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Congressional Testimony

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Hearing on the State of Small Depository Institutions

NCUA is the independent federal agency created by the U.S. Congress to regulate, charter, and supervise federal credit unions. With the backing of the full faith and credit of the United States, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of more than 98 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

At MyCreditUnion.gov and Pocket Cents, NCUA also educates the public on consumer protection and financial literacy issues.

Congressional Testimony

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, the National Credit Union Administration appreciates the invitation to testify about the state of small depository institutions. I am Larry Fazio, Director of NCUA's Office of Examination and Insurance.

With one-third of credit unions having less than $10 million in assets and two-thirds of credit unions having less than $50 million in assets, NCUA is acutely aware of the importance of scaling its regulatory, supervisory, and assistance programs to address the unique circumstances of small credit unions.[1] As a result, the agency has made significant progress in considering the concerns of small credit unions during the last five years. Where the rules that affect small credit unions are within the agency's control and where regulatory exemptions and tailored rules would not significantly affect safety and soundness, NCUA has taken proactive action to ease those burdens.

One way NCUA has eased burdens was to revise the definition of a small credit union under the Regulatory Flexibility Act from less than $10 million in assets to less than $50 million in assets.[2] As a result, the NCUA Board must specifically consider the potential regulatory burden and alternatives for small credit unions in any rule the agency finalizes going forward.

Other examples of NCUA's recent efforts to provide regulatory relief include exempting small credit unions from:

- NCUA's risk-based net worth rule;
- the agency's interest rate risk rule;
- advanced provisions of NCUA's liquidity and contingency funding rule; and
- the posting of creditor notices during voluntary liquidations.

In the process of updating the Regulatory Flexibility Act threshold for defining a small entity, the NCUA Board also committed the agency to revisiting the threshold by January 2015 and every three years thereafter. This review process will ensure NCUA's definition of a small credit union remains current with the credit union system's evolution.

[1] For purposes of this testimony, the use of the term "small credit unions" refers to federally insured credit unions with less than $50 million in assets, unless otherwise indicated.
[2] See http://www.gpo.gov/fdsys/pkg/FR-2013-01-18/pdf/2013-00864.pdf.

In recent years, NCUA has additionally implemented a streamlined supervisory program to minimize examination burdens for the smallest of federal credit unions that are financially and operationally sound, cutting annual examination times at institutions with less than $30 million in assets from as much as 100 hours to 40 hours. Finally, NCUA provides high-quality training, individualized consulting, grants, loans, and other services to small credit unions and other qualified institutions through our Office of Small Credit Union Initiatives.

My testimony today will begin by reviewing NCUA's mission. As the Committee requested, I will then describe the current state of small credit unions, their performance, and the challenges they face. My testimony will also cover the agency's current and prospective efforts to calibrate regulation and supervision based on a credit union's size and complexity of activities, as well as NCUA's many proactive programs providing assistance to small credit unions. Finally, I will offer ideas for the Senate Banking Committee to consider when deliberating on regulatory relief proposals.

NCUA's Mission

NCUA's primary mission is to provide, through regulation and supervision, a safe and sound credit union system. NCUA performs this important public function by:

- Examining all federal credit unions;
- Participating in the supervision of federally insured, state-chartered credit unions in coordination with state regulators; and
- Insuring individual accounts at federally insured credit unions up to $250,000 and joint accounts up to $250,000 per member.

As required by the Federal Credit Union Act, NCUA also serves as the administrator of the $11.6 billion National Credit Union Share Insurance Fund.[3] In this role, NCUA provides oversight and supervision to 6,429 federally insured credit unions. Of these credit unions, NCUA directly supervises the 4,029 federal credit unions chartered by the agency.

Currently, federally insured credit unions represent 98 percent of all credit unions in the United States and serve more than 98 million credit union members.[4]

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[3] Congress established the National Credit Union Share Insurance Fund in 1970 as part of the Federal Credit Union Act (P.L. 91-468) and amended the Share Insurance Fund's operations in 1984 (P.L. 98-369). The fund operates as a revolving fund in the U.S. Treasury under the administration of the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state-chartered credit unions that request federal insurance. Funded by federally insured credit unions, the Share Insurance Fund is backed by the full faith and credit of the United States.
[4] The term "credit union" is used throughout this testimony to refer to federally insured credit unions. NCUA does not oversee approximately 132 state-chartered, privately insured credit unions. As a policy matter, in 2007 NCUA issued a report to Congress concluding that the federal government should be the sole provider of primary deposit insurance. Federal deposit insurance has played an important role in maintaining confidence in the financial system and the stability

State of Small Credit Unions

As shown in Chart 1, the number of credit unions has been declining consistently for more than two decades even as membership in the system has grown steadily. Between 1990 and 2013, credit union membership rose by 66.3 percent, while the number of credit unions fell 49.7 percent. This consolidation among credit unions is consistent with larger trends within the entire financial services marketplace, but credit unions are still unique with their smaller size and exclusive focus on serving their members.

