STATEMENT

OF

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"CONDITION OF THE BANKING INDUSTRY"

BEFORE THE

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I. Introduction

The National Credit Union Administration (NCUA) appreciates this opportunity to provide agency views on "The State of the Banking Industry." The federally insured credit union industry comprises a relatively small but important part of the financial institution community, and NCUA's perspective on the financial performance of the institutions the agency regulates and insures will hopefully add to the overall understanding of a wide range of issues. Despite the dislocations in the credit markets, and the attendant effect on the mortgage industry and now the broader economy, the federally insured credit union industry continues to be financially strong. NCUA is very aware of the need for close and diligent regulatory oversight in the context of the difficult environment cited above.

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 member accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund, NCUA provides oversight and supervision to 8,101 federally insured credit unions, representing 98 percent of all credit unions and approximately 87 million members.[1]

[1] Approximately 170 state-chartered credit unions are privately insured and are not subject to NCUA oversight.

II. Financial Status of the Credit Union Industry

The financial state of the federally insured credit union industry remains strong and healthy with financial trends indicating a safe and sound industry. The following discussion highlights key operating trends and supports the conclusion that federally insured credit unions have heeded NCUA's guidance issued to date, particularly related to the risks associated with real estate lending, and are well positioned to weather the current downturn in the economy.

Federally Insured Credit Unions Experience Continued Growth in Assets and Shares

Aggregate assets of federally insured credit unions increased $43.46 billion, or 6.12 percent, to a new high of $753.46 billion. Federally insured credit unions continue to focus priority on meeting the lending needs of the membership as net loans comprise 70 percent of total assets.

Total shares grew 5.19 percent in 2007 to $632 billion. Strong growth in money market shares, IRA/KEOGH accounts, and certificates accounted for the majority of the growth. 2007 also marked the third consecutive year regular shares experienced negative growth, and the second consecutive year-end reporting period that total share certificates represented the largest category of total shares.

Federally Insured Credit Unions Continue to Provide Members with a Full Range of Loan Products

Loans continue to be the largest federally insured credit union balance sheet item, representing an industry-wide commitment to providing members with a full range of lending products and services. At the end of 2007, net loans represented 69.42 percent of aggregate credit union assets. Additionally, loan growth outpaced share growth in 2007, with total loans increasing $32.5 billion, resulting in a loan-to-share ratio of 83.3 percent – compared to a 10-year average loan-to-share ratio of 76.3 percent. As with 2006, real estate loans accounted for the majority of all loan growth in 2007, and represent 51.45 percent of total loans. During 2007, fixed rate first mortgages increased 14.40 percent or $13.08 billion, and adjustable rate first mortgages increased 9.49 percent, or $6.54 billion.

Delinquency and Net Loan Losses Have Increased in the Current Environment

As this document will highlight, federally insured credit unions have appropriately positioned themselves to withstand the current economic cycle and related mortgage lending crisis. However, the federally insured credit union industry is not immune to the macro economic impact of increasing credit risk exposure created by the current housing market. After several years of declining delinquency levels, 2007 saw an increase in the aggregate delinquent loan ratio. Aggregate delinquency increased from .68 percent to .93 percent of total loans outstanding. In comparing the various categories of delinquent loans (2-6 months, 6-12 months, and greater than 12 months), NCUA recognizes an increase in the dollar amount of delinquent loans in the 2-6 month

category over the last several years. The dollar amount of loans in the 6-12 month category increased in 2007 after maintaining a consistent level dating back to 2002. Similarly, the dollar amount of delinquent loans greater than 12 months delinquent have remained stable during this same time period.

Focusing more closely at delinquent real estate loans in particular, federally insured credit unions saw real estate delinquency nearly double in 2007, albeit from only .34 percent to only .67 percent. While this amount represents a high watermark for mortgage delinquency in the last 13 years, it is important to note that federally insured credit unions have demonstrated an ability to weather economic storms in the past as they did when federally insured credit union mortgage delinquency hit a high of .56 percent back in 1995.

The largest area of concern within the category of real estate loans is the increase in the category of Other Real Estate Adjustable Rate Loans, mostly made up of Home Equity Lines of Credit (HELOCs). Delinquency for this category increased from .36 percent in 2006 to .80 in 2007.

