STATEMENT

OF

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"SUBPRIME AND PREDATORY LENDING: NEW REGULATORY GUIDANCE, CURRENT MARKET CONDITIONS, AND EFFECTS ON REGULATED FINANCIAL INSTITUTIONS"

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
U.S. HOUSE OF REPRESENTATIVES

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I. Introduction

NCUA's primary mission is to ensure the safety and soundness of federally insured credit unions. It performs this important public function by examining all federal credit unions, participating in the supervision of federally insured state chartered credit unions in coordination with state regulators, and insuring credit union members' accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund, NCUA provides oversight and supervision to approximately 8,362 federally insured credit unions, representing 98% of all credit unions and approximately 87 million members. [1]

Federally insured credit unions' holdings of mortgage loans represent a relatively small part of the overall mortgage market. Mortgage lending in federally insured credit unions is mostly comprised of traditional fixed rate mortgages where the risk of payment shock or negative amortization is minimal. However, some federally insured credit unions offer nontraditional mortgage products and loans to subprime borrowers as a means of reaching out to disadvantaged and lower income individuals.[2] NCUA supports these outreach efforts when they are part of a planned, controlled, risk based lending program. In guidance issued to all federally insured credit unions, NCUA supports risk based lending programs as a tool to reach out to all credit union members, where the programs are measured and meet supervisory expectations. NCUA has outlined safe and sound lending practices for federally insured credit unions offering loans to borrowers who access subprime products in order to obtain credit through risk based lending programs.

NCUA carefully monitors mortgage performance indicators in federally insured credit unions to gauge the effectiveness of underwriting and collection activity. To date, federally insured credit unions have not experienced an unsound level of mortgage loan delinquency, net charge-offs, or foreclosures. Through examination, NCUA ensures federally insured credit unions have adequate collection policies and procedures in place. To the extent federally insured credit unions face increasing mortgage defaults, NCUA expects they will follow normal collection policies and procedures in working with members to return them to a current payment status where possible.

[1] Approximately 174 state chartered credit unions are privately insured and are not subject to NCUA oversight.

[2] NCUA defines subprime borrowers as those who have weak credit histories (e.g., delinquent payments, charge-offs, judgments, bankruptcies), or reduced payment capacity (e.g., high debt ratios or low credit scores). The same definition was used by the other federal financial institution regulatory agencies in 2001 guidance entitled *Interagency Guidance on Subprime Lending: Expanded Guidance for Subprime Lending Programs.*

II. Mortgage Lending in Federally Insured Credit Unions

Mortgage loans in federally insured credit unions represent only 9% of mortgage loans outstanding in all federally insured depository institutions.[3] In 2006, the Mortgage Bankers Association estimated mortgage loan originations in the marketplace of over $2.51 trillion, of which federally insured credit unions originated only 2% or $54 billion.[4]

Approximately 68% of federally insured credit unions offer mortgage loans to their members. Those not offering mortgage loans are generally smaller federally insured credit unions that cannot afford the expertise or infrastructure required to manage significant mortgage portfolios. Additionally, smaller federal credit unions have difficulty implementing a wide range of mortgage products since loans to a single member are statutorily limited to 10% of a federal credit union's total unimpaired capital and surplus.[5] Consequently, as illustrated below, the majority of federally insured credit union mortgage lending occurs in larger credit unions.

Federally Insured Credit Unions by Asset Size	Number of Mortgage Loans Originated in 2006	% of Federally Insured Credit Union Mortgage Loan Portfolio as of 12/31/2006
Greater than $1 billion	509,936	43.02%
$500 million-$1 billion	255,009	17.75%
$50 million-$500 million	560,061	33.03%
$10 million-$50 million	100,546	5.71%
Less than $10 million	9,321	0.49%

<u>Fixed Rate Mortgages in Federally Insured Credit Unions</u>

Totaling $149 billion, traditional fixed rate mortgage loans comprise 61% of federally insured credit union mortgage loans outstanding. Fixed rate mortgage loans accounted for 80% of the increase in mortgage loans in 2006. Of first-lien mortgage loans, 57% are traditional fixed rate mortgage loans.[6] Fixed rate mortgages in federally insured credit unions grew at a rate of almost 16% in 2006, with most fixed rate growth in longer term products. This is likely indicative

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[3] NCUA data and *FDIC- Statistics on Depository Institutions Report, 1-4 Family Residential Net Loans and Leases for all depository insured institutions as of 12/31/2006.* 31 Dec. 2006. Federal Deposit Insurance Corporation. < http://www2.fdic.gov/SDI/SOB>.

[4] NCUA Data and *MBA Mortgage Finance Forecast.* 12 Feb. 2007. Mortgage Bankers Association. <http://www.mbaa.org/files/Bulletin/InternalResource/48425_MortgageFinanceMarketForecast-February2007.pdf>.

[5] 12 C.F.R. 701.21(c)(5). Unimpaired capital and surplus equals shares plus post-closing, undivided earnings.