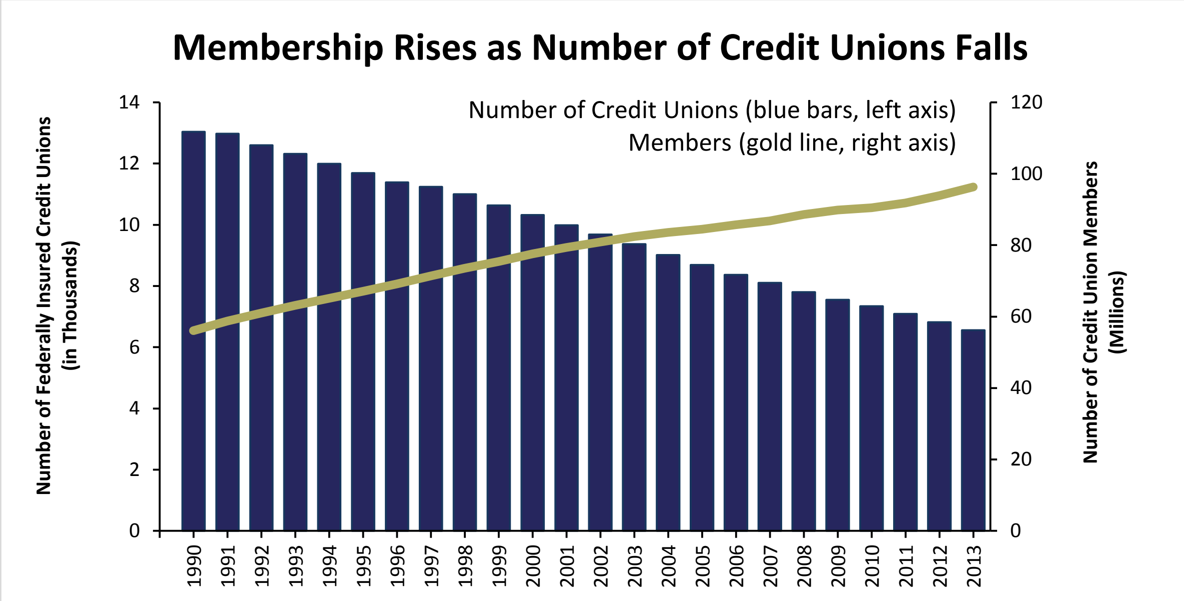

Chart 1

One factor contributing to the decline in the number of credit unions is that many generally cannot take advantage of economies of scale given their small size. Other factors include a single-sponsor credit union that loses its sponsor, lack of succession planning within the credit union before a long-term CEO retires, and technological changes. Bad management decisions, insufficient internal controls, and employee fraud also have played a role in the system's consolidation. In all, employee fraud led to $311.4 million in losses for the Share Insurance Fund between 2010 and 2013 at liquidated credit unions.

Additionally, some credit unions lack the resources and capabilities to provide the financial services and products that today's consumer considers essential. This situation is particularly apparent in small credit unions. Today, checking accounts, real estate loans, ATM and debit cards, and home banking services (including mobile banking) are available at roughly 60 percent of credit unions with less than $50 million in assets. But essentially

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of our economy, and the lessons learned from failures of private deposit insurance schemes should not be forgotten. See http://www.ncua.gov/Legal/Documents/DepositInsuranceStudyReporttoCongress-Ver6-4.pdf for more details.

all credit unions with assets of greater than $50 million provide each of these services. These differences have persisted over the past ten years, underscoring the competitive challenges that small credit unions must confront.[5]

Between 2003 and 2013, the credit unions that ceased operations tended to be small credit unions. Out of 9,369 credit unions active at the end of 2003, there were 7,472 small credit unions. In all, 2,850 credit unions left the system by the end of 2013, of which 2,636 (92.5 percent) were small credit unions. However, more than 90 percent of the small credit unions that left the system during the decade voluntarily merged with another credit union. Of the 4,836 credit unions that were small in 2003 and were still active in 2013, nearly 90 percent still had assets less than $50 million at the end of 2013.[6]

While many small credit unions closed or merged during the last decade, some successfully grew beyond the small credit union threshold. In all, 538 small credit unions at the end of 2003 grew above $50 million by 2013.[7] This statistic demonstrates that, given the right circumstances, small credit unions have the ability to survive and thrive.

Small credit unions also account for a smaller share of total system assets than they did ten years ago. At the end of 2003, small credit unions accounted for 14 percent of assets in federally insured credit unions. That share declined to 6 percent by the end of 2013.[8]

Finally, membership at small credit unions fell as a share of total system membership in the ten years starting at the end of 2003. The number of members in small credit unions declined from 22 percent of total membership in federally insured credit unions at the end of 2003 to 10 percent by the end of 2013.[9]

Performance Metrics by Asset Class

The challenges small credit unions confront are also reflected in their financial performance. To put the operational pressures and compliance burdens faced by small credit unions in perspective, one only needs to look at the number of employees in different asset classes. At the end of 2013, the median number of full-time equivalents at the credit unions with less than $10 million in assets was two, while credit unions between $10 million and $50 million in assets had seven.[10] These numbers have remained static for more than a decade.

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[5] See Appendix I for more details.
[6] See Appendix II for more details.
[7] Ibid.
[8] See Appendix III for more details.
[9] Ibid.
[10] See Appendix IV for more details.

Additionally, while they tend to have higher net worth ratios, small credit unions generally underperform larger credit unions in most financial measures.[11] This may occur, in part, because these small credit unions have made business decisions to pay their members higher interest rates on share deposits and share certificates, charge lower rates on loans, and offer more services rather than further increasing retained earnings and net worth. Other factors contributing to lower returns at small credit unions include higher proportional costs to deliver services effectively to their members and higher charge-off rates.

During the past ten years, median annual average loan, asset, and membership growth rates at the smallest credit unions, those with less than $10 million in assets, have all been negative.[12] Although credit unions with $10 million to $50 million in assets performed somewhat better in loan and asset growth, at the median, they, too, have experienced annual declines in median average membership over the past ten years. In contrast, median average membership, loans, and assets have grown over the past decade at credit unions above $50 million in assets.

The data for the most recent year confirm these trends.[13] Over the year ending in the fourth quarter of 2013, median loan growth fell 0.8 percent at credit unions with less than $10 million in assets, and grew 1.0 percent in credit unions between $10 million and $50 million in assets. By contrast, median loan growth was 4.1 percent in credit unions with $50 million to $250 million in assets, and 8.4 percent in credit unions with over $250 million in assets.[14] Median asset growth and membership growth show similar trends, with rates increasing with the size of the asset class.

Finally, averaged over the past 10 years, the median return on average assets in credit unions with less than $10 million in assets was just 7 basis points, compared with 29 basis points at credit unions with $10 million to $50 million in assets, 43 basis points at credit unions with $50 million to $250 million in assets, and 64 basis points at credit unions with over $250 million in assets.[15] The low median returns on average assets among the smallest credit unions indicate that many are losing money each year. Even with the smallest credit unions' high net worth ratios, the negative earnings at many of them highlight the need for policymakers to examine options for providing regulatory relief.

Regulatory Flexibility Act

In recognition of the operational and financial challenges faced by small credit unions, the NCUA Board in January 2013 reviewed the threshold used to identify which credit unions qualify as small entities under the Regulatory Flexibility Act. Under this law, NCUA must

[11] Ibid.
[12] Ibid.
[13] Ibid.
[14] Ibid.
[15] Ibid.

give special consideration of regulatory burden and alternatives of small credit unions every time the agency issues a new regulation. Based on system percentages carried forward from the last update in 2003 and corresponding risks to the Share Insurance Fund, the Board determined that credit unions with less than $50 million in assets, up from the prior $10 million threshold, were small entities for purposes of the Regulatory Flexibility Act.

