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June 13, 2023

The Honorable Sandra L. Thompson
Director
Federal Housing Finance Agency
400 Seventh Street SW
Washington, DC 20024

RE: Regulatory Review [No. 2023-N-5]

Dear Director Thompson:

The Credit Union National Association (CUNA) represents America's credit unions and their more than 135 million members. On behalf of our members, we are writing in response to the Federal Housing Finance Agency's (FHFA) request for comment on its notice of regulatory review.[1]

Background

The FHFA has issued a notice of a regulatory review, and the review must conform to the process described in FHFA's Regulatory Review Plan from February 2012. As part of the review, the FHFA "is requesting comments on how its regulations may be made more effective and less burdensome."[2]

The FHFA's Regulatory Review Plan was established pursuant to Executive Order 13579,[3] which requests that independent agencies like the FHFA develop a plan to periodically review their significant regulations to see whether the regulations can become more effective or less burdensome by modifying, streamlining, expanding, or repealing them. Under its Regulatory Review Plan, FHFA reviews its regulations at least every five years.

We appreciate the FHFA's engagement in the regulatory review process, and we applaud its willingness to voluntarily perform a regulatory review every five years. While the FHFA is not required to conduct these regulatory reviews by statute, meaning that specific requirements such as those under the Administrative Procedures Act calling for agency consideration of comments

[1] Notice of Regulatory Review, 88 Fed. Reg. 22919 (Apr. 14, 2023).
[2] *Ibid.*
[3] Executive Order 13579—Regulation and Independent Regulatory Agencies (July 11, 2011), *available at* https://obamawhitehouse.archives.gov/the-press-office/2011/07/11/executive-order-13579-regulation-and-independent-regulatory-agencies.

received do not apply, we urge it to thoroughly analyze all public comments received through the regulatory review process with the goal of improving the effectiveness of its regulatory framework and making them less burdensome.

CUNA strongly believes that the housing finance system must ensure that lenders of all sizes have equal access to the secondary mortgage market and the services provided by the government-sponsored entities regulated by the FHFA, including Fannie Mae and Freddie Mac (collectively the Enterprises) and the Federal Home Loan Banks (FHLBanks).[4] The following comments related to the regulations covering the Enterprises and the FHLBanks, respectively, are made with that overarching theme in mind.

Enterprises

Part 1254—Validation and Approval of Credit Score Models

To ensure that credit unions have equal access to the secondary market and the Enterprises, transparency into decisions made by the FHFA and Enterprises is of vital importance, especially when those decisions may have wide-reaching effects upon credit unions and other secondary market players. Accordingly, CUNA urges the FHFA to consider how it and/or the Enterprises can facilitate stakeholders' acquisition of historical information gathered by the Enterprises in connection with the validation and approval of new credit score models.[5]

FHFA's regulations governing the Enterprises' validation and approval of credit score models do not require that the Enterprises release any comprehensive data about a newly-approved credit score model.[6] Nor do they require the Enterprises to make raw credit score data publicly available for testing despite the acknowledgment that the raw data could be expensive to procure.[7] That said, part 1254 permits the Enterprises to "obtain any historical consumer credit data necessary . . . to test a credit score model's historical record of measuring and predicting default rates and other credit behaviors."[8]

The inability to obtain this data without separate effort and/or significant cost could negatively affect a credit union's ability to continue accessing the secondary market and delivering loans to the Enterprises. Prudent risk management principles may call for the testing of newly-approved

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[4] *The Compendium of CUNA Policies on Legislative and Regulatory Issues*, 13, CUNA (Feb. 2022), *available at* https://www.cuna.org/content/dam/cuna/advocacy/actions/documents/CUNA_Compendium%20of%20Policies_DG.pdf.
[5] *See generally* 12 CFR Part 1254 (setting forth the requirements that the Enterprises need to satisfy to validate and approve credit score models).
[6] Validation and Approval of Credit Score Models, 84 Fed. Reg. 41,886, 41,898 (Aug. 16, 2019).
[7] *Ibid.*
[8] 12 C.F.R. § 1254.6(b).

and validated credit score models before using them in production.[9] If a credit union must pass the costs of obtaining the data onto its members or otherwise wait for data to become available, then that could lead to pricing increases borne by those members or to reduced access to the secondary market if the credit union encounters difficulty in testing the models.

The issue of access to data is extremely relevant now as the Enterprises roll out their outreach efforts for the implementation of the transition from the tri-merge to bi-merge requirement and switch from the Classic FICO model to the FICO Score 10T and VantageScore 4.0 scoring models.[10] Credit unions have voiced their concern about how much this transition might cost and how it may impact operations. Credit unions would prefer that information about the transition be released to the public early in the process so they have sufficient time to determine how the transition will affect their operations. For example, credit unions have commented on the fact that the implementation timeline calls for one quarter to pass between when Classic FICO historical data is published and when the bi-merge requirement goes into effect.[11] Having access to this and other data can help credit unions and other industry stakeholders adequately assess how moving to these new credit score requirements will affect their operations while minimizing any potential negative impacts on access to the secondary markets.