Not surprisingly, the aggregate net charge-off ratio for all loans also increased during 2007, albeit only 5 basis points to .50 percent of average loans. Looking more closely at just real estate loans, NCUA noted an increase in net charge offs from .03 percent in 2006 to .08 percent in 2007; with the majority of the increase identified as Other Real

Estate Loans (HELOCs/Second Deed of Trust). This trend broke a 4-year span of net real estate loan losses alternating between .02-.03 percent of average real estate loans.

Federally Insured Credit Unions Reporting Real Estate Foreclosures Up in 2007

To facilitate better risk identification and monitoring, NCUA began collecting data on foreclosed real estate with the June 2006 Call Report cycle. Call Report data shows foreclosure trends have been increasing each quarter to a high of $332 million as of year-end 2007. Consistent with what has been observed nationwide, data supports the last half of 2007 was especially challenging for federally insured credit unions and consumers as foreclosures increased 28 percent and 22 percent for the quarters ending September 30, 2007 and December 31, 2007 respectively.

Higher Provision for Loan and Lease Losses Impacted Earnings in 2007

The level of earnings for federally insured credit unions declined further in 2007, to .65 percent of average assets. This decline was largely due to an increased Provision for Loan and Lease Losses expense needed to adequately fund for estimated losses in the lending portfolio based on the current environment. This level of return, however, was more than sufficient to cover the cost of operations and contribute to the already solid level of net worth. This is consistent with NCUA's commitment to focus examination and supervision efforts on a federally insured credit union's ability to build capital to meet members' needs, and not just obtain an arbitrary level of return which may sacrifice service to the membership. This philosophy on evaluating earnings was

presented to examiners and federal credit unions in Letter to Credit Unions 06-FCU-04 in August of 2006.

Federally Insured Credit Unions Have Strong Net Worth

Aggregate net worth increased $4.32 billion, or 5.28 percent, in 2007 to $86.25 billion, representing the highest dollar level in credit union history. Although asset growth outpaced capital growth in 2007, thereby diluting the industry net worth ratio to 11.44 percent of total assets, the overwhelming majority of federally insured credit unions remain very well capitalized. In fact, as of December 31, 2007, 99.34 percent of all federally insured credit unions were at least "adequately capitalized" or better, with 98.6 percent of all federally insured credit unions "well capitalized".[2]

Looking Forward

In addition to evaluating standard risk trend reports each quarter, NCUA will be monitoring an increasing trend in activity of consumer credit card loans as well as delinquent credit card loans. As of December 2007, credit card loan delinquency was 1.33 percent, nearly reaching a high reported back in 2003. This could be an indicator of consumers facing financial difficulties and needing to access the only readily available cash source, particularly now that access to additional cash through HELOCs may have been cut off or significantly reduced. NCUA will continue to monitor this

[2] NCUA's Prompt Corrective Action (PCA) framework utilizes a statutory net worth category classification to include: "Well Capitalized" for credit unions with a total net worth ratio of 7 percent or above, "Adequately Capitalized" for credit unions with a total net worth ratio of 6 – 6.99 percent, "Undercapitalized" for credit unions with a total net worth ratio of 4 – 5.99 percent, "Significantly Undercapitalized" for credit unions with a total net worth ratio of 2 – 3.99 percent, and "Critically Undercapitalized" for credit unions with a total net worth ratio of less than 2 percent. NCUA utilizes a modified version of this matrix for newly-chartered credit unions.

apparent trend over the next several Call Report cycles and provide relevant guidance to the industry and agency staff if warranted.

III. Mortgage Lending in the Federally Insured Credit Union Industry

A Closer Look at the Current State of Federally Insured Credit Union Mortgage Lending

As a point of reference, during 2007, the Mortgage Bankers Association estimated first mortgage loan originations in the marketplace of over $2.33 trillion, of which federally insured credit unions originated only 2.53 percent or $59 billion first mortgage loans.[3] First mortgage loans in federally insured credit unions represent only 7.40 percent of mortgage loans outstanding in all federally insured depository institutions.[4]

In considering trends related to all mortgage loans, 70 percent 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 percent of a federal credit union's total unimpaired capital and surplus.[5] Consequently, the majority of federally insured credit union

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[3] Based on information available at the Mortgage Bankers Association website for 2007 Purchase and Refinance Originations http://www.mbaa.org/files/Bulletin/InternalResource/60108_.pdf.