As noted earlier, the Board committed the agency to revisiting the Regulatory Flexibility Act threshold by January 2015 and every three years thereafter. This triennial review of the small credit union definition under the Regulatory Flexibility Act is in addition to NCUA's rolling three-year review of all regulations.[16]

Since 1987, NCUA has followed a well-delineated and deliberate process to continually review its regulations and seek comment from stakeholders, such as credit unions and trade associations representing the credit union system. Through this agency-initiated process, NCUA conducts a rolling review of one-third of all its regulations each year, meaning that the agency reviews all of its regulations at least once every three years. Each year, NCUA publishes the list on its website of the applicable regulations up for review that year and invites public comment.

The change in the definition of a small credit union is also consistent with Chairman Debbie Matz's ongoing Regulatory Modernization Initiative. The initiative balances two principles:

- Safety and soundness—strengthening regulations necessary to protect credit union members and the Share Insurance Fund.
- Regulatory relief—revising and removing regulations that limit flexibility and growth, without jeopardizing safety and soundness.

At the time of the adjustment of the definition of a small credit union under the Regulatory Flexibility Act, the number of small credit unions nearly doubled. Approximately 2,270 additional credit unions became eligible for regulatory relief, bringing the total of small credit unions to over 4,670 or 68 percent of all credit unions. The growth in the number of small credit unions is illustrated in Chart 2 on the next page.

For consistency and to provide immediate regulatory relief, the NCUA Board extended the $50 million Regulatory Flexibility Act threshold to two preexisting regulatory exemptions. First, the Board increased from $10 million to $50 million the threshold that defines what credit unions are complex, narrowing the category of credit unions that could be subject to risk-based net worth requirements and the associated prompt corrective action mandates. Second, the Board increased from $10 million to $50 million the threshold used to exempt credit unions from the requirements of our interest rate risk rule.

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[16] See http://www.ncua.gov/Legal/Regs/Pages/Regulations.aspx.

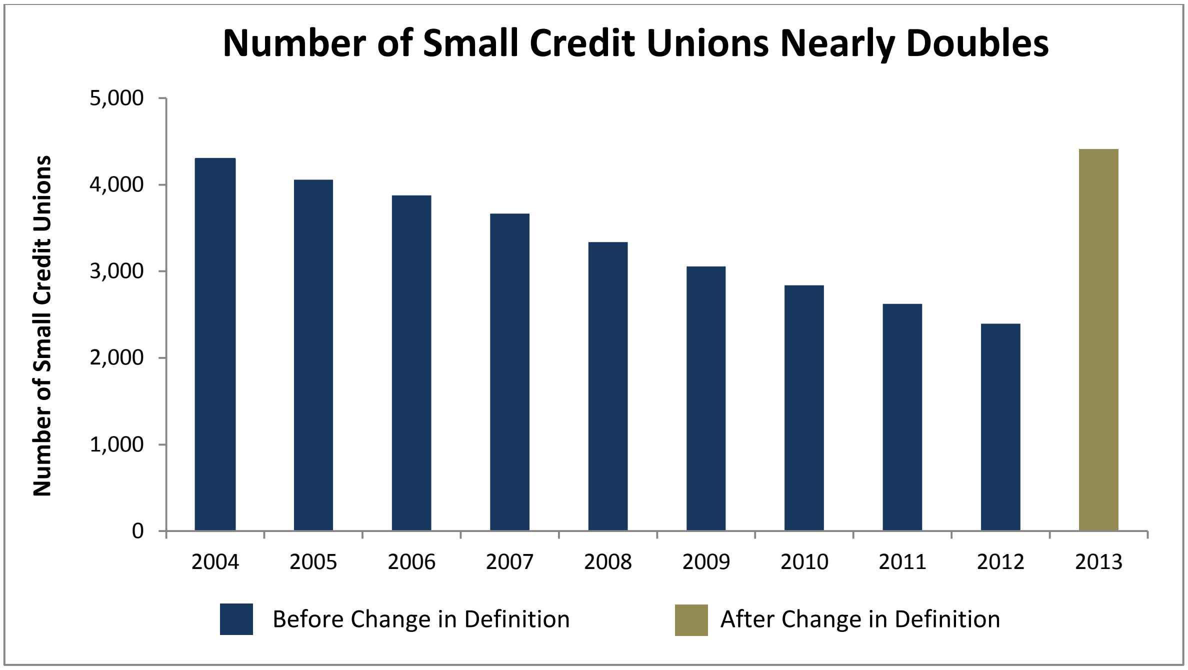

Chart 2

Subsequently, the Board extended relief at the same levels in new rules requiring certain liquidity contingencies and creditor notices in voluntary liquidations. Additionally, in a coordinated policy change, the NCUA Board nearly doubled the number of credit unions able to apply for the Office of Small Credit Union Initiatives' individualized consulting services by increasing the eligibility threshold to $50 million.

Regulatory Costs and Benefits

In developing any regulation, NCUA strives to ensure the agency's rulemakings are reasonable and cost-effective. Under the leadership of Chairman Matz, the NCUA Board has recently used asset-size exemptions as a tool to limit regulatory burdens for smaller institutions.

When promulgating new rules, the NCUA Board considers the potential benefits, as well as the direct and indirect potential costs. Direct costs include any expenses credit unions are likely to incur in complying with the rule. These costs might include the additional time spent collecting data, reporting, and training staff, as well as the need to acquire new software or services. Indirect costs might include higher lending rates or fees, lower rates on share deposits, or other constraints on a credit union's activities.

