WRITTEN TESTIMONY
OF
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ON
MODERNIZING BANK SUPERVISION AND REGULATION, PART II
BEFORE THE SENATE BANKING COMMITTEE

MARCH 24, 2009

Chairman Dodd, Ranking Member Shelby, and members of the Committee, on behalf of the Credit Union National Association (CUNA), I appreciate the opportunity to appear before you to express the need for maintaining an independent federal regulatory agency for federally-insured credit unions.

I am Dan Mica, the President and CEO of CUNA. CUNA is the largest credit union advocacy organization in this country, representing approximately 90 percent of our nation's 8,000 state and federal credit unions and their 92 million members.

Mr. Chairman, I applaud you for addressing this pressing issue. The collapse of the financial system has exposed flaws in the regulation of US financial institutions, and these flaws absolutely must be addressed. I suggest, however, that most of the current crisis was caused by the actions of relatively unregulated financial institutions, and by compensation practices at even regulated institutions that encouraged excessive risk taking. I can assure you that neither of these two factors exists at credit unions. Credit unions did not in any way contribute to the current financial debacle and their current regulatory regime coupled with the cooperative structure militates against credit unions

ever contributing to a financial crisis. Therefore it is imperative that credit unions not be swept up in the tide of regulatory reform that is so essential for some other parts of the financial system.

Credit unions' unique mission, governance structure, and ownership structure necessitate an independent federal regulator in order to ensure that the credit union model is not eroded as a result of the misapplication of bank regulations to credit union operations. Unlike for-profit banks, credit unions are not-for-profit institutions that exist to serve their member-owners rather than to profit from them. Also unlike banks, the members of the credit union own their institutions, which are subject to a democratic, one-member-one-vote system irrespective of members' account balances or any other factor.

I am aware that, on Friday, March 21, NCUA did place two wholesale, or "corporate," credit unions into conservatorship. Those institutions serve only other credit unions, not people, and are completely different from the 8,000 retail, or "natural person," credit unions in this country. Natural person credit unions have very narrow investment powers and very conservative investment policies, whereas corporate credit unions enjoy broader investment powers. Essentially, what created losses at the two corporate credit unions were declines in the values of mortgage-backed securities in which they had invested. Although these securities were originally AAA-rated and appeared prudent when they were made, market developments provide to the contrary. Let me emphasize two points here: first, few, if any, of the mortgages backing the securities were originated by credit unions; and second, the credit union system itself is funding the losses on these

investments. That is not to say that we would reject some government help with the problem; we would prefer some help, which we would pay back, spreading the losses over time. But we expect to pay for the problem ourselves, and the problem says nothing about the condition or operations of credit unions that you and I can join.

Getting back to the current discussion of regulatory restructuring, let me call your attention to the fact that, for decades, the banking industry has sought the extinction of credit unions in this country. Rather than pursue this goal in the marketplace, banks often seek to leverage legislation and regulations against credit unions through intense, well-funded lobbying and litigation. We urge Congress not to allow its deliberations about financial regulatory restructuring regulatory to become a vehicle for more of these tactics. The loss of the diversity, conservative management, and consumer ownership of credit unions through the creation of inappropriate regulatory mechanisms would be tragic not only for credit unions, but also for the 92 million consumers who take advantage of credit union service. As I explain in more detail below, regulatory restructuring could force credit unions into the mold of the banks if restructuring is not approached with care.

Changes to the Credit Union Regulatory Structure Should be Tailored to the Need

Although the causes of the current economic crisis are complex, few can doubt that the skyrocketing rates of mortgage loan defaults and foreclosures of the past few years were the catalyst, with the resulting drop in housing values serving to exacerbate these problems. The primary culprits were subprime mortgage loans characterized by high

rates with large interest-rate re-sets, negative amortization, lack of sufficient underwriting, or other indicators of fraud.

Unlike other types of financial institutions, credit unions originated few if any of the subprime mortgage loans with these characteristics and have not otherwise been the cause of our current economic circumstances. Credit unions' generally conservative lending practices and ongoing efforts to place the needs of members over profits have distinguished them from those who made unscrupulous loans in recent years.

