STATEMENT

OF

THE HONORABLE GIGI HYLAND
BOARD MEMBER

NATIONAL CREDIT UNION ADMINISTRATION

"ACCELERATING LOAN MODIFICATIONS, IMPROVING FORECLOSURE PREVENTION, AND ENHANCING ENFORCEMENT"

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

THURSDAY, DECEMBER 6, 2007

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 federally-insured 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 8,163 federally-insured credit unions, representing 98 percent of all credit unions and approximately 87 million members.

II. Credit Union Industry Mortgage Lending - NCUA Overview

Through the first half of 2007, the Mortgage Bankers Association estimated mortgage loan originations in the marketplace of over $1.33 trillion, of which federally insured credit unions originated only 2.14% or $28.3 billion.[1] Mortgage loans in federally-insured credit unions represent only 9% of mortgage loans outstanding in all federally-insured depository institutions.[2]

Nearly 60% of federally insured credit unions offer mortgage loans to their members. Those not offering mortgage loans are generally smaller credit unions that cannot afford the expertise or infrastructure to grant mortgages or manage 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.[3] Consequently, the majority of federally-insured credit union mortgage lending occurs in larger credit unions.

[1] Based on information available at the Mortgage Banker's Association website for 2007 Originations http://www.mbaa.org/files/Bulletin/InternalResource/57620_.pdf

[2] 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>.

[3] 12 C.F.R. 701.21(c)(5). Unimpaired capital and surplus equals shares plus post-closing, undivided earnings.

Demand for mortgage loans in federally insured credit unions remains high. Mortgage loans led all loan types in growth in the first half of 2007, increasing $11.2 billion (93% of all new loan growth) to a new high of 50% of total loans. NCUA continues to closely watch performance indicators in the mortgage lending area through data collection and the examination and supervision process.

Impact of Legislation on Specific Mortgage-Based Products

The proposed legislation will not have a significant financial impact on federally-insured credit unions, since these credit unions are not heavily involved in the types of products NCUA expects to be impacted by the legislation (e.g. nontraditional real estate loans, participation loans, and mortgage-backed investment securities).

Real Estate Loans

As the following table indicates, federally-insured credit unions typically grant traditional mortgage loans:[4]

Types of Federally-Insured Credit Union Real Estate Loans[5]					
Quarter Ending:	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Total Fixed Rate First Mortgages	37.2%	37.2%	37.6%	38.3%	38.2%
Total Balloon/Hybrid First Mortgages	16.7%	16.9%	17.1%	16.9%	17.1%
Total Adjustable First Mortgages	11.5%	11.3%	11.1%	11.0%	10.8%
Total Other Real Estate	34.6%	34.6%	34.2%	33.8%	33.9%
Total Real Estate Loans	100.0%	100.0%	100.0%	100.0%	100.0%
Non-Traditional: Interest Only/Optional Payment Loans[6]	N/A	N/A	1.9%	1.8%	2.1%

[4] NCUA uses a data collection tool, 5300 call report, to obtain credit union financial and operational information.
[5] The table reflects the percentage of each real estate loan type to total outstanding real estate loans.
[6] NCUA only captures the balance of Interest Only/Optional Payment Loans and does not distinguish the type of such loans. Therefore, the Interest Only/Optional Payment Loans dollars are intermixed into the various types of loans listed in the table.

The non-traditional loans (Interest Only/Optional Payment Loans), the loans likely to be most impacted by the legislation, only make up approximately 2 percent of total real estate loans outstanding and .8 percent of total assets.

Delinquency in real estate lending has increased in 2007; however, it still remains at a manageable level.

Real Estate Loan Delinquency > 2 Months					
Quarter End:	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
1st Mortgage Fixed/Total 1st Mtg Fixed Loans	0.24%	0.28%	0.28%	0.36%	0.44%
1st Mortgage Adjustable Rate/Total 1st Mtg Adjustable Rate Loans	0.28%	0.33%	0.31%	0.33%	0.46%
Interest Only & Payment Option First Mortgage/Total Int Only and Pmt Opt First Mtg Loans	N/A	N/A	0.34%	0.34%	0.89%

As noted in the table, nontraditional loans (interest only and optional payment loans) experienced an increase in delinquency. Federally-insured credit unions will continue manage this increase through their existing collection policies and procedures. NCUA examiners will review federally-insured credit union delinquency control efforts during their examinations and, when needed, issue Documents of Resolution with federally-insured credit union officials to ensure proper controls are in place and functioning.