[6] First-lien mortgage loans are loans in which credit unions hold first lien position on the collateral securing the mortgage.

of credit union members refinancing adjustable rate mortgage loans into fixed rate loans as interest rates rise.

Adjustable Rate Mortgages in Federally Insured Credit Unions

Adjustable rate mortgage loans comprise about 39% of all federally insured credit union mortgage loans, and accounted for 20% of the increase in mortgage loans in 2006. While this growth rate is significant, it is down from a 42% increase over this same time period in 2005. In all, adjustable rate mortgage loans grew at a rate of 6%, or less than half the growth of fixed rate mortgage loans in 2006. This indicates federally insured credit union members are refinancing into more fixed rate products in a rising interest rate environment. As of December 31, 2006, adjustable rate first mortgage loans totaled $68.8 billion or about 28% of all federally insured credit union mortgage loans outstanding.

Nontraditional Mortgage Lending in Federally Insured Credit Unions

Nontraditional mortgage products, such as "interest-only" or "payment option" adjustable rate mortgage loans, are also offered in some federally insured credit unions and comprise a smaller subset of adjustable rate mortgage loans. Due to the evolving nature of mortgage loan products, NCUA has not previously collected specific information about the various types of adjustable rate mortgage loans beyond information about their maturities. Given the growth in popularity of nontraditional mortgage products (often referred to as "exotic," "hybrid," or "alternative" mortgage products), NCUA's 5300 Call Report has now been amended to specifically collect data on certain nontraditional mortgage loans. Results will become available after the March 2007 reporting cycle. [7]

In February, the House Committee on Financial Services sent a letter to NCUA and other federal regulators expressing concern about underwriting and consumer disclosure for certain Hybrid Adjustable Rate Mortgages (Hybrid ARMs), including "2-28" and "3-27" adjustable rate mortgages. These loans often have certain features that can present added risks to borrowers and financial institutions if not underwritten properly. NCUA shares the Committee's concern about riskier Hybrid ARMs having features that may be detrimental to consumers, and more particularly, to subprime borrowers.[8]

Current data indicates federally insured credit unions are not heavily involved in Hybrid ARM mortgage lending. As of December 31, 2006, all of the Hybrid ARM products in federally insured credit unions comprised less than 17% of federally insured credit union mortgage loans outstanding. The pool of loans, in which "2-

[7] NCUA's 5300 Call Report is the data collection tool used to collect required financial statement reports from federally insured credit unions on a quarterly basis.
[8] NCUA alerted its examiners and the credit union industry to the increasing risks in mortgage lending in 2005 with a supervisory alert and letter to credit unions. In 2006, NCUA provided nontraditional mortgage information to its specialized lending subject matter examiners in regional conferences during training sessions.

28" and "3-27" ARMs are reported on NCUA's 5300 Call Report, also contains other more traditional short term Hybrid ARMs, such as "3-1" and "5-1" ARMs. "3-1" and "5-1" ARMs may have less frequent interest rate adjustments and better terms since they are more typically marketed to prime borrowers than are "2-28s" or "3-27s." Federally insured credit unions have offered "3-1" and "5-1" ARMs for many years, whereas "2-28" and "3-27" ARMs have only more recently gained popularity in the mortgage market. For these reasons, it is unlikely that riskier Hybrid ARMs such as "2-28s" and "3-27s," comprise a material portion of all Hybrid ARMs held by federally insured credit unions.

There are several reasons why these riskier Hybrid ARMs are not prevalent in federally insured credit unions. As earlier addressed, many federally insured credit unions are smaller institutions that lack the sophistication or resources to underwrite these types of loans. Second, and very importantly, the Federal Credit Union Act prohibits prepayment penalties and establishes a statutory limit for interest rates not to exceed 18%.[9] Because of these statutory provisions, the regulatory environment for federal credit unions is not conducive to some of the features that make the cost of underwriting these loans more tenable to other types of institutions. For example, some institutions effectively lock subprime borrowers into upward payment adjustments and higher interest rates by charging prepayment penalties if the borrower wishes to refinance the loan.

Mortgage Loan Performance In Federally Insured Credit Unions

Demand for mortgage loans in federally insured credit unions remains high. Mortgage loans led all loan types in growth in 2006, increasing $25.61 billion (71% of all new loan growth) to a new high of 49% of total loans. NCUA continues to closely watch performance indicators in the mortgage lending area through data collection and the examination and supervision process.