This distinction has been recognized by many in Congress. For example, Congressman Barney Frank (D-MA) has publicly stated that the economic crisis would never have occurred if all lenders originated loans in the same manner as credit unions.

Unfortunately, the high rates of mortgage defaults and foreclosures have affected credit unions and their members as the current recession has deepened. Increased unemployment and other factors have affected the ability of some members to keep current on their mortgage, auto loan, and other obligations. Notwithstanding these difficulties, credit unions have been able to continue making loans, while other types of financial institutions have curtailed lending, and these efforts have been noted by the mainstream media. According to a March 15th *Wall Street Journal* article, as banks cut back on lending, credit union loans rose by 7% in 2008 to over $575 billion, up $35 billion from the previous year. The article also noted that bank loans in the country declined about $31 billion during this time.

We certainly recognize that the current economic circumstances highlight the need to restructure the financial regulatory system. However, we believe these efforts should focus on protecting consumers, preserving their financial choices—including through dual chartering—and limiting the systemic risk that is currently posed by institutions within the financial system which present disproportionate risk and have not been subject to sufficient regulatory oversight.

Although we recognize that there are many suggestions to address these issues, such as creating a centralized systemic risk regulator or perhaps by enhancing the Federal Reserve Board's authority in the area of systemic risks, we urge Congress to exclude from the scope of such regulation smaller institutions that have shunned undue risk. Credit unions are among those in this category. By focusing on institutions whose operations and actions present the greatest risk, Congress will avoid the danger that credit unions—the very institutions that observed conservative lending and underwriting practices—could find themselves deprived not only of a voice, but even an audience, at a regulator dominated by larger, riskier institutions. We look forward to reviewing from this perspective the specific proposals and bills that will be introduced in the near future.

Another caution comes from our experience with the Treasury under the past Administration and at times, the Federal Reserve Board. More specifically, credit unions and their regulator have not always had opportunities to provide input on the development of rules and policies that impact their operations to the same extent as

banks. For instance, credit unions often have difficulty getting appointments with key Federal Reserve officials, and those officials routinely decline requests to appear before credit union audiences. A previous head of the Federal Deposit Insurance Corporation (FDIC) publicly called for taxation of credit unions, and the Office of Thrift Supervision, which has sometimes been short on institutions to regulate, has encouraged credit unions to convert to thrift charters. This should come as no surprise because those agencies' bank stakeholders view credit unions as their competition and spend a great deal of time, money, and effort lobbying against credit union interests, suing the National Credit Union Administration (NCUA), and using any other available means to try to put credit unions out of business.

While we are hopeful that this is changing, past practices from these agencies help to illustrate why including small institutions, such as credit unions, under a large regulator focused on banks and/or other major market players would be detrimental to the interests of credit unions and their members.

Since credit unions have not posed any systemic risks to the financial system or otherwise been the cause of the current economic crisis, we believe that only minimal changes need to be made to the regulatory structure of credit unions, including federally-insured credit unions that are regulated by NCUA. The goal of these changes should be to enhance the quality of NCUA's regulatory structure and supervisory oversight.

Credit Unions Need an Independent Federal Regulator

Not-for-profit credit unions' unique mission, democratic governance, and cooperative ownership structure necessitate an independent federal regulator for credit unions. The U.S. credit union system should continue to be regulated and supervised by an independent federal agency for the following three reasons:

1. <u>Inherent risk aversion.</u> The cooperative structure of credit unions presents management with very different incentives related to risk taking than at for-profit institutions. These differences require a correspondingly different system of prudential regulation and deposit insurance than that which is appropriate for-profit institutions.
2. <u>Preservation of member benefits.</u> The cooperative structure produces substantial benefits to credit union members, which should be preserved.
3. <u>Long-term viability.</u> If the prudential regulation of credit unions were merged with that of for-profit depository institutions, credit unions would be transformed into for-profit institutions.

The credit union way of doing business is significantly different even from mutual savings associations' because mutual thrifts are for-profit, rely heavily on proxy voting, have self-perpetuating and management-controlled boards, and almost always base their member-depositors' voting power on their account balances giving, for example, one vote for every $100 in a depositor's account. As the 105th Congress noted in the findings to the Credit Union Membership Access Act in 1998:

> "Credit unions, unlike many other participants in the financial services market, are exempt from Federal and most State taxes because they are member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means."

