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TESTIMONY

OF

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OF

COMMUNITYAMERICA CREDIT UNION

ON BEHALF OF THE

CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE

COMMITTEE ON BANKING, HOUSING & URBAN AFFAIRS

UNITED STATES SENATE

HEARING ENTITLED

"EXAMINING THE STATE OF SMALL DEPOSITORY INSTITUTIONS"

SEPTEMBER 16, 2014

Testimony
of
Dennis Pierce
Chief Executive Officer
CommunityAmerica Credit Union
On Behalf of the
Credit Union National Association
Before the
Committee on Banking, Housing & Urban Affairs
United States Senate
Hearing Entitled
"Examining the State of Small Depository Institutions"
September 16, 2014

Chairman Johnson, Ranking Member Crapo and Members of the Committee:

Thank you very much for the opportunity to testify at today's hearing. My name is Dennis Pierce, and I am Chief Executive Officer of CommunityAmerica Credit Union in Kansas City, Missouri. I am also Chairman of the Board of Directors of the Credit Union National Association (CUNA), on whose behalf I am testifying today. CommunityAmerica Credit Union is the second largest credit union in Missouri with $1.9 billion in assets and over 180,000 members. CUNA is the largest credit union trade association in the United States representing over 6,600 federally and state chartered credit unions and their 100 million members.

As you know, credit unions are member-owned, not-for-profit financial cooperatives, which exist to promote thrift and provide access to credit for provident purposes to their members. This is the express purpose of credit unions – nothing more and nothing less. Credit unions are not in business to make money for outside stockholders. The users of credit unions are not a means to an end; for the credit union, its members are the end. This characteristic is the key differential between not-for-profit credit unions and for-profit banks. The credit union structural difference helped cooperative financial institutions come through the Great Recession nearly unscathed while the banking industry teetered on near-complete collapse. When considering regulatory burden, particularly as it relates to consumer financial protection, it is critical that policymakers understand that the incentive structure for credit unions and banks is quite different, and the regulatory structure should reflect those differences. In short, credit union members really don't need that much protection from the credit unions they own.

As financial institutions, credit unions are subject to a number of regulations imposed on them by Federal and state regulators. With respect to both safety and soundness regulation and consumer protection regulation, the regulatory regime to which credit unions are subject has increased significantly in recent years, largely in response to a financial crisis that natural person credit unions neither caused nor to which they contributed. These regulatory changes have made it more difficult for credit unions to serve their members and have provided credit union members with little, if any, benefit. And, in some cases, the regulations that have been imposed since the financial crisis have made things worse for credit union members.

My testimony today will describe the current state of credit unions' regulatory burden, our concern with proposed regulations under consideration by the National Credit Union Administration (NCUA) and the Federal Housing Finance Agency (FHFA) and our views on pending regulatory relief legislation.

Credit Unions' Regulatory Burden

Credit unions face a crisis of creeping complexity with respect to regulatory burden. It is not that any particular regulation presents an unmanageable situation for credit unions, but the accumulation of regulatory requirements and the frequency with which these requirements change that contributes to a degradation of member service because it diverts finite resources away from our purpose and mission. Since the beginning of the financial crisis, credit unions have been subject to more than 180 regulatory changes from at least 15 different Federal regulatory agencies.

The Ever-Increasing Regulatory Burden Impacts Small Financial Institutions Disproportionately

The impact of these regulations hits smaller institutions particularly hard. The credit union system is growing, but it remains significantly smaller than the banking sector. My credit union is a large credit union, but would be considered a small bank. To put the question of size in perspective, consider that each of the four largest banks in the United States has total assets greater than the combined assets of the entire credit union system. Congress and regulators ask a lot of small, not-for-profit, financial institutions when they tell them to comply with the same rules as J.P. Morgan, Bank of America and Citibank, because the cost of compliance is proportionately higher for smaller-sized credit unions than these behemoth institutions. Almost half of the credit unions in the United States operate with five or fewer full-time equivalent employees; the largest banks likely have compliance departments that exceed that number by multiples of a hundred or more. The rules that the Consumer Financial Protection Bureau (CFPB) has promulgated so far have not taken this disparity– and disproportionate burden – into consideration as much as we feel they can or should under the law.

When a regulation is changed or a new rule is released, there are certain upfront costs that must be incurred no matter the institution: staff time and credit union resources must be applied to assess what is necessary to comply;

disclosures must be changed; data processing systems must be reprogrammed; and staff have to be retrained. Credit union members must be told how the new rule or change will affect them, and at times members get frustrated because of the change. None of these changes are of a minimal undertaking, and when they have to be done simultaneously, the burden to conform to the new rule or law can be overwhelming, especially for a smaller institution.

Moreover, the cumulative effect of current compliance responsibilities and ever increasing new ones is staggering. This is a key reason that more than 300 small credit unions each year merge with larger institutions.

Every dollar that a credit union spends on complying with a regulation is a dollar that is not spent to the benefit of its membership. And, because credit unions sustain their operations through retained earnings, the money that is spent on compliance directly impacts credit union members, affecting rates, dividends and even the services that may be offered. What is maddening to credit union managers and volunteers is the abundance of rules and regulations to which they have been subjected recently, promulgated in response to actions taken by others in the financial services sector. Credit unions feel as if they are being made to pay for the sins of others. The losers in this situation are the 100 million credit union members who turn to their financial cooperatives, their credit unions, as an alternative to for-profit banks.

Allow me to provide you with some examples of how recent regulations have affected the way that CommunityAmerica Credit Union serves their members.

