National Association of Federal Credit Unions

Testimony of

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On Behalf of

The National Association of Federal Credit Unions

"How Prospective and Current Homeowners Will Be Harmed by the CFPB's Qualified Mortgage Rule"

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Introduction

Good morning, Chairman Capito, Ranking Member Meeks and Members of the Subcommittee. My name is Daniel Weickenand and I am testifying this afternoon on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the CEO of Orion Federal Credit Union headquartered in Memphis, Tennessee. Founded in 1957 as Memphis Area Teachers' Credit Union, Orion FCU has grown to become the largest credit union in western Tennessee, with over 50,000 members, and over $530 million in assets. To better serve our field of membership, in August 2012, Orion was granted low-income designation from the National Credit Union Administration (NCUA), as about one-third of Memphis residents live below the poverty line.

Prior to being named CEO of Orion FCU, I served as the Chief Financial Officer of FEDEX Employees Credit Association for over nine years after beginning my career as a financial institution auditor. I am proud of Orion's growth and our dedication to offering a full spectrum of financial services from checking and savings accounts, to auto loans and mortgages.

In 2013, I was elected as a Director-at-Large to NAFCU's Board of Directors. In this role, I help drive the trade association's agenda. As you know, NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. I also serve on NAFCU's Regulatory and National Share Insurance Committees. NAFCU member credit unions collectively account for approximately 68 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to discuss the Consumer Financial Protection Bureau's (CFPB) 'ability-to-repay' rule and the impact the Qualified Mortgage (QM) standard will have on credit union lending and the 97 million credit union members across the country. As members of the subcommittee are aware, the QM standard is only one piece of a complicated set of mortgage rules that had a compliance deadline of last Friday.

Historically, credit unions have served a unique function in the delivery of essential financial services to American consumers. Established by an Act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom may otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need – a niche that credit unions still fill today.

Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 80 years have passed since the Federal Credit Union Act (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain wholly committed to providing their members with efficient, low-cost, personal financial service; and,

- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 6,600 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. Furthermore, unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the Credit Union Membership Access Act (CUMAA – P.L. 105-219). In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means … [and it] continue[s] to fulfill this public purpose."

Credit unions have always been some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital. Furthermore, there are many consumer protections already built into the Federal Credit Union Act, such as the only federal usury ceiling on financial institutions and the prohibition on prepayment penalties that other institutions have often used to bait and trap consumers into high cost products.

Despite the fact that credit unions were not the cause of the financial crisis, they are still firmly within the regulatory reach of several provisions contained in the Dodd-Frank Act, including all rules promulgated by the Consumer Financial Protection Bureau (CFPB). The breadth and pace of CFPB rulemaking is troublesome as the unprecedented new compliance burden placed on credit unions has been immense. Many credit unions have had to add compliance staff and increase the workload on compliance officers just to keep up. Unfortunately, this takes away from resources that they could be dedicating to their members in services and loans. This is what NAFCU warned of during the financial reform debate and one of the reasons why we were the only trade association that opposed the CFPB having authority over credit unions.

The impact of this growing compliance burden is evident as the number of credit unions continues to decline, dropping by more than 900 institutions since 2009. While there are a number of reasons for this decline, a main one is the increasing cost and complexity of complying with the ever-increasing onslaught of regulations. Credit unions didn't cause the financial crisis and shouldn't be caught in the crosshairs of regulations aimed at those

entities that did. Unfortunately, that has not been the case thus far. As we are hearing from many of our credit union members, "enough is enough" when it comes to the tidal wave of new regulations.

As evidenced by today's hearing, the subcommittee has clear concerns about the breadth and pace of rulemaking stemming from the Dodd-Frank Act and what impact such rules will have on the mortgage origination process. Given the correlation between the health of the housing sector and the overall economy, we appreciate the subcommittee's well placed focus.

