# MEETING OF THE BOARD OF CREDIT UNION ADVISORS
**July 14, 2016**
**1:00pm**

**Utah Department of Financial institutions**
**324 South State Street, Suite 201**
**Salt Lake City, Utah**

**Minutes**

**Board Members Present:**
Scot Baumgartner, Kent Greenfield, Meagan Nattress, Ilene Rollo

**Department of Financial Institutions Staff Present:**
Ed Leary, Paul Allred, Darryle Rude, Riley Bergstedt, and Emily Stanton

**Others present:**
Thomas Gourdin, Firefighters Credit Union; Scott Johnson, City Center Credit Union; Tami Olsen, Utah Heritage Credit Union; Bret Rigby, TransWest Credit Union and Heather Line and Stephen Nelson, Utah Credit Union Association

1. **Call meeting to order** – Scot Baumgartner

2. **Minutes – April 14, 2016**

Megan Nattress made the motion to accept the minutes as printed. Ilene Rollo seconded. Motion passes.

3. **Qualified vs Non-Qualified Mortgages –** Eva Rees

Eva Rees provided handouts. **(See Handouts A - F)**
Qualified and Non-Qualified are summarized by the borrower's ability to repay. The Federal Regulators are looking for credit unions to take more responsibility in ensuring borrowers have the ability to repay. Eva and Riley Bergstedt stressed that our examiners do not go in to institutions looking at qualified and non-qualified as simply "good" or "bad." We are examining from a safety and soundness perspective and looking specifically at the underwriting and risk policies. Credit Unions should make loans that they feel are appropriate, know which ones are qualified and non-qualified and account for an increased legal risk on a non-qualifying loan.

There was a discussion about underwriting guidelines and what steps credit unions can take to have quality mortgage loans.

A. **Definition of a Qualified Mortgage**

B. **Safe Harbor & Rebuttable Presumption**

C. **Interagency Statement on Supervisor Approach for Qualified and Non-Qualified Mortgage Loans**

D. **Supervisory Guidance on Qualified and Non-Qualified Mortgages**

E. **Ability to Repay and Qualified Mortgage Rules**

F. **Supervisory Letter – NCUA Office of Examination & Insurance**

- Page 2 section A. contains the 8 basic mortgage underwriting requirements needed with every consumer mortgage loan.
- Page 9 contains written exam procedures from the NCUA. You should not expect a lot of difference between these guidelines and the Department's.

## 4. Update on CECL – Riley Bergstedt

Riley provided a handout. **(See Handout G)**
Riley asked for comments from the industry and invited attendees to share their concerns and ask questions. There was a discussion about:

- The cost to purchase new software and examiners suggesting 3rd party software is necessary.
- Concern over the conversion and difficulties choosing the best software for the credit union's needs.
- Size and sophistication of the institution: how examiners will go from the smallest institutions to the larger credit unions and how to mitigate a "one size fits all" exam approach.

The Department is mindful of the impact on smaller institutions and wants to stress we will continue to learn more and time goes on. Riley advised that moving forward credit unions should apply what they are currently using to estimate probable loss and apply that approach to the portfolio for the life of the loan, expanding the "buckets" and classifications. Institutions should also focus on enhancing tracking and collecting data at this point, before 2020.

G. **Joint Statement on the New Accounting Standard on Financial Instruments – Credit Losses: FRB, FDIC, NCUA and OCC.**

## 5. Industry Updates and Comments – Riley Bergstedt

**A. New NCUA Chairman**
President Barack Obama appointed Rick Metsger to be the ninth Chairman of the National Credit Union Administration Board on May 1, 2016.

**B. NCUA Board – Call Report Modernization**
NCUA has noted it plans to update the information collected in the call report, removing data no longer relevant and adding new data reflecting new authorities provided to credit unions through NCUA rules.

**C. Extending the Exam Cycle**
Rick Metsger called for a review of the NCUA's examination process, specifically the frequency of examinations. His goal is to allow regional directors to have more discretion in scheduling exams for federal credit unions and federally insured, state chartered institutions. Riley affirmed his statement from the previous meeting; the DFI will not be moving to an 18 month or extended exam cycle. We will continue to follow a 12 to 15 month exam cycle.

**D. NCUA takes first step towards incorporating "S" in CAMEL Rating System**
Federal banking supervisors already include an "S" in the rating system, as do 16 state credit union regulators. The UDFI is one of 16 states that have already added Sensitivity to Market risk into our CAMELS rating and has been included in our exams since early 2014. Five additional state credit union regulators are working to adopt this approach.

## 6. Comments from the Industry

The floor was opened for comments, questions and concerns from the industry.

**A.** Kent Greenfield of Education First Credit Union passed along some praise and mentioned he appreciated the examiners that came in and their comments. The exam went smoothly.

**B.** Thomas Gourdin of Firefighters Credit Union thanked the Department for how they conducted the exam while he took care of a personal matter. The fact that what he was going through was important to the Examiner in Charge and to Riley made a huge difference to him.

## 7. Commissioner Comments - Commissioner Leary

Commissioner Leary reviewed these items:

**A. Legislative Audit**
The legislative audit, focused solely on deferred deposit lenders, is still ongoing. We have seen a draft of the audit report but at this time no hearing has been scheduled.

**B. Lassonde Institute**
The initial $300,000 contribution from the restricted account has been delivered to the Lassonde Institute. Based upon the legislative appropriation there is provision in our budget for an additional $300,000. On September 21st the Department of Financial Institutions Board will hear a presentation from a representative from the Lassonde Institute with a description of how they have spent the funds so far and the expectations for the future. The board will make a determination about the next $300,000 in December.

**C. Consumer Financial Protection Bureau (CFPB)**
Commissioner Leary talked about the Departments relationship with the CFPB.

## 9. Other Items

**A. Thank you for coming**
Emily Stanton thanked the group for making time to attend and extended the offer to expand email recipients to include anyone who may be interested in attending.

## 10. Next Meeting – October 26, 2016 at 1:00 p.m.

# Full Definition of a Qualified Mortgage: Updated for 2015

The term 'qualified mortgage' was first used within the text of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which became federal law on July 21, 2010. The Dodd-Frank Act provided a general definition (essentially an outline) of the QM loan. The CFPB was then given the task of finalizing that definition, which they did in January 2013. The rule took effect in January 2014. Here are the key features of a qualified mortgage in 2015:

### No Excessive Upfront Points and Fees

In this context, 'points and fees' are additional costs charged by the lender during mortgage application, processing and closing. The QM rule puts a limit on these additional charges, including those used to compensate mortgage brokers and loan officers.