The CFPB's recently finalized a new "Ability to Repay" Rule. This rule has resulted in a longer turnaround time for credit union members to close a loan. The regulation requires us to do additional verification on our borrower's ability to repay. In our case, this additional verification includes calling an employer directly and confirming pay information rather than just getting stated income or a paystub. These members have often been members for a number of years – we know their financial situation, and can trust the information and documentation that they are providing. While we feel we need to do this to comply, this additional verification step has slowed down the lending process, required more administrative work on our staff and has so far not led to any ability to repay issues that we were not already catching before. I can see why this process was created for larger financial institutions who do not have such a tight relationship with their borrowers, but in institutions of our size, it is superfluous and over-reactive.

Another requirement has also wreaked administrative havoc in our credit union. Financial institutions are now required to give a list of ten homeownership counseling agencies to all home loan applicants. This has led to questions by members concerned that we are already concluding that they are going to have a hard time making their mortgage payments. It may make sense to send this information with the first collection letter, but putting it at the front of the loan application process is confusing and disconcerting to members, and, frankly, quickly forgotten once they move on with their loan. If they do have financial trouble down the way, they are not going to look back at opening documents to seek help.

A new proposal by the CFPB regarding debt collection would align the debt practices rule to the debt collection practices. This rule is meant for debt collectors, but will impact credit unions. Aligning these two rules will make it much harder for credit unions to collect debt and could force institutions to simply outsource the function.

When regulatory burden slows down the member-credit union interaction, confuses the member or forces a credit union to outsource a function, member service is degraded. This should be a concern for the Committee and Congress, and we urge you to address it through changes to the relevant statutes and oversight of the relevant regulatory agencies.

Credit Unions Continue to Have Concerns Regarding Examination Conduct and Consistency

We also encourage the Committee to continue to exercise its oversight responsibilities with respect to the conduct and consistency of credit union examinations. This is an ongoing concern for many credit unions.

Preliminary results from CUNA's 2014 Examination Survey continue to show that most credit unions view heavier regulatory/exam requirements as putting increasing pressure on credit union resources. Overall 76% of recently-surveyed respondents mention this concern.

A substantial percentage of credit union CEOs are just plain dissatisfied with their exams. Overall, 28% of credit union executives indicate they are dissatisfied, with 17% indicating they are "somewhat dissatisfied" and 11% indicating they are "very dissatisfied". These percentages have not changed appreciably over the three years CUNA has conducted the survey.

Credit union CEOs generally give exam teams positive ratings on a number of items, such as giving credit unions the opportunity to comment, being open to discussion, and knowledge of rules and regulations and the credit union. However, exam teams receive especially negative ratings on in a number of very important areas. For example, over half (51%) say that their examiner or exam team applied "guidance" as if it was enforceable regulation and a similar percentage (52%) indicated that examiners were "covering themselves". Beyond this, roughly 40% say that examiners, at times, make recommendations then later provide contradictory guidance and a similar percentage (39%) said that examiners inappropriately tell institutions how to run their businesses.

More than one-third of respondents (35%) indicate that examiners make excessive use of Documents of Resolution (DORs). Fully 40% of responding credit unions are currently under a DOR. And 43% say that items are appearing in DORs that used to be handled more routinely.

We have seen little improvement in these concerns - each of these metrics mirrors results seen in surveys over the past two years. This is why we support legislative efforts to address examination issues, including S. 727, the Financial Institution Examination Fairness and Reform Act, which has been introduced by Senators Jerry Moran (R-KS) and Joe Manchin (D-WV), and its House companion, H.R. 1553, which has been introduced by Representative Shelley Moore Capito (R-WV) and Carolyn Maloney (D-NY). We encourage the Committee to address these concerns.

The remainder of my written testimony discusses concerns that credit unions have with pending regulatory matters at the National Credit Union Administration and the Federal Housing Finance Agency, as well as pending legislation that would reduce credit unions' regulatory burden. These bills are but a small step toward regulatory relief; there is much more that needs to be done. Failure to take even small steps in the direction of reducing credit unions' regulatory burden will result in the continued trend of consolidation in the credit union sector – fewer credit unions serving America's consumers and small businesses. That is a public policy outcome only the banking trade associations would applaud.

Credit Unions Have Significant Concerns with the National Credit Union Administration's Proposed Rule on Risk-Based Capital

In January 2014, NCUA issued a proposed rule related to risk-based capital standards for credit unions.[1] The agency has indicated that it was prompted to update its standards following a 2012 GAO study, a report from its Office of Inspector General and lessons learned from the financial crisis. CUNA is a strong, historic supporter of risk-based capital for credit unions, but we strongly oppose this proposal because we believe it is a solution in search of a problem; it exceeds NCUA's statutory authority; and it would adversely impact credit unions' ability to serve their members without providing meaningful benefit to the protection of the National Credit Union Share Insurance Fund (NCUSIF).

The Proposal Is a Solution In Search of a Problem

There were 8,100 federally-insured credit unions at the start of the worst financial crisis in this nation's history. In total, only 25 of those deemed "complex" by the proposal failed. If in place at that time, the proposal would not have prevented any of those failures nor would it have significantly reduced losses to the NCUSIF. It would have caused substantial overcapitalization of thousands of other healthy credit unions thus substantially reducing service and capital to members when many needed it the most.