The unique cooperative structure of credit unions entails a set of incentives for managers that differ markedly from those presented to managers of for-profit institutions. The not-for-profit, democratically controlled, and member focused orientation of credit unions has a significant effect on the behavior of credit union managers. Credit unions must over time earn a positive bottom line to retain earnings to build capital, which is crucial to federally insured depository institutions. However, credit unions operate in a mode of merely generating adequate net income to build capital, rather than profit maximization. They are driven instead to maximize member satisfaction. The managers and boards of credit unions do not own stock in the credit union (there is no such thing) and they have no stock options. They therefore have much less incentive to pursue risky initiatives that might increase the stock price and hence their own wealth. One of the very driving forces that led to the current financial crisis is completely absent from credit unions.

In the words of Edward Kane of Boston College Finance Department, who correctly foresaw and analyzed the savings and loan debacle of the late 1980s: "The cooperative structure of human-person credit unions creates reservoirs for firm value and systems for distributing claims to future cash flows that differ markedly from those of other deposit

institutions. These differences make it less feasible for managers to pursue and to benefit from either corrupt lending or go-for-broke strategies of risk-taking."

The table that follows starkly illustrates Kane's point in terms of one of the most basic risks that financial institutions take on: the risk of lending. Credit union loan losses are consistently lower than at banks, across all loan types. Although credit unions and banks make similar types of loans, the credit union record of relatively conservative lending is striking. Over the past decade, bank loan charge-offs ranged from eight times higher than the credit union norm (for business loans) to nearly two times higher than the credit union norm (for non-credit-card consumer loans).

Financial Institution Chargeoffs Net of Recoveries (as a % of Loans Outstanding)

	Credit Card Loans		Other Consumer Loans		Mortgage Loans		Business Loans	
Year	Banking Institutions	Credit Unions	Banking Institutions	Credit Unions	Banking Institutions	Credit Unions	Banking Institutions	Credit Unions
1999	4.40	1.85	1.01	0.59	0.07	0.03	0.57	0.12
2000	4.36	1.57	1.15	0.52	0.08	0.02	0.81	0.05
2001	5.15	1.76	1.26	0.60	0.15	0.02	1.43	0.10
2002	6.22	1.98	1.45	0.72	0.13	0.02	1.76	0.09
2003	5.61	2.14	1.47	0.81	0.13	0.02	1.25	0.08
2004	4.99	2.01	1.28	0.80	0.07	0.03	0.54	0.10
2005	4.74	2.13	1.35	0.83	0.05	0.02	0.32	0.05
2006	3.44	1.49	1.06	0.75	0.08	0.03	0.32	0.08
2007	4.06	1.62	1.52	0.83	0.23	0.08	0.54	0.09
2008	5.44	2.84	2.13	1.28	0.99	0.29	1.01	0.34
10-Yr. Average	**4.84**	**1.94**	**1.37**	**0.77**	**0.20**	**0.06**	**0.86**	**0.11**
Bank as a % of CU	**2.50**		**1.77**		**3.57**		**7.79**	

Sources: FDIC, NCUA, and CUNA Policy Analysis.

These differences in loan losses stem from the natural tendency toward risk aversion induced by the cooperative structure. Further, credit unions lending is virtually exclusively consumer and small business oriented. The Treasury Department found in 2001 that: "Over 50 percent of the [credit union business] loans reported to us by survey respondents were made for businesses with assets under $100,000 and about 86 percent of those made were to businesses with total assets less than $500,000." Obviously, such

striking differences in natural behavior and market orientation require a different form of prudential regulation and deposit insurance.

The behavioral differences seen in cooperative financial institutions also produce large societal advantages that are worth promoting and preserving. Some of these benefits are non-financial, such as the ability to exert control of the institution through the democratic process, access to large cooperative ATM networks, financial counseling, auto buying services, and the like. Significant financial benefits also are obvious. The credit union difference provides consumers with consistently favorable interest rates on loans and savings accounts and also gives rise to the imposition of fewer and lower fees. The table that follows highlights some of the financial advantages that were available in 2008. The 1.73 percentage point average rate differential on 4-year used car loans translates into nearly $600 in savings to the consumer who uses a credit union to finance a $15,000 vehicle.