Many of NCUA's regulations strengthen the safety and soundness of credit unions the agency supervises. The benefit of these safety and soundness regulations is that they reduce the likelihood of credit union failures and, in doing so, promote stability and protect the Share Insurance Fund. Any loss to the Share Insurance Fund is ultimately borne by surviving credit unions, which can be required to pay increased premiums. As member-owned cooperatives, this means the members, who are the owners and customers of the credit unions, may ultimately have to repay these costs. As the developments of the last decade have demonstrated, the cost of regulatory inaction can result in failures that impose a greater cost to credit unions and society than the cost of action.[17]

Through the public comment process, the NCUA Board gains insight on potential costs and unintended consequences directly from the credit unions the agency supervises and insures. The Board then uses this information to make adjustments to the final rule. A good example of this process is NCUA's final rule on emergency liquidity and contingency funding, adopted by the Board in October 2013. The proposed rule applied to all federally insured credit unions with more than $50 million in assets, but the public comment period yielded a number of important observations about the compliance requirements associated with establishing emergency lines of credit.

Based on this information, the NCUA Board reconsidered the balance between costs and benefits specifically for credit unions between $50 million and $250 million in assets. The final rule exempted these credit unions from establishing emergency lines of credit with the Federal Reserve's Discount Window, NCUA's Central Liquidity Facility, or both. Instead, the NCUA Board only required credit unions of this size to develop contingency funding plans that clearly set out strategies for meeting emergency liquidity needs.

Examples of Scaled Regulation

In addition to calibrating the liquidity and contingency funding rule to provide the least possible burden for small credit unions, NCUA has scaled many of its other regulations based on the asset size of the credit union. Examples of such tailored regulation include the agency's interest rate risk rule and the proposed risk-based capital rule issued earlier this year. A brief discussion of each of these matters follows.[18]

Interest Rate Risk Rule

NCUA's focus on interest rate risk management has been constant and pronounced for more than 15 years, as evidenced by a steady issuance of guidance to examiners and credit unions on asset-liability management. Since 2010, interest rate risk management has been a heightened focus for NCUA, and it is a primary supervisory focus for the agency in 2014.

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[17] The collapse of five corporate credit unions during the recent financial crisis best illustrates this point. To date, credit unions have paid $4.8 billion in assessments and experienced $5.6 billion in losses in the form of contributed capital. These costs reduced credit union earnings and assets and, as a result, may have decreased interest paid on share deposits, increased loan rates, and constrained credit union services for their members.

[18] See Appendix V for a more complete listing of NCUA's efforts to scale regulations, calibrate examinations, and provide assistance designed to address the unique circumstances of smaller credit unions.

NCUA's focus on interest rate risk exposure has increased due to the extraordinary low level of rates and the overall lengthening of asset durations in the credit union system. NCUA is mindful that a period of rapidly rising rates could be a particularly challenging scenario for some credit unions. To stay ahead of the curve and maintain stable earnings, all credit unions need to put in place policies to survive adverse rate environments.

These concerns led the NCUA Board to issue a final rule on managing interest rate risk in January 2012. Generally, the rule categorizes credit unions based on size, which is correlated to risk exposure, to determine the need to adopt a written policy on interest rate risk. Consistent with the Board's policy to exempt small credit unions from regulations when prudent, the size and exposure criteria in the interest rate risk rule exempt small credit unions with less than $50 million in assets, while protecting the Share Insurance Fund through coverage of most of the system's assets.

The NCUA Board took this action based on several factors. First, most small credit unions use short-term liabilities like regular share deposit accounts and share certificates to fund medium-term assets such as new and used auto loans, and unsecured personal loans and lines of credit. This strategy typically increases earnings and net worth. Second, small credit unions are not as active in the residential mortgage lending as larger credit unions, primarily due to resource issues.[19] Finally, smaller credit unions hold relatively more cash and short-term investments on their balance sheets.[20] While holding earnings down in the current low rate environment, holding more cash and short-term investments favorably positions small credit unions to take advantage of rising interest rates in the future.

Proposed Risk-Based Capital Rule

Most recently, NCUA has sought to provide regulatory relief for small credit unions in its proposed rule on risk-based capital. In January 2014, the NCUA Board issued a proposed rule to revise the risk-based capital framework for federally insured credit unions tailored to protect the system and consumers from losses. The rule modernizes the existing risk-based net worth rule and is required by the Federal Credit Union Act. Generally, the proposed rule would require credit unions that take greater risks to hold more capital against those risks to protect the Share Insurance Fund from losses.

While seeking to enhance the safety and soundness of the credit union system, the proposed rule would only apply to credit unions with assets of $50 million or more. As a result, two-thirds of all credit unions are not affected by the proposed rule. These credit unions pose minimal risk to the Share Insurance Fund and have more limited exposure to interest rate risk, as noted above.

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[19] As of June 30, 2014, real estate loans at large credit unions accounted for 32.6 percent of total assets, compared to 15.6 percent at small credit unions.
[20] As of June 30, 2014, small credit unions maintained cash and short-term investment balances at 23.4 percent of total assets, compared to 13.2 percent for large credit unions.

The exemption of credit unions with less than $50 million in assets is consistent with the NCUA Board's efforts to exempt small credit unions from regulation when prudent, as well as the Federal Credit Union Act. Chairman Matz has also publicly indicated that the NCUA Board will explore whether to further increase the asset threshold for complex credit unions in order to exempt more credit unions from the final risk-based capital rule.

Small Credit Union Examination Program

Beyond providing targeted relief for smaller credit unions when possible through the issuance of regulatory exemptions and the adoption of tailored rules, NCUA provides relief to smaller credit unions through the examination process.

Since 2002, NCUA has followed a risk-focused exam program which is designed to allocate agency resources to the credit unions and areas of operation that exhibit the greatest risk to the Share Insurance Fund. The program relies on examiner judgment to determine what areas need review. Over time, NCUA has fine-tuned this approach by adding minimum scope requirements and establishing the National Supervision Policy Manual.

While the risk-based examination program has worked generally well, NCUA recognized the distribution of examination resources was out of balance with the credit union system's risks. NCUA was spending more exam hours on the smallest credit unions rather than the largest credit unions that have the concentration of assets in the system. With the continuing changes in the credit union system, NCUA shifted its focus on the size, scale, and scope of credit union examinations.

NCUA has since moved to concentrate supervision on credit union activities that pose the most risk. Larger risks have wider consequences. In recognition that larger, more complex credit unions require more attention, NCUA began streamlining exams for the smallest credit unions and putting examiners where their work will be most effective in protecting the Share Insurance Fund.

