Consumer Finance Podcast: Protection and Safety and Soundness Perspective of Credit Union Regulation
Host: Chris Willis
Guests: James Stevens and Carlin McCrory
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[Chris Willis]

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-practice leader of Troutman Pepper's Consumer Financial Services Regulatory group. And we have a great episode for you about all things credit union. But before we jump into credit unions, let me remind you to visit and subscribe to our blog, ConsumerFinancialServicesLawMonitor.com. Be sure to subscribe because we update this blog several times a day, every day, with everything that's going on in the consumer finance industry. And don't forget to check out our other podcast, *FCRA Focus*, which is released monthly on all popular podcast platforms. And if you like our podcast, let us know. Leave us a review on your favorite podcast platform.

Now, as I said today, we're going to be talking about all things credit union. And in fact, this is a great opportunity for us to showcase our expertise in both the consumer protection side of credit union regulation and the safety and soundness side of credit union regulation. And to do that, I'm joined by two of my colleagues here in Troutman Pepper's Atlanta office, Carlin McCrory, and James Stevens. So, Carlin, James, welcome to the podcast.

[Carlin McCrory]

Thanks for having me, Chris.

[James Stevens]

Thanks for having me too, Chris. I look forward to being here with you and your listeners.

[Chris Willis]

Well, that's great. And I'm sure they're going to be very interested to hear what you guys have to say today. Carlin, we're going to start with the consumer protection side of credit unions. And so, I had a few questions for you about what's going on with the National Credit Union Administration. And in particular, each year, the NCUA comes out with its supervisory priorities. And so, can you tell our audience a little bit about what the NCUA has said about its 2022 consumer protection priorities?

[Carlin McCrory]

Sure. So, the NCUA released its 2022 supervisory priorities. As per usual, they have a lot of overlap with the 2021 priorities. For example, cybersecurity, BSA, AML, the live war transition, and consumer financial protection are all topics that were previously in the 2021 supervisory priorities. However, the 2022 priorities added a few new topics, and these include payments, loan participations, fraud, and interest rate risk.

[Chris Willis]

So, what can you tell me in terms of a little bit more detail about the various consumer financial protection priorities that you just mentioned? I'm sure a lot of our listeners will be very interested in that.

[Carlin McCrory]

The examiners will really focus on the COVID-19 pandemic and how you handled that, fair lending, the Servicemembers Civil Relief Act, Fair Credit Reporting Act, and then overdraft programs, which we'll talk about a little bit later. So as for the pandemic, the regulators are really going to be looking at how you handled mortgage forbearances and other loan accommodations in your portfolio. Again, they're going to look at your policies and procedures, as always, to see how you handled the pandemic and your lending. We're also seeing that fair lending is a very hot topic these days with the regulators. The CFPB has shown a heightened interest in this as well. But as it relates specifically to the NCUA, examiners are also going to assess whether your institution has policies and procedures to evaluate the fairness and the accuracy of your appraisals. Also, after releasing these 2022 priorities, in February, the NCUA released an additional letter to federally insured credit unions regarding fair lending and non-discrimination requirements for credit unions.

[Chris Willis]

And what did the NCUA say on that topic in this subsequent document that you're just talking about?

[Carlin McCrory]

Sure. So, this is nothing new, but the creditor has to evaluate married and unmarried applicants using the same standards. As for joint applicants, creditors can't treat applicants any differently based off of being married. And we can't require that an applicant's spouse or another person sign the application if that person qualifies on his or her own behalf. As for age, again, this is nothing new, this is all in ECOA, but we can't take into account the applicant's age as long as they can enter into a binding contract. Lastly, they really honed in on redlining being an illegal practice, but this is important for credit unions in specific because of your fields of membership, which are oftentimes defined by geographical areas. So, you have to ensure that you're providing equal access to credit in all areas defined by your fields of membership.

Lastly, on this topic, which I thought was very interesting is the NCUA discussed indirect lending specifically as it relates to your auto-lending programs and those discretionary markups. So, what I mean by that, and as you all I'm sure are well aware, there are programs where dealers can establish their own compensation by increasing the interest rate above the credit union's buy rate. And credit unions that permit these discretionary markups need to be very careful that these dealers in increasing that interest rate above the buy rate are not doing such on a prohibited basis or discriminatory basis.

[Chris Willis]

Well, that's pretty interesting, Carlin. And like a lot of the first items you mentioned about joint applicants, and married applicants, and including age, and underwriting, as you said, are just black letter things in the Equal Credit Opportunity Act. Redlining is something that's been with us for a long time, but not something that I remember the NCUA doing much on. And the NCUA now seems to also be wading into the dealer finance charge issue that the CFPB so thoroughly embedded itself in around 2013 to 2016. Is it your sense that there's a greater amount of attention being paid by the NCUA to fair lending issues as compared to the past?

[Carlin McCrory]

Absolutely. It's definitely a hot topic, like we've talked about with the CFPB. All of the regulators are taking a keen eye to fair lending and discriminatory practices.

[Chris Willis]

So, speaking of hot topics, you also mentioned overdraft programs. I feel like I can't read the news any day of the week and not hear about overdraft, but what's the NCUA saying about it?

[Carlin McCrory]

So, the NCUA has always been looking at your policies, and procedures, and the documents you give your consumers on your overdraft programs, and making sure you're complying with Reg E. However, we saw that Todd Harper, Chairman of the NCUA, spoke on overdraft fees back in March in a webinar. And I quote from him, he stated, "It's time to start rethinking your overdraft programs." So, in this webinar, he recognizes that all credit unions aren't going to cut their fees or completely eliminate these overdraft programs immediately, but we need to start thinking about some alternatives. So, these can be anything from linking to savings accounts, offering affordable lines of credit, or short-term small dollar loans. He posed some other alternatives such as shifting heavy over drafters into standard loan products, like credit cards. He also posed possibly promoting tiered or premium accounts, where certain customers will pay monthly account fees, but these account fees will help the consumer pay less in overdraft protection fees. He also stated that exploring non-interest revenue sources for value add-on products and services is a really good opportunity as well.