2008 Average Monthly Interest Rates on Loans and Savings Accounts at Credit Unions and Banking Institutions

	48M CAR 2YR OLD		HOME EQ LOC 80%		UNSECRD FIX36		CREDITCRD CLASC		30YR FIX MTG		REG SAVINGS		MONEY MARKET		1 YR CD	
Month	**CU**	**Bank**	**CU**	**Bank**	**CU**	**Bank**	**CU**	**Bank**	**CU**	**Bank**	**CU**	**Bank**	**CU**	**Bank**	**CU**	**Bank**
January	6.31	7.87	6.98	7.19	10.96	12.71	12.02	14.62	5.81	5.86	0.89	0.66	1.81	1.04	4.1	3.25
February	6.09	7.64	6.32	6.30	10.85	12.61	11.93	14.22	6.28	6.28	0.86	0.61	2.44	1.82	3.6	2.81
March	5.94	7.48	6.04	6.01	10.78	12.53	11.90	13.90	6.05	6.04	0.82	0.55	2.26	1.59	3.18	2.45
April	5.76	7.42	5.52	5.60	10.70	12.41	11.86	13.60	6.11	6.18	0.77	0.53	2.3	1.64	2.94	2.36
May	5.67	7.41	5.33	5.33	10.63	12.48	11.79	13.49	6.26	6.26	0.75	0.51	2.21	1.53	2.87	2.39
June	5.64	7.45	5.28	5.29	10.64	12.47	11.75	13.16	6.53	6.53	0.74	0.51	1.93	1.36	2.87	2.51
July	5.65	7.46	5.22	5.30	10.62	12.50	11.72	13.14	6.61	6.67	0.73	0.51	2.14	1.57	2.91	2.59
August	5.64	7.47	5.18	5.33	10.58	12.44	11.68	13.05	6.55	6.57	0.73	0.5	2.14	1.62	2.98	2.65
September	5.67	7.47	5.17	5.36	10.57	12.46	11.64	13.01	6.22	6.27	0.72	0.5	2.14	1.62	3.04	2.69
October	5.69	7.54	4.97	5.15	10.62	12.51	11.68	13.03	6.66	6.60	0.71	0.48	2.1	1.56	3.07	2.65
November	5.71	7.54	4.82	4.95	10.61	12.51	11.66	12.80	6.13	6.08	0.7	0.47	2.07	1.49	3.04	2.56
December	5.72	7.50	4.68	4.87	10.59	12.46	11.64	12.74	5.48	5.59	0.68	0.43	1.99	1.27	2.9	2.19
2008 Avg.	5.79	7.52	5.46	5.56	10.68	12.51	11.77	13.40	6.22	6.24	0.76	0.52	2.13	1.51	3.13	2.59
Bank-CU		1.73		0.10		1.83		1.62		0.02		-0.24		-0.62		-0.53

Source: Datatrac.

In the aggregate, CUNA economists estimate that credit unions provided $8 billion in direct financial benefits to the nation's 92 million credit union members in the year ending June 2008. These benefits are equivalent to approximately $90 per credit union member or approximately $170 per member household. Loyal credit union members—

those who use their credit union extensively—receive total financial benefits that are much greater than this average.

The continued existence of these substantial societal benefits would be seriously jeopardized were the credit union regulator or credit union regulations merged into those focused on for-profit institutions. Credit unions represent just 6% of total depository institution assets. If the credit union regulator were merged into a for-profit regulatory body, the views, attitudes, and philosophy of the not-for profit cooperative sector would undoubtedly be swamped and credit union behaviors would almost certainly "morph" into behaviors similar to those found in the for-profit sector.

The not-for-profit mission and democratic governance structure of credit unions as cooperatives necessitate a fundamentally different supervisory approach at the federal level than banking supervision does. This fundamentally different approach to supervision requires an independent federal regulator that understands the unique nature of credit unions and will not become hostile to credit unions, as the FDIC and Farm Credit Administration were when they regulated federal credit unions. The United States is also far from the only country to recognize that credit unions, as not-for-profit cooperatives, require an independent credit union regulator. Most G20 countries—including Canada, Mexico, Germany, France, South Korea, Argentina, and Brazil—have recognized that having bank regulators supervise credit unions at the national level just does not work, and so have many non-G20 nations. It also worth noting that the establishment of a super-regulator in the United Kingdom, the Financial Services

Authority, has failed to save British financial institutions from substantial entanglement and dislocation in the current crisis.