The proposal does not reflect credit unions' robust historical financial performance including during times of severe financial market distress. NCUA has not – and cannot – justify the proposal as issued for comments in light of the vigorous health of federally insured credit unions in general. If finalized as proposed, the overall negative impact of the proposal would be far greater than

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[1] Proposed rule on prompt corrective action; risk based capital (12 CFR Parts 700, 701, 702, 703, 713, 723 and 747) issued by NCUA on January 23, 2014.
http://www.ncua.gov/Legal/Documents/Regulations/PR20140123PCA.pdf

the agency has anticipated and would result in a much smaller credit union system over the long term.

The Proposed Rule Exceeds NCUA's Statutory Authority

The proposed rule would impose a risk-based capital standard for the purposes of determining whether a credit union is well-capitalized. However, the *Federal Credit Union Act* directs the NCUA to establish risk-based net worth requirements for which the adequately capitalized level does not provide adequate protection.[2] In his comment letter to NCUA, former Senate Banking Committee Chairman Alfonse D'Amato clearly expressed the intent of this provision of the *Federal Credit Union Act*, which was added under his leadership in 1998:

> *"When we crafted the credit union version of PCA, we modeled it after the bank version already in place, but we incorporated some very important differences to reflect the different nature of banks and credit unions…. we instructed NCUA to construct only a risk-based net worth floor, to take account of situations where the 6% requirement to be adequately capitalized was not sufficient… If we had intended there should also be a separate risk-based requirement to be well capitalized (in addition to the 7% net worth ratio), we would have said so."*[3]

We strongly believe that if NCUA feels it needs to establish a higher risk-based capital standard for the purposes of determining whether a credit union is well-capitalized, compared to an adequately capitalized credit union, then it should seek such authority from Congress.

Furthermore, the proposed rule would permit NCUA examiners to establish individual capital standards for credit unions on a case-by-case basis; our reading of the *Federal Credit Union Act* suggests that this is an authority that

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[2] 12 U.S.C. § 1790d(d).

[3] Letter from the Honorable Alfonse D'Amato to the National Credit Union Administration. May 7, 2014. http://www.ncua.gov/Legal/CommentLetters/CLRisk20140507AD'Amato.pdf

Congress has not conveyed to the agency, and it would be inconsistent with the recommendations of the Department of Treasury and the Governmental Accountability Office.[4,5] Credit unions face too many uncertainties already without having to contend with whether NCUA will impose additional capital beyond what is indicated in the rule in order to meet well-capitalized requirements.

The Proposed Rule Would Adversely Impact Credit Unions' Ability to Serve Their Members and Would Not Substantially Improve the Protection of the Share Insurance Fund

Given its major weaknesses—which would seriously constrict credit union growth and financial performance—we believe major changes are needed in the final rule. The agency has indicated a number of such changes are under consideration. However, if implemented without change, the proposed rule would doom credit unions to a marginal role in the financial marketplace without effectively achieving the objectives NCUA has identified. It would clumsily identify credit unions in need of additional capital at the expense of overcapitalizing many other well-managed credit unions. Member service and credit availability from credit unions would suffer, because credit unions will move away from decision making based on the best interest of the members and communities that they serve and toward operating as if they were for-profit banking institutions. Short of withdrawing the proposal, we have urged NCUA to issue a revised proposal for comment.

As we discuss in our comment letter, we have many other issues with the proposed rule.[6] We object to the proposal's interest rate risk scheme, because

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[4] U.S. Treasury Report to Congress, Credit Unions, at 8 (December 1, 1997)
[5] GAO-12-247.
[6] Letter from Bill Cheney, President and Chief Executive Officer, Credit Union National Association to the National Credit Union Administration. May 28, 2014. http://www.ncua.gov/Legal/CommentLetters/CLRisk20140528BCheney.pdf

it completely ignores liabilities. We also have expressed concern that the proposed rule discounts the 1% deposit credit unions place in the NCUSIF; and with the proposed rule's one-dimensional, asset-based definition of a "complex" credit union.

In addition, we believe the risk-weights in the proposed rule are misaligned given the *Federal Credit Union Act's* mandate that NCUA develop a system that takes into consideration the unique characteristics of the credit union system, and would have unnecessarily harsh consequences on credit unions, their members and communities. In many cases, the proposed risk-weights, which attempt to account for interest rate and for concentration risk among other factors, are substantially more stringent than similar risk-weights in the Basel III rules for small banks, even though credit union performance on these assets is generally stronger. If implemented as proposed, it would lead to a contraction in credit union lending, particularly mortgage lending and small business lending, at a time when the economy is recovering from a very significant financial crisis.

For example, the traditional small agricultural credit union serving farmers and ranchers in rural America would be required to dramatically change the way it serves its members. In summary, the regulator's proposed risk weights would make it more difficult for credit unions to lend to their members as they have historically done in a safe and sound manner.

This concern was eloquently articulated by the Midwest Agricultural Credit Union Coalition. In their May 22, 2014, comment letter, 21 credit unions from seven states joined together to tell the NCUA the devastating impact the risk-based capital proposal would have on their service to member farmers and ranchers:

> *"This proposed rule will inhibit the future of member business lending in the American Midwest. The proposed rule improperly treats all [member business loans (MBL)] the same, grouping agricultural loans with construction loans. There are many credit unions in the Midwest that have an extremely long history in agricultural lending, with the expertise, operational processes and managerial oversight in place, and has been in place, to be very successful in making low-risk loans to their members. The proposed rule does nothing to take into account of how MBL risk is mitigated through the experience that these credit unions have. Furthermore, if the rule were to be finalized as proposed, many of these credit unions would have to cease or significantly modify their agricultural lending practices, thus removing another lender from the marketplace. In some rural locations in the Midwest, the credit union is the only agricultural lender. This proposed rule will hurt the consumer and the American farmer."*[7]

The last thing we need during this fragile recovery is for regulators to make it more difficult for credit unions to lend to their members, but that would be an impact of the proposal.

