Meeting Between Governor Stein
and the National Association of Federal Credit Unions (NAFCU)
December 4, 2013

Participants: Governor Jeremy C. Stein, James Clouse, Robert Frierson, Stuart Passmore, Richard Watkins, Jeremy Oldfather, Rodney Ramcharan, Jon Hiratsuka, and Shahera Williams (Federal Reserve Board)

Michael Parsons, Robert Templeton, Richard Harris, Jeanne Kucey, James Cutler Dawson, Debra Schwartz, Rodney Taylor, Daniel Weickenand, Jihan Bahhur, Brian Berger, Patricia Briotta, Susan Broaddus, David Carrier, Douglas Christman, Michael Coleman, Lisa Cox, Anthony Demangon, Philip Hoffman, Carrie Hunt, Curtis Long, Katherine Marisic, Angela Meyster, Jilian Pevo, Randall Salser, Tessema Tefferi, and Bradford Thaler (NAFCU)

Summary: Representatives of the NAFCU, a trade association that represents the interests of federal credit unions, met with Governor Jeremy Stein and Federal Reserve Board staff to discuss the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The NAFCU representatives stated that credit unions are under a significant regulatory compliance burden, including from a number of Dodd-Frank Act regulations that are set to take effect in January 2014. The NAFCU representatives expressed concern about pending litigation regarding debit card interchange fees and about how the interagency proposal on credit risk retention, including the qualified residential mortgage provisions (Docket No. R-1411), might affect the secondary mortgage market. NAFCU representatives also commented on the need for guidance to help credit unions implement the alternatives to credit ratings promulgated in recent regulations.

The NAFCU representatives provided written views on these topics, which is attached.

Attachment

Debit Card Interchange Fees

NACS, et al., v. Board of Governors has the potential to change the face of interchange for credit unions and all other financial institutions alike. As such, NAFCU is appreciative of the Federal Reserve Board's decision to appeal the district court's ruling relating to the cap on interchange fees and network exclusivity provisions. In relation to interchange fees, NAFCU's last Economic & CU Monitor survey indicated that approximately 21.8 percent of our members' non-interest income came from debit card interchange fees. Although the district court's ruling does not directly influence fees charged by smaller issuers, NAFCU believes that market forces will drive down the fees financial institutions of all sizes can charge.

The impact of a fee cap will be substantially greater compared to other institutions because, unlike other financial institutions, credit unions cannot raise capital simply by going to the open market. The only capital they can raise comes from retained earnings.

The loss of fee income aside, the ruling also presents a substantial increase in compliance burden for credit unions. Credit unions of all sizes will be subject to the district court's interpretation of the network exclusivity rules, requiring at least two unaffiliated networks for each authentication method, if they are to go into effect. This interpretation of the network exclusivity provisions would require massive changes to the existing debit card system for issuers, according to 78 percent of Federal Reserve Survey (survey) respondents. NAFCU believes that serious safety and soundness issues will arise once credit unions factor the cost of complying with this requirement and, at the same time, realize reduced debit fee income. NAFCU appreciates that the Federal Reserve Board recognizes the importance of keeping the current electronic debit card payments system in place while these issues are considered in appeal.

Credit Ratings

Pursuant to the Dodd-Frank Act, the NCUA and other federal banking regulators have removed references to credit ratings in regulations, or replaced them with other appropriate standards of creditworthiness. The NCUA implemented the relevant provisions of the Dodd-Frank Act in three ways. First, for investments, the final rule replaces the minimum credit rating requirement with a requirement that credit unions conduct an internal credit analysis of the investment pursuant to one of two narrative standards: "investment grade" or "minimal amount of credit risk." Second, for counterparty transactions, the final rule replaces the minimum credit rating requirement with one that the credit union conduct an internal credit analysis of the counterparty pursuant to a standard set by the credit union's board. Finally, for regulations not concerning investments and counterparty suitability, the final rule removes the ratings requirement without requiring a substitute analysis.

NAFCU understands that, generally, an overreliance on credit ratings is not appropriate, especially with respect to risky investments. However, NAFCU remains concerned that without appropriate guidance on how to implement these new standards, credit unions will be exposing both themselves and their members to unnecessary credit risk. Further, there is the chance that individual credit unions and other lenders will develop disparate credit standards, and both they and their prudential regulators will face difficulty comparing and analyzing their financial statements. Accordingly, NAFCU urges regulators to strive for improved and detailed guidance concerning internal credit analysis to give credit unions a more concrete scale against which to measure their investments.

Government Sponsored Enterprises and Qualified Residential Mortgages

The Dodd-Frank Act also directed the Federal Housing Finance Agency (FHFA) to create parameters for "qualified residential mortgages" (QRM). The FHFA issued a proposed rule that would generally require securitizers to retain at least five percent of the risk for home mortgages. The proposed rule would eliminate this requirement for mortgages that meet certain underwriting standards and would thus qualify as QRMs. In an initial proposal, the QRM exception would have required a down payment of 20 percent as well as a loan-to-value ratio of 36 percent. However, the FHFA has now re-proposed the rule without these two requirements. Instead, QRM would be aligned with the CFPB's definition of "qualified mortgage." NAFCU strongly advocated for this change and is supporting the FHFA (and the other agencies working with the FHFA) on the re-proposal. While credit unions are technically exempt, the rule's impact will nevertheless be felt by any participant in the mortgage market.

The QRM proposal raises a broader question regarding the long-term health and viability of the secondary mortgage market. Credit unions rely heavily on the secondary market to make mortgage loans. Without a healthy secondary market, credit union mortgage lending would decrease significantly. The government should take steps to ensure there is a healthy and vibrant secondary market.

NAFCU strongly believes that housing finance reform must include guaranteed access for credit unions to the secondary market. In addition, NAFCU believes that fair pricing for credit union loans must be a part of any reform. To achieve guaranteed access and fair pricing, any reform must include the government guarantee of the principal and interest on mortgage-based securities. We also caution against reducing the government's role in the market too quickly by eliminating the guarantee on non-FHA loans, as doing so risks creating instability in the market, resulting in declining demand for mortgages and declining house prices.

Ensuring credit union access to the secondary market is one of NAFCU's top legislative and regulatory priorities. NAFCU is concerned that some current reform proposals would leave a secondary market dominated by a handful of large banking institutions. This could create undesirable consequences for credit unions and other small financial institutions, such as community banks.