CMG MI Signals

3rd Quarter 2009

The Modification Alternative to Refinancing

Updating Your ALCO Policy Can Eliminate Reporting Issues

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The following scene has recently replayed at Credit Unions across the country. A member—let's call her Mary—visits her local branch, wanting to take advantage of low interest rates by refinancing her mortgage. After a short discussion, the Credit Union's loan officer understands the following:

- The Credit Union holds Mary's mortgage in portfolio.
- She is current on her mortgage and has never missed a payment.
- Her household employment, income and credit scores have remained stable since the existing loan closed.

As a potential refinancing, it sounds like a slam dunk. At least the loan officer thinks so, until the property appraisal arrives and shows a decline in the value of Mary's home, resulting in a new loan-to-value that falls outside of lending guidelines. For many Credit Unions, this is an intractable problem that can shatter members' hopes of reducing their mortgage payments.

But should it be a stumbling block? Short of violating underwriting guidelines, can anything be done to help Mary and the thousands of other members who fit her profile? CMG Mortgage Insurance Company (CMG MI) believes there is an alternative: Loan modification.

Not All Modifications Qualify as Impaired Loans/TDRs

Loan modifications have been around a long time, but they may be new to Credit Unions in the context of helping members who are current in their payments and not in imminent danger of default to take advantage of lower interest rates. Modifying the loan would achieve this goal, but many Credit Unions feel they can't offer modifications to good-quality members — because doing so may automatically reclassify that loan as a *Troubled Debt Restructure*, or TDR.

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If a loan was current prior to its modification, is it still deemed current after the change? Or does the act of changing the terms of a loan make it a TDR? These are not trivial questions, as the National Credit Union Administration (NCUA) requires TDRs—also known as impaired loans—to be reported and for the reporting institution to post additional reserves against potential losses. Many Credit Unions have addressed the problem of classification by using policies established by their Asset Liability Committees (ALCOs), which require all modified loans to be categorized as impaired.

This result is a widespread belief that modifications are only for problem loans, which limits the tool's effectiveness and range of uses.

This was never an issue when property values rose year after year, but in today's recessionary environment, policies that diminish the role of loan modifications work against: 1) improving the financial position of members and 2) reducing the risk of a loan already in portfolio.

Define Your Terms

There is a way for Credit Unions to get around this problem. To begin with, let's look at how TDRs are defined by the NCUA. In a letter issued to the Michigan Credit Union League, the NCUA's counsel recommended "…We note credit unions must report any loan modifications, including those made under the Making Home Affordable program, on their NCUA 5300 reports. Credit unions should refer to Statement of Financial Accounting Standard No. 15 … to determine whether to define a modification as a 'Troubled

Debt Restructuring' and report it accordingly."

Statement No. 15 issued by the Financial Accounting Standard Board (or "FASB," the designated organization in the private sector for establishing standards of financial accounting) was actually superseded in July under the FASB's codification project and is now listed as "Topic 310." It states that a troubled debt restructuring is defined as such "[I]f the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider."

Determining whether your member's request for a refinance/loan modification qualifies as a TDR is therefore a 2-step process:

1. Determine whether the member is experiencing financial difficulty.
2. Determine whether your Credit Union will be granting a concession.

Bring Your Credit Union's ALCO Policy into the Present

Next, check your Credit Union's ALCO Policy as to how loan modifications/TDRs are defined in it and how this definition compares with that in FASB Topic 310 (formerly Statement No. 15). It may not be a problem, but if the Policy's internal consistency requires that you report *every* loan modification as a TDR, you should work with your ALCO and your Accounting Department to further evaluate that Policy's definition of a TDR. The bottom line is that if the borrower's position can be improved, so will that of the Credit Union.

Restrictive ALCO Policies should be updated to reflect the new wisdom that not all loan modifications are TDRs or impaired loans — a loan modification qualifies as a TDR only when there is a credit life event for the borrower (health crises, divorce, or other catastrophic problem that means he or she can't pay the mortgage) that constitutes "financial difficulty." A refinance for a member with a job and with good credit but whose property has depreciated in value is not a TDR. This member is still able to make payments under the current terms of their mortgage, so the Credit Union is not making a concession it "would otherwise not have considered."

With a new ALCO Policy in place, the Credit Union will no longer be required to report these refinances as TDRs to the NCUA — and post the additional loan loss reserves. Instead, it will be able to help members while strengthening its own financial position.

This window of opportunity for refinances may close soon, as interest rates go up. *Now is the critical time for Credit Unions to get their ALCO Policies changed* — so they can accommodate the demand for refinancing the mortgages of members in good standing.

Talk to CMG MI About Insured Loans that Need Refinancing

CMG MI understands the challenges that you and your members face, and we want to support Credit Unions in modifying the mortgage loans we insure. In the words of the NCUA, "prudent workout arrangements can be in the best interest of all parties involved."

Talk to us if you are trying to help a member refinance or modify a loan that has been sold to the GSEs. For members who would like to refinance but have properties that have declined in value, we have developed a suite of programs, CU HomeKeepers, that works with the government Home Affordable Refinance Program (HARP) and Home Affordable Modification Program (HAMP).

For members who simply want to take advantage of lower interest rates and refinance, but are otherwise in good standing, we offer our Standard Refi and EZ-Refi programs. Visit **www.cmgmi.com/cuhomekeepers** to learn more or contact your CMG MI Account Executive.

Internal Guidelines Are Not Set in Stone

In this time of unprecedented change for the mortgage industry, we all need to take a look at our internal policies and guidelines and determine if they are adequate to the situation — or merely preserve an outdated way of thinking. For many Credit Unions, their ALCO Policies were put in place at a time when declining property values were hardly imaginable.

Now that the unimaginable has happened, ALCO Policies — and other guidelines — must be brought into line with what's actually going on. Any internal policy should be regularly examined to ensure that it reflects the actual economic environment and is not inhibiting legitimate business opportunities. The mortgage industry will continue to be volatile for the foreseeable future. As Credit Unions aspire to an even larger share of the nation's mortgage market, they'll need to keep pace with the changes to come.

CMG Mortgage Insurance Company (CMG MI) supports sustainable homeownership with products and services that can help Credit Unions keep members in their homes. What are the challenges to homeownership in your community – and how can we help? Let us know what you think and what we can do for you by contacting your CMG MI Account Executive or sending an e-mail to CMGMortgage.InsuranceCo@cmgmi.com

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