Federally-insured credit unions typically have experienced low real estate foreclosure rates as demonstrated in following table:

Foreclosed Real Estate					
Quarter Ending:	**Sep-06**	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**
Amount (in Millions)	$143.8	164.1	190.2	213.4	271.8
Percentage Increase	N/A	14.11%	15.93%	12.17%	27.40%
Percentage of Total Real Estate Loans Outstanding	0.06%	0.07%	0.08%	0.08%	0.10%

Although there has been a significant percentage increase in total real estate foreclosures in 2007, the actual dollar amount ($272 million) represents only a small fraction, .1 percent, of total real estate loans ($264 billion) outstanding in federally-insured credit unions.

Credit Union Service Organizations

Federally-insured credit unions may invest in, or loan to, credit union service organizations (CUSOs).[7] As of September 2007, 81 CUSOs provide loan support services to federally-insured credit unions. These services include: debt collection services; loan processing, servicing, and sales; and sale of repossessed collateral. The proposed legislation potentially could impact a CUSO's loan services provided to members as well as the value of the CUSO on FCU balance sheets. However, since investments and loans to CUSOs are minimal ($1.05 billion and $579 million respectively), any negative impact is not deemed material.

Participation Loans

Federally-insured credit unions may buy and sell participation loans.[8] These types of loans include, but are not limited to, real estate loans which may be impacted by the legislation. Should the participation loan reprice in accordance with the proposed legislation, the participating federally-insured credit unions would not realize the originally contracted and expected rate of return. However, the legislation also could prevent foreclosure and preserve the loan's collateral value.

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[7] Credit Union Service Organization is an entity through which credit unions may provide services to their members.

[8] Participation loan means a loan where one or more eligible organizations [credit unions] participates pursuant to a written agreement with the originating lender. Buyer credit unions may only participate in loan types that it is legally empowered to make and only participate in loans to its own members or members of the selling credit union.

Participation loans do not comprise a significant portion of federally-insured credit union loan portfolios as indicated by the following table:

Participation Loans (in Billions)					
Year End:	Dec-03	Dec-04	Dec-05	Dec-06	Sep-07
Outstanding	$4.10	6.28	7.49	8.41	10.31
***Purchased YTD**	$1.99	3.15	2.95	2.87	2.39
***Sold YTD**	$1.36	1.70	1.77	1.69	1.03
Participation Loans Outstanding / Total Loans	N/A	1.5%	1.6%	1.7%	2.0%

*Sep '07 data is annualized

As of September 2007, participation loans represented 2 percent of total federally-insured credit union assets. As indicated by the following table, the significant majority (92 percent) of total loan participations are held in federally-insured credit unions with assets of $100 million or more:

Participation Loans				
Asset Size	Number of Credit Unions	Percentage of Credit Union Assets	Percentage of Participation Loans	Sum of Percentage of Participation Loans
>1Bil	5.98%	46.87%	43.64%	43.64%
500Mil-1Bil	9.08%	21.23%	23.61%	67.25%
100Mil-500Mil	32.30%	25.30%	24.78%	92.02%
50Mil-100Mil	15.84%	3.84%	3.84%	95.86%
<50Mil	36.80%	2.75%	4.14%	100%

Since participation loans do not comprise a material portion of federally-insured credit union assets, the proposed legislation is not expected to materially affect this area of federally-insured credit union operations.

Mortgaged-Backed Investments

The bill may have an impact on those federally-insured credit unions that have purchased investment securities backed by mortgage obligations. Restructuring or modifying the terms of the underlying mortgage obligations could have an impact

