

Discussion Draft Proposed WAC “Guidance” for Credit Unions

WAC 208-480-010

PURPOSE OF THESE RULES. These rules are designed to help Washington state-chartered credit unions establish, reiterate, integrate and maintain their own policies and procedures regarding subprime and nontraditional mortgage lending guidance. These policies and procedures are required by a new state law, SHB 2770, Chapter 108, Laws of 2008. [cite RCW when available]

WAC 208-480-020

WHAT IS THE “GUIDANCE”?

Because of concerns about problems with subprime mortgage lending, the federal government issued the Interagency Guidance on Nontraditional Mortgage Product Risks and a Statement on Subprime Mortgage Lending (collectively, “the Guidance”).

In 2007, Governor Christine Gregoire convened the Washington State Task Force for Homeowner Security. The Task Force recommended including the federal Guidance in state legislation. The 2008 Washington State Legislature enacted SHB 2770, requiring the Department of Financial Institutions to apply the two Guidance documents to financial institutions in Washington. Starting in 2008, credit unions, banks, mortgage brokers and other Washington state financial institutions must have “Policies and Procedures” that use the Guidance.

WAC 208-480-030

WHAT DOES THE GUIDANCE REQUIRE OF CREDIT UNIONS?

The stated intent of the guidance is to help borrowers to better understand adjustable rate mortgage (ARM) risks. The guidance requires credit unions and other financial institutions to have “Policies and Procedures” that focus on the various risks of subprime/nontraditional mortgage lending.

The Guidance requires credit unions to be aware of portfolio and risk management practices, to use appropriate underwriting standards and to abide by consumer protection principles. Credit unions also need to maintain strong internal control systems. Many of the recommendations in the Guidance are good business practices, and may already be followed by credit unions.

Not all of the elements of the Guidance may be applicable to all credit unions. Credit unions must determine which elements are relevant to their operations, and incorporate only those subjects into their policies and procedures.

WAC 208-480-040

IS THERE A LIST OF SUBJECTS THAT CREDIT UNIONS MUST INCLUDE IN THEIR POLICIES AND PROCEDURES

Yes, the guidance requires all financial institutions, including credit unions, to focus on the following subjects and apply the relevant ones to their existing policies and procedures:

- Help borrowers understand ARM risks, including:
 - Low initial payment
 - High or unlimited reset rate caps
 - Low or no documentation loans
 - Problems of frequent refinancing
 - Risk layering
 - Simultaneous second lien loans
 - Prepayment penalties
 - NCUA prohibited practices
- Understand portfolio and risk management practices, including:
 - Relationship between subprime lending and predatory lending
 - Risks of loans based on foreclosed or liquidation value
 - Problem of loan “flipping”
 - Fraud detection
 - Use of qualifying standards
 - Maintenance of appropriate capital levels
 - Use of appropriate allowance for loan and lease loss levels
 - Risks of stated income loans
- Underwriting standards
- Workout arrangements
- Consumer protection principles, including:
 - Use of a summary disclosure form
 - Avoidance of steering borrowers to inappropriate products
 - Explanation of payment shock risk
 - Explanation of prepayment penalty
 - Explanation of balloon payment
 - Explanation of costs of low documentation or stated income loans
 - Compliance with Truth in Lending Act and other federal requirements
 - Importance of good consumer communications in promotional materials and product descriptions
 - Explanation of borrower responsibility for taxes and insurance

- Development and maintenance of strong internal controls, including:
 - Management of deals with third party originators
 - Management of secondary market risk
 - Effective management information and reporting
 - Use of stress testing and performance measures
 - Actual practices consistent with policies

WAC 208-480-050

WHERE CAN I READ THE GUIDANCE DOCUMENTS ?

You can find the two federal Guidance documents on the internet:
<http://www.fdic.gov/news/news/press/2006/pr06086b.pdf> and
<http://www.fdic.gov/news/news/press/2007/pr07055a.html>

You can also click on the links on the DFI website at www.dfi.wa.gov

If you do not have internet access, you may contact the Department of Financial Institutions, Division of Credit Unions (DCU) for a copy of the documents.

Read these documents to ensure your credit union's application of the law, and to comply with its required integration of the Guidance into your policies and procedures. If your credit union needs help incorporating the Guidance to your Policies and Procedures, contact your lawyer.

WAC 208-480-060

WHY DO I NEED TO READ THE FEDERAL GUIDANCE DOCUMENTS?

The federal Guidance consists of two lengthy documents that are very detailed. Because they are required by state statutory law, they apply in their entirety. DCU cannot merely summarize them or give you a checklist. You must read the documents in order to apply them to your particular credit union, by integrating the Guidance into your own Policies and Procedures.

WAC 208-480-070

WHAT WILL the DIVISION OF CREDIT UNIONS (DCU) DO ABOUT COMPLIANCE WITH GUIDANCE POLICIES AND PROCEDURES?

Every state-chartered credit union is different. There is no one-size-fits-all Guidance available. DCU will not issue Model Guidance, because the process of self-analysis that a credit union needs to do, in order to develop its own Guidance Policies and Procedures, is beneficial. The DCU does not provide technical legal advice.

Also, the Guidance is complex, and will result in variations in wording or applicability of Guidance Policies and Procedures among credit unions, depending upon the size and

complexity of that particular credit union, the characteristics of its membership base, and the type of mortgage lending it does, if any.

For supervision purposes, the Division of Credit Unions will:

1. verify that a credit union has integrated the Guidance into its Policies and Procedures, as part of its risk-focused exam. DCU will not mandate the length or exact wording used in the Guidance Policies and Procedures.
2. review the Guidance Policies and Procedures with the credit union, if a consumer complaint indicates a problem or issue regarding subprime and nontraditional mortgage lending practices
3. verify that a credit union is following its policies and procedures.

The DCU expects prompt compliance by credit unions with the requirements of this rule.

The law provides DCU with examination, enforcement and investigation authority to take appropriate action against credit unions that are in noncompliance with the Guidance Policies and Procedures requirement.