In September 2012, NCUA adopted a streamlined examination program for financially and operationally sound credit unions with less than $10 million in assets. As part of the Small Credit Union Examination Program, NCUA aims to spend only 40 exam hours on average per small, well-managed credit union. Before the new program, NCUA had spent as much as 100 exam hours in credit unions of this asset size. This decreased examination burden reflects a reduced scope aimed at focusing on the most pertinent areas of risk in small credit unions—lending, recordkeeping, and internal control functions.

In 2014, NCUA expanded the Small Credit Union Examination Program to include federal credit unions with $30 million or less in total assets that receive a composite CAMEL rating of 1, 2, or 3 at their last examination.[21] Under the recalibrated program, the target examination time is 65 hours on average for eligible federal credit unions with assets from $10 million to $30 million.

NCUA is currently testing additional improvements for this program. NCUA anticipates fully implementing the new procedures for the Small Credit Union Examination Program in 2015.[22] Prior to implementation, NCUA will train staff and provide information about the changes to affected federal credit unions.

NCUA's Office of Small Credit Union Initiatives

In addition to the agency's concerted efforts to reduce the regulatory and supervisory burdens for small credit unions, NCUA makes available, through the agency's Office of Small Credit Union Initiatives, a wide variety of programs to assist small credit unions. Created in 2004, the office fosters credit union development and the effective delivery of financial services for small, new, and low-income credit unions,[23] as well as minority depository institutions. To help viable small credit unions thrive, 28 NCUA staff offer individualized consulting, loan and grant opportunities, targeted training, and valuable partnership and outreach.

Through this office, NCUA provides enrolled credit unions one-on-one consulting on strategic management and operational issues. Many small and developing credit unions have immediate needs for operational assistance such as chartering, field of membership expansion, and internal controls. The 474 consulting service contacts provided by the office during 2013 well surpassed those of the past two years, 325 and 245 provided during 2012 and 2011, respectively. Credit unions using NCUA's consulting services are better able to plan for the future by thinking strategically and developing a business plan that supports the credit union's field of membership.

Congress also established the Community Development Revolving Loan Fund to provide grants and reduced-rate loans to low-income credit unions, many of which are small credit unions.[24] This program enables the low-income credit unions to provide financial services

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[21] The CAMEL rating system is based upon an evaluation of five critical elements of a credit union's operations: Capital adequacy, Asset quality, Management, Earnings and Liquidity. The CAMEL rating system is designed to take into account and reflect all significant financial, operational and management factors that examiners assess in their evaluation of a credit union's performance and risk profile. CAMEL ratings range from 1 to 5, with 1 being the highest rating.

[22] For larger, more complex credit unions, NCUA will continue to perform risk-focused exams.

[23] A low-income credit union is one in which a majority of its membership (50.01 percent) qualifies as low-income members. Low-income members are those members who earn 80 percent or less than the median family income for the metropolitan area where they live, or the national metropolitan area, whichever is greater. During the last two years, NCUA has nearly doubled the number of low-income credit unions through a streamlined designation process. Under the Federal Credit Union Act, the low-income designation offers certain benefits and regulatory relief.

[24] Small credit unions are slightly more likely to be low-income credit unions. Overall, 70 percent of low-income credit unions are small credit unions compared to small credit unions making up two-thirds of the system.

and stimulate economic activities in underserved communities, as well as reach members who have limited access to basic financial services. The program is funded by congressional appropriations and managed by the Office of Small Credit Union Initiatives. In 2014, NCUA has awarded more than $1.5 million to 331 low-income credit unions through two grant rounds. Demand for these funds has consistently and significantly exceeded available appropriations.

Grant initiatives focus on innovation, collaboration, and development of credit unions to increase and improve financial services to their members. Specific uses for the grants in the last two fiscal years have included:

- Developing and implementing new products and services to benefit the community;
- Supporting financial literacy and school branching efforts;
- Training credit union staff, officials, and managers;
- Shaping future leaders by providing an opportunity for students to work in the credit union system; and
- Encouraging collaboration among credit unions to reduce expenses.

NCUA also provides reduced-rate loans to low-income credit unions through the Community Development Revolving Loan Fund. The goal is to help credit unions provide basic financial services to low-wealth, unbanked, and under-banked consumers. Additionally, such support enables the credit unions to improve their operations.

In October 2011 the NCUA Board approved a comprehensive rewrite of the regulations governing the Community Development Revolving Loan Fund's loan functions. The change cut regulatory burdens, eliminated red tape, and streamlined program administration. Most significantly, the rule removed the requirement that NCUA charge an interest rate between 1 and 3 percent. The Board made this change to provide flexibility to charge below-market rates no matter how low or how high the prevailing rates move in the future. The modified rule also better detailed the application and award processes, and post-award reporting requirements.

The revised rule has resulted in increased demand for loans by low-income credit unions. As of June 2014, NCUA had a total of $7.6 million in outstanding loans to low-income credit unions, including $570,000 in loans made to four credit unions in 2013. During the first six months of 2014, NCUA funded nine loans totaling $4.25 million. The majority of these loans were for credit unions to implement loan products in low-income communities.

NCUA's Office of Small Credit Union Initiatives also uses technology to effectively and efficiently deliver timely training to a broad range of audiences in the credit union system.

In 2013, NCUA introduced new videos, a monthly webinar series, and specialized full-day "CEO Boot Camps" to its mix of training events. This was in addition to its traditional in-person workshop format. During 2013, NCUA trained 26,134 credit union officials, board members, and volunteers. As of June 30 this year, NCUA had trained 17,540 more individuals.

A final service provided by NCUA's Office of Small Credit Union Initiatives is partnerships and outreach. Achieving a successful partnership requires the right mix of timing, commitment, and resources. By working with other government agencies and non-profit organizations, NCUA expands credit union access to products and services that may benefit their memberships.

During 2013, NCUA began work with two non-profits, Net Impact and SCORE. Net Impact uses a network of more than 40,000 graduate students and young professionals who seek to make a positive change in their communities socially or environmentally through their work. SCORE is supported by the U.S. Small Business Administration and assists small businesses, such as credit unions, through a network of over 11,000 volunteers experienced in many facets of business. NCUA maintains partnerships with other federal agencies including, the Assets for Independence Program of the U.S. Department of Health and Human Services and the U.S. Department of the Treasury's Community Development Financial Institutions Fund.