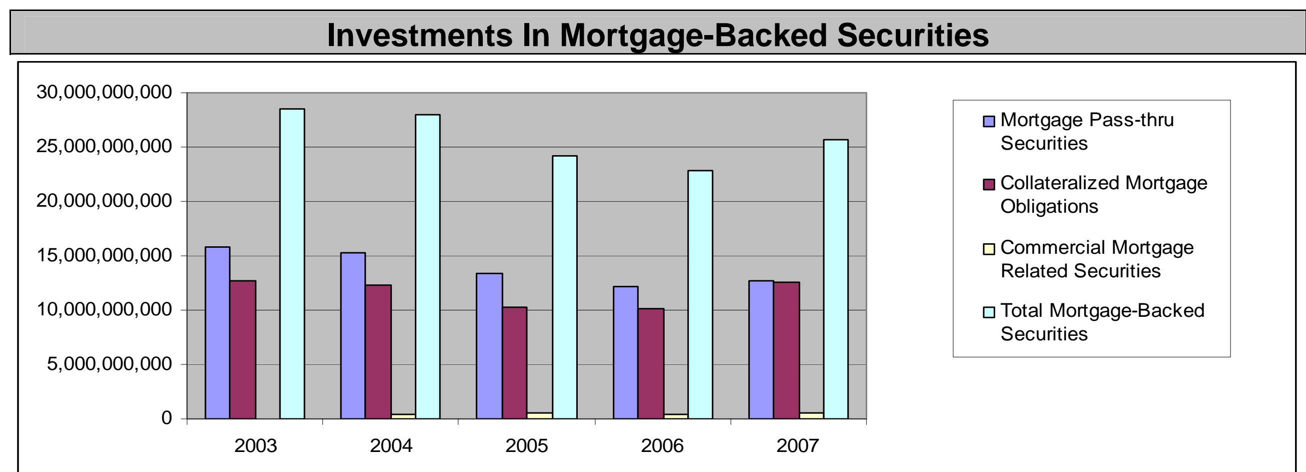
(reduced cash flow, reduced earnings, etc.) on the value of the investment. Though these federally-insured credit unions have a responsibility to weigh the risks of such investment instruments, the effect of a new law upon these investments can not be reasonably foreseen.

Federally-insured credit union investments securitized by mortgage products represent 3.5 percent of federally-insured credit union assets and 30 percent of federally-insured credit union net worth. With the exception of a slight increase in 2007, mortgage-backed securities in relation to total assets have been declining since at least 2003.

Mortgage-Backed Securities - Percentage of Federally-Insured Credit Union Assets					
Year End:	**Dec-03**	**Dec-04**	**Dec-05**	**Dec-06**	**Sep-07**
Mortgage Pass-Thru Securities[9]	2.59%	2.36%	1.96%	1.72%	1.70%
Collateralized Mortgage Obligations	2.08%	1.89%	1.52%	1.43%	1.69%
Commercial Mortgage Related Securities	N/A	0.07%	0.08%	0.05%	0.06%
Total Mortgage-Backed Securities	4.67%	4.32%	3.55%	3.21%	3.45%

As indicated by the following graph, federally-insured credit union investments in mortgage-backed securities has generally declined over the last several years.

Investments In Mortgage-Backed Securities



[9] A mortgage pass-through security consists of a set of marketable shares in a portfolio (pool) of real estate mortgages for which investors receive monthly payments of both interest and principal. Normally the package is secured by credit insurance so that investors are protected from the credit risks of the individual mortgages in the portfolio. However, no protection is provided against the cash flow and return volatility associated with unanticipated principal prepayments, which typically occur when interest rates drop and homeowners refinance their mortgages.

Given that mortgage-backed securities do not comprise a significant portion of federally-insured credit union assets, and the declining trend of ownership in such investments, NCUA does not expect the proposed legislation will significantly impact the value of federally-insured credit union investments or create a safety and soundness issue for the credit union industry.

Mortgage-Backed Investments – Corporate Credit Unions

NCUA regulates and/or insures thirty Corporate Credit Unions.[10] These credit unions are permitted to purchase and hold investments backed by mortgage products; however, by regulation these investments must be AAA or AA rated.[11] These higher rated investments assist in mitigating the risk of loss associated with the particular investment. Though these investments may include subprime loans, such loans are not predominant in the pool thereby mitigating risks which may impact investment value and performance.