Generally speaking, the points and fees paid by the borrower must not exceed 3% of the total amount borrowed, if the loan is to be considered a qualified mortgage. Certain exceptions have been made for 'bona fide discount points' on prime loans. For details on these and other exceptions, refer to the "Official Documents" section below.

### No Toxic Loan Features

In this context, a 'toxic' loan feature can refer to any high-risk feature that may have contributed to the mortgage and housing collapse of 2008. Such features are prohibited by the qualified mortgage rule, as defined by CFPB:

- *No interest-only loans*. These are mortgage products where the borrower defers the repayment of principal and pays only the interest, usually for a certain period of time.
- *No negative-amortization loans*. These are loans where the principal amount borrowed increases over time, even while monthly payments are being made. This often happens as the result of the interest-only payments mentioned above.
- *No terms beyond 30 years*. In order to meet the definition of a qualified mortgage, the loan must have a repayment term of 30 years or less.
- *No balloon loans*. In most cases, balloon loans will be prohibited by the QM rules. But some exceptions have been made. Smaller lenders in 'rural or underserved areas' may still make such loans. Definition: A balloon mortgage is one that has a larger-than-normal payment at the end of the repayment term.

### Limits on Debt-to-Income Ratios

In general, the qualified mortgage will be granted to borrowers with debt-to-income / DTI ratios no higher than 43%. As the name implies, the debt-to-income ratio compares the amount of money a person earns each month (gross monthly income) to the amount he or she spends on recurring debt obligations.

This aspect of the QM rule is intended to prevent consumers from taking on mortgage loans they cannot realistically afford. A temporary (after January 2014) exception will be granted for loans that are eligible to be sold or insured by Freddie Mac, Fannie Mae, FHA or the VA.

## Legal Protections: Safe Harbor & Rebuttable Presumption

Lenders that generate QM-compliant mortgage loans will receive some degree of legal protection against borrower lawsuits. The level of protection they receive will depend on the type of loan they make. So, in essence, there are two types of qualified mortgages:

***Safe Harbor*** — Of the two types of QM loans, this one gives lenders the highest level of legal protection. These are lower-priced loans with interest rates closer to the prime rate. They are typically granted to consumers with good credit histories (less risk). If the borrower ends up in default / foreclosure down the road, the lender would be considered to have legally satisfied the Ability-to-Repay rule. Thus, it would be harder for the borrower to sue the lender in court. However, borrowers can still challenge their lenders in court if they feel the loan falls short of the QM parameters outlined above.

***Rebuttable Presumption*** — These are higher-priced loans that are typically granted to borrowers with lower credit scores. In this context, 'higher-priced' refers to a loan with an interest rate that is more than 1.5% higher than the current prime rate. Lenders who grant these types of mortgages will receive a type of legal protection known as rebuttable presumption, which offers less protection than the safe harbor explained above. If the borrower ends up in a foreclosure situation, he or she could still win an ability-to-repay lawsuit if they can prove "the creditor did not consider their living expenses after their mortgage and other debts."

**Note:** Regardless of these protection clauses (safe harbor and rebuttable presumption), consumers can still legally challenge their lenders for breaking *other* federal consumer-protection laws. In other words, these protections do not preclude other types of lawsuits relating to mortgage loans.

**Board of Governors of the Federal Reserve System**
**Federal Deposit Insurance Corporation**
**National Credit Union Administration**
**Office of the Comptroller of the Currency**

**December 13, 2013**

# Interagency Statement on Supervisory Approach for Qualified and Non-Qualified Mortgage Loans

## Purpose

The agencies[1] are issuing this statement to clarify safety-and-soundness expectations and Community Reinvestment Act (CRA) considerations for regulated institutions engaged in residential mortgage lending in light of the Consumer Financial Protection Bureau's (Bureau) Ability-to-Repay and Qualified Mortgage Standards Rule (Ability-to-Repay Rule), which was issued January 10, 2013, and is effective January 10, 2014.[2]

## Background

The Bureau's Ability-to-Repay Rule implements Section 129C of the Truth in Lending Act, which requires lenders to make reasonable, good faith determinations that consumers have the ability to repay mortgage loans before extending such loans. The Bureau's Ability-to-Repay Rule provides lenders with a presumption of compliance with the ability-to-repay requirements for loans that meet the regulatory definition of a "qualified mortgage" (QM). In accordance with the Bureau's Ability-to-Repay Rule, a QM may not have certain features, such as negative amortization, interest-only payments, or certain balloon structures, and must meet limits on points and fees and other underwriting requirements.

The Bureau's Ability-to-Repay Rule provides lenders with several ways to satisfy the ability-to-repay requirements, including making loans that do not qualify as QMs, referred to as "non-QM" loans. Please refer to the Bureau's Ability-to-Repay Rule[3] for a detailed explanation.

## Safety-and-Soundness Expectations

The agencies recognize that many institutions are in the process of assessing how to implement the Bureau's Ability-to-Repay Rule. The agencies emphasize that institutions may originate both QMs and non-QMs, based on their business strategies and risk appetites. Residential mortgage loans will not be subject to safety-and-soundness criticism based solely on their status as QMs or non-QMs.

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[1] Board of Governors of the Federal Reserve System (FRS), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the National Credit Union Administration (NCUA).

[2] *See* Ability-to-Repay and Qualified Mortgage Standards Rule under the Truth in Lending Act (Regulation Z), 78 FR 6408 (Jan. 30, 2013), as amended.

[3] Refer to the Bureau's web site at http://files.consumerfinance.gov/f/201309_cfpb_titlexiv_updates.pdf.

Regardless of whether residential mortgage loans are QMs or non-QMs, the agencies continue to expect institutions to underwrite residential mortgage loans in a prudent fashion and address key risk areas in their residential mortgage lending, including loan terms, borrower qualification standards, loan-to-value limits, and documentation requirements. Institutions also should apply appropriate portfolio and risk management practices. Institutions should continue to comply with the applicable guidance on residential mortgage lending issued by their respective federal regulators.

**The Community Reinvestment Act and Fair Lending**

The agencies recognize that some institutions may originate only or predominantly QMs, particularly when the Bureau's Ability-to-Repay Rule first takes effect. In fact, the agencies note that some institutions' existing business models are such that all of the loans they originate satisfy the requirements for QMs.

As recently addressed in the *Interagency Statement on Fair Lending Compliance and the Ability-to-Repay and Qualified Mortgage Standards Rule* issued on October 22, 2013,[4] the requirements of the Bureau's Ability-to-Repay Rule and the fair lending laws are compatible. Similarly, the requirements of the Bureau's Ability-to-Repay Rule and CRA are compatible. Accordingly, the agencies that conduct CRA evaluations[5] do not anticipate that institutions' decision to originate only QMs, absent other factors, would adversely affect their CRA evaluations.