NCUA's most current call report data indicates mortgage loan delinquencies greater than 30 days increased in 2006, moving upwards from 0.79% to 0.99%. Mortgage loan delinquencies over 60 days were at only 0.34% of total mortgage loans. While mortgage loan delinquencies in federally insured credit unions have increased overall over the last five years, the level of delinquency has remained sound and relatively consistent, as demonstrated in the following table:

Mortgage Loan Delinquency and Net Charge-Offs In Federally Insured Credit Unions					
Year Ending:	**2002**	**2003**	**2004**	**2005**	**2006**
Delinquency >30 days	0.91%	0.83%	0.77%	0.79%	0.99%
Delinquency >60 days	0.30%	0.28%	0.25%	0.27%	0.34%
Net Charge-Offs/Average Mortgage Loans	0.02%	0.02%	0.02%	0.02%	0.03%

[9] 12 U.S.C. §§1757(5)(A)(vi) and 1757(5)(A)(vii)

As also shown in the table above, while mortgage loan charge-offs increased in 2006, the ratio of net mortgage loan charge-offs to average mortgage loans totaled only 0.03%. Federally insured credit union mortgage loans in foreclosure have increased over the last three quarters from $136 million to $165 million, or by approximately 20%. Still, mortgage loans in foreclosure represented only 0.07% of total mortgage loans outstanding at year-end. While these trends merit continued observation, the above mentioned mortgage loan performance ratios are not alarming.

III. NCUA's Ongoing Efforts to Promote Sound Risk Based Lending

Subprime lending and nontraditional mortgage programs provide access to credit for some members that would not be available in traditional lending programs. In that regard, NCUA fully supports sound loan programs designed to reach out to disadvantaged or subprime credit union members for the mutual benefit of all involved.

Alternative loan products, known as "credit builder," "subprime," "people helping people," and "micro" loans all represent market-driven, practical attempts at providing consumer alternatives. Importantly, federally insured credit unions have utilized subprime lending as a vehicle to reach out to disadvantaged members, providing access to credit to a subset of borrowers who might not otherwise qualify. NCUA has previously issued guidance supporting subprime lending when part of a safe and sound risk based lending program.[10]

<u>NCUA Guidance</u>

Through several issuances of guidance, NCUA has outlined risk based lending concepts. Although mortgage lending is not specifically addressed in these issuances, these concepts are still applicable. NCUA periodically issues guidance to federally insured credit unions through Letters to Credit Unions. Examiners routinely discuss the guidance set forth in these letters with credit union management and evaluate their responses through the examination and supervision function.

Recognizing the emergence of risk based lending efforts in the credit union industry, in 1995, NCUA issued Letter to Credit Unions 174 to all federally insured credit unions discussing the potential advantages and disadvantages to federally insured credit unions of risk based lending programs, or programs

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[10] Risk based lending is a means by which a credit union may be able to more effectively meet the credit needs of all its members. It involves setting a tiered pricing structure that assigns loan rates based upon an individual's credit risk. The precepts of risk based lending are more fully discussed in NCUA Letters to Credit Unions 174, *Risk Based Loans* and 99-CU-05, *Risk Based Lending.*

where subprime credit could be offered. Risk based lending involves setting a tiered pricing structure that assigns loan rates based upon an individual's credit risk. A tiered pricing structure enables federally insured credit unions to make more loans to disadvantaged, lower income, or credit-challenged individuals. Through a carefully planned risk-based lending program, federally insured credit unions can make loans to somewhat higher-risk borrowers, as well as better serve their lower-risk members.

Letter to Credit Unions 174 stated that "[c]redit unions should engage in risk-based lending, not as a means of re-pricing existing balance sheets, but as a tool to reach out to the underserved..." and also noted that "[s]afety and soundness should remain of paramount importance...." Attached to Letter to Credit Unions 174 was an informational whitepaper discussing safety and soundness considerations and stressing the importance of consumer compliance issues related to risk based lending. Specifically, the whitepaper discussed the necessity of planning, policies, procedures, portfolio limitations and monitoring, and effective pricing. Additionally, the whitepaper reminded federally insured credit unions of their obligations under the Equal Credit Opportunity Act, Fair Housing Act, and the Fair Credit Reporting Act. Finally, the whitepaper outlined the examination procedures NCUA would use to review these programs.

In 1999, NCUA issued Letter to Credit Unions 99-CU-05 to all federally insured credit unions restating that soundly managed risk based lending programs were a way to reach out to all members. In Letter to Credit Unions 99-CU-05, NCUA noted that those receiving the largest benefit from risk based lending programs would be individuals attempting to repair or establish credit, but reiterated the need for sound planning, underwriting, monitoring, and control. Additionally, Letter to Credit Unions 99-CU-05 noted that a federally insured credit union's capital adequacy would be evaluated considering the volume and type of risk based lending pursued and the adequacy of the credit union's risk management program. Lastly, Letter to Credit Unions 99-CU-05 provided federally insured credit unions with more information about NCUA's expectations for risk based lending program planning, loan policies, and procedures.

In 2004, NCUA issued Letter to Credit Unions 04-CU-13 to all federally insured credit unions discussing NCUA's supervisory expectations for controls over several types of specialized lending, including subprime lending.
Subprime lending involves higher levels of risk and requires greater skill to successfully implement. Properly managed, however, it can be a viable and safe component of a federally insured credit union's balance sheet. A well-managed subprime program enables federally insured credit unions to serve disadvantaged members. Sound underwriting practices, effective control and monitoring systems and sufficient capital levels are key components to a well-managed program. All of these aspects are more fully elaborated in NCUA's guidance on this topic.