In fact, the commentary accompanying the proposed rule significantly underestimates the impact of the proposal on credit unions, their members and the communities that they serve. NCUA indicates that less than 10% of covered credit unions would be affected by the proposal – only 189 would be reclassified from well-capitalized to adequately capitalized and only 10 would be reclassified to undercapitalized – and that these credit unions would be required to raise a total of $63 million of additional capital to become adequately capitalized, given no changes in their balance sheets.[8] This estimate ignores several operational realities. First, very few credit unions seek to maintain capital levels precisely at the required minimum amount. They generally want to maintain a buffer

[7] Letter from the Midwest Agricultural Credit Union Coalition to the National Credit Union Administration. May 22, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk2014MACUC.pdf
[8] 79 Fed. Reg. 11, 188.

above those minimums so that they can manage unexpected changes in their balance sheets; and, their examiners generally prefer that they maintain the buffer. The NCUA estimate calculates only the amount that the ten credit unions reclassified as undercapitalized would need to achieve an adequately-capitalized classification; it does not take into consideration the capital required for those ten credit unions to achieve a well-capitalized classification nor does it take into consideration the buffer that those credit unions would seek to maintain above the minimum threshold to be considered well capitalized.

Further, the $63 million completely ignores the 189 credit unions that would be reclassified from well to adequately capitalized. These credit unions also would certainly find it necessarily prudent to attempt to raise sufficient capital quickly to restore their well-capitalized status. Doing so would require $480 million in additional capital.

Finally, many other credit unions that would come perilously close to having their capital classifications reduced from well- to adequately-capitalized would face similar pressures.

On net, across all potentially affected credit unions (those with more than $40 million in assets), we conservatively estimate that the rule would compel credit unions to add an additional $3.0 - $4.5 billion in capital in an effort to maintain or manage buffers above the higher requirements.[9]

In our comment letter, we urged NCUA to pursue risk-based capital standards as part of a multi-faceted capital reform strategy, which would include statutory capital reform. Representatives Peter King (R-NY) and Brad

[9] The actual increase in the amount of capital required to be well capitalized would rise by about twice that much, but for many credit unions existing capital buffers are sufficiently high that a reduction in those buffers would likely not lead to the need for additional capital.

Sherman (D-CA) have introduced a bill, H.R. 719, the *Capital Access for Small Businesses and Jobs Act*. This legislation has the support of the NCUA Chairman and enjoys cosponsorship by an additional 49 bipartisan members of the House of Representatives.[10] It would be a good place to start the conversation regarding credit union capital reform.

For these reasons and others, the proposed rule has received a historic amount of interest from stakeholders. As noted above, CUNA expressed concerns to the agency in a comprehensive comment letter filed in May, as did CommunityAmerica Credit Union.[11,12] These letters were among the more than 2,200 comment letters the agency received. We appreciate the leadership of Chairman Johnson and Ranking Member Crapo who recently sent a letter to the NCUA on this matter, as well as that of the other 25 Senators who have weighed in on this proposal. The proposed rule has generated similar interest in the House of Representatives where more than 324 Members signed a letter to the agency organized by Representatives Peter King (R-NY) and Gregory Meeks (D-NY).[13,14] The level of continuing interest and concern regarding this proposed rule can be clearly appreciated through the stream of letters going from Capitol

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[10] Letter from NCUA Chairman Debbie Matz to Representative Peter King. May 30, 2014.

[11] Letter from Bill Cheney, CUNA, to NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140528BCheney.pdf

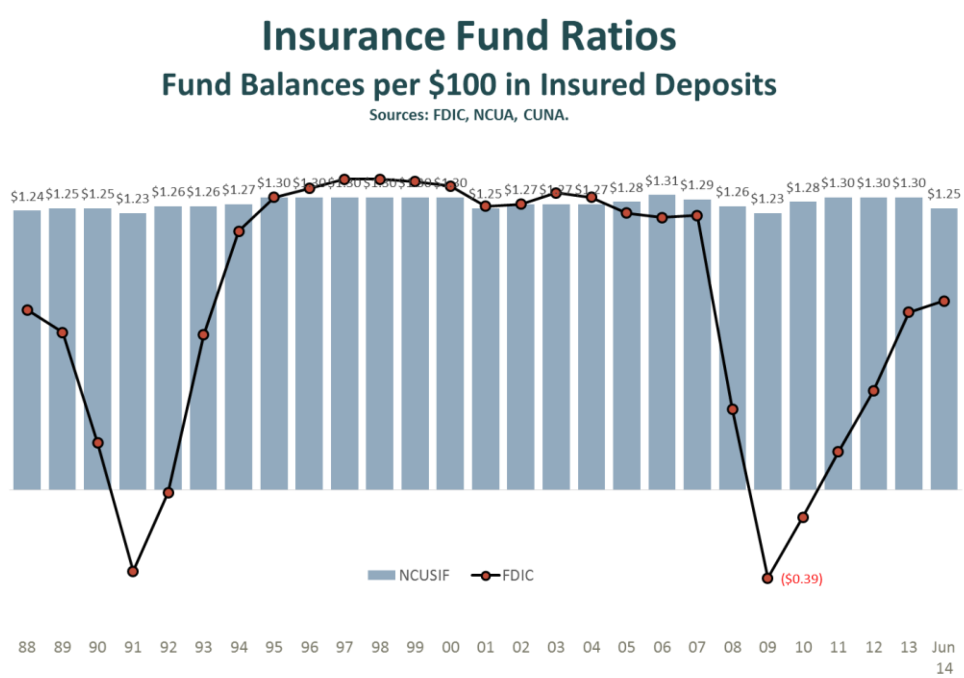
[12] Letter from Dennis Pierce, Chief Executive Officer, Community America Credit Union, to the National Credit Union Administration. May 16, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140516DPierce.pdf