As required by the CRA, the agencies assess institutions' performance in helping to meet the credit needs of their communities, including low- and moderate-income neighborhoods, consistent with safe-and-sound operations. Each evaluation takes into account the unique performance context of the institution.

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[4] FDIC: *See* http://www.fdic.gov/news/news/press/2013/pr13091a.html;
FRS: *See* http://www.federalreserve.gov/newsevents/press/bcreg/20131022a.htm;
NCUA: *See* http://www.ncua.gov/News/Pages/NW20131022Interagency.aspx; and
OCC: *See* http://www.occ.gov/news-issuances/news-releases/2013/nr-ia-2013-164.html.

[5] The federal financial agencies with supervisory authority for CRA are the FRS, the OCC, and the FDIC.

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# Supervisory Guidance on Qualified and non-Qualified Mortgages

## NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

| | | | |
|---|---|---|---|
| DATE: | January 2014 | LETTER No.: | 14-CU-01 |
| TO: | Federally Insured Credit Unions | | |
| SUBJ: | Supervisory Guidance on Qualified and non-Qualified Mortgages | | |
| ENCL: | Supervisory Letter — CFPB's Ability-to-Repay and Qualified Mortgage Rule | | |

Dear Board of Directors and Chief Executive Officer:

The enclosed letter to NCUA examiners provides a preview of how credit union mortgage lenders will be expected to comply with the Consumer Financial Protection Bureau (CFPB)'s recently finalized rule on Ability-to-Repay (ATR) and Qualified Mortgages (QMs).

**This rule becomes effective January 10, 2014, and applies to all federally insured credit unions.**

**As with any new requirement in its early stages after becoming effective, NCUA field staff will take into account a credit union's good-faith efforts to comply with the new rule.**

NCUA field staff will be placing particular emphasis on the safety and soundness implications of mortgage lending under this new paradigm. Whether your credit union originates Qualified or non-Qualified Mortgages, examiners will be evaluating credit risk, liquidity risk, and concentration risk.

**I want to emphasize that credit unions may originate both Qualified and non-Qualified Mortgages.** Non-QM lending can be an effective member service if conducted safely and soundly. NCUA will not subject a mortgage to safety-and-soundness criticism solely because of the loan's status as a QM or non-QM. Credit unions choosing to make non-QMs will need to take into account the potential new market and legal risks.

The enclosed Supervisory Letter also describes specific examination procedures and expectations for credit union mortgage lenders.

NCUA Regulatory Alert 14-RA-01 provides additional information about the new rule and its exemptions.

I encourage you to review both letters and to contact your regional office or state supervisory authority if you have any questions.

Sincerely,

/ s /

Debbie Matz
Chairman

Enclosures

# Ability to Repay (ATR) and Qualified Mortgage (QM) Rules

| | | |
|---|---|---|
| **INTRODUCTION AND PURPOSE** | | |
| **REGULATORY REFERENCES** | | |
| **RECORD RETENTION REQUIREMENTS** | | |
| **Implementation** | **Yes/No** | **Comments** |
| Has the credit union evaluated the current products or services it offers to members to determine applicability ? | | |
| Based on the products the credit union offers to members, have they determined which Dodd-Frank Act regulatory amendments impact their current products ? | | |
| Has the credit union developed an implementation plan ? | | |
| **Planning/Evaluation** | **Yes/No** | **Comments** |
| 1. Does the credit union's business plan address its Qualified and/or Non-Qualified Mortgage lending program? | | |
| 2. Does the plan establish clear performance objectives and benchmarks based on reasonable projections and assumptions? | | |
| 3. Did the credit union evaluate its capital exposure prior to implementing the program and is the credit union's capital sufficient to cover the potential exposure from these activities? | | |
| 4. Does the credit union periodically analyze the staffing and operational costs (e.g., overhead, technology, fixed assets) of implementing the program? | | |
| 5. Does the credit union evaluate the profitability of the program on an on-going basis? Are collection expenses, increased personnel expenses, and potentially higher loan losses considered? | | |
| 6. Does the credit union have staff experienced and trained in administering qualified and non-qualified mortgage loans? | | |
| 7. Does the credit union periodically assess its pricing structure? | | |
| 8. Does the credit union stress test its loan pools including an estimate of the portfolio's susceptibility to deteriorating economic market and business conditions? | | |
| 9. If credit scoring is used, does the credit union evaluate the scoring attributes to determine that they are effective determinants of risk and, in addition, compare them to nationally recognized scores? | | |
| 10. Does the credit union evaluate that the qualified and non-qualified mortgage lending program is in compliance with consumer compliance regulations (eg., ECOA, TILA, Reg X, RESPA) ? | | |
| **Ability-to-Repay and Qualified Mortgage Standards (Reg Z 1026.43)** | **Yes/No** | **Comments** |

| Ability to Repay (ATR) and Qualified Mortgage (QM) Rules | | |
|---|---|---|
| 1. To the extent the credit union seeks to preserve its ability to make loans that are not Qualified Mortgages, do their policies and procedures address the key components of the ability-to-repay provisions, including: | | |
| a. Obtaining and verifying certain financial information related to the member(s)? | | |
| b. Ensuring that members have sufficient assets or income to pay back the mortgage? | | |
| c. For adjustable-rate mortgages, that the monthly payment is calculated using either a fully indexed rate or an introductory rate, whichever is higher? | | |
| d. Any exemptions that apply and a full description of when the exemptions apply and conditions for exemptions (e.g., for a customer trying to refinance certain risky loans only after specific conditions are met)? | | |
| 2. Qualified Mortgages: does the credit union's policies and procedures address the key components of the qualified mortgage provisions, including: | | |
| a. Documenting, where applicable, that loans were eligible for purchase by Fannie Mae or Freddie Mac or insurable by FHA? | | |
| b. Restrictions on charging points and fees and prohibition of certain risky loan features (as applicable)? | | |
| c. Limits on debt to income ratios (as applicable)? | | |
| d. Full descriptions of qualifications for any qualified mortgage provisions (e.g., if the loan is made by a smaller creditor in rural or underserved areas)? | | |

# Supervisory Letter

NCUA | Office of Examination & Insurance
1775 Duke Street, Alexandria, VA 22314
www.ncua.gov

**SL No. 14-01**
**January 3, 2014**

**TO:** All Field Staff

**SUBJECT:** CFPB's Ability-to-Repay and Qualified Mortgage Rule

**ENCLOSURE:** Dodd-Frank Act Mortgage Rules Questionnaire

This supervisory letter provides information about the new Ability-to-Repay and Qualified Mortgage Rule (ATR/QM) issued by the Consumer Financial Protection Bureau (CFPB). The rule requires mortgage lenders to consider a consumer's ability to repay a home loan before extending credit to them. The rule establishes standards for Qualified Mortgages (QMs) that meet the ability-to-repay requirements, and provides a safe harbor for lenders that originate QMs.[1] **The rule applies to new mortgage loans made on or after January 10, 2014.[2]**

This letter establishes supervisory expectations with respect to credit unions' compliance with the new rule, including ensuring that credit unions meet certain risk-management expectations with regard to QM and non-QM loans. Also enclosed is a new questionnaire that will be incorporated into AIRES to assist field staff in conducting exams related to this rule.