Credit Union Industry Guidance

The NCUA supports efforts by lenders to develop workout plans for borrowers to reduce foreclosure risk. In April 2007, NCUA issued joint guidance with the Federal Financial Regulators,[12] Letter to Credit Unions 07-CU-06 Working with Residential Mortgage Borrowers, encouraging federally-insured credit unions to work constructively with residential mortgage borrowers who may be unable to meet their contractual payment

[10] A Corporate Credit Union is a credit union devoted to providing products and services to natural-person credit unions which are in its field of membership.
[11] Investments rated as AAA or AA represent high credit-quality investment grade products.
[12] The Federal Financial Regulators consist of the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision.

obligations. NCUA believes prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the federally-insured credit union and the member. To further educate federally-insured credit unions on mortgage risk, in October 2006, NCUA issued joint guidance with the Federal Financial Regulators (Letter to Credit Unions 06-CU-16 Interagency Guidance on Nontraditional Mortgage Product Risk) which discussed prudent underwriting and risk management practices for nontraditional mortgage loans,[13] as well as the need to ensure consumer understanding of loan terms and underlying product risks. While nontraditional and subprime mortgage loans are not major components of federally-insured credit union mortgage portfolios, NCUA was concerned that predatory and unsound lending in other areas of the marketplace may increase members' monthly debt burdens significantly, resulting in a "ripple effect" that would not only impact federally-insured credit union members but also federally-insured credit union asset quality. If federally-insured credit union members begin to experience difficulty making payments on homes they have financed elsewhere, loan accounts at their federally-insured credit unions could also be impacted.

In May 2007, NCUA issued joint guidance with the Federal Financial Regulators, Letter to Credit Unions 07-CU-07 Consumer Information for Nontraditional Mortgage Products, to assist federally-insured credit unions in implementing the consumer information recommendations of the recently issued Interagency Guidance on Nontraditional Mortgage Product Risks (NTM guidance). The NTM guidance states that institutions offering nontraditional mortgage products should provide consumers with information

[13] Nontraditional mortgage loans are also referred to as "exotic," or "alternative" mortgage products.

that is designed to help them make informed decisions when selecting and using these products.

III. NCUA Comments on the Legislative Proposals

NCUA is pleased to offer comments regarding H.R. 4178, the Emergency Mortgage Loan Modification Act of 2007, introduced by Congressman Michael Castle. NCUA will also comment on suggested changes to the legislation offered by the Federal Deposit Insurance Corporation, the recent commitment by four mortgage lenders to freeze adjustable rate mortgages for California borrowers, and the recent amendment to H.R. 3915 authored by Congressmen Frank, Miller, and Watt.

H.R. 4178, The Emergency Mortgage Loan Modification Act of 2007

NCUA believes prudent workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the federally-insured credit union and the member. NCUA has encouraged its federally-insured credit unions to work with troubled borrowers using appropriate loss mitigation strategies including loan modifications and workout plans when available and practicable.[14] NCUA supports H.R. 4178's goal of facilitating the ability of residential mortgage loan holders to assist consumers facing foreclosure. NCUA offers the following comments concerning specific aspects of the bill.

[14] Joint Interagency Media Release, *Federal Regulators Encourage Institutions to Work with Mortgage Borrowers Who Are Unable to Make Their Payments,* (July 17, 2007), http://www.ncua.gov/indexnews.html; Letters to Credit Unions 07-CU-09, *Statement on Subprime Mortgage Lending* (July 2007); Joint Interagency Media Release, *Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages* (September 4, 2007), http://www.ncua.gov/indexnews.html.

Paragraph (a)

The bill provides residential mortgage loan holders with a safe harbor from contractual liability for entering into a qualified loan modification or workout plan. The safe harbor applies to a limited circumstance involving a loan: where payment is in default or payment default is reasonably foreseeable; is secured by a lien on an owner-occupied dwelling; was consummated on or after January 1, 2004; and where the annual percentage rate (APR) exceeds the yield on a Treasury security of a comparable maturity period by more than 3 percentage points for a first lien (5 percentage points for other than a first lien) or the most recent conventional rate mortgage by more than 175 basis points for a first lien (375 basis points for other than a first lien). The safe harbor does not apply to Veteran Administration (VA) loans.

NCUA believes the safe harbor will enable residential mortgage loan holders to offer modified loans or workout plans on loans previously ineligible for modification because of contract restrictions, for example, participated loans and loans included in a loan pool. The six-month duration of the safe harbor, beginning with the enactment of Section 129A, means that holders will need to act quickly to identify eligible loans and initiate a qualified loan modification or workout plan.

Paragraph (b)(1) Qualified Loan Modification or Workout Plan

Paragraph (b)(1) indicates that, in order to be exempt from contract liability, a residential mortgage loan must meet certain criteria. The loan must be in payment default, near payment default, or payment default is reasonably foreseeable; and, the holder must

reasonably believe the net present value to be realized on the loan will be maximized under the modification or workout plan.