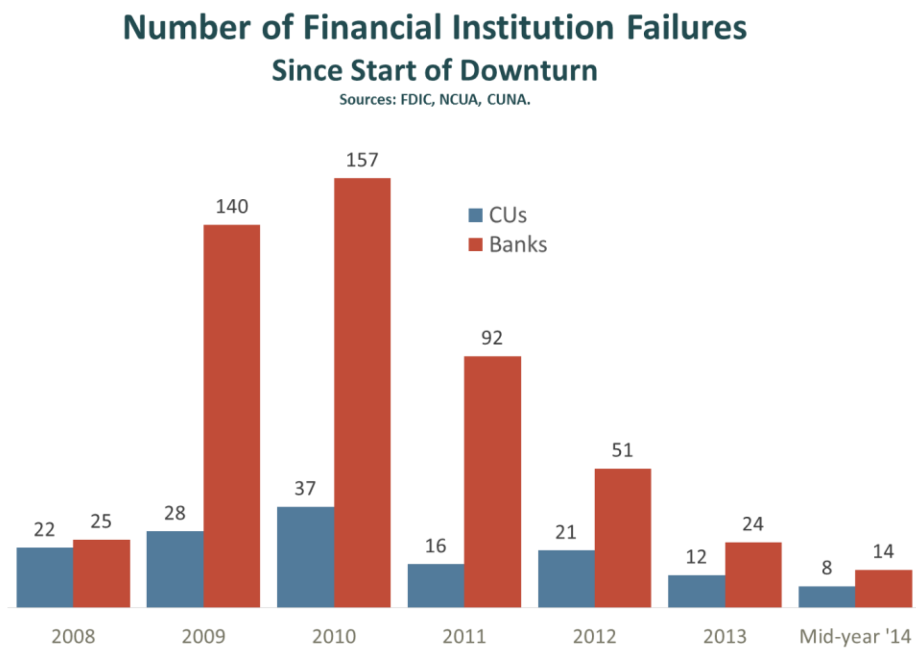
[13] Comment letters received by NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/Regs/Pages/PR20140123RiskBasedCapital.aspx

[14] Letter from Representatives Peter King, Gregory Meeks and 322 Members of the House of Representative to NCUA regarding the proposed rule on prompt corrective action; risk based capital issued January 23, 2014.
http://www.ncua.gov/Legal/CommentLetters/CLRisk20140515Congress.pdf

Hill to the NCUA urging them to take the concerns credit unions have with this proposal into consideration as the rule is finalized.

America's credit unions – since their inception – have been the model of risk management in the U.S. financial system, as the following two charts demonstrate. No other class of financial institution has been as resilient to risk as credit unions. The absence of a profit motive, a mission of service and a cooperative ownership structure, are all reasons for this performance. That fewer credit unions have failed throughout their history than any other types of financial institution is no accident – it is because credit unions are different.





NCUA should be encouraging credit unions to do more of what they do now to serve their members and communities—not limiting them so they can only do less. Credit unions appreciate the oversight role that the Committee has with respect to NCUA, and we encourage the Committee to exercise that responsibility to ensure that the risk-based capital rule that is finally implemented is consistent with the law, balances the best interests of credit union members with the safety of the money they entrust to their credit union and recognizes that credit unions are cooperative institutions formed to serve their members on a not-for-profit basis.

Credit Unions Have Significant Concerns with the Federal Housing Finance Agency Proposed Revisions to Federal Home Loan Bank Eligibility Requirements

We are very concerned about the September 2, 2014 proposal from FHFA to revise the agency's rules regarding membership in a Federal Home Loan Bank (FHLB). FHLBs are critical sources of liquidity for many credit unions, and based on a very preliminary assessment, the proposed regulation would make it much more difficult for credit unions to maintain access to the FHLB system. CUNA questions the need for the proposal at all.

This proposed rule, which is based on an advance notice of proposed rulemaking (ANPR) issued almost four years ago, creates two core requirements for financial institutions. First, the rule would require all financial institutions who are FHLB members to hold one percent of their assets in "home mortgage loans" on an ongoing basis. The proposed regulation suggests that FHFA is considering raising this requirement to as high as five percent in the future. While financial institutions currently must meet the one percent-of-assets threshold to become FHLB members, there is no requirement at this time that the member maintain it to remain a member.

Second, all FHLB-member credit unions—but, because of a statutory limitation in the *Federal Home Loan Bank Act*, only certain banks—would also be required to hold 10% of assets in "residential mortgage loans" on an ongoing basis. As with the one percent test, the 10%-of-assets threshold must be met by the institution in order to become a FHLB member, but there is no current requirement that the member maintain it to remain a member. Credit unions are not treated equally with banks in this regard because the Federal Home Loan Bank Act exempts from the "10 percent" requirement any "community financial institution," defined as FDIC-insured banks with less than $1 billion in average total assets (adjusted annually for inflation) over the preceding three years. Federally insured credit unions are not given parity with banks in this regard. The *Federal Home Loan Bank Act* should be amended to ensure credit unions are given parity and considered "community financial institutions."