[4] NCUA data and *FDIC- Statistics on Depository Institutions Report, 1-4 Family Residential Net Loans and Leases for all depository insured institutions as of 9/30/2007.* 30 Sept. 2007. Federal Deposit Insurance Corporation. < http://www2.fdic.gov/SDI/SOB>.

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

mortgage lending occurs in larger federally insured credit unions, as the following chart illustrates:

Federally Insured Credit Unions by Asset Size	Number of Mortgage Loans Originated in 2007	% of Federally Insured Credit Union Mortgage Loan Portfolio as of 12/31/2007
Greater than $1 billion	494,526	46.86%
$500 million-$1 billion	214,743	16.89%
$50 million-$500 million	485,256	30.85%
$10 million-$50 million	84,087	4.98%
Less than $10 million	7,366	0.42%

Demand for mortgage loans in federally insured credit unions remains high. As mentioned earlier, mortgage loans led all loan types in growth in 2007, increasing $27 billion (83 percent of all loan growth) to a new high of 51 percent of total loans. NCUA continues to closely watch performance indicators in the mortgage lending area through data collection and the examination and supervision process.

As the following chart demonstrates, the majority of mortgage loans in federally insured credit unions are fixed rate, with almost all of the remainder being standard adjustable rate mortgages. Nontraditional mortgages are offered by less than 6 percent of federally insured credit unions and represent just over 2 percent of mortgage loans outstanding.

Type of Mortgage	Dollar Amount of Mortgage Loan Portfolio (billions)	% of Federally Insured Credit Union Mortgage Loan Portfolio as of 12/31/2007
Fixed Rate	$157	57.9%
Adjustable Rate	$114	42.1%
Interest Only or Payment Option[6]	$6.3	2.3%

Fixed rate mortgage loans accounted for 77.5 percent of the increase in mortgage loans during 2007. Fixed rate mortgages in federally insured credit unions grew at a rate of 15.3 percent during 2007. Adjustable rate mortgage loans accounted for 22.5 percent of the increase in mortgage loans during 2007, and grew at a rate of 5.6 percent. This indicates a clear preference by federally insured credit union members for fixed rate mortgage loans in the current economic environment, and likely includes a significant degree of refinancing of adjustable rate mortgages.

Nontraditional Mortgage Lending in Federally Insured Credit Unions

Recognizing the increase in nontraditional mortgage products in the broader market (also referred to as "exotic," or "alternative" mortgage products), NCUA amended the 5300 Call Report to collect data on certain nontraditional first mortgage loans. Results

[6] NCUA does not capture information relating to the type (fixed or adjustable) of "interest-only" or "payment-option" loans, just the dollar amount outstanding for these loan products. This amount is reflected in the totals for both fixed and adjustable rate mortgage loans outstanding.

for these mortgage products became available with the March 2007 reporting cycle.[7] The data indicates that these mortgage products (specifically "Interest-Only" or "Payment Option" mortgages) are only offered in a small number of federally insured credit unions and comprise a very small portion of the total mortgage portfolio.

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

Types of Federally Insured Credit Union Real Estate Loans[8]					
Quarter Ending:	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**
Total Fixed Rate First Mortgages	37.2%	37.6%	38.3%	38.2%	38.4%
Total Balloon/Hybrid First Mortgages	16.9%	17.1%	16.9%	17.1%	17.2%
Total Adjustable First Mortgages	11.3%	11.1%	11.0%	10.8%	10.6%
Total Other Real Estate	34.6%	34.2%	33.8%	33.9%	33.8%
Total Real Estate Loans	100.0%	100.0%	100.0%	100.0%	100.0%
Non-Traditional: Interest Only/Optional Payment Loans[9]	N/A	1.9%	1.8%	2.1%	2.3%

The non-traditional loans (Interest Only/Optional Payment Loans) only make up about 2.3 percent of total real estate loans outstanding and .83 percent of total assets.