NCUA believes clearly defined terms and criteria will be beneficial to holders in determining to which loans the safe harbor applies. NCUA suggests including the same definition of reasonably foreseeable default used in the September 2007 interagency statement issued by NCUA, the other Federal Financial Regulators, and the Conference of State Bank Supervisors. A footnote in the bill explains default is reasonably foreseeable when the lender actually makes contact with the borrower, assesses the ability to pay, and has a reasonable basis to conclude the borrower will be unable to continue to make mortgage payments in the foreseeable future.[15]

Paragraph (b)(2) Qualified Mortgage

A residential mortgage loan meeting the definition of a qualified mortgage is not eligible for safe harbor protection. Under the bill, "qualified mortgage" describes a residential mortgage loan where the annual percentage rate on the loan does not equal or exceed the yield on a Treasury security with a comparable maturity period by more than 3 percentage points for a first lien (5 percentage points for other than a first lien), or the most recent conventional mortgage rate by more than 175 basis points for a first lien (375 basis points for other than a first lien). A loan made or guaranteed by the Secretary of Veterans Affairs is also a qualified mortgage.

[15] Joint Interagency Media Release, *Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages* (September 4, 2007), http://www.ncua.gov/indexnews.html.

The effect of this paragraph is to exclude residential mortgage loans written to more traditional standards or made or guaranteed by the Secretary of Veterans Affairs. NCUA supports the bill's focus on loans that, by their terms, are at higher risk for default. In light of this focus, the agency suggests the definition also should include loans insured by the Federal Housing Authority.

Paragraph (b)(3) Residential Mortgage Loan

A residential mortgage loan is defined in the bill as a loan secured by an owner-occupied dwelling and is not a qualified mortgage. NCUA recommends changing the definition of "residential mortgage" loan from a loan secured by a lien on an owner-occupied dwelling to a loan secured by a lien on the borrower's principal dwelling. This change would specifically target the benefits of the bill to borrowers in danger of losing their primary residence and not seasonal or other homes.

Paragraph (c) Effective Period

The bill applies only to a qualified loan modification or workout plan initiated during the six-month period beginning on the date of the enactment of Section 129A. NCUA has concerns about the six-month period in which borrowers may restructure their real estate loans. First, it will be difficult for a federally-insured credit union to determine the foreseeable likelihood of foreclosure of a borrower whose loan does not reprice in the short-term, given the multitude of variables (employment, income, housing market value changes, etc.). Second, because loan modification, or a workout plan, is not automatic, borrower awareness and timely communication with creditors will be important to the process, particularly where impending foreclosure may not be apparent through the

borrower's payment or income data. Third, NCUA anticipates an increased volume of real estate documentation processing required to modify the terms of real estate loans impacted by the bill.

As indicated in the table below, only 24 percent of federally-insured credit union 1st mortgage adjustable rate loans will reprice within one year.

Adjustable Rate 1st Mortgage Loans Maturity To Total Adjustable Rate Real Estate Loans					
Year End:	**Dec-03**	**Dec-04**	**Dec-05**	**Dec-06**	**Sep-07**
Adjustable Rate < 1 year	N/A	27.11%	24.94%	23.92%	24.47%
Adjustable Rate >1 year	N/A	72.89%	75.06%	76.08%	75.53%

Because of the restricted time period and the potential for default scenarios arising late in the time period, it would be beneficial for holders to know what must occur for a modification or a plan to be considered "initiated." NCUA recommends Congress consider extending the timeframe to at least twelve months.

Alternatives to H.R. 4178

FDIC Loan Modification Amendments

The FDIC has offered two alternatives to H.R. 4178: a non-binding Sense of Congress provision, and a statutory provision. Both alternatives would establish certain presumptions. First, a servicer's duty to maximize the net present value of pooled loans is owed to all investors and parties having an interest in the pooled loans, if there is no specific contractual provision to the contrary. Second, a loan modification or workout plan is deemed in the best interest of all investors and parties if payment default on the

subject loan(s) is reasonably foreseeable, the dwelling securing the loan is owner-occupied, and the anticipated recovery under the loan modification or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis. The best interest presumption recognizes a view that securitization trusts generally permit loan modifications when used appropriately to maximize the value to bondholders.[16] Neither amendment would use the loan's annual percentage rate as a basis for determining the loan's eligibility for modification or workout.