Beyond correcting this statutory deficiency, we urge Congress to ask tough questions of FHFA regarding the need for this proposal as well as the details. Although we recognize FHFA has an interest in ensuring that FHLB members maintain a commitment to housing finance, we believe this is a regulation in search of a problem. We are unaware of any financial institutions who can jump through the substantial regulatory hoops to become FHLB members, who are willing to buy stock in the FHLBs, and who meet the 10% requirement at the time of membership who are not committed to housing. This regulation will create another compliance task for credit unions, who will be forced to maintain a close watch over their balance sheet to ensure they meet an arbitrary requirement on an ongoing basis. FHFA acknowledges that the proposed regulation will put the existing FHLB membership for some credit unions in jeopardy. Loss of FHLB membership will limit access to the low-cost sources of funding provided by the FHLBs, restricting credit at a time when our nation's housing recovery remains fragile.

We are also troubled by the 60-day comment period, which is simply not enough time given the important policy issues involved. If implemented as proposed, this rule may require credit unions to restructure their balance sheets to ensure compliance. Additional time is important to digest what the consequences of this proposal will be in the real world. In any event, it is unclear to us that there is an immediate need for FHFA to finalize this proposal on an accelerated basis, especially given the ANPR was initially issued almost four years ago. We have urged the agency to extend the comment period for a minimum of 60 additional days (for at least 120 total).

FHLB liquidity was a critical resource during the last financial crisis and the proposed regulation would limit its utility in a future crisis. We hope FHFA will reconsider this proposal and look forward to working with the agency to make it work for credit unions.

Credit Union Ask the Senate to Approve House-Passed Regulatory Relief Legislation

As Congress approaches the conclusion of its session, we encourage the Senate to take action on the following measures which have already passed the House of Representatives.

H.R. 749 / S. 635 – the Privacy Notice Modernization Act

The *Privacy Notice Modernization Act* (H.R. 749 / S. 635) is an example of legislation that both reduces regulatory burden and improves consumer protection. The legislation would require financial institutions to send their customers privacy policy notifications when the privacy policy is changed. Under current law, financial institutions must send these notices on an annual basis regardless of whether the policy changes. This imposes a significant cost on credit unions and results in very little consumer benefit. Since 2001, credit unions have sent over 1 billion privacy notices to their members, averaging over 87,000,000 notices a year.

A voter survey conducted in 2013 showed that fewer than one-quarter of consumers read the privacy notifications they receive, and over three-quarters of consumers would be more likely to read them if they were only sent when the financial institution changed its policy. This suggests that the public policy goal of privacy notifications would be better achieved if the notices had more meaning to consumers. We believe that this legislation achieves this goal.

The legislation passed the House of Representatives in March 2013. A companion bill has been introduced in the Senate by Senators Brown (D-OH) and Moran (R-KS), enjoying cosponsorship by 72 Senators. We encourage the

Senate to pass this legislation and send it to the President's desk as soon as possible.

H.R. 3468 / S. 2698 / S. 2699 - Credit Union Share Insurance Fund Parity Act

We encourage the Senate to consider legislation providing parity in insurance coverage for lawyer trust accounts and other similar trust accounts held at a federally insured credit union. Senators King (I-ME), Warner (D-VA), Tester (D-MT) and Fischer (R-NE) have introduced regulatory relief legislation that includes a provision to address this issue: S. 2698, the Regulatory Easement for Lending Institutions that Enable a Vibrant Economy Act (RELIEVE Act); and S. 2699, a standalone measure that would address this issue.

The *Federal Credit Union Act* directs NCUA, which administers the NCUSIF, to provide insurance coverage that is on par with the Federal Deposit Insurance Corporation. However, the NCUSIF does not provide equal insurance treatment for certain types of accounts that are similar to accounts held by bank customers and insured by the FDIC, including Interest on Lawyer Trusts Accounts (IOLTAs) and other similar trust accounts.

An IOLTA is set up by an attorney as an escrow account containing pooled client funds, with interest generated by the funds going to support legal services for the poor. NCUA has stated that the client continues to own the money and that the attorney is only serving as a custodial agent; therefore, membership status (in the credit union) of the client(s), as the owner(s) of the funds, and not that of the attorney or IOLTA administrator, determines whether the IOLTA account can be maintained by the credit union and whether it is insurable.[15] As a result, in order for the attorney to maintain an IOLTA account

[15] NCUA legal opinion letter 96-0841

at most credit unions, all of the clients whose funds would be deposited must be members of the credit union.[16]

In May, the House of Representatives passed by voice vote H.R. 3468, a bill that would clarify that NCUSIF insurance coverage can be extended to IOLTA accounts, and other similar trust accounts. We encourage the Senate to resolve the disparity in treatment of IOLTA accounts by considering the House bill, S. 2698 or S. 2699 as soon as possible.

S. 1806 / H.R. 3584 - Capital Access for Small Community Financial Institutions Act

S. 1806 and its House companion, H.R. 3584, would correct a drafting oversight in the *Federal Home Loan Bank Act* which has resulted in a small number of privately insured credit unions ineligibility to join a Federal Home Loan Bank.