CUNA Supports Specific, Modest Changes to Improve NCUA Operations

We agree that a review of the operations of all federal financial institution regulators is certainly in order, including review of NCUA. We certainly do not mean to suggest that NCUA is a perfect regulator. Some of NCUA's issues stem from legislation. For instance, the Federal Credit Union Act limits to one the number of members of the NCUA Board who can come from credit unions. None of the other bank regulators has a similar restriction, and this one can promote an NCUA Board that has little relevant experience outside the government. Even more significant is the absence from the Act of any express authority for NCUA to address systemic risk within the credit union system. This lack has significantly restricted NCUA from doing what it needs to do to address the current crisis, and sharply contrasts with similar, but broader authority delegated to the FDIC. The fundamental point, however, as outlined above, is that it is paramount that credit unions be regulated independently.

Although an independent credit union regulator is essential, we believe that there are commonalities among all financial institution regulators and that these synergies should be used to facilitate improved operations among all of these agencies. In that connection, we urged the previous Administration that the President's Working Group, which includes the Federal Reserve Board, the Federal Deposit Insurance Corporation and

others, include NCUA as well. We intend to renew this request to the current Administration.

We recognize that coordination among the regulators already occurs in a number of contexts. For example, the Federal Financial Institutions Examination Council (FFIEC) is a formal interagency body that prescribes uniform standards and forms for financial institution examinations. Also, the Financial Crimes Enforcement Network (FinCen) regularly convenes meetings of the Bank Secrecy Act Advisory Group (BSAAG), of which CUNA is a member. The BSAAG performs an important function by providing a forum for discussing how Bank Secrecy Act requirements can be used more effectively to combat terrorist financing. Another noteworthy example is the Financial Literacy and Education Commission, which is comprised of twenty federal agencies with the goal of developing and monitoring a national strategy to improve financial literacy in the United States. We also think that the coordination of training opportunities for the staffs of the financial regulatory agencies could help enhance efficiencies and contain agency costs.

A means to facilitate these goals could be the creation of an additional interagency committee or task force to oversee these efforts and which would include equal representation from all the relevant agencies, including NCUA. This will help ensure a consistent approach to rulemaking while recognizing that the differences among financial institution charters may require different rules in specific areas.

Separate Regulator for Consumer Protection

Most financial transactions involving consumers are currently covered by federal consumer protection laws. These include transactions involving credit and debit cards, automated teller machine transactions and other electronic fund transfers, deposit account transactions, mortgages and home equity loans, and other unsecured credit transactions.

There has been significant debate as to whether a separate agency should be established with the mission of providing consumer protections with regard to credit and other financial transactions. The Federal Reserve Board currently issues the rules to implement many of the major consumer protection laws, most of which apply to credit unions. Enforcement of these rules is shared by both NCUA and the Federal Trade Commission.

Other agencies also issue rules that protect consumers in financial transactions. Notable examples are in the area of privacy and fair credit reporting. These are often joint rulemaking efforts by all of the financial institution regulators, including NCUA. Significant exceptions include the rules issued under the Real Estate Settlement Procedures Act, which imposes disclosure and other requirements for mortgage lending and are implemented by the Department of Housing and Urban Development.

Much of the impetus for consolidating consumer protection regulation in a single agency comes from the desire to stop certain financial institutions from making "unsafe" products available to unwitting consumers. Credit unions do not have much history of

selling unsafe products to their members, although there can be healthy debates about whether some products, such as overdraft protection and payday-loan equivalents, are good for consumers or not. Sometimes the same product can be pro- or anti-consumer, depending on its terms and on how it is serviced. Since the managers of firms tend to serve the interests of owners, and credit unions are owned by their members who are represented by democratically elected boards with authority over managers, consumers do not typically need much protection from their credit unions. However, inadvertent errors can occur, and comparative disclosures are important.