Letter to Credit Unions 04-CU-13 outlined NCUA's underwriting expectations for federally insured credit unions engaged in subprime lending, noting the need to focus on borrowers' ability to repay loans as structured. A questionnaire on Subprime Lending Controls was also introduced to federally insured credit unions as an attachment to Letter to Credit Unions 04-CU-13. This questionnaire is currently used as part of the evaluation of risk based lending and subprime lending programs in federally insured credit unions with loan portfolios containing significant amounts of subprime loans.

In 2005, NCUA specifically addressed emerging risks in mortgage lending and concerns about alternative or exotic mortgage products in the overall mortgage market when a Supervisory Alert was issued to its examiners. The alert focused on the evolution of products in the mortgage market, the unusual volume of originations of variable rate mortgage products in a low interest rate environment, and the market trend toward liberalization of underwriting standards. The alert outlined potential issues with "interest-only," "payment-option," and "hybrid" adjustable rate mortgages with illustrations of payment shock for each of the products discussed.

The above referenced Supervisory Alert was then issued to federally insured credit unions in October 2005 with Letter to Credit Unions 05-CU-15 which also addressed the use of alternative or exotic mortgage products to afford housing in areas of high housing value appreciation. Additionally, Letter to Credit Unions 05-CU-15 notified federally insured credit unions that "NCUA field staff will be monitoring these trends and will evaluate not only interest rate risk related to mortgage lending but also the increased credit risk associated with these newer mortgage products and more liberal underwriting standards."

In 2006, NCUA issued Nontraditional Mortgage Guidance and began work on Proposed Subprime Lending Guidance, both in tandem with other regulators. While nontraditional and subprime mortgage lending are not major components of federally insured credit union mortgage portfolios, NCUA is concerned that predatory and unsound lending in other areas of the marketplace may increase consumers' monthly debt burdens significantly, resulting in a "ripple effect" that would not only impact credit union members but also federally insured credit union asset quality. If credit union members begin to experience difficulty making payments on homes they have financed elsewhere, loan accounts at their federally insured credit unions will also be impacted. NCUA continues to work with other regulators to finalize proposed consumer illustrations that outline ways to clearly disclose the risks of Nontraditional Mortgage products.

The Interagency Nontraditional Mortgage Guidance was drafted to address loan products with the risks of both payment shock and/or negative amortization. Since fully amortizing loans do not pose a risk of negative amortization, they were not initially included in the guidance. More recently, NCUA participated with the other FFIEC agencies in proposing interagency guidance on Subprime Mortgage Lending bridging the gap between these loan types, and other fully amortizing Hybrid ARMs such as "2-28" and "3-27" adjustable rate mortgages. It would ensure the issue of payment shock is addressed through appropriate underwriting in these loans, which are most commonly offered to subprime borrowers. The proposed guidance also requests comments regarding whether applying a more stringent underwriting standard to other ARMs would stifle the market or reduce the availability of credit. NCUA will continue to work with the other FFIEC agencies to address this issue through Interagency Guidance and internal implementation.

Consumer Protection for Credit Union Mortgage Applicants

Credit unions must comply with the same mortgage specific federal regulations as other federally insured institutions, including: Truth in Lending (Regulation Z), the Real Estate Settlement Procedures Act (RESPA), the Home Owner's Equity Protection Act (HOEPA), the Flood Disaster Preparedness Act (FDPA), the Fair Housing Act (FHA), and the Home Mortgage Disclosure Act (HMDA).[11] NCUA's examiners review compliance with applicable laws and regulations in the normal course of the examination and supervision process.

As the enforcement authority for HMDA in credit unions, NCUA is responsible for the oversight of HMDA data collection.[12] For the 2005 reporting period, approximately 2,300 institutions overseen by NCUA for the purpose of HMDA reporting submitted loan/application register data. The respondents included federally insured credit unions, non-federally insured credit unions, and credit union service organizations. Combined, the NCUA respondents submitted data for 813,783 loan applications.

Based on the HMDA data collected, credit unions appear to be actively meeting the need for mortgage products among credit union applicants for mortgage credit. Reporting credit unions approved an overwhelming majority of the applications processed during the 2005 reporting period. Approximately 69% of all applications resulted in a loan origination. Moreover, the reporting credit unions denied fewer than 13% of all applications. Of the total applications processed, 11.90% resulted in a denial of credit and 1.06% resulted in a denial of a request for pre-approval of credit.

Credit unions are also serving underserved areas with mortgage products. When credit unions complete the loan/application registers, they identify the location of the properties under consideration by census tract. The HMDA data compares the income levels of the census tracts of the properties under consideration to the income levels of the larger metropolitan statistical areas (MSA) that encompass the properties. NCUA uses a similar methodology when determining, for the purposes of chartering policy, if an area qualifies as underserved. An area with a median family income level at or below 80% of the median family income for the larger metropolitan statistical area is underserved.

[11] These laws also apply to privately insured credit unions.
[12] NCUA is responsible for HMDA data collection for federally insured and privately insured credit unions.