The CFPB's Ability-to-Repay / Qualified Mortgage Rule

NAFCU generally supports efforts to ensure that consumers are not placed into mortgages they cannot afford. This was the long-standing practice of credit unions before the financial crisis and continues to be the case post-crisis. Accordingly, NAFCU and its member credit unions have taken advantage of every possible avenue to educate the new Consumer Financial Protection Bureau about the unique nature of credit unions. While we have a positive relationship with the CFPB, and have weighed in on this issue repeatedly, we maintain concerns about the Qualified Mortgage (QM) standard that has been developed. We are concerned that this rule will potentially reduce access to credit and hamper the ability of credit unions to continue to meet their member's needs. As you know, the compliance deadline for the ability-to-repay rule outlining the QM standard just passed on Friday, January 10, 2014.

Under the new ability-to-pay rule, lenders must review eight key underwriting criteria and verify that borrowers have the income or assets that lead to a reasonable belief that the borrower can afford to repay the mortgage. Credit unions have long had strong underwriting standards, as was demonstrated by the quality of their loans during the financial crisis. Still, failure to follow the specific ability-to-repay rule can be costly for the lender as they may have to refund proceeds paid by the borrower and could lose the

ability to foreclose on the property if the loan goes into default. Loans that meet the QM standards are deemed to meet the ability-to-repay requirements.

In addition to underwriting criteria to verify a reasonable expectation of repayment, there are several basic criteria that most credit union loans must generally meet to be deemed a Qualified Mortgage:

- No negative amortization and interest-only payments;
- No balloon payments;
- Loan term of 30 years or less;
- Generally, a 3% cap on points and fees; and,
- the member's debt-to-income (DTI) must be 43% or less.

Credit unions must meet the ability-to-repay requirements for all closed-end consumer credit loans secured by a dwelling. The credit union's compliance with the eight underwriting criteria is necessary prior to originating a mortgage loan. However, meeting the additional criteria to obtain QM status is not required and credit unions may make a “non-QM” loan and accept the additional liability that comes along with it.

Unfortunately, a number of mortgage products sought by credit union members, and offered by credit unions, may disappear from the market as they are non-QM loans. For example, a forty-year mortgage loan cannot be a QM because it exceeds the maximum loan term for QMs. This has been a product sought by credit union members in high-cost areas as it can help lower the monthly mortgage payment. While credit unions can still originate forty-year mortgages, since the special legal protections for meeting the ability-to-repay requirements will not be extended, many may cease to do so. Similarly, because of a problematic definition, a number of credit unions make mortgage loans with points and fees greater than 3% because of their relationships with affiliates and because they can leverage those relationships to get the best deal for their members. Those mortgages will also not receive QM status, which could mean higher costs down the line for credit union members.

For non-qualified mortgages, a credit union will not receive any presumption of compliance with the ability-to-repay requirements. Under the rule, the least risk to credit

unions would be to originate only QM loans. Limiting loans to solely QMs would reduce the legal risk and help ensure their loans are eligible for sale on the secondary market (as the Federal Housing Finance Agency has stated it will not allow Fannie Mae and Freddie Mac to buy non-QM loans, with the exception of the debt-to-income ratio component of the QM definition). Additionally, the ability to sell the loans will help credit unions manage interest rate and concentration risks.

A recent NAFCU survey of its members revealed that a majority of credit unions will cease or greatly reduce their offerings of non-QMs. The credit unions that will offer non-QMs have indicated that only a very small portion of the mortgage offerings will consist of non-QMs.

At Orion FCU, the executive management team, in consultation with our board of directors, made a conscious decision at the onset of the financial crisis to double down on our efforts to return as much as possible to our members and the community they live in. We continue to follow this philosophy and oftentimes sacrifice earnings in order to achieve these important objectives. In today's lending environment, with interest rates at record lows, margins on non-QM loans will be very narrow. When you take into account the additional legal liability associated with non-QM loans, this margin will be even narrower. While some institutions may start charging a premium on their loans to account for the additional risk associated with non-QMs, we do not feel this is in the best interest of our credit union, our members and our community. Consequently, we have decided to cease to offer non-QM loans at this time.

