured like profit-hungry big banks. It is essential that the FHFA find variations to this structure to provide smaller lenders with a meaningful avenue through which to participate in front-end transactions.

A potential alternative may be the use of an aggregator to pool the loan production of several smaller lenders. NAFCU's member credit unions are, however, troubled by this option because the FHFA has not outlined the mechanics of the potential aggregation process. Pending further guidance from the FHFA on the type of aggregator to be used and how an aggregator may work to benefit the credit union industry, NAFCU cautions against moving forward with proposals for front-end credit risk transactions. Use of an aggregator may have a substantial impact on credit unions' secondary market options, so NAFCU looks forward to working with the FHFA to craft a solution that would be mutually beneficial for the credit union industry and the GSEs.

Housing industry experts have suggested the GSEs pilot a program in which small lenders take credit risk together through the Federal Home Loan Banks (FHLBs). The FHLBs could serve as a conduit to take on the risk associated with front-end transactions by posting the full recourse amount and provide insurance to the GSEs. Therefore, despite potential burdens that may arise through the use of an aggregator, the FHLBs could act as loan aggregators that pool the loan production of their local member institutions. NAFCU supports the implementation of such a pilot program because it would ensure that credit unions have access to front-end transactions and are truly on a level playing field.

Alternatively, NAFCU suggests that the FHFA reconsider the option of giving the FHLBs the authority to experiment with securitizing and selling existing mortgages held in their Acquired Member Assets program. NAFCU realizes that this may require legislative action, but financial market conditions have improved and the time has come to reevaluate the role of the FHLBs. Allowing the FHLBs to securitize and sell mortgage loans could facilitate credit union participation in front-end transactions and increase competition for the GSEs, resulting in lower mortgage rates for borrowers. Such a program could also lower systemic risk by reducing some of the market dependence on Fannie Mae and Freddie Mac. Additionally, as of December 2015, both state- and federally chartered credit unions that are federally or privately insured are eligible for membership in the FHLBs. Therefore, almost all credit unions have access to FHLB membership and a pilot program through the FHLB could be the perfect solution to assisting credit union participation in front-end credit risk transfer transactions.

Finally, NAFCU generally supports recent steps by Freddie Mac to implement deeper mortgage insurance credit risk transfer as another means of sharing credit risk, but remains wary of the implications for credit unions. NAFCU is concerned that credit unions will have to pay much higher interest rate payments for deeper private insurance coverage. Thus, it will be even more expensive, overall, for credit unions to originate loans to the GSEs compared to larger lenders. There is also concern that such transactions will significantly reduce the volume of credit union originated loans sold to the GSEs, which will adversely impact the mortgage loan programs credit unions offer to their members.

NAFCU would greatly appreciate the chance to meet with the FHFA to further discuss these concerns and possible alternative structures for front-end credit risk transfer transactions.

Conclusion

NAFCU is grateful for the opportunity to provide our comments on the FHFA's Request for Input regarding single-family credit risk transfer. If you have any questions or concerns, please do not hesitate to contact me at akossachev@nafcu.org or (703) 842-2212.

Sincerely,

Ann C. Kossachev

Ann Kossachev
Regulatory Affairs Counsel