Census tract income information was available for approximately 90% of the mortgage loan applications reported. For underserved areas, 66% of mortgage loan applications the credit unions processed resulted in originations, with fewer than 18% of the mortgage loan applications that included property in underserved areas denied. The approval rate in areas for mortgage loans in non-underserved census tracks was 75%, with only approximately 10% denied.

During 2005, reporting credit unions originated over 72,000 mortgages, with 13.5% of those originations occurring in underserved areas. The median family income reported by the applicants who received mortgages in underserved areas was $55,000. [13] In contrast, the median family income for applicants who received mortgages in areas that did not qualify as underserved was much higher at $72,000.

IV. NCUA and Federally Insured Credit Union Outreach

The NCUA and the credit union industry have historically devoted resources to addressing the homeownership needs of disadvantaged communities. Federally insured credit unions assist members in making the transition to homeownership by providing affordable loans and financial homebuyer education. NCUA has implemented several programs to encourage federally insured credit unions to expand homeownership opportunities and provide financial education to members.

A 2005 study by the Annie E. Casey Foundation indicated that the single most important step that could be taken to strengthen home ownership opportunities and retention among very low-income families is to expand and improve the delivery of financial literacy education and homeownership education and counseling. [14] In addition, the study states that the sharp growth of subprime lending in recent years appears to have increased the need for homeownership education while simultaneously making it more difficult for homeownership education groups to reach clients.

NCUA is a member of the Financial Literacy and Education Commission (the Commission), a federal entity established under the Financial Literacy and Education Improvement Act, enacted by Title V of the Fair and Accurate Credit

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[13] Median family income reflects the income level at which half of all families earn more, and half earn less. The American Community Survey defines a family as "a householder and one or more people living in the same household who are related by birth, marriage, or adoption." See *American Community Survey.* U.S. Census Bureau. <http://factfinder.census.gov /home/saff/main. html?_lang=en>.

[14] "Strengthening the Ladder for Sustainable Homeownership," prepared by the National Housing Conference for the Annie E. Casey Foundation, February 2005, page 18. The Foundation was established in 1948. The Foundation's stated mission is to foster public policies, human service reforms, and community supports that more effectively meet the needs of today's vulnerable children and families.

Transactions Act of 2003, to improve financial literacy and education of persons in the United States.

The principal duties of the Commission include: (1) encouraging government and private sector efforts to promote financial literacy; (2) coordinating financial education efforts of the federal government, including the identification and promotion of best practices; (3) the development of a national strategy to promote financial literacy and education among all American consumers; (4) the establishment of a website to serve as a clearinghouse and provide a coordinated point of entry for information about federal financial literacy and education programs, grants, and other information; and (5) the establishment of a toll-free hotline available to members of the public seeking information about issues pertaining to financial literacy and education.

In addition to serving as a member of the Commission, NCUA Chairman Johnson has served as Chairman of its MyMoney.gov website subcommittee since October 2006. The MyMoney.gov web site was created to provide public access to financial education tools and resources, which will empower Americans to save, invest and manage money wisely to meet personal goals. In this role, the Chairman coordinates the efforts of twenty federal agencies to improve financial education across the nation.

The Access Across America initiative, announced in February 2002, incorporated the Agency's activities for federally insured credit unions expanding services into underserved areas. The program has been designed to partner with federal government agencies and other organizations to identify and facilitate the use of resources available for federally insured credit unions to assist in their efforts to serve individuals in underserved areas.

As an adjunct to the Access Across America initiative, the Partnering and Leadership Successes (PALS) program was introduced in 2003 to provide best practices in serving members and marketing to potential members in underserved areas and communities. The agency coordinated widely attended workshops where a mix of federally insured credit unions presented programs focused on serving those in the lower economic strata. These programs included partnering opportunities with the Neighborhood Reinvestment Corporation, Latino outreach, and micro-business lending opportunities with the Small Business Administration. NeighborWorks® America is a national nonprofit organization created by Congress to provide financial support, technical assistance, and training for community-based revitalization efforts. There are 22 credit unions participating on NeighborWorks® Boards and Committees.[15] NCUA has incorporated the most successful aspects of PALs into the Access Across America programs and plans to continue to offer these valuable efforts in the future.

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[15] "Credit Union Partnerships With NeighborWorks Organizations: Proven Models for Success" booklet released jointly by NCUA and the National Reinvestment Corporation in 2002.

NCUA's Office of Small Credit Union Initiatives (OSCUI) conducts regional and national training workshops on a variety of topics to help small and low income designated credit unions (LICUs) succeed.[16] For example, in 2006, OSCUI held 20 national workshops covering subjects such as establishing financial literacy programs. Approximately 1,900 federally insured credit union representatives from 1,060 federally insured credit unions attended these workshops. NCUA plans to host another twenty workshops for 2007. Marketing to potential members and developing products designed for low- to moderate-income members will be discussed at this year's workshops.