I cannot tell you how difficult this decision has been. Orion takes great care in placing our members with the right mortgage product, and the QM standard will inevitably force us to turn many creditworthy borrowers away. For example, in November of 2010, we started a special "Orion Home Run Program" that allows qualifying participants to rent a home for a set period of time. During the rental period, the participant is expected to make timely payments, keep the home in good condition and have a positive impact on their neighborhood. When the rental period lapses, the home can then be purchased

outright at a reduced price with the previous rental payments applied as the down payment. Despite demonstrating an ability–to-repay, it is likely that many program participants would not fit the QM standard and therefore would not have the opportunity to become a homeowner through Orion FCU at this time.

As a NAFCU Board member, I have talked with many of my fellow credit union CEO's about this issue. I know that many of them share the same concerns that we have at Orion FCU and some have stopped their non-QM lending for the time being. Others may be cautiously going forward with non-QM loans, but many have indicated that they will be more stringent in making them and do them only on a limited basis. For Orion FCU, approximately 10% of all of our mortgage loans in the last few years would be classified as non-QM. Unfortunately, today these loans, and the people they would have helped, are no longer being offered by my credit union. In order to serve our members, we, and I am sure my fellow CEOs, will continue to look for other ways to help members get the affordable credit that they need. This could include future re-evaluation of our decisions on non-QM loans. However, at this time the uncertainty and the liability is just too great.

While the CFPB has sought input on the rules, the fact that the statute is so limiting means that significant changes to the ability-to-repay rule must be mandated by Congress. While credit unions understand the intention of the rule and importance of hindering unscrupulous mortgage lenders from entering the marketplace, this rule is unnecessarily restrictive for credit unions. There are several changes to the QM standard that would make it more amenable to the quality loans credit unions are already making. Congressional action in these areas would help open the spigot of mortgage lending that has been now shut off for a number of Americans.

Points and Fees

First and foremost, NAFCU strongly supports bipartisan pieces of legislation in the House (H.R. 1077/ H.R. 3211) introduced by Representative Bill Huizenga to alter the definition of "points and fees" prescribed by the QM standard. NAFCU supports exempting from the QM cap on points and fees: (1) affiliated title charges, (2) double

counting of loan officer compensation, (3) escrow charges for taxes and insurance, (4) lender-paid compensation to a correspondent bank, credit union or mortgage brokerage firm, and (5) loan level price adjustments which is an upfront fee that the Enterprises charge to offset loan-specific risk factors such as a borrower's credit score and the loan-to-value ratio.

Clearly, as constructed, the assumption being made by including affiliate fees in the calculation of points and fees stems from affiliate fees being higher than non-affiliate fees. However, in the case of credit unions and credit union services organizations, credit union members are often able to secure lower fees because of this relationship. Given the unique nature of credit unions compared to other loan originators, they look for the best interests of their member-owners in these relationships and seek to get them the best deal.