There are several reasons why these riskier mortgage loans 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

[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] The table reflects the percentage of each real estate loan type to total outstanding real estate loans.
[9] 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.

these types of loans. Also, as member-owned not-for-profit cooperatives, federally insured credit unions lending motivation is designed to be member-oriented, appropriately concerned with the suitability and impact on the member. In addition, the Federal Credit Union Act prohibits prepayment penalties and establishes a statutory limit for interest rates.[10] 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.

Mortgage Loan Performance

Over the last decade, aggregate mortgage delinquency as been very low, averaging only .38 percent and mortgage loan losses has been equally low at .04 percent even with the increased numbers associated with these trends in 2007. Real estate delinquency did increase in 2007; however, it still remains at a manageable level.

Real Estate Loan Delinquency > 2 Months					
Quarter End:	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**
1st Mortgage Fixed/Total 1st Mtg Fixed Loans	0.28%	0.28%	0.36%	0.44%	0.48%
1st Mortgage Adjustable Rate/Total 1st Mtg Adjustable Rate Loans	0.33%	0.31%	0.33%	0.46%	0.69%
Interest Only & Payment Option First Mortgage/Total Int Only and Pmt Opt First Mtg Loans	N/A	0.34%	0.34%	0.88%	1.66%

[10] The Federal Credit Union Act establishes a limit of 15% per annum inclusive of all service charges, with authority for the NCUA Board to establish a higher ceiling when certain economic conditions are met. The ceiling is currently set at 18%. 12 U.S.C. §§1757(5)(A)(vii) and 1757(5)(A)(viii).

As noted in the table above, nontraditional loans (interest only and optional payment loans) experienced an increase in delinquency. Federally insured credit unions will continue to 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.

Credit unions typically have also experienced low real estate foreclosure rates as demonstrated in following table:

Foreclosed Real Estate					
Quarter Ending:	**Dec-06**	**Mar-07**	**Jun-07**	**Sep-07**	**Dec-07**
Amount (in Millions)	164.1	190.2	213.4	271.8	331.9
Percentage Increase	14.11%	15.93%	12.17%	27.40%	22.11
Percentage of Total Real Estate Loans Outstanding	0.07%	0.08%	0.08%	0.10%	0.12%

Although there has been a significant percentage increase in total real estate foreclosures in 2007, the actual dollar amount of $332 million represents only a small fraction, .1 percent, of the $271 billion in total real estate loans outstanding in federally insured credit unions, and does not represent a viable threat to the safety and soundness of the credit union industry.

Mortgage-Backed Securities in Federally Insured Credit Unions

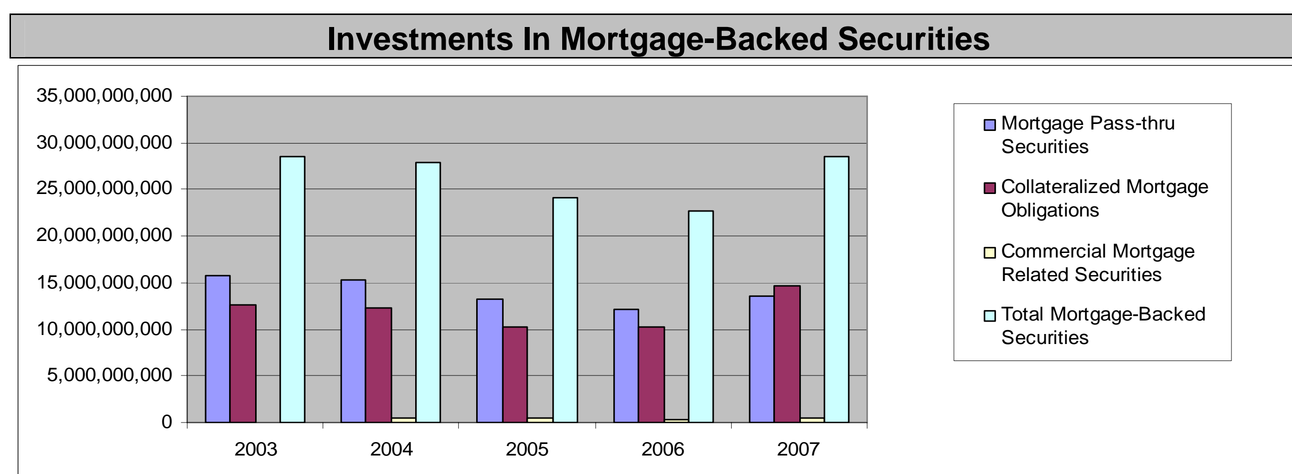
Federally-insured credit union investments securitized by mortgage products represent 3.79 percent of federally insured credit union assets and 33.14 percent of federally