**The guidance in this document applies to the supervision of all federally insured credit unions.** If you have any questions on the following material, please direct them to your immediate supervisor or regional management.

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## I. Background

Sections 1411 and 1412 of the Dodd-Frank Wall Street Reform and Consumer Protection Act require creditors to make a reasonable, good-faith assessment of a consumer's ability to repay any loan secured by a dwelling before extending credit to that consumer. This requirement was

[1] The complete text of the new rule is available on the CFPB's website at www.consumerfinance.gov/regulations/ability-to-repay-and-qualified-mortgage-standards-under-the-truth-in-lending-act-regulation-z/.

[2] The Ability-to-Repay and Qualified Mortgage rule is one of seven mortgage-lending-related rules issued by the CFPB in 2013. Credit unions are subject to all of these rules. See the appendix for a full list of new rules and their respective compliance dates.

written into the Dodd-Frank Act in response to the mortgage crisis, which resulted from many mortgages being made to consumers without regard to the consumer's ability to repay and which led to the nation's recent economic recession.

The CFPB's new rule implements the Dodd-Frank Act requirement and establishes certain protections from liability for QMs. The rule also limits prepayment penalties and requires creditors to retain evidence of compliance with the rule for three years after a covered loan is consummated.

### *A. Ability-to-Repay Requirement*

The new rule requires that, before or at the consummation of a mortgage loan, a credit union consider at least the following eight underwriting factors and use reasonably reliable third-party records to verify all information on which it relies:[3]

- Current or reasonably expected income or assets (other than the value of the property. securing the loan) the consumer will rely on to repay the loan.
- Current employment status (if a credit union relies on employment income when assessing the consumer's ability to repay).
- Monthly mortgage payment for this loan (using the introductory or fully-indexed interest rate, whichever is higher, and monthly, fully-amortizing payments that are substantially equal).
- Monthly payments on any simultaneous loans secured by the same property.
- Monthly payments for property taxes and required insurance, and certain other costs related to the property such as homeowners' association fees or rent.
- Debts, alimony, and child support obligations.
- Monthly debt-to-income ratio and residual income using the total of all of the mortgage and non-mortgage obligations, as a ratio of gross monthly income.
- Credit history.

A loan is not permissible if the credit union does not make a reasonable, good-faith determination that the member has the ability to repay the loan. Credit unions are responsible for developing and applying their own underwriting standards and making changes to these standards over time in response to empirical information, and changing economic and other conditions. Each credit union must establish its own ability-to-repay criteria in the context of the facts and circumstances relevant to their market, organization, and membership.

[3] Additional factors may be considered, but, at a minimum, these eight factors must be considered.

## *B. Qualified Mortgages*

Loans can achieve QM status under three categories: general, temporary, and small creditor. The following table summarizes the types and criteria for QMs.

<table>
<tr><th rowspan="2"></th><th rowspan="2">General QMs</th><th rowspan="2">Temporary QMs</th><th colspan="2">Small Creditor QMs</th></tr>
<tr><th>General</th><th>Balloon-Payment</th></tr>
<tr><td>Loan Restrictions</td><td colspan="3">• No negative-amortization, interest-only, or balloon-payment features<br>• Loan term may not exceed 30 years</td><td>• Balloon-payment feature allowed; other restrictions apply</td></tr>
<tr><td>Caps on Points and Fees</td><td colspan="4">• Generally 3 percent of total loan amount; higher cap for loans less than $100,000<br>• Up to two additional bona fide discount points allowed depending on rate</td></tr>
<tr><td>Higher-Priced Definition</td><td colspan="2">APR* exceeds the APOR** by 1.5 percentage points or more for first-lien loan and 3.5 percentage points or more for subordinate-lien loans</td><td colspan="2">APR* exceeds the APOR** by 3.5 percentage points or more for both first-lien and subordinate-lien loans</td></tr>
<tr><td>Underwriting Requirements (alternative)</td><td>• Underwrite based on fully amortizing schedule using maximum rate permitted in the first five years<br>• Consider and verify income or assets, current debt obligations, alimony, and child support<br>• Determine that the consumer's monthly debt-to-income ratio is no more than 43 percent</td><td>Loan must be eligible for purchase, guarantee, or insurance by Fannie Mae or Freddie Mac, FHA, VA, USDA, or the Rural Housing Service</td><td>• Underwrite based on fully amortizing schedule using maximum rate permitted in the first five years<br>• Consider and verify income or assets, current debt obligations, alimony, and child support<br>• Determine the consumer's monthly debt-to-income ratio, but the 43 percent threshold does not apply</td><td>• Loan term must be five years or longer<br>• Loan is fully amortized over 30 years or less<br>• Must consider and verify debts, income, and debt-to-income ratio or residual income (the 43 percent threshold does not apply)</td></tr>
<tr><td>Other Requirements</td><td colspan="2">N/A</td><td colspan="2">Must generally hold the loan in portfolio for 3 years</td></tr>
<tr><td>Expiration</td><td>N/A</td><td>Earliest of:<br>1) Date GSE exits federal conservatorship or receivership<br>2) Date the relevant agency's own QM rule takes effect<br>3) January 10, 2021</td><td>N/A</td><td>Small creditors' eligibility to originate balloon-payment QMs expires on January 10, 2016, unless that creditor operates predominantly in rural or underserved areas</td></tr>
<tr><td colspan="5">* APR = Annual Percentage Rate, ** APOR = Average Prime Offer Rate</td></tr>
</table>

For more information on the QM standard, refer to NCUA Regulatory Alert 14-RA-01 and the CFPB's *Ability-to-Repay and Qualified Mortgage Rule Small Entity Compliance Guide*.

The QM standard is intended to give creditors more certainty about potential legal liability. The new rule provides creditors that originate QMs two different levels of protection from liability. QMs that are not higher-priced[4] have a safe harbor under the new rule, meaning that they are conclusively presumed to comply with the ability-to-repay requirements. QMs that are higher-priced are presumed to be in compliance with the ability-to-repay requirement, but a borrower can rebut that presumption.