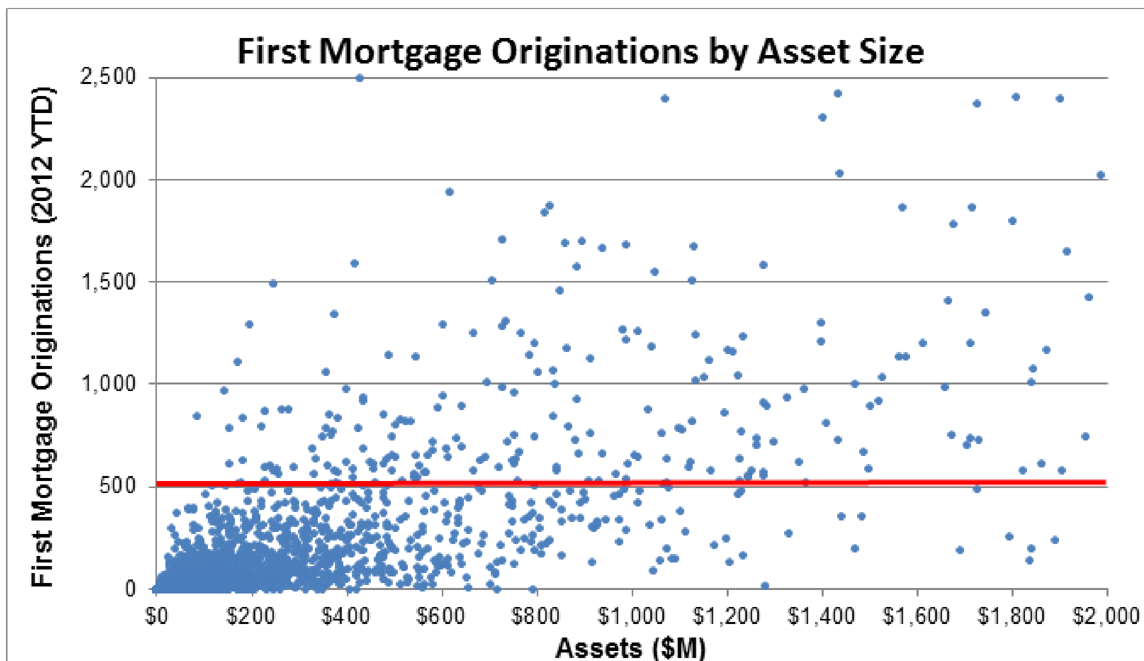
Making important exclusions from the cap on points and fees will go a long way toward ensuring many affiliated loans, particularly those made to low- and moderate-income borrowers, attain QM status and therefore are still made in the future.

"Small Credit" Exemption and Loans Held in Portfolio

NAFCU appreciates the CFPB's recognition that the ATR/QM rule presents significant challenges to small credit unions. To alleviate burdens on small creditors, the CFPB provided a "small creditor" exemption, under which credit unions with less than $2 billion in assets who conduct 500 or fewer mortgages in a year, and hold all of the mortgages in portfolio, are not subject to the rule.

While NAFCU acknowledges that this exemption is intended to provide relief for smaller institutions, there are several aspects that we believe need to be modified. First, we believe that both the asset-size and the 500 mortgages thresholds are too low. As the chart below indicates, there are many credit unions that are approaching one or both of the thresholds, which will effectively render the exempt moot for them.

<u>Mortgages Extended by Credit Unions with $2 billion in Assets or Less</u>



NAFCU also believes that *all* mortgages held in portfolio should be exempt from the QM rule. This exemption should not be limited to small credit unions. NAFCU supports exempting mortgage loans held in portfolio from the QM rule as the lender, via its balance sheet, already assumes risk associated with the borrower's ability-to-repay.

40-year Loan Product

Credit unions offer the 40 year product their members often demand. To ensure that consumers can access a variety of mortgage products, NAFCU supports mortgages of duration of 40 years or less being considered a QM.

Debt-to-Income Ratio

NAFCU supports Congress directing the CFPB to revise aspects of the 'ability-to-repay' rule that dictates a consumer have a total debt-to-income (DTI) ratio that is less than or equal to 43 percent in order for that loan to be considered a QM. This arbitrary threshold will prevent otherwise healthy borrowers from obtaining mortgage loans and will have a particularly serious impact in rural and underserved areas where consumers have a

limited number of options. The CFPB should either remove or increase the DTI requirement on QMs.

Loans Sold to the Government Sponsored Entities

NAFCU also believes that mortgages that are sellable to Fannie Mae and Freddie Mac should be deemed to meet the ATR standards and provided safe harbor protection. NAFCU believes that Fannie Mae and Freddie Mac have adequately stringent underwriting standards.