In 1989, in the wake of the savings and loan crisis, the Federal Home Loan Bank System was opened up for the first time to commercial banks and credit unions. Unfortunately, the bill was drafted in such a way to apply only to an "insured credit union" as defined under the *Federal Credit Union Act*. If the legislation had used a broader term – such as "state credit union" or "state-chartered credit union" terms that are clearly defined in the 12 USC 1752 of the *Federal Credit Union Act*, this would not be an issue. This is why, for many years, we have suggested that this was likely an oversight in drafting. Unfortunately, it has meant that this small group of credit unions has been denied the right to even apply for membership in the Federal Home Loan Bank System for over two decades.

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[16] Federal credit unions that are designated as "low income" face fewer restrictions in setting up IOLTA accounts since they are allowed to accept non-member funds.

The House of Representatives has recognized this as a problem. In 2004 and 2006, the full House passed legislation to correct this. In 2008, as part of the *Housing and Economic Recovery Act of 2008*, Congress made a small change that permits privately-insured, state-chartered credit unions which are designated as CDFIs to apply for membership to the Federal Home Loan Banks; however, of the 132 privately insured credit unions, only two hold CDFI status.

We understand some policymakers have concerns with respect to the existence of a private insurance option for certain state chartered credit unions; however, this legislation would not expand that option for credit unions nor would it present an increased risk to the Federal Home Loan Bank System.

If this legislation were enacted, privately insured credit unions would not be the only non-federally insured institutions eligible for membership in the Federal Home Loan Bank System. Insurance companies, which are not federally insured, were original members of the System and they remain so today. In fact, 119 insurance companies presently borrow from the Federal Home Loan Bank System and report borrowings of nearly twice that of the 427 federally insured credit unions that also currently have advances outstanding, according to the *Combined Financial Report of the Federal Home Loan Bank System for the Quarter ending on September 30, 2013*.

It has never seemed fair to our small institutions that some of the largest banks in the world, or insurance companies (which are not federally insured) or a foreign bank's U.S. subsidiary can borrow billions of dollars from the Federal Home Loan Bank System, but credit unions serving teachers in Ohio and Texas, firefighters in California, postal and county workers in Illinois and farmers in Indiana cannot.

In May, the House of Representatives passed H.R. 3468 by a vote of 395-0. This bi-partisan piece of legislation would allow state-chartered, privately insured credit unions, to apply for membership in the Federal Home Loan Bank System. The Senate companion bill has been introduced in the Senate by Senators Brown (D-OH) and Portman (R-OH). We encourage the Senate to pass this bill as soon as possible.

S. 1916 / H.R. 2672 – Helping Expand Lending Practices in Rural Communities Act

S. 1916, and its House companion, H.R. 2672, would direct the CFPB to establish an application process to determine whether an area should be designated as a rural area if the CFPB has not designated it as one. Designation of "rural" by the CFPB has many implications for credit unions, particularly with respect to the type of products credit unions may offer their members in these areas. For instance, the Escrow Requirement under the *Truth in Lending Act* Rule requires certain lenders to create an escrow account for at least five years for higher-priced mortgage loans. If those loans are made by small lenders that operate predominately in rural or underserved counties, they are exempt from this requirement. Another example incudes the Ability to Repay and Qualified Mortgage (QM) Standards under the *Truth in Lending Act* Rule by which mortgage loans with balloon payments do not meet the QM definition. Like the Escrow Rule, small lenders that operate predominately in rural areas are eligible to originate balloon-payment QMs. The CFPB has defined "rural" by using the U.S. Department of Agriculture Economic Research Services' urban influence codes.

H.R. 2672 passed the House of Representatives by voice vote in May. We urge the Senate to pass this legislation prior to adjournment.

S. 1511 / H.R. 3211 - The Mortgage Choice Act

CUNA supports Senate passage of S. 1511, the *Mortgage Choice Act of 2013*. S. 1511 is bipartisan legislation that would give mortgage lenders much needed relief from the CFPB's "Ability to Repay/Qualified Mortgage (QM)" rule that was implemented due to provisions within the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.

The current QM rule prohibits "Points & Fees" from exceeding three percent of the total loan amount. Due largely to the loose interpretation of what constitutes a "point" or a "fee", otherwise qualified borrowers will experience the inability to pass the QM test, consequently failing to have their loan approved.

The legislation would exclude from the calculation of points and fees, compensation paid to affiliated businesses, such as land title companies. Defining points and fees in this way will maintain a competitive marketplace, prevent over-pricing or limiting choice in low-moderate income areas and allow consumers to enjoy the existing benefit of working through one mortgage provider. The House of Representatives recently passed companion legislation (H.R. 3211) by voice vote.

Credit Unions Encourage the Senate to Consider Other Measures and Issues

S. 1927 – The Data Security Act

Credit unions take the security of member data seriously. Recent reports indicate that financial institutions discovered consumer data available for sale on the black market, and the data was traced to a breach at Home Depot. The reports also suggest the Home Depot breach may be larger in scope than the Target breach. While the investigation continues, this latest data security breach demonstrates yet again the need for data security requirements for merchants.

Merchant data breaches have become a chronic issue, because data security standards are inconsistent across the board. Simply put, credit unions and other financial institutions are subject to high data protection standards under the Gramm-Leach-Bliley Act and merchants are not subject to federal data protection standards. Under today's federal law, there is no merchant accountability.

As today's hearing focuses on the unique challenges facing small financial institutions, it is important to recognize that the costs of a merchant data breach scenario for a small financial institution will be relatively greater than those of large financial intuitions. For example, a small credit union does not enjoy the economies of scale as a national megabank. Therefore, the costs of everything from replacing a debit card to monitoring suspicious activities, will be greater. Merchant data breaches are a continuing challenge for smaller financial institutions.