Regulatory Relief Legislation

The Committee's invitation additionally asked NCUA to comment about ways to provide regulatory relief through legislation.

Today, there is considerable diversity in scale and business models in the financial services marketplace. As noted earlier, many credit unions are very small and operate on extremely thin margins. They are challenged by unregulated or less-regulated competitors, as well as limited economies of scale. They often provide services to their members at a loss out of commitment to offer a specific product or service.

To that end, NCUA would advise Congress to provide regulators with flexibility in writing rules to implement new laws. Such flexibility would allow the agency to effectively limit additional regulatory burdens on smaller institutions by appropriately scaling the regulatory requirements. As previously noted, NCUA continues to modernize existing regulations with an eye toward balancing requirements appropriately with the risk small credit unions pose to the credit union system. By allowing NCUA discretion on scale and timing to implement new laws, we can more flexibly mitigate the cost and administrative burdens of these smaller institutions while balancing consumer and financial system risk priorities.

Another way Congress could help small credit unions that have a federal charter is to modify the Federal Credit Union Act to give NCUA the authority to streamline field of membership changes and permit them to grow their membership by adding underserved areas. The Federal Credit Union Act currently only permits federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership.

Allowing federal credit unions that do not have a multiple common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change could also eventually enable more credit unions to participate in the programs of the Community Development Financial Institutions Fund,[25] thus increasing the availability of credit and savings options in the distressed areas where the small credit unions operate.

Additionally, NCUA supports targeted regulatory relief bills now pending in Congress. One such bill is H.R. 3468, the Credit Union Share Insurance Fund Parity Act, which the U.S. House of Representatives passed in May. The bill is virtually identical to S. 2699, which Senator Angus King and Senator Mark Warner introduced in late July. NCUA has no safety and soundness concerns with either of these proposals.

Currently, federally insured credit unions cannot offer the same level of insurance on deposits as banks and thrifts for lawyers' trust accounts. Deposit insurance at banks and thrifts for these accounts is $250,000 per owner of the funds (client), per financial institution, assuming the account is properly designated as a trust account and proper accounting of each client's funds is maintained. Because not all clients of a lawyer are credit union members, credit unions cannot offer the same level of insurance for lawyers' trust accounts. The bills pending in the Senate are narrowly scoped to achieve the desired result of providing parity between federal share and federal deposit insurance coverage.

NCUA also reiterates the agency's support for S. 968, the Small Business Lending Enhancement Act, sponsored by Senator Mark Udall and Senator Rand Paul.[26] This bill modifies the current cap on members business lending. It also contains appropriate safeguards to ensure NCUA can protect safety and soundness as a qualified credit union gradually increases its member business lending program.

In federally insured credit unions, member business loans are limited to the lesser of 12.25 percent of assets or 1.75 times net worth. For smaller institutions with the membership demand and the desire to serve the business segments of their field of membership, the low limit makes it very difficult or impossible to successfully build a qualified member business lending service. Many smaller institutions are unable to deliver commercial lending services cost effectively, which denies small businesses in their communities access to credit and working capital.

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[25] Located within the U.S. Department of the Treasury, the Community Development Financial Institutions Fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States.
[26] http://www.ncua.gov/News/Press/CT20110616Matz.pdf

These institutions miss an opportunity to support the small business community and to provide a better service alternative to the small business borrower. Small businesses are an important contributor to the local economy as a provider of employment and as a user and producer of goods and services. NCUA believes members that are small business owners should have full access to financial resources in the community, including credit unions, but this may be inhibited by the cap on member business loans.

Additionally, NCUA supports H.R. 719, the Capital Access for Small Businesses and Jobs Act, pending in the House. Most federal credit unions only have one way to raise capital—through retained earnings. Without access to other ways to raise capital, credit unions are exposed to risk when the economy falters. Financially strong and well-capitalized credit unions also may be discouraged from allowing healthy growth out of concern it will dilute net worth and trigger prompt corrective action under the Federal Credit Union Act.

A credit union's inability to raise capital outside of retained earnings limits its ability to expand into fields of membership more effectively and to offer greater options to eligible consumers. NCUA has therefore previously encouraged Congress in letters and testimony to consider authorizing healthy and well-managed credit unions, as determined by the NCUA Board, to issue supplemental capital that will count as net worth.

Finally, NCUA requests that the Senate Banking Committee consider legislation to provide the agency with examination and enforcement authority over third-party vendors, including credit union service organizations. Although NCUA may examine vendors with their permission, NCUA cannot enforce any corrective actions. NCUA can merely make recommendations and present findings to each vendor's credit union clients.

NCUA's lack of authority over third-party vendors poses a regulatory burden for credit unions, as the agency must rely upon credit unions to report certain information on the vendors with which they do business. This situation particularly affects small credit unions that must rely on vendors for many products and services that larger credit unions could provide in-house. A legislative fix would provide some regulatory relief for credit unions in that NCUA would be able to work directly with key infrastructure vendors, like those with a cyber-security dimension, to obtain necessary information to assess risk and deal with any problems at the source. Obtaining this authority is the agency's top legislative priority.[27]

While providing important services and helping small credit unions to achieve economies of scale, there are inherent risks in credit union service organizations, or CUSOs for short. Since 2008, NCUA estimates that nine CUSOs have caused more than $300 million in

[27] NCUA has two other legislative priorities. The first priority would enhance access to emergency liquidity for the credit union system by making targeted changes to the Central Liquidity Facility and expanding the agency's access to the U.S. Treasury. The second priority would permit NCUA to charge risk-based premiums for the Share Insurance Fund much like the Federal Deposit Insurance Corporation charges for the Deposit Insurance Fund. Risk-based premiums would lessen the funding burden on small credit unions, which generally pose less risk to the Share Insurance Fund.

direct losses to the Share Insurance Fund and led to the failures of credit unions with more than $2 billion in assets. In one such example, a CUSO caused losses in 24 credit unions, some of which failed, and more than half of the affected institutions were small credit unions.

For federally insured credit unions of all sizes, CUSOs provide products and services that can significantly affect financial well-being, and, in the case of technology service providers, the security posture of credit unions and the members they serve. At year-end 2013, credit unions using the services of a CUSO accounted for $920 billion in assets or 87 percent of system assets. This is up from 79 percent of assets at year-end 2009.