*Small Creditors*

The new rule provides that mortgages issued by small creditors will be considered QMs under certain conditions, provided the creditor has considered and verified a consumer's debt-to-income ratio.[5] The small creditor QM status applies to credit unions that have less than $2.028 billion in assets and, together with all its affiliates, originates 500 or fewer first-lien mortgages per year. The rule offers a two-year transition period during which all small creditors can make balloon-payment QMs; however, when that period expires (on January 10, 2016) only small creditors serving rural or underserved areas[6] will be able to originate balloon-payment QMs. Small creditor loans will lose their QM status if they are sold or otherwise transferred less than three years after consummation. These loans will retain their QM status if they are:

- Sold more than three years after consummation.
- Sold at any time to another creditor that meets the small creditor asset size and origination volume criteria.
- Sold pursuant to a supervisory action or agreement at any time.
- Transferred as part of a merger or acquisition of or by the creditor at any time.

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[4] General and temporary QMs are considered higher-priced if the loan's annual percentage rate (APR) exceeds the average prime offer rate (APOR) by 1.5 percentage points or more for first-lien loan and 3.5 percentage points or more for subordinate-lien loans. Small creditor general and balloon-payment QMs are considered higher-priced if the loan's APR exceeds the APOR by 3.5 percentage points or more for both first-lien and subordinate-lien loans. The Federal Financial Institutions Examination Council publishes APOR tables at www.ffiec.gov/ratespread/aportables.htm.

[5] Under the small creditor QM category, no specific debt-to-income limit applies.

[6] CFPB will publish an annual list of rural or underserved counties.

### *C. Non-Qualified Mortgages*

Credit unions may offer loans that do not qualify as a QM ("non-QM" loans) as long as a reasonable, good-faith determination is made that the member is able to repay the loan based on common underwriting factors in compliance with the ability-to-repay rule. Credit unions can continue to rely on existing underwriting guidelines that are sound and tested, resulting in loans that have generally performed well, as long as (1) the ability-to-repay rule requirements are met and (2) the credit union documents the information it has considered to make its determination.

**IMPORTANT:** Credit unions must understand and adequately address the increased risks posed by non-QM loans held in their portfolios. (See Guidance for Field Staff for more information about these risks.)

### *D. Ban on Prepayment Penalties*

Section 107(5) of the Federal Credit Union Act prohibits federal credit unions (FCUs) from charging prepayment penalties; however, state-chartered credit unions' ability to charge prepayment penalties varies from state to state. Under the new rule, all federally insured, state-chartered credit unions (FISCUs), even those chartered in a state that permits prepayment penalties, are banned from assessing most prepayment penalties, except on certain non-higher-priced QMs with either fixed or step rates.

Prepayment penalties are allowed on these non-higher-priced loans only if the penalties satisfy certain restrictions, are permitted under law, and if the creditor has offered the consumer an alternative loan without such penalties.

### *E. Record Retention Requirement*

The new rule requires creditors to retain evidence that it complied with the ability-to-repay requirements for at least three years after the origination of the loan. Credit unions may elect to maintain these records for a longer period as outlined in Appendix A (Record Retention Guidelines) to Part 749 of NCUA's Rules and Regulations.

## II. Risks Associated with QMs and Non-QMs

In order to comply with the new rule, most credit unions will need to enhance their written loan policies,[7] procedures, and processes with regard to mortgage lending. Credit unions will then need to perform regular periodic reviews to ensure that the rule requirements are consistently met. NCUA's primary objective in reviewing credit union mortgage lending is to ensure that credit unions have sound underwriting practices in place that mitigate certain mortgage-lending risks; nevertheless, there are certain risks associated with QM and non-QM lending that credit unions need to consider.

### *A. Credit Risk*

The ability-to-repay requirement of the new rule is intended to protect the borrower and the lender by requiring creditors to adequately research, assess, and document the borrower's ability to repay.

While QMs are presumed to have met the ability-to-repay requirements for legal purposes, QM borrowers remain at risk of default in the event of any number of circumstances (such as job loss, a drop in home value, etc.), which translates into credit risk for the lender. Meeting the minimum requirements of a QM loan does not automatically make it a "good" loan. These loans can still present credit risk as a result of:

- Inherent limitations in underwriting methodologies.
- Subsequent events that affect the borrower.
- High loan-to-value ratios.
- Inadequate or weak appraisals.
- Loan servicing or escrow account management problems.
- Weak collection practices and policies.
- Mismanaged loan modification practices and policies.

Non-QM borrowers present similar default risks as QM borrowers. In addition, certain features of non-QM loans, such as listed below, can present additional risk:

- Negative amortization.
- Interest-only or balloon payments.
- "No-doc" (no verification of income) loans.

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[7] Section 701.21 of NCUA's Rules and Regulations requires federal credit unions to establish written loan policies. For FISCUs, regulatory requirements for written loan policies vary from state to state. However, all federally insured credit unions must maintain written loan policies to be considered safe and sound.

- Elevated debt-to-income ratios.

Field staff need to ensure that credit unions have adequate policies that clearly outline procedures and criteria for granting QM and non-QM mortgages, and staff that are trained to grant mortgage loans in this new environment.

### *B. Liquidity Risk*

Credit unions that originate non-QM loans may find it difficult to find a suitable secondary market for these loans. This may create liquidity challenges in addition to capital management implications for the credit union.

Under the new rule, a credit union that qualifies under the "small creditor" definition may originate QMs with a balloon-payment feature. However, the rule requires that the loan be held in the credit union's portfolio for three years in order to maintain its QM status. This requirement will have clear liquidity implications that the credit union needs to take into consideration.

### *C. Concentration Risk*

When a credit union's loans are heavily concentrated in any sector, it will face the risk that a downturn in that sector will have an outsized impact on the credit union's overall loan portfolio. Thus, any concentration in mortgage loans presents certain risks. Credit unions need to closely monitor the size and performance of their QM and non-QM portfolios, establish concentration limits, and document those limits clearly in their loan policy. Field staff should look for management reporting that tracks the performance of loans by characteristic (e.g. QM versus non-QM loans). In addition, underwriting standards should be reviewed regularly and modified if the risk of the portfolio increases.

### *D. Legal Risk*

The new rule provides a presumption that creditors who originate QMs have complied with the ability-to-repay requirements and thus receive a safe harbor that protects them from certain legal action. Higher-priced QMs are provided a rebuttable presumption. Non-QMs are not covered by either protection, meaning that a credit union that originates this type of loan is exposed to a potentially higher level of legal risk. Lawsuits could be initiated by a single borrower or a group of members in the form of a class action lawsuit. If the borrower proves in court that the credit union failed to make a reasonable, good faith determination of the ability to repay during loan origination, the credit union could be liable for legal fees and up to three years of finance charges and fees.