Although we certainly see the appeal in creating a separate agency that would issue and implement consumer protection rules as this would centralize this important function, we would want to make sure that there is no net increase in the regulatory burden imposed on credit unions. Since we have not contributed to the problem, we would like not to pay a big price for the answer to a question that barely exists in our industry. In particular, enforcement and examination should remain primarily in the hands of NCUA; unleashing a new army of enforcers and examiners would add little to consumer well-being except costs, in the case of credit unions.

However, we would be concerned that shifting rulemaking power from NCUA to a separate agency would curtail NCUA's authority. NCUA has had responsibility in implementing many consumer protection rules, often as a joint effort with other agencies. We believe that the creation of a separate agency should not limit NCUA's ability to continue to provide input and ensure that new rules address specific credit union

concerns. We would also be concerned with any changes that would limit NCUA's current enforcement authority in this area.

History Teaches Lessons About Supervision of Credit Unions

Although the first credit unions in the United States were state-chartered credit unions established in New Hampshire and Massachusetts around 1909—we will be celebrating the centenary of U.S. credit unions in Boston later this year—federal regulation of credit unions did not begin until 1934.

That year, at the height of the Great Depression, Congress passed the Federal Credit Union Act and created the federal credit union charter. (Federal deposit insurance—or, as we call it, share insurance—for federal and state-chartered credit unions did not come into being until 1970.) Congress created the federal credit union charter in large part because the financially troubled banks of the time were not able to meet the public demand for consumer and small business credit. The troubles of those times were not so different from our current problems. Foreclosures abounded. Banks—many of which had significant numbers of uncollectible loans on their books, as well as other bad assets—were unable or unwilling to extend necessary credit. Not-for-profit credit unions were encouraged to step up and do what for-profit banks could or would not do.

The passage of the Federal Credit Union Act marked the beginning of a long period in which federal credit union regulation was something of a wandering orphan.

The first stop, from 1934 to 1942, was at the Farm Credit Administration, perhaps because the Farm Credit Administration regulated Farm Credit System cooperatives rather than for-profit banks. While the relationship between credit unions and the Farm Credit Administration was initially good, by the late-1930s many Farm Credit Administration officials had become indifferent or openly hostile to credit unions since the agency was overburdened and federal credit union supervision had no real connection to the Farm Credit Administration's basic functions.

The second stop, beginning in 1942, was the FDIC. There, the hazards of being regulated by an agency primarily dedicated to the banking industry soon became apparent. Only weeks after federal credit unions came under FDIC supervision, then-CUNA President R.A. West said "we are very much of an orphan in the [FDIC] and . . . steps must be taken to relieve this situation as quickly as possible." In various statements, the FDIC denigrated the importance of credit unions, urged Congress to give them low priority, and dismissed the importance of credit unions in the FDIC's own work.

By 1947, it was clear that federal credit unions needed a regulator of their own in order to prosper, and CUNA began to seek such an arrangement. That wish was partially fulfilled when Congress created the Bureau of Federal Credit Unions in 1948. The Bureau wandered between the now-dissolved Federal Security Agency and the Department of Health, Education and Welfare before evolving into the completely independent NCUA we know today.

Admittedly, federal credit unions' experience with regulation by FDIC and other multi-jurisdictional agencies occurred decades ago, but Congress has wisely not repeated the mistake of having credit unions supervised at the federal level by a bank regulator or another multi-jurisdictional agency. As discussed earlier in this statement, anti-credit union bias periodically manifests itself today within federal banking regulatory agencies. History teaches that credit union regulation should not be entrusted to a multifunctional regulator, and especially not one whose primary constituency is the banking industry.

Conclusion

Mr. Chairman, thank you again for the opportunity to testify on this important issue. The issues you are examining are important. Once they are settled, we believe it will be appropriate for Congress to take a hard look at some other long-postponed issues, such as whether the current powers of credit unions are sufficient to serve their members, or whether they have been limited for the benefit of the banking industry. Meanwhile, we urge Congress to maintain the independent federal regulator for credit unions not only for the well-being of credit unions, but also for the well-being of the 92 million consumers who benefit from credit union membership.