We urge the FHFA to consider requiring the Enterprises to disclose comprehensive data and historical raw credit score data obtained in connection with the validation and approval of new credit score models, or, in the alternative, to help credit unions and other industry stakeholders obtain this data in a timely, equitable, and efficient manner. Doing so will reduce burdens on credit unions and other stakeholders and minimize the risk of reducing access to the secondary market.

Federal Home Loan Banks

The FHLBanks' core mission is to "provide [FHLBank] members with a reliable source of funding for housing finance, community lending and asset-liability management as well as liquidity for members' short-term needs."[12] Credit unions, in turn, rely on the FHLBanks as a source of liquidity to serve their members' needs. CUNA applauds the FHFA's efforts to comprehensively review

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[9] *See* Interagency Statement on the Use of Alternative Data in Credit Underwriting, (Dec. 2019), *available at* https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/interagency-statement-use-alternative-data-credit-underwriting ("Based on that analysis, data that present greater consumer protection risks warrant more robust compliance management. Robust compliance management includes appropriate testing, monitoring and controls to ensure consumer protection risks are understood and addressed.").

[10] *See* FHFA, FHFA Announces Validation of FICO 10T and VantageScore 4.0 for Use by Fannie Mae and Freddie Mac (Oct. 24, 2022), *available at* https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Announces-Validation-of-FICO10T-and-Vantage-Score4-for-FNM-FRE.aspx (announced the validation and approval of both the FICO Score 10T and the VantageScore 4.0 credit scoring models and changing the requirement that lenders provide credit reports from all three nationwide credit reporting agencies (tri-merge) to requiring only two (bi-merge)).

[11] *See* Fannie Mae and Freddie Mac, Enterprise Credit Score and Reports Initiative Partner Playbook (May 31, 2023) at 7, *available at* https://singlefamily.fanniemae.com/media/34286/display (noting that historical Classic FICO data will be published in the fourth quarter of 2023 and the bi-merge requirement will be implemented in the first quarter of 2024).

[12] FHLBANKS' MISSION, https://fhlbanks.com/mission.

the FHLBanks' operations and mission and takes this opportunity to reinforce some of the comments provided in our previous letters responding to the comprehensive review. Specifically, we encourage the FHFA:

- To support any policy changes required to permit Credit Union Service Organizations (CUSOs) to join the FHLBanks as members;
- To avoid creating barriers like tiered memberships or other tests that might negatively impact credit unions' ability to promote homeownership through a holistic financial well-being approach; and
- To consider waiving the tangible capital requirement when evaluating new advances to FHLBank members.

Eligibility Requirements—12 C.F.R. § 1263.6

Both credit unions and CUSOs would benefit if CUSOs have the express authority to join the FHLBanks as members.[13] CUSOs are "formed and/or owned by one or more credit union[s] to provide a specific product or service within the credit union industry."[14] The mortgage-related CUSOs, of which there are approximately seventy across the United States, originate, process, underwrite, and service loans for credit unions.[15] CUSOs help credit unions, especially those that may not be able to offer mortgage loans to their members by themselves, to "provide innovative products and services, increase efficiencies, and gain economies of scale."[16] CUSOs would benefit from FHLBank membership by being able to access FHLBank advances, mortgage purchase programs, and other programs that promote community lending and affordable housing.[17]

The benefits for credit unions and CUSOs could be achieved without posing additional risk to the FHLBank System. Even though CUSOs are not subject to supervision by the National Credit Union Administration (NCUA), the credit unions that own CUSOs are supervised by state and/or federal regulators like the NCUA.[18] Moreover, CUSOs must comply with state licensing requirements to engage in mortgage activity, and "NCUA actively communicates with and conducts periodic reviews of large CUSOs and evaluates any risks that CUSOs may expose credit unions to in credit union supervisory examinations."[19]

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[13] *See* 12 U.S.C. § 1424(a)(1) (providing for eligibility of CDFIs); 12 C.F.R. § 1263.6(a) (same). CUSOs that are non-depository Community Development Financial Institutions (CDFIs) are eligible for membership, but CUSOs that are not CDFIs are ineligible.
[14] Letter from CUNA to The Honorable Sandra L. Thompson, Director, FHFA (Oct. 31, 2022) at 8-9, https://news.cuna.org/ext/resources/NewsNow/2022/10-2022/Comment-Letter---FHFA-Comprehensive-Review-of-the-FHLBank-System.pdf.
[15] *Ibid.*
[16] Letter from Sullivan to Thompson, *supra* note 14, at 8.
[17] *Id* at 9.
[18] *Ibid.*
[19] *Ibid.*

In short:

> CUNA supports any legislative and regulatory changes to expressly include CUSOs for membership, and strongly encourages FHFA to support policy changes that would allow all CUSOs to be eligible for membership to FHLBanks, as this will help them better assist their member credit unions' community lending activities. CUSO membership would further FHFA's duty to ensure the operations and activities of FHLBanks foster liquidity and efficient, competitive, and resilient national housing finance markets.[20]