In addition to the training, NCUA administers the Community Development Revolving Loan Fund (CDRLF) program. The CDRLF is funded through Congressional appropriations and provides financial assistance for federally insured credit unions serving predominantly low-income members. This financial assistance may be in the form of loans or technical assistance grants (TAGs). TAG initiatives are broadly structured so that LICUs may create outreach programs that meet their communities' needs. Although NCUA's grant initiatives do not specifically address foreclosure prevention, several approved TAG initiatives have been for the purpose of wealth building and financial education, which includes lessons about saving and being prepared for unexpected expenses, managing credit, budgeting, and purchasing a home.

Financial education and member outreach programs directly or indirectly prepare credit union members and the community for long-term homeownership, while avoiding foreclosure. NCUA has approved TAGs for federally insured credit unions that focus on this preparation. For example, Syracuse Cooperative Federal Credit Union, recipient of a TAG, offers financial education workshops in two languages addressing homeownership, qualifying for a mortgage, and building credit. The credit union also uses financial advisors who help members avoid foreclosure by providing housing counseling and access to mortgage lenders, realtors, or legal advisors. Another TAG recipient, Shiloh of Alexandria (VA) Federal Credit Union, provides a financial counseling program that addresses debt consolidation and credit awareness. The objective of the program is to provide affordable homeownership options to lower income individuals by providing down-payment and closing cost assistance and below-market interest rates on loans. These important initiatives, as well as loans to offset low-cost mortgage loans for the underserved, continue to receive support from the CDRLF.

Another way federally insured credit unions make mortgage products accessible and affordable to low-income consumers is to partner with government entities that provide assistance. Some federally insured credit unions that are certified by the U.S. Department of the Treasury's Community Development Financial

[16] CDFI award profiles and financial assistance amounts are as of March 8, 2007.

Institutions (CDFI) Fund are recipients of awards.[17] These awards assist in defraying the costs of serving disadvantaged communities. The following are examples of the work performed by CDFI credit unions:

- The People's Community Partnership Federal Credit Union, located in Oakland, California, is a CDFI and an NCUA low-income designated credit union (LICU)[18]. CDFI assisted the credit union by providing funds to support classes on budgeting, banking, credit, and home buying to their predominantly minority membership. NCUA also provided a grant to the credit union to provide free tax return service for some low-income members.

- Latino Community Credit Union (LCCU) is a CDFI and LICU located in Durham, North Carolina. Its mission is to "improve the financial condition of the Hispanic community through the delivery of affordable financial services and financial education programs specifically targeted to underserved Hispanic immigrants in North Carolina."[19] The CDFI Fund has awarded $2 million to cover a portion of the cost to support a new branch, enhance delivery of services, and to implement a home mortgage lending program for new Latino immigrants, who make up over 85 percent of LCCU's membership.

- Self-Help Credit Union is a CDFI and LICU located in Durham, North Carolina. Its mission is directed toward "creating ownership and economic opportunity for minorities, women, rural residents, and low-wealth families." The credit union offers a variety of residential mortgage products and specializes in serving customers who cannot obtain conventional financing due to credit or other problems, and individuals who have traditionally been underserved, including female-headed, minority, and low-income households, rural families, and first-time buyers[20]. The credit union's bilingual financial education workshops include a home buying topic. Self-Help was awarded two grants from the CDFI Fund to help defray the costs of offering homeownership loans and other loan products in its service area.

In addition to a partnership with government entities, credit unions partner with other entities to offer Individual Development Accounts (IDAs). IDAs are savings

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[17] The CDFI Fund provides financial and technical assistance awards in order to promote access to capital and local economic growth in urban and rural low-income communities across the nation. A CDFI is "a specialized financial institution that works in market niches that are underserved by traditional financial institutions" and include regulated institutions such as community development banks and credit unions, and non-regulated institutions such as loan and venture capital funds.
[18] A LICU has a membership consisting of 50 percent or more low-income members.
[19] Credit union mission and product description from Latino Community Credit Union. 8 Mar. 2007.<http://cooperativalatina.org>.
[20] Credit union mission and product description from Self-Help Credit Union. 8 Mar. 2007. <http://www.self-help.org>.

accounts designed to assist low-income people on their path toward asset ownership through matched savings and financial education. Credit unions partner with local organizations to provide IDA programs with different goals.

Examples include:

- Alternatives Federal Credit Union (Alternatives) is a CDFI and LICU located in New York, New York. Its mission is "to build wealth and create economic opportunity for underserved people and communities." Alternatives began offering IDAs in 1998. It partners with local organizations (Challenge Industries, Tompkins Community Action and Department of Social Services) to provide IDA programs, each with different goals, savings matches and eligibility requirements. The CDFI Fund awarded funds to support its affordable housing loan activities. In addition to the partnerships mentioned, the credit union has a partnership with Ithaca Neighborhood Housing Services.[21]

- Fort Campbell Federal Credit Union located in Clarksville, Tennessee, created the Home Front Mortgage Program to help active duty military personnel stationed at Fort Campbell buy houses in Tennessee or Kentucky by eliminating down payments. First-time home buyers attend free homeownership counseling provided by BALANCE, a financial education and counseling service. The counseling can be done at any time as long as it is completed by the time the loan closes.