[Chris Willis]

Okay, well, thanks Carlin. And as I said at the top of the podcast, it's really a wonderful thing here at Troutman Pepper, that in addition to our strong consumer protection practice, which Carlin just gave you a lot of details about with respect to credit unions, we also have a fantastic well-rounded financial services practice. And James Stevens is a big part of that. And James, one of your specialties is safety and soundness issues, both for banks and credit unions. So, I thought we'd talk for a second about some of those issues that affect credit unions. So, let's start off with talking about loan participations. I know that loan participations have increased in credit unions in recent years. What's the implications of that phenomenon?

[James Stevens]

Yeah, Chris, you're right. I think it's two things that have been driving that growth. I mean, a lot of other things perhaps, but two big things in the past couple years, has been the pandemic and the massive amount of deposit growth at all financial institutions. And as credit unions have built up large amount of shares, they are looking for opportunities to put that money to work, and loan participations have been a source for that.

The other are the growth of the FinTech space that we've been seeing. A lot of credit unions are getting into that. They're originating either directly or indirectly through QSOs perhaps. And then some of them are just trying to be a liquidity source and buying loan participations. And so, I think the NCUA has said recently that that's going to be one of their key supervisory priorities. Those that are on a flow basis, they're going to be looking at them from a third-party vendor management standpoint, making sure that credit unions are doing their due diligence, they're monitoring these programs. And they're going to want to make sure, really, that the credit unions that are buying these loan participations really understand and are managing the legal compliance and the reputational risks. I always say that one thing that a credit union can't do is outsource compliance. And I think that when you are buying big, big chunks of loan participations, that's going to be something that's going to be looked at very carefully by your regulators.

[Chris Willis]

That's really interesting, James. And another thing that I know is very consequential on the safety and soundness side for financial institutions, including credit unions, is CECL, the new accounting standard that credit unions are bracing for the implementation of in 2023. For credit unions that engage in consumer lending, how will that impact them?

[James Stevens]

CECL is probably my least favorite supervisory topic to talk about. Fortunately, it's mostly an accounting topic, but there's certainly a legal aspect to it. So just in case everybody here is not up to speed on CECL. CECL's a new loan impairment model under GAAP. And so historically, financial institutions would put up their allowance based on incurred losses in their portfolio. What CECL does is accelerate that and say that you have to estimate losses at the time you make a loan. So what we've seen, as other financial institutions have already adopted CECL, is that for many banks that have done that, they are seeing a dramatic increase in their reserves on consumer loans because the idea is that loans that are being made right now, June 2022 or in January of 2023, where we're in or teetering towards a recession, that if you're estimating the loss in that loan, when made, it's probably going to be higher than if you're making a loan where you're just going to be making an allowance at the time the loss is incurred.

I think the other phenomenon that we've seen, specifically with respect to the consumer space, is that you've had this tremendous growth in alternative data that's driving consumer lending. And so, the problem... I mean alternative data is great. And I think that we could have a whole podcast on that. You probably already have had a whole podcast on that, Chris. But I think that when you're talking about reserving for loan losses, the problem with alternative data is that it hasn't been through multiple cycles. We just haven't seen the up and down cycles occurring during the time that alternative data has taken such a prominence in consumer lending. And so, it's really hard to say what the estimate of the loss is when you're using data that's never been used through up and down cycles.

[Chris Willis]

And James, speaking of a recession, again, it's a constant theme in the news, and if you're watching the stock market in the financial news, that the United States may be headed towards a recession. So, if that happens and we actually do enter a recession in the United States, how will that impact consumer loan portfolios that credit unions are holding from a regulatory standpoint?

[James Stevens]

In a recession, the regulators start looking really hard at credit portfolios. And credit unions, of course, are tremendous lenders to the consumer community, and so they have large consumer portfolios. What I also know is that what we've seen over the past say decade or so is a tremendous focus on risk management. And so, I think when you put those two phenomenon together, what we can predict is that when we get into that pending recession is that we're going to see a tremendous focus on credit risk management. And with credit unions, it's going to be credit risk management with respect to consumer portfolios. And so, credit unions would be smart to be looking at making sure they have safe and sound lending practices, certainly that they're complying with consumer financial protection laws, including all the disclosure regulatory requirements, cleaning up things that maybe are not buttoned up enough. And then also looking at hardship, financial hardships, and how they're addressing them, and how they're meeting the needs of their communities. Regulators want to see that. They want to see it done also safe and sound and compliant with the consumer financial laws. So, I think that's the biggest takeaway for me when I think about credit unions going into a recessionary environment and thinking about how that's going to look with the focus on credit risk management.

[Chris Willis]

Well, thanks a lot, James. And I think this discussion with you and Carlin has really showcased the fact that our financial services practice here at Troutman Pepper can offer a credit union or any other financial institution everything they need in a one stop shop. So, I'm very grateful that, Carlin, you and James, both joined me on the podcast today. And of course, I'm especially grateful for you, our listeners, listening into the podcast today. Don't forget to visit our blog at ConsumerFinancialServicesLawMonitor.com and hit that subscribe button so that you can get our daily updates about everything that's happening in the consumer finance industry. And head over to troutman.com and add yourself to our consumer financial services email list so that you can get our alerts and sign up for our industry only webinars. And of course, stay tuned for a great new episode of this podcast every Thursday. Thank you all for listening.