Avoid Nexus Tests That Might Hinder Credit Unions' Ability to Benefit from FHLBank Membership or Access FHLBank Services

Credit unions are member-owned, not-for-profit financial cooperatives with a statutory mission "to meet the credit and savings needs of consumers, especially persons of modest means."[21] They use the FHLBank System as a source of liquidity to support their members' homeownership goals. While those goals can be satisfied through mortgage loans made to credit union members with funds obtained from the FHLBanks, credit unions have found that a holistic approach combining education and counseling with a diverse range of product offerings, including depository and lending products, best serves their members' needs.[22]

CUNA appreciates the concerns raised through the comprehensive review process about the appropriate nexus between FHLBank activity and the funding of home lending and community investment, including the Director's own concerns about FHLBank advances being used for balance sheet purposes rather than direct funding of home lending or community investment.[23] During the review process, commenters raised the idea of a tiered membership tying advances and pricing to different tiers.[24] Other roundtable discussions during the comprehensive review socialized a possible nexus test that involved housing asset levels (e.g., whole mortgage loans retained in portfolio).[25]

The problems with tiered membership and housing asset level tests are that they penalize credit unions that may not fit into the types of tiering criteria being discussed[26] or cannot hold a sufficient level of mortgage loans in portfolio.[27] Moreover, the proposed nexus tests may prescribe activities that run counter to what credit unions have found to be successful in helping their members achieve their homeownership goals. Consequently, we urge FHFA to refrain from implementing any kind

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[20] *Ibid.*
[21] Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998).
[22] Letter from CUNA to The Honorable Sandra L. Thompson, Director, FHFA (Mar. 31, 2023) at 3-5, https://www.cuna.org/content/dam/cuna/advocacy/letters-and-testimonials/2023/FHFA33123.pdf.
[23] FHFA Director Sandra. L. Thompson, Keynote Fireside Chat, Forum on the Future of the Federal Home Loan Bank System, Washington, DC (Feb. 10, 2023), https://www.brookings.edu/events/forum-on-the-future-of-the-federal-home-loan-bank-system/.
[24] *See* Letter from Sullivan to Thompson, *supra* note 23, at 4 (discussing tiered membership).
[25] *See ibid.* (discussing possible housing asset level test).
[26] *See* Letter from Jesse Van Tol, Nat'l Cmty. Inv. Coal., to The Honorable Sandra L. Thompson, Director, FHFA (Oct. 31, 2022), https://ncrc.org/ncrc-calls-for-reforms-to-federal-home-loan-bank-system/ (suggesting tiering of advances based on Community Reinvestment Act ratings, an act that does not apply to credit unions).
[27] See Letter from CUNA to Thompson, supra note 23, at 4 (discussing housing asset level test).

of nexus test that might adversely impact the comprehensive approach to supporting homeownership and community development that works for credit unions and their members.

Tangible Capital Advance Requirement—12 C.F.R. § 1266.4(b)

The regulatory requirement to review a credit union's tangible capital in assessing creditworthiness before making new advances is outdated, does not accurately reflect creditworthiness, and should be revised. The limitations on access to FHLBank advances prohibit making new advances to an FHLBank member with negative tangible capital unless the member's federal banking agency or insurer expressly requests in writing that the FHLBank make such an advance.[28] The definition of tangible capital under the regulation, however, "is out of step with the regulatory capital regimes established by NCUA and the other banking regulators."[29] In addition to the misalignment of the definition of tangible capital and the regulatory capital regimes governing credit unions and banks, the current economic climate (i.e., rising rate environment combined with pandemic-related effects on the housing market and credit union balance sheets) makes it more likely that a credit union or another financial institution will have negative tangible capital even if there is sufficient regulatory capital on hand.[30] These two factors suggest that tangible capital may not be an accurate measurement of creditworthiness in determining whether to make a new advance to an FHLBank member, especially because "[t]he FHLBanks already engage in a rigorous credit review process and credit unions are highly regulated and frequently examined by a prudential regulator."[31]

Therefore, we recommend that FHFA waive the tangible capital requirement before making a new advance, or alternatively amend the tangible capital requirement to align with the regulatory capital requirements implemented by the NCUA and the other banking agencies. This can help ensure that creditworthy credit unions and other financial institutions continue to have access to FHLBank advances to serve the housing needs of their communities.

Conclusion

Thank you for this opportunity to provide input on the Notice of Regulatory Review. If you have questions or if we can be of any assistance, please do not hesitate to contact me at (202) 603-1985 or dpark@cuna.coop.

Sincerely,

David Park

David Park
Senior Director of Advocacy & Counsel

[28] 12 C.F.R.§ 1266.4(b)(1).
[29] Letter from CUNA to Thompson, *supra* note 14, at 10.
[30] *Ibid.*
[31] *Ibid.*