- O.U.R. Federal Credit Union is a CDFI and LICU located in Eugene, Oregon. The credit union targets its mortgage products and services to low-income micro entrepreneurs, Latino residents, and other Lane County, OR residents. The CDFI Fund awarded multi-year financial assistance that covered a portion of the cost of outreach to the Hispanic residents, a financial education program, affordable loan programs and development of a new mortgage loan program. United Way also assists the credit union in serving low-income persons. The credit union is a HUD-approved housing counseling agency.

- Community Trust Credit Union is a CDFI and LICU located in Modesto, California. Its products and services are directed toward "people who are traditionally underserved by mainstream financial institutions."[22] The credit union partners with many community based organizations that include the California State University, United Way, Hispanic American Society, and Council for the Spanish Speaking, to extend financial services to the underserved. The CDFI Fund has awarded the credit

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[21] "Credit Union Partnerships With NeighborWorks Organizations: Proven Models for Success" booklet released jointly by NCUA and Neighborhood Reinvestment Corporation in 2002.
[22] Credt union mission and product description from Community Trust Credit Union. 8 Mar. 2007. <http://www.myctcu.com>.

union with funds to open a new branch in a “neighboring community with very high levels of poverty and unemployment, in order to provide affordable financial services to currently un-banked individuals”; acquire technology and equipment to serve the community; and improve the delivery of its services.

Non-CDFI, non-LICU, federally insured credit unions also work to provide education and easier access to homeownership for their members. Following are a few examples of how large credit unions work with other entities or utilize their resources to aid with member education and initial down-payments:

- Reliant Federal Credit Union partnered with the State of New York Mortgage Agency (SONYMA) to offer affordable mortgage loans to first-time home buyers. The SONYMA Partnership Program offers low down payment requirements, flexible underwriting requirements, interest rate lock-in periods that are longer than conventional lock-in periods, and closing cost assistance. As part of this program, the member is required to complete a financial education course through a SONYMA approved source.

- Hiway Federal Credit Union, located in St. Paul, Minnesota, provides their members not only with affordable housing, but with sustainable housing by offering loans members can afford under Fannie Mae’s (FNMA) “My Community Program.” The credit union has also partnered with Lutheran Social Services (LSS) which has offices throughout the state to provide instruction on credit scoring and how the members can improve their credit scores. If a member’s mortgage application is denied due to poor credit, the member receives two free counseling sessions with LSS. Members that complete the LSS program may be approved for a mortgage loan.

- Royal Credit Union, located in Eau Claire, Wisconsin, was recognized by the Wisconsin Housing and Economic Development Authority (WHEDA) and is in the top ten in the state for WHEDA loans. In 2006, Royal assisted 166 families participating with WHEDA. The credit union also uses other programs to help their members with home ownership including programs from Federal Home Loan Mortgage Corporation (Home Possible Program) and Veterans Administration programs. The credit union also conducts various home buyer seminars throughout the year to teach members about the steps necessary for home ownership.

- Goldenwest Federal Credit Union, located in Ogden, Utah, is a major participant in the Utah Housing Finance Agency’s first time home buyer mortgage program. Under the program, first time home buyers, single parents, and members who have not owned a home in three years are eligible to participate. The credit union also participates in an “Own in Ogden” program that provides a down payment of up to $6,000 for homes located in low-income areas and in the “Good Neighbor Next Door

Program" which allows firefighters, policemen and school teachers to buy a U.S. Department of Housing and Urban Development foreclosure at 50 percent of value. In 2006, the credit union originated over 67 loans totaling $7.1 million in the programs.

- Navy Federal Credit Union, located in Merrifield, Virginia, focuses on ensuring that their military members are provided financial services throughout the world. On their website, they have a step-by-step process to assist members with determining how much they can afford to borrow. In addition, there is a short video on the website explaining the home buying process. The credit union also provides free mortgage counseling and a variety of mortgage loan products to suit the individual needs of its members, whether they are first-time or experienced home buyers. Additionally, they maintain the servicing of their members throughout the lifetime of the loan. This allows Navy Federal to help its members as they encounter special circumstances.

- Police and Fire Federal Credit Union, located in Philadelphia, Pennsylvania, offers a "lender-assist" mortgage which is designed for members with a minimal or no down-payment. This mortgage product provides members assistance of one percent of the loan amount to be applied toward closing costs. Additionally, the credit union has partnered with the Consumer Credit Counseling Service of Delaware Valley to provide members with access to free confidential credit counseling and debt management planning.

- Redstone Federal Credit Union, located in Huntsville, Alabama, offers first time home buyers the opportunity to obtain a grant from the Federal Home Loan Bank of Atlanta for down payment and closing assistance. The credit union offers real estate loans with a loan-to-value ratio of up to 100 percent utilizing programs sponsored by FNMA and USDA. Redstone FCU participates in the North Alabama Individual Development Account Program sponsored by Family Services and Department of Health and Human Services for low income families that are not immediately ready for homeownership, including many with past credit problems or first time homebuyers. This program allows families to save for a down payment with matching funds up to $6,000. The credit union provides financial counseling services for all homeownership loans.