The proposals may bear additional consideration. They appear to reflect a servicer's existing duty to investors and include a presumption that a creditor acts in the best interest of investors where the servicer modifies a loan or implements a workout plan for residential mortgage loans meeting certain criteria. The creation of a rebuttable presumption could encourage servicers to use loan modifications and workout plans as an alternative to foreclosure. The presumption does not terminate an investor's rights under contract but requires the investor to meet a burden of proof in order to proceed with a claim.

The proposals potentially have a broader reach than H.R. 4178 as they do not include an effective period and are not limited to "subprime" loans. NCUA believes the FDIC's proposals have merit but warrant further detail and discussion.

[16] July 24, 2007 letter from SEC Chairman Cox to Chairman Frank, House Committee on Financial Services.

California Agreement with Lenders

Details of the agreement reached between California Governor Arnold Schwarzenegger and California's four largest loan servicers were not available. Our understanding of this agreement is that the participating loan servicers will freeze adjustable interest rates on mortgages for California subprime borrowers. We further understand this agreement is limited to borrowers who occupy their homes, are current and timely on their monthly payments, and would not be able to afford the higher interest rates associated with a reset of their adjustable rate mortgages.

NCUA notes that the agreement reached in California includes ideas similar to information provided in the September 4, 2007 interagency letter referenced earlier in our testimony. This interagency letter encouraged residential mortgage loan servicers to work constructively with borrowers at risk of default to avoid unnecessary foreclosures. The letter also suggested servicers review the governing documents for mortgage loans transferred into securitization trusts to determine the full extent of their authority to restructure delinquent or defaulting loans. Similar to the California agreement, the letter supports offering workout plans to residential borrowers who are at risk of default, for example, from resetting interest rates.

NCUA believes the proactive nature of the California agreement is beneficial for both the borrower and the lender encouraging action before a default scenario arises. NCUA also believes the California agreement may be an indication that states are well-positioned to promulgate these types of solutions for borrowers and servicers within a state.

IV. PATTERN or PRACTICE of VIOLATION AMENDMENT to HR 3915

Congressmen Frank, Miller, and Watt have authored an amendment to H.R. 3915 imposing civil penalties on creditors, who as a pattern or practice, violate the following minimum standards for mortgages: to determine in good faith the consumer's ability to repay the loan; or, in the case of a refinancing, to determine in good faith the refinanced loan will provide a net tangible benefit to the consumer. The civil penalties imposed are in addition to any money penalty imposed under an administrative enforcement action by the Federal Financial Regulators or the Federal Trade Commission. The amendment would also permit any person to submit information regarding the violation to any Federal Financial Regulator or the Federal Trade Commission regardless of whether the regulator has jurisdiction over the entity involved in the alleged violation.

NCUA believes the additional penalty may deter pattern or practice violations but is concerned that any additional penalty be applied in a balanced and consistent manner. It appears that under this amendment, a federally regulated entity would be subject to an administrative monetary penalty and a civil penalty in contrast to non-federally regulated entities. This result would be inconsistent with the general direction of H.R. 3915 of applying similar regulatory standards to all mortgage loan originators. Additionally, in assessing whether and to what extent to impose an administrative penalty, whether a violation is part of a pattern or practice of violations is one of several factors considered in determining the amount of the penalty.

Additionally, NCUA believes permitting information to be submitted to any of the regulatory agencies could potentially hinder a timely investigation of the alleged violation. Information regarding an entity's regulatory authority is included in many consumer disclosures and consumers should be encouraged to provide information directly to the appropriate regulator.

V. CONCLUSIONS

Consumers face an increasingly complex financial landscape where the expansion of choices has been accompanied by a corresponding number of potentially disadvantageous and costly options. While the availability of new and innovative mortgage products has been beneficial to a large segment of the American public, recent market volatility has presented problems for consumers who may lack the financial flexibility to deal with changing rates and terms.

NCUA supports Congressional scrutiny of the complex issues involved, as well as any responsible legislative effort that enhances consumer protection while preserving the mortgage financing market's ability to attract and retain capital and liquidity. In this statement NCUA has offered several specific suggestions for enhancing the legislative approach, and continues to appreciate the opportunity to provide input to an important and timely issue.