Given the current interest rate environment, it is also worth noting that credit unions are closely monitoring the extent to which a secondary mortgage market will develop for non-QM loans. This is a critical matter as credit unions need unrestricted access to liquidity to facilitate new lending. The likelihood of a viable secondary mortgage market for non-QM loans is questionable given that the Government Sponsored Enterprises will only purchase mortgages with QM features with the exception of the debt-to-income requirement. Accordingly, credit unions will make few if any loans with longer than 30-year terms or interest-only loans, which are in demand and appropriate for some borrowers.

Lastly, NAFCU appreciates that the CFPB is looking for “good faith effort” of compliance in the early months after the rule takes effect. However, this could create ambiguity and we are hopeful that the CFPB will work closely with the credit union prudential regulator, the National Credit Union Administration (NCUA) to ensure that (1) the NCUA has a clear understanding of what “good faith effort” means; and (2) the NCUA communicates with credit unions their exam expectations in regard the mortgage rules.

As mentioned at the beginning of my testimony, the ability-to-repay rule is just one piece of thousands of pages of new mortgage regulation and guidelines from the CFPB.

Covering everything from the scope of coverage under the Home Ownership and Equity Protection Act, comprehensive changes to mortgage origination and servicing, amended rules associated with the Truth in Lending Act and Financial Institutions Reform, Recovery, and Enforcement Act, changing requirements for escrow accounts and issuing rules under Dodd-Frank relative to what constitutes a QM -- the breadth and pace of new requirements are daunting. A timeframe of less than 12 months to implement the rules should have caused serious pause for lawmakers and regulators. Even if the mortgage proposals are well intended, they come with a significant burden particularly to smaller institutions that have trouble just keeping up to be sure that they stay compliant with all of the new rules. That is why NAFCU urged a delay in the implementation date of the new rules.

Areas Where Credit Unions Need Regulatory Relief

The new mortgage rules are just part of the growing regulatory onslaught being placed on credit unions. The time and money spent learning and complying with the new mortgage standards, along with complying with a number of other burdensome and outdated regulations, takes money and staff away from our mission of helping credit union members.

At the beginning of the 113th Congress NAFCU was the first credit union trade association to formally call on the new Congress to adopt a comprehensive set of ideas generated by credit unions that would lead to meaningful and lasting regulatory relief for our industry. As part of that effort, NAFCU sent a five-point plan for regulatory relief to Congress (**Attachment A**) to address some of the most pressing areas where credit unions need relief and assistance. The five-point plan includes administrative improvements for powers of the NCUA, capital reforms for credit unions, structural improvements for credit unions, operational improvements for credit unions, and as demonstrated by the Target Corporation data breach on December 19, 2013, much needed changes to data security standards for all entities handling sensitive consumer information. There are number of provisions in this plan that have been introduced as

part of the *Regulatory Relief for Credit Unions Act of 2013* (H.R. 2572), by Representative Gary Miller (R-CA).

Conclusion

In conclusion, NAFCU recognizes the efforts of the CFPB to help ensure consumers are not placed in mortgages that they cannot afford. Credit unions have been working to put their members into affordable mortgages before the financial crisis and continue to do so post-crisis. The unique nature of the relationship between credit unions and their members means that credit unions demonstrate flexibility to give their members products that work for them on an individual basis. The restrictions of the new QM mortgage standard have eliminated this ability in many cases. Given the new liability and the additional costs that come with doing non-QM loans, many credit unions like mine have ceased or severely cut back their non-QM lending.

Congressional action to provide relief on some of the QM standards would help alleviate some of the problems and allow the spigot of mortgage credit to continue to flow to many Americans. Furthermore, Congressional action on regulatory relief would help ease the growing burdens associated with new compliance standards.

I thank you for the opportunity to appear before you today and would welcome any comments you may have.

Attachment A: **NAFCU letter to Chairman Johnson, Chairman Hensarling, Ranking Member Crapo and Ranking Member Waters calling on Congress to provide credit union regulatory relief; February 12, 2013.**