insured credit union net worth. With the exception of an 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**	**Dec-07**
Mortgage Pass-Thru Securities[11]	2.59%	2.36%	1.96%	1.72%	1.79%
Collateralized Mortgage Obligations	2.08%	1.89%	1.52%	1.43%	1.94%
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%	3.79%

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



Mortgage-Backed Investments – Federally Insured Corporate Credit Unions

[11] 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.

NCUA regulates and/or insures twenty-eight federally insured corporate credit unions.[12] These federally insured corporate credit unions are permitted to purchase and hold investments backed by mortgage products; however, by regulation these investments must be AAA or AA rated.[13] 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.

The majority of mortgage-related securities held by natural person federal credit unions are either issued or guaranteed by government sponsored enterprises.[14] For natural person federal credit unions, the agency does not collect data on holdings insured by mono-line companies. Natural person federal credit unions may not invest in collateralized debt obligations (CDOs) to the extent CDOs are not mortgage-related securities.

To date, federal credit unions have not taken significant impairment charges for private label mortgage-backed securities. Similarly, the agency is aware of only isolated charges among state chartered, federally insured credit unions for permanent impairments of mortgage-backed securities or CDOs.

[12] 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.
[13] Investments rated as AAA or AA represent high credit-quality investment grade products.
[14] Investment regulations for state-chartered federally insured credit unions and state-chartered non-federally insured credit unions are set by each State.

Among federally insured corporate credit unions, the total exposure to securities insured by mono-line companies also is relatively small. Federally insured corporate credit unions are permitted to purchase only investment grade securities. Federally insured corporate credit unions hold small amounts of CDOs and have taken small impairment charges.

NCUA's corporate credit union supervision program closely monitors all investment security holdings. In response to decreased liquidity in the bond market, NCUA has increased the frequency of portfolio reviews at federally insured corporate credit unions.

NCUA's Demonstrated History of Mortgage Lending Guidance to the Industry

In the late 1970s, legislation expanded services to federally insured credit union members, to include mortgage lending. This added another option for consumers who found it difficult to obtain real estate loans from commercial banks and savings institutions. Over the last thirty years or so, mortgage lending in federally insured credit unions has been considered a relatively safe product, subject more to interest rate risk exposure than the credit risk typically associated with lending products. Typically, as emerging risks have been identified, NCUA has provided written guidance to federally insured credit unions, in the form of Letters to Credit Unions. Many of these pieces of guidance, some dating back to the 1970s, have been either cancelled or superseded by more relevant guidance to address emerging risks.

Letter to Credit Unions 124, dated June 1991, provides guidelines, most of which is still relevant in today's environment, for developing and maintaining an effective real estate lending portfolio; it addresses both the interest rate and credit risk associated with this type of lending. When written, the guidelines contained in this letter were not intended to curtail such lending but rather to clarify areas of risk and concern.

Recognizing the emergence of risk based lending efforts in the federally insured 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 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 credit unions with more information about NCUA's expectations for risk based lending program planning, loan policies, and procedures.

Over time, as the federally insured credit union industry evolved and demand for mortgage products increased, NCUA focused attention on the importance of proper balance sheet risk management for real estate loan products. In August of 1999, NCUA issued Letter to Credit Unions 99-CU-12 after identifying some interest rate risk given the changing balance sheet structure in a period when members where locking

mortgage interest rates at the lowest point in thirty years. This letter and accompanying attached set of guidelines formally introduced such tools as GAP analysis, income simulation models, Net Economic Value, and other Asset Liability Management concepts.

NCUA revisited this important concept of proper interest rate risk management in the fall of 2003 when it issued Letter to Credit Unions 03-CU-15, titled Real Estate Concentrations and Interest Rate Risk Management for Credit Unions with Large Positions in Fixed-Rate Mortgage Products. This letter reemphasized the importance of properly monitoring and managing an increasing portfolio of fixed-rate mortgage products; at the time the industry was experiencing another record period of reduced interest rates coupled following several years of strong share growth.