Both QM and non-QM loans can be granted safely with proper controls, procedures, and policies. Nevertheless, legal risks are present and there is no precedent as yet for how courts will interpret the ability to repay rule, in addition to how a court will rule on fact pattern specific scenarios should a credit union be taken to court. Credit unions must consider the cost and implications associated with this risk when deciding if and to what extent to offer non-QM loans, in pricing these loans, in determining appropriate capital levels, and in operating such a program (including the impact on collection and loan modification procedures and the need for periodic review and calibration of the non-QM underwriting criteria).

## III. Guidance for Field Staff

The ability-to-repay determination in the CFPB's new rule is required of all federally insured credit unions that originate mortgage loans. As with any new requirement in its early stages after becoming effective, in determining supervisory ratings NCUA field staff will take into account a credit union's good faith efforts to comply with the new rule.

The QM provision of the new rule offers certain liability protections to credit unions that originate mortgages, but credit unions are not required to originate only QMs. From a safety-and-soundness perspective, a credit union may originate both QM and non-QM loans, based on its business strategy and risk appetite. NCUA will not subject a mortgage loan to safety-and-soundness criticism because of the loan's status as a QM or non-QM loan.[8]

**IMPORTANT:** A credit union may originate both QMs and non-QMs as appropriate for its overall business strategy and risk appetite. Field staff should not make safety-and-soundness criticisms based on a mortgage loan's status as a QM or non-QM loan.

NCUA continues to expect credit unions to underwrite residential mortgage loans in a prudent fashion and address key risk areas, including loan terms, borrower qualification standards, loan-to-value limits, documentation requirements, and portfolio- and risk-management practices, regardless of whether a residential mortgage loan is a QM or non-QM.

Consistent with this expectation, an improperly underwritten or past-due residential mortgage loan may be subject to criticism at origination or afterward, as appropriate to the facts and circumstances of the loan and regardless of its status as a QM or non-QM.

[8] See the joint industry guidance issued by the Federal Reserve Board of Governors, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and NCUA on December 13, 2013, available at www.ncua.gov/News/Pages/NW20131213QualifiedMtgLoans.aspx.

## IV. Exam Procedures

When conducting a review of a credit union's mortgage portfolio, field staff should ensure that the credit union:

- Reviews and updates its policies, procedures, and internal controls directly related to ensuring compliance with the ability-to-repay requirement. At a minimum, the underwriting standards must include the eight required factors.
- Verifies all the information used to determine a consumer's ability to repay using reasonably reliable third-party records. The credit union must retain these records for at least three years.
- Periodically evaluates the program and Allowances for Loan and Lease Losses (ALLL) funding in response to empirical results (based on actual delinquency and loss history) and current economic conditions.[9]
- Establishes concentration limits for the overall real estate portfolio as well as concentration limits for any non-QM mortgages.
- Prices any non-QM mortgages adequately to address the additional risk.
- Retains knowledgeable and experienced personnel who understand the risks related to non-QM mortgage lending if applicable.
- Determines how providing non-QMs will fit into its strategic plan and benefit its members.
- Identifies and tracks non-QMs in the loan portfolio to provide for adequate monitoring regarding loan performance, loss ratio, and ALLL funding pools.
- Addresses legal risks, including having qualified legal counsel review non-QM mortgage loan programs.
- Accounts for the impact these loans will have on Asset/Liability Management (ALM) modeling and liquidity management.

[9] As part of this evaluation, credit unions should look at mortgage loans that have defaulted early or shortly after any adjustable loan rate resets. These types of defaults could indicate that the credit union is not conducting reasonable, good-faith ability-to-repay determinations.

## V. Additional Guidance Relevant to the Ability-to-Repay and QM Standards Rule

This document outlines the safety-and-soundness concerns related to QM lending, and builds on previously issued NCUA guidance, including:

- *Ability-to-Repay and Qualified Mortgage Requirements from the Consumer Financial Protection Bureau* (Regulatory Alert, 14-RA-01)
- *Appraisals for Higher-Priced Mortgage Loans* (Regulatory Alert, 13-RA-08)
- *CFPB's New Rule on Real Estate Appraisals and Other Written Valuations under the Equal Credit Opportunity Act* (Regulatory Alert, 13-RA-07)
- *New Escrow Requirements under the Truth in Lending Act* (Regulatory Alert, 13-RA-05)
- *Concentration Risk* (Letter to Credit Unions, 10-CU-03)
- *Interagency Guidance on Nontraditional Mortgage Product Risk* (Letter to Credit Unions, 06-CU-16)
- *Increasing Risks in Mortgage Lending* (Letter to Credit Unions, 05-CU-15)
- *Interagency Policy Statement on the Allowance for Loan and Lease Losses* (NCUA Accounting Bulletin 06-01)

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If you have any questions on the material in this letter, please direct them to your immediate supervisor or regional management.

Sincerely,

Larry Fazio
Director, Office of Examination & Insurance

**Board of Governors of the Federal Reserve System**
**Federal Deposit Insurance Corporation**
**National Credit Union Administration**
**Office of the Comptroller of the Currency**

**June 17, 2016**

# Joint Statement on the New Accounting Standard on Financial Instruments - Credit Losses

## Purpose

The Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC) (hereafter, the agencies) are issuing this joint statement to provide initial information about the new accounting standard, Accounting Standards Update (ASU) No. 2016-13, *Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.*[1]

The Financial Accounting Standards Board (FASB) recently issued this new accounting standard, which introduces the current expected credit losses methodology (CECL) for estimating allowances for credit losses. The new accounting standard allows a financial institution to leverage its current internal credit risk systems as a framework for estimating expected credit losses.

This joint statement also provides initial supervisory views regarding the implementation of the new accounting standard. This important accounting change requires the attention of each financial institution's board of directors and senior management.

## Scope of the New Accounting Standard

The new accounting standard applies to all banks, savings associations, credit unions, and financial institution holding companies (hereafter, institutions), regardless of asset size.

## Key Elements of the New Accounting Standard

Under CECL, the allowance for credit losses is a valuation account, measured as the difference between the financial assets' amortized cost basis and the net amount expected to be collected on the financial assets (i.e., lifetime credit losses).[2]

To estimate expected credit losses under CECL, institutions will use a broader range of data than under existing U.S. generally accepted accounting principles (GAAP). These data include

[1] The FASB issued ASU 2016-13 on June 16, 2016. A complete copy of the document is available here.

[2] Paragraph 326-20-30-1 states, "The allowance for credit losses is a valuation account that is deducted from the **amortized cost basis** of the **financial asset(s)** to present the net amount expected to be collected on the financial asset."

information about past events, current conditions, and reasonable and supportable forecasts relevant to assessing the collectability of the cash flows of financial assets.