Third-party vendors provide important services that allow small credit unions to achieve better economies of scale and access to necessary expertise and infrastructure to provide member services that would otherwise be out of reach for them. As a result, small credit unions in particular rely on vendors to provide many important services to members.

The challenge is that third-party vendors, including CUSOs, are not within NCUA's regulatory authority. This limits the agency's ability to assess risk to credit unions and, ultimately the Share Insurance Fund, and respond to any problems. NCUA addressed the need for this authority in testimony before Congress several times in recent years by asking that the agency have the same authority as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve.[28]

NCUA has developed a legislative proposal which we believe would afford the agency the appropriate statutory authority. NCUA stands ready to work with the Committee on legislation to effectuate the necessary changes so that all credit unions can responsibly and effectively utilize the services of CUSOs and technology service providers.

Conclusion

In closing, NCUA recognizes the need to address the particular circumstances of small credit unions. We do this by tailoring our rules and exempting small credit unions when possible. We also calibrate our examinations of credit unions based on the size, scope, and risk of the institution. Further, NCUA provides direct assistance to small credit unions so they can develop the strategic plans and undertake the required activities to provide needed services to their members. Finally, NCUA is supportive of several targeted legislative proposals, like those to provide parity in insurance coverage for lawyers' trust accounts and raising the cap on member business lending, and we ask that the Committee consider providing regulators with appropriate flexibility in any future legislation.

Thank you again for the invitation to testify. I am happy to answer any questions.

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[28] For example, see http://www.ncua.gov/News/Press/CT20101209Matz.pdf.

APPENDIX I

Provision of Services by Asset Class

	Less than $50 million	Less than $10 million	$10 million to $50 million	$50 million to $250 million	Over $250 million	Credit Union System
2003, Fourth Quarter						
Number of Credit Unions	7,472	4,576	2,896	1,410	487	9,369
Provision of Services:						
Checking Accounts	60.0%	39.4%	92.5%	98.3%	99.0%	67.8%
Auto Loans	94.8%	91.7%	99.9%	99.9%	100.0%	95.9%
Real Estate Loans	57.9%	36.3%	92.1%	98.9%	99.4%	66.3%
ATM/Debit Card	N/A	N/A	N/A	N/A	N/A	N/A
Home Banking	32.5%	12.4%	64.2%	93.5%	98.4%	45.1%
2008, Fourth Quarter						
Number of Credit Unions	5,770	3,275	2,495	1,406	630	7,806
Provision of Services:						
Checking Accounts	64.3%	41.6%	94.2%	99.3%	99.5%	73.5%
Auto Loans	95.1%	91.5%	99.8%	100.0%	99.8%	96.4%
Real Estate Loans	60.8%	37.0%	92.1%	99.8%	100.0%	71.0%
ATM/Debit Card	57.5%	32.9%	89.8%	97.9%	99.5%	68.2%
Home Banking	51.8%	24.9%	86.9%	98.6%	99.5%	64.1%
2010, Fourth Quarter						
Number of Credit Unions	5,176	2,782	2,394	1,472	691	7,339
Provision of Services:						
Checking Accounts	64.7%	40.4%	92.9%	99.3%	99.6%	74.9%
Auto Loans	94.9%	90.6%	99.9%	99.9%	99.9%	96.4%
Real Estate Loans	60.6%	35.0%	90.4%	99.8%	100.0%	72.2%
ATM/Debit Card	58.8%	33.1%	88.6%	98.0%	99.6%	70.5%
Home Banking	53.2%	24.9%	86.1%	98.6%	99.4%	66.7%
2013, Fourth Quarter						
Number of Credit Unions	4,332	2,181	2,151	1,452	770	6,554
Provision of Services:						
Checking Accounts	65.4%	39.0%	92.2%	99.2%	99.6%	76.9%
Auto Loans	95.0%	90.3%	99.7%	99.9%	99.7%	96.6%
Real Estate Loans	60.6%	32.6%	89.0%	99.7%	100.0%	73.9%
ATM/Debit Card	62.0%	33.3%	91.2%	99.1%	99.9%	74.7%
Home Banking	59.0%	29.1%	89.4%	99.0%	99.9%	72.7%

APPENDIX II

Small Credit Unions at 2003 Year End and Status at 2013 Year End[29]

2003, Fourth Quarter	
Filed a Call Report as a Federally Insured Credit Union	**7,472**
2013, Fourth Quarter	
Did not file Call Report	**2,636**
Merger	2,452
Other	184
Filed a Call Report as a Federally Insured Credit Union	**4,836**
with Assets Less than $50 Million	4,298
with Assets More than $50 Million	538

[29] This table uses NCUA's current definition of small credit union—that is, less than $50 million—for all data points regardless of timeframe. The NCUA Board raised the threshold for the definition of a small credit union in January 2013 from less than $10 million in assets to less than $50 million in assets.

APPENDIX III

Historical Composition of Credit Unions by Asset Class

	Less than $10 million	$10 million to $50 million	$50 million to $250 million	Over $250 million	Total
2003, Fourth Quarter					
Number of Credit Unions	4,576	2,896	1,410	487	9,369
Share of all Credit Unions	48.8%	30.9%	15.0%	5.2%	100.0%
Total Assets (millions)	16,894	68,361	153,668	371,202	610,125
Share of all Credit Unions	2.8%	11.2%	25.2%	60.8%	100.0%
Members	4,677,125	13,225,427	23,772,874	40,753,535	82,428,961
Share of all Credit Unions	5.7%	16.0%	28.8%	49.4%	100.0%
2008, Fourth Quarter					
Number of Credit Unions	3,275	2,495	1,406	630	7,806
Share of all Credit Unions	42.0%	32.0%	18.0%	8.1%	100.0%
Total Assets (millions)	12,371	59,764	154,144	584,768	811,047
Share of all Credit Unions	1.5%	7.4%	19.0%	72.1%	100.0%
Members	3,218,399	10,294,574	20,781,626	54,283,725	88,578,324
Share of all Credit Unions	3.6%	11.6%	23.5%	61.3%	100.0%
2010, Fourth Quarter					
Number of Credit Unions	2,782	2,394	1,472	691	7,339
Share of all Credit Unions	37.9%	32.6%	20.1%	9.4%	100.0%
Total Assets (millions)	10,789	57,625	162,003	683,924	914,341
Share of all Credit Unions	1.2%	6.3%	17.7%	74.8%	100.0%
Members	2,557,179	8,891,451	19,797,070	59,238,258	90,483,958
Share of all Credit Unions	2.8%	9.8%	21.9%	65.5%	100.0%
2013, Fourth Quarter					
Number of Credit Unions	2,181	2,151	1,452	770	6,554
Share of all Credit Unions	33.3%	32.8%	22.2%	11.7%	100.0%
Total Assets (millions)	8,750	52,933	162,058	838,208	1,061,949
Share of all Credit Unions	0.8%	5.0%	15.3%	78.9%	100.0%
Members	1,883,008	7,394,223	18,287,607	68,713,870	96,278,708
Share of all Credit Unions	2.0%	7.7%	19.0%	71.4%	100.0%