Moving forward, NCUA identified a need to refocus the industry's attention to proper credit risk management of lending, including real estate lending, in the wake of alternative lending arrangements to increase lending opportunities. In September 2004, NCUA issued Letter to Credit Unions 04-CU-13, titled, Specialized Lending Activities to focus attention on three higher risk lending activities – subprime lending, indirect lending, and outsourced lending relationships. This letter highlighted some benefits of each of these arrangements while clearly outlining expectations that federally insured credit unions only engage in these activities after ensuring they have a system of internal controls to properly manage the unique risks involved.

As referenced in this Letter to Credit Unions, 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.

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 available to examiners 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 the spring of 2005, NCUA and the other banking agencies jointly issued guidance, titled Credit Risk Management Guidance for Home Equity Lending, to focus industry attention to an increasing concentration of Home Equity Lines of Credit (HELOCs) and close-end home equity loans. This guidance document offered up a credit risk management system supported by, among others, product development and marketing,

origination and underwriting, third-party originations, collateral valuation management, and operations, servicing, and collections.

Later in 2005, after identifying precursor trends to the current mortgage environment and declining housing market, NCUA developed guidance for staff in the form of a Supervisory Letter on the increasing risks in mortgage lending. The letter 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" and "payment-option" adjustable rate mortgages with illustrations of payment shock for each of the products discussed.

The above referenced Supervisory Letter 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, as well as an apparent transition to a more liberalization of mortgage credit standards in general. 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 were 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 consumers' 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.

As a result of comments received on the consumer protection section of the proposed Nontraditional Mortgage Guidance, the agencies crafted proposed illustrations of Consumer Information for Nontraditional Mortgage Products.[15] These illustrations are designed to assist consumers by providing examples of model or sample disclosures or other descriptive materials as part of the Interagency Nontraditional Mortgage Guidance.

Then, in April of 2007, NCUA and the other FFIEC[16] member agencies jointly released a statement encouraging financial institutions to work constructively with residential mortgage borrowers who may be unable to meet their contractual payment obligations.

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[15] See 71 FR 58672.
[16] The Federal Financial Institutions Examination Council is made up of the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the State Liaison Committee.

This joint statement explains that prudent workout arrangements consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

In July of 2007, NCUA and the other FFIEC member agencies jointly released a finalized Interagency Statement on Subprime Mortgage Lending[17] to address emerging risks and lending practices associated with certain subprime adjustable rate mortgage products that can cause payment shock to consumers. As with nontraditional mortgage products, although these types of loans do not appear to be prevalent in the federally insured credit union industry, the NCUA cautioned against the potential "ripple effect" to asset quality if some members have these types of loans at other financial institutions and are struggling to repay considerably higher priced mortgage payments. As with the Interagency Nontraditional Mortgage Guidance, the agencies issued proposed illustrations to assist financial institutions in implementing the guidance specifically related to the consumer protection section of the Interagency Statement on Subprime Mortgage Lending.

Last September, NCUA, the other FFIEC member agencies, and the Conference of State Bank Supervisors jointly issued a statement encouraging federally regulated financial institutions and state-supervised entities that service securitized residential mortgages to review and determined the full extent of their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss

[17] The agencies published for comment the proposed Statement on Subprime Mortgage Lending on March 8, 2007. See 72 FR 10533.

mitigation strategies designed to preserve homeownership. Appropriate loss mitigation strategies may include, for example, loan modifications, conversions of an adjustable rate mortgage into a fixed rate mortgage, deferral of payments, or extending amortization. In addition, this issuance suggests institutions consider referring appropriate borrowers to qualified homeownership counseling services that may be able to work with all parties to avoid unnecessary foreclosures.

IV. CONCLUSION

The federally insured credit union system remains financially sound; they have effectively implemented guidance issued by NCUA related to real estate lending and have positioned the industry to weather this current economic downturn. While the data shows the industry is not entirely insulated from the adverse impact of the real estate lending crisis, it also supports the strong risk management principles effectively implemented by federally insured credit unions nationwide.