- ESL Federal Credit Union, located in Rochester, New York, offers a "No-Down Mortgage Loan" and a "Low-Down Mortgage Loan" which finances up to 97 percent of the purchase price and a "Neighborhood Solution" loan with no down payment or low-down payment options. Additionally, the credit union offers a "No Closing Cost Mortgage" program which allows financing up to 95 percent on fixed or adjustable rate loans.

V. Consequences of Subprime Mortgage Market Dislocation for Federally Insured Credit Unions

While certain segments of the broader mortgage market have experienced record levels of mortgage foreclosures, federally insured credit union foreclosure rates remain relatively low. As of December 31, 2006, the national 30 day mortgage delinquency rate on 1-to-4 family residential properties was 4.95% of all outstanding mortgage loans and 1.19% of outstanding mortgages were in the foreclosure process.[23] Conversely, federally insured credit union mortgage delinquencies over 30 days totaled only 0.99% of all federally insured credit union mortgages and only 0.07% of outstanding federally insured credit union mortgages were in the foreclosure process.

Federally insured credit union mortgages are performing well in relation to the broader mortgage market, but NCUA is concerned about the "ripple effect" of the dislocation to the subprime mortgage market on federally insured credit unions and credit union members. As the number of consumers experiencing difficulty with housing payments increases, federally insured credit unions may be adversely impacted by rising delinquencies in both second mortgage loans and other consumer credit delinquencies.

At the end of 2006, asset quality in federally insured credit unions was at the best year-end level in six years. Overall delinquency improved from a high of 0.82% in 2001 to 0.68% of loans, while the net charge-off to average loans ratio improved from a high of 0.56% in 2003 to 0.45%. Meanwhile, federally insured credit unions' net worth to assets ratio grew to 11.54%, its highest level in six years. With federally insured credit unions exhibiting strong and improving asset quality, sound levels of net worth, and relatively limited involvement with subprime mortgages, NCUA is cautiously optimistic about federally insured credit unions' positioning with regard to the current subprime mortgage market dislocation.

VI. Conclusion

Federally insured credit unions originate and retain a relatively small amount of nontraditional or subprime mortgages. Federally insured credit union mortgage lending makes up only a small part of the overall mortgage market, and is predominantly comprised of more traditional fixed rate mortgages. Some federally insured credit unions offer nontraditional mortgage products or risk based lending programs as a means of reaching underserved members who otherwise would not qualify for loans. NCUA has outlined safe and sound

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[23] According to the Mortgage Banker's Association's (MBA) *National Delinquency Survey* issued 3/13/07 with data as of 12/31/2006. The MBA's *National Delinquency Survey* is based on a sample of over 43 million mortgage loans serviced by mortgage companies, commercial banks, thrifts, and credit unions. Typically, federally insured depository institutions have lower delinquency rates than the overall national 30 day delinquency average.

lending practices for these types of loan programs and carefully monitors mortgage lending performance indicators in individual federally insured credit unions and the industry. Current federally insured credit union mortgage performance is indicative of sound underwriting and appropriate collection efforts in federally insured credit unions. To date, NCUA has not noted an unsound level of mortgage loan delinquency, net charge-offs, or foreclosures in federally insured credit unions. Through its examination process, NCUA ensures federally insured credit unions have collection policies and procedures in place to deal with any increase in foreclosures and work with members to return them to a current status where possible.

NCUA continues to support the recent Interagency Guidance on Nontraditional Mortgage Products, and views it as a key step in addressing the general weakening of underwriting standards in the overall mortgage market. While, in NCUA's assessment, nontraditional mortgage products are not prevalent in federally insured credit unions, the guidance sets forth best practices and information valuable to credit unions that may offer these products. NCUA also recognizes the possibility that federally insured credit unions and their members could also be negatively affected by nontraditional mortgage loans granted outside of federally insured credit unions in the broader mortgage market. To that end, NCUA has an interest in ensuring these loans are prudently underwritten and clearly understood by borrowers wherever they are offered.

NCUA also supports the recently proposed Interagency Guidance on Subprime Mortgage Lending. While subprime lending in federally insured credit unions is normally part of a broader risk based lending program, the underwriting standards proposed by the guidance are prudent and consistent with the message NCUA has been conveying to federally insured credit unions for years. Loans to subprime borrowers must be underwritten prudently and should not be granted to the borrower's detriment. It is critical that subprime mortgage borrowers be given timely information to ensure they understand the risks involved with the products they select. NCUA will work with the other agencies to finalize this important guidance as soon as possible.

Attachments

I. NCUA Letter to Credit Unions 174

II. NCUA Letter to Credit Unions 99-CU-05

III. NCUA Letter to Credit Unions 04-CU-13
with attached Subprime Questionnaire

IV. NCUA Letter to Credit Unions 05-CU-15
with attached 10-06 Supervisory Alert

V. NCUA Letter to Credit Unions 06-CU-16