**Single measurement approach:** Impairment measurement under existing U.S. GAAP is often considered complex because it encompasses a number of impairment models for different financial assets.[3] In contrast, the new accounting standard introduces a single measurement objective to be applied to all financial assets carried at amortized cost, including loans held for investment and held-to-maturity securities.

**Scalability:** While there are differences between today's incurred loss methodology and CECL, the agencies expect the new accounting standard will be scalable to institutions of all sizes. Similar to today's incurred loss methodology, the new accounting standard does not prescribe the use of specific estimation methods. Rather, allowances for credit losses may be determined using various methods. Additionally, institutions may apply different estimation methods to different groups of financial assets. Thus, the new standard allows institutions to apply judgment in developing estimation methods that are appropriate and practical for their circumstances. The agencies do not expect smaller and less complex institutions will need to implement complex modeling techniques.

**Purchased credit-deteriorated assets:** Another change from existing U.S. GAAP involves the treatment of purchased credit-deteriorated assets. For such assets, the new accounting standard requires institutions to estimate and record an allowance for credit losses at the time of purchase, which is then added to the purchase price rather than being reported as a credit loss expense. In addition, the definition of purchased credit-deteriorated assets[4] is broader than the definition of purchased credit-impaired assets in current accounting standards.

**Accounting for available-for-sale debt securities:** The new accounting standard also updates the measurement of credit losses on available-for-sale debt securities. Under this standard, institutions will record credit losses on available-for-sale debt securities through an allowance for credit losses rather than the current practice of write-downs of individual securities for other-than-temporary impairment.

**Retained accounting concepts:** The new accounting standard does not change the existing write-off principle in U.S. GAAP or current nonaccrual practices, nor does it change the current accounting requirements for loans held for sale, which are measured at the lower of amortized cost or fair value.

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[3] Current U.S. GAAP includes five different credit impairment models for instruments within the scope of CECL: ASC Subtopic 310-10, *Receivables-Overall*; ASC Subtopic 450-20, *Contingencies-Loss Contingencies*; ASC Subtopic 310-30, *Receivables-Loans and Debt Securities Acquired With Deteriorated Credit Quality*; ASC Subtopic 320-10, *Investments-Debt and Equity Securities-Overall*; and ASC Subtopic 325-40, *Investments-Other-Beneficial Interest in Securitized Financial Assets*.

[4] The new accounting standard defines purchased financial assets with credit deterioration as acquired individual financial assets (or acquired groups of financial assets with similar risk characteristics at the date of acquisition) that have experienced a ***more than insignificant*** deterioration in credit quality since origination, based on the assessment of the acquirer.

**Effective dates:** The FASB has set the following effective dates for the new standard, which depend on an institution's characteristics:

- Public business entities (PBE) that are U.S. Securities and Exchange Commission (SEC) filers[5] (SEC filers): Fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.
- Other PBEs (non-SEC filers[6]): Fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.
- Non-PBEs (private companies): Fiscal years beginning after December 15, 2020, including interim periods beginning after December 15, 2021.

For all institutions, early application of the new standard is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

The table summarizes the effective dates.

| Effective Dates | | |
|---|---|---|
| | **U.S. GAAP Effective Date** | **Regulatory Reporting Effective Date*** |
| **PBEs that are SEC filers (SEC filers)** | Fiscal years beginning after December 15, 2019, including interim periods within 2020 | March 31, 2020 |
| **Other PBEs (non-SEC filers)** | Fiscal years beginning after December 15, 2020, including interim periods within 2021 | March 31, 2021 |
| **Non-PBEs (private companies)** | Fiscal years beginning after December 15, 2020, including interim periods beginning after December 15, 2021 | December 31, 2021 |
| **Early application for all entities** | Early application permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years | |

**For institutions with calendar year ends*

[5] An SEC filer, as defined in U.S. GAAP, is an entity that is required to file its financial statements with the SEC under the federal securities laws or, for an FDIC-insured depository institution, the appropriate federal banking agency under Section 12(i) of the Securities and Exchange Act of 1934.

[6] A PBE that is not an SEC filer would include (1) an entity that has issued securities that are traded, listed, or quoted on an over-the-counter market, and (2) an entity that has issued one or more securities that are not subject to contractual restrictions on transfer and is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including footnotes) and make them publicly available periodically (e.g., pursuant to Section 36 of the Federal Deposit Insurance Act and Part 363 of the FDIC's regulations). For further information on the definition of a PBE, refer to ASU 2013-12, *Definition of a Public Business Entity*, issued in December 2013.

**Transition:**[7] On the effective date, institutions will apply the new accounting standard based on the characteristics of financial assets as follows:

- **Financial assets carried at amortized cost** (e.g., loans held for investment and held-to-maturity debt securities): A cumulative-effect adjustment will be recognized on the balance sheet as of the beginning of the first reporting period in which the new standard is effective.
- **Purchased credit-deteriorated assets:** Financial assets classified as purchased credit-impaired assets prior to the effective date will be classified as purchased credit-deteriorated assets as of the effective date. For all purchased-credit deteriorated assets, institutions will be required to gross up the amount of the financial asset for its allowance for expected credit losses as of the effective date and should continue to recognize the noncredit discount or premium as interest income, if appropriate, based on the effective yield on such assets determined after the gross-up for the allowance.
- **Available-for-sale and held-to-maturity debt securities:** Debt securities on which other-than-temporary impairment had been recognized prior to the effective date will transition to the new guidance prospectively (i.e., with no change in the amortized cost basis of these securities).

## Initial Supervisory Views

### Measurement Methods

The new accounting standard does not specify a single method for measuring expected credit losses; rather, institutions should use judgment to develop estimation methods that are well documented, applied consistently over time, and faithfully estimate the collectability of financial assets by applying the principles in the new accounting standard.

The new accounting standard allows expected credit loss estimation approaches that build on existing credit risk management systems and processes, as well as existing methods for estimating credit losses (e.g., historical loss rate, roll-rate, discounted cash flow, and probability of default/loss given default methods).[8] However, certain inputs into these methods will need to change to achieve an estimate of lifetime credit losses. For example, the input to a loss rate method would need to represent remaining lifetime losses, rather than the annual loss rates commonly used under today's incurred loss methodology. In addition, institutions would need to consider how to adjust historical loss experience not only for current conditions as is required under the existing incurred loss methodology, but also for reasonable and supportable forecasts that affect the expected collectability of financial assets.

Nevertheless, taking these factors into account, the agencies expect that smaller and less complex institutions will be able to adjust their existing allowance methods to meet the requirements of the new accounting standard without the use of costly and complex models.

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[7] Refer to paragraph 326-10-65-1 for transition related to ASU 2016-13.