APPENDIX IV

Historical Performance by Asset Class

	2013, Fourth Quarter Median			
	Less than $10 million	$10 million to $50 million	$50 million to $250 million	Over $250 million
Loan Growth (annual)	-0.77	0.98	4.14	8.36
Asset Growth (annual)	-0.29	1.35	2.40	3.87
Membership Growth (annual)	-1.43	-0.90	0.44	2.88
Loan-to-Share Ratio	55.61	54.41	63.93	71.71
Net Worth Ratio	14.12	11.39	10.38	10.32
Return on Average Assets	0.04	0.17	0.41	0.72
Delinquency Rate	1.50	0.95	0.91	0.83
Noninterest Expenses-to-Total Assets	3.65	3.59	3.73	3.41
Full-Time Equivalent Employees	2	7	30	144

	5-Year Median			
	Less than $10 million	$10 million to $50 million	$50 million to $250 million	Over $250 million
Loan Growth (annual)	-1.50	0.15	2.06	3.95
Asset Growth (annual)	1.62	4.16	5.47	6.77
Membership Growth (annual)	-1.48	-0.67	0.55	2.6
Loan-to-Share Ratio	58.05	58.29	67.13	71.88
Net Worth Ratio	14.36	11.44	10.09	9.77
Return on Average Assets	-0.23	0.07	0.28	0.60
Delinquency Rate	2.18	1.29	1.16	1.14
Noninterest Expenses-to-Total Assets	4.09	3.99	4.02	3.57
Full-Time Equivalent Employees	2	7	29	137

	10-Year Median			
	Less than $10 million	$10 million to $50 million	$50 million to $250 million	Over $250 million
Loan Growth (annual)	-0.63	1.8	4.31	6.63
Asset Growth (annual)	-0.39	2.77	4.94	6.76
Membership Growth (annual)	-1.66	-0.56	0.79	2.75
Loan-to-Share Ratio	65.59	65.23	72.26	77.70
Net Worth Ratio	14.82	12.24	10.74	10.29
Return on Average Assets	0.07	0.29	0.43	0.64
Delinquency Rate	2.41	1.29	1.07	0.95
Noninterest Expenses-to-Total Assets	4.01	4.01	4.05	3.58
Full-Time Equivalent Employees	2	7	28	128

APPENDIX V

Examples of NCUA's Efforts to Scale Regulation and Support Small Credit Unions

Rule/Program	Description
Small Credit Union Definition	• A credit union with less than $50 million in assets is excluded from certain NCUA rules. • NCUA also must consider the specifically consider the potential regulatory burden and alternatives for small credit union in any rulemaking. • NCUA will review the small credit union definition by January 2015 and then every three years. The review will keep the definition up-to-date as the system evolves.
Interest Rate Risk	• Credit unions with $50 million or less in assets are excluded.
Liquidity and Contingency Funding	• Credit unions with less than $50 million in assets must maintain a basic written liquidity policy. • Credit unions $50 million and over in assets must establish and document a contingency funding plan. • Credit unions $250 million and over in assets also must establish and document access to at least one contingent federal liquidity source.
Voluntary Liquidations Creditor Notices	• Federal credit unions with less than $1 million in assets are exempt. • Federal credit unions with less than $50 million in assets but more than $1 million in assets are required to place just one creditor notice.
Risk-Based Capital	• Credit unions with less than $50 million in assets are excluded under the existing risk-based net worth rule and the proposed risk-based capital rule. NCUA is considering raising the threshold for exemptions before finalizing the revised rule.
One-on-One Consulting Services	• Credit unions with less than $50 million in assets are eligible to apply for customized consulting from NCUA.
Net Worth Restoration Plans	• Credit unions with less than $10 million in assets must receive NCUA assistance in developing Net Worth Restoration Plans, if requested.
New Credit Union Support	• Federal credit unions with less than $10 million in assets and less than 10 years in operation are eligible for NCUA consulting assistance. • Federal credit unions with less than $10 million in assets must receive NCUA assistance with business plan revisions, if requested.
Generally Accepted Accounting Principles	• Credit unions with assets under $10 million are exempted from complying with the reporting requirements of Generally Accepted Accounting Principles.
Audits	• Credit unions between $10 million to $500 million in assets may choose one of three lower-cost alternatives for their annual financial statement audits: a balance sheet audit, a report on examination of internal control over Call Reporting, or an Audit per the Supervisory Committee Guide.
Truth in Savings Act	• Non-automated credit unions with $2 million or less in assets after subtracting any non-member deposits are exempted from the Truth in Savings Act.
Operating Fees	• Federal credit unions with less than $1 million in assets are exempted from the annual operating fee that funds federal credit union regulation. • Federal credit unions with more than $1 million in assets pay annual operating fees scaled to size.
Small Credit Union Examination Program	• Operationally sound federal credit unions with less than $10 million in assets received streamlined exams averaging 40 hours. • Operationally sound federal credit unions with assets between $10 million and $30 million receive streamlined examinations averaging 65 hours.
Federally Insured, State-Chartered Credit Union Examinations	• Federally insured, state-chartered with less than $250 million in assets are generally not subject to an annual onsite NCUA examination.
Electronic Filing	• To assist in the migration to electronic filing of quarterly Call Reports, NCUA helped manual filers obtain computers and assigned an Economic Development Specialist to work with small credit unions identified as filing manually each quarter.