[8] For example, neither a vintage nor a discounted cash flow method is required for estimating expected credit losses.

### Use of Vendors

The agencies will not require institutions to engage third-party service providers to calculate their allowances for credit losses. If an institution chooses to use a third-party service provider to assist with this process, the institution should follow the agencies' guidance on third-party service providers.[9]

The agencies encourage institutions to discuss the availability of historical loss data with their core loan service providers. System changes related to the collection and retention of data may be warranted.

### Portfolio Segmentation

The new accounting standard requires institutions to measure expected credit losses on a collective or pool basis when similar risk characteristics exist. Although the new accounting standard provides examples of such characteristics, smaller and less complex institutions may continue to follow the practices they have used for appropriately segmenting the portfolio under an incurred loss methodology or they may refine those practices.

Further, if a financial asset does not share risk characteristics with other financial assets, the new accounting standard requires expected credit losses to be measured on an individual asset basis. As with practices applied under the incurred loss methodology, financial assets on which expected credit losses are measured on an individual basis should not also be included in a collective assessment of expected credit losses.

### Data

To implement the new accounting standard, institutions should collect data to support estimates of expected credit losses in a way that aligns with the method or methods that will be used to estimate their allowances for credit losses. Depending on the method selected, institutions may need to capture additional data. Institutions also may need to retain data longer than they have in the past on loans that have been paid off or charged off.

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[9] For the agencies' guidance on third-party service providers, refer to the following:

- FRB, Supervision and Regulation Letter 13-19/Consumer Affairs Letter 13-21, "Guidance on Managing Outsourcing Risk"
- FDIC, Financial Institution Letter 44-2008, "Guidance for Managing Third-Party Risk"
- OCC, Bulletin 2013-29, "Third-Party Relationships: Risk Management Guidance"
- NCUA, Supervisory Letter No. 07-01, "Evaluating Third Party Relationships"

### Qualitative Adjustments and Systematic Allowance Processes

Similar to the agencies' expectations under an incurred loss methodology, institutions should develop and document their allowance methodology and apply it in a thorough, disciplined, and consistent manner.[10] Estimating allowance levels, including assessments of qualitative adjustments to historical lifetime loss experience, involves a high degree of management judgment, is inevitably imprecise, and results in a range of estimated expected credit losses. For these reasons, institutions are encouraged to build strong processes and controls over their allowance methodology.

### Future Supervisory Guidance

The agencies are determining the nature and extent of supervisory guidance institutions will need during the implementation period, with a particular focus on the needs of smaller and less complex institutions. If institutions have issues or concerns about implementing the new accounting standard, they should discuss their questions with their primary federal supervisor.

### Successful Transition

Until institutions implement the new accounting standard, they must continue to calculate their allowances for loan and lease losses using the existing incurred loss methodology. Institutions should not begin increasing their allowance levels beyond those appropriate under existing U.S. GAAP in advance of the new standard's effective date. However, institutions are encouraged to take steps to assess the potential impact on capital.

Although the agencies recognize the impact of CECL will vary from institution to institution, the agencies encourage institutions to start planning and preparing for their transition to the new accounting standard by:

- Becoming familiar with the new accounting standard.
- Discussing with the board of directors, industry peers, external auditors,[11] and supervisory agencies how best to implement the new accounting standard in a manner appropriate to the institutions' size and the nature, scope, and risk of their lending and debt securities investment activities.
- Reviewing existing allowance and credit risk management practices to identify processes that can be leveraged when applying the new accounting standard.
- Identifying data needs and necessary system changes to implement the new accounting standard consistent with its requirements, the allowance estimation method or methods to be used, and supervisory expectations.
- Determining how and when to begin collecting the additional data that may be needed for implementation.

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[10] For the agencies' expectations under the incurred loss methodology, refer to the "Interagency Policy Statement on the Allowance for Loan and Lease Losses" issued in December 2006.

[11] When discussing the new accounting standard and its implementation with their external auditors, institutions and their audit committees should be mindful of applicable auditor independence requirements.

- Planning for the potential impact of the new accounting standard on capital.

Senior management, under the oversight of the board of directors, should work closely with staff in their accounting, lending, credit risk management, internal audit, and information technology functions during the transition period leading up to the effective date of the new accounting standard as well as after its adoption.

### Interagency Coordination

The agencies' goal is to ensure consistent and timely communication, delivery of examiner training, and issuance of supervisory guidance pertaining to the new accounting standard. The agencies will be especially mindful of the needs of smaller and less complex institutions when developing supervisory guidance describing the expectations for an appropriate and comprehensive implementation of this standard. The guidance will not prescribe a single approved method for estimating expected credit losses. Furthermore, because appropriate allowance levels are institution-specific amounts, the guidance will not establish benchmark targets or ranges for the change in institutions' allowance levels upon adoption of CECL or for allowance levels going forward.

## Conclusion

The move to an expected credit loss methodology represents a change to current allowance practices for the agencies and institutions. The agencies support an implementation of the FASB's new accounting standard that is both reasonable and practical, taking into consideration the size, complexity, and risk profile of each institution.

There was a discussion about underwriting guidelines and what steps credit unions can take to have quality mortgage loans.

**A. Definition of a Qualified Mortgage**

**B. Safe Harbor & Rebuttable Presumption**

**C. Interagency Statement on Supervisor Approach for Qualified and Non-Qualified Mortgage Loans**

**D. Supervisory Guidance on Qualified and Non-Qualified Mortgages**

**E. Ability to Repay and Qualified Mortgage Rules**

**F. Supervisory Letter – NCUA Office of Examination & Insurance**

- Page 2 section A. contains the 8 basic mortgage underwriting requirements needed with every consumer mortgage loan.
- Page 9 contains written exam procedures from the NCUA. You should not expect a lot of difference between these guidelines and the Department's.

## 4. Update on CECL – Riley Bergstedt

Riley provided a handout. **(See Handout G)**
Riley asked for comments from the industry and invited attendees to share their concerns and ask questions. There was a discussion about:

- The cost to purchase new software and examiners suggesting 3rd party software is necessary.
- Concern over the conversion and difficulties choosing the best software for the credit union's needs.
- Size and sophistication of the institution: how examiners will go from the smallest institutions to the larger credit unions and how to mitigate a "one size fits all" exam approach.

The Department is mindful of the impact on smaller institutions and wants to stress we will continue to learn more and time goes on. Riley advised that moving forward credit unions should apply what they are currently using to estimate probable loss and apply that approach to the portfolio for the life of the loan, expanding the "buckets" and classifications. Institutions should also focus on enhancing tracking and collecting data at this point, before 2020.

**G. Joint Statement on the New Accounting Standard on Financial Instruments – Credit Losses: FRB, FDIC, NCUA and OCC.**