CUNA supports S. 1927, the *Data Security Act of 2014*, introduced by Senators Carper (D-DE) and Blunt (R-MO), would provide a national standard for businesses to protect sensitive consumer information, rather than a myriad of differing state laws and regulations. Importantly, this legislation recognizes the high data security protection standards that financial institutions must follow. Under this legislation, breached entities would be responsible for investigating the source of the breach and reporting the breach to appropriate authorities and the consumer(s) affected. Congress should act quickly to enact this legislation.

H.R. 3240 – The Regulation D Study Act

H.R. 3240, bipartisan legislation introduced by Representatives Pittenger (R-NC) and Maloney (D-NY), directs the Government Accountability Office (GAO) to study the impact of the Federal Reserve Board's monetary reserve requirements, implemented through Regulation D, on depository institutions, consumers and monetary policy. Credit unions became subject to monetary reserves in 1980.

Regulation D impacts credit union members by limiting the number of automatic withdrawals from a member's savings account to six transactions per month. The impact of this limit is to unnecessarily cause credit union members to overdraft their checking accounts when a debit draws the checking account balance below zero and the member has already had six automatic transfers during the month. When this happens, members who may have the funds in a savings account to cover the debit are hit with nonsufficient fund fees (NSF) from their financial institution and, when a check is involved, a returned check fee from the merchant. This is not a result of an overdraft protection program – this happens because of a regulatory cap on automatic transfers. It is difficult for credit union members affected by the cap to understand that this is out of the control of the credit union when the funds to cover the debit are sitting in their savings account at the credit union.

We would like to see this cap increased or eliminated altogether, but we understand that one of the reasons the regulation is in place is because the Federal Reserve uses it as a tool to conduct monetary policy. So, as a first step toward the possible change in this cap, the legislation directs the Government Accountability Office (GAO) to study the issue so that more information will be available for Congress to determine whether an increase in or the elimination of this cap would substantially affect their ability to conduct monetary policy.

Specifically, H.R. 3240 directs the GAO to examine and report within one year of enactment on the following topics: an historic overview of how the Federal Reserve has used reserve requirements to conduct monetary policy; the impact of the maintenance of reserves on depository institutions, including the operations requirements and associated costs; the impact on consumers in managing their accounts, including the costs and benefits of the reserving system; and, alternatives to required reserves the Federal Reserve may have to effect monetary policy. The bill also directs the GAO to consult with credit unions and community banks.

This bill is timely. According to former Federal Reserve Chairman Ben Bernanke, "…reserve balances far exceed the level of reserve requirements and the level of reserve requirements thus plays only a minor role in the daily implementation of monetary policy."[17] A GAO study will allow an objective assessment of whether the rarely changed monetary reserves imposed on depository institutions and consumers are necessary in order for the Fed to implement monetary policy in the 21st century. CUNA strongly supports this bill, which recently passed the House Financial Services Committee by voice vote.

H.R. 4466 – The Financial Regulatory Clarity Act

Credit unions support H.R. 4466, the *Financial Regulatory Clarity Act*. This commonsense bipartisan legislation would require financial regulators to determine whether new regulations are duplicative or inconsistent with existing Federal regulations. Requiring a regulator to consider whether its new rule or regulation is consistent with or duplicative of existing regulations would only contribute to stronger rule making and reduce regulatory burden.

[17] Letter from Federal Reserve Chairman Ben Bernanke to Representative Robert Pittenger, September 20, 2013.

H.R. 4226 – The Credit Union Residential Loan Parity Act

We support H.R. 4226, the *Credit Union Residential Loan Parity Act*. This legislation, introduced by Representatives Royce (R-CA) and Huffman (D-CA), addresses a disparity in the treatment of certain residential loans made by banks and credit unions. When a bank makes a loan to purchase a 1-4 unit non-owner occupied residential dwelling, the loan is classified as a residential real estate loan; however, if a credit union were to make the same loan, it would be classified as a business loan and therefore would be subject to the cap on member business lending under the *Federal Credit Union Act*.

H.R. 4226 would amend the *Federal Credit Union Act* to provide an exclusion from the cap for these loans. In addition, H.R. 4226 would authorize NCUA to apply strict underwriting and servicing requirements for the loans.

Enactment of this legislation would not only correct this disparity but it would also enable credit unions to provide additional credit to borrowers seeking to purchase residential units, including low-income rental units. Credit unions would be better able to meet the needs of their members, if this bill was enacted, and it would also contribute to the availability of affordable rental housing.

H.R. 4383 - Bureau of Consumer Financial Protection Small Business Advisory Board

Shortly after the CFPB was established, the Bureau leadership announced the creation of a credit union advisory council (CUAC). This group, the creation of which CUNA strongly urged, advises the agency on the impact of the Bureau's proposals on credit unions, sharing information, analyses, recommendations and the unique perspective of not-for-profit financial institutions with the agency director and staff. However, since the CUAC is not required by law, it could be abolished at any time. We believe the CUAC is an important resource for the agency and also provides a forum for credit union officials to provide direct feedback to the agency on how proposals and final rules will affect credit unions' operations.

H.R. 4383, as amended by the House Financial Services Committee, codifies the CFPB Credit Union Advisory Council as a legal requirement. Working with the bill's sponsor, and the Chairman and Ranking Member of the House Financial Services Committee, language was inserted that would codify the CUAC and establish permanency for its needed existence. H.R. 4383 was passed by voice vote in the House Financial Services Committee. The full House of Representatives could consider the legislation before adjournment of the Congress; CUNA strongly supports its consideration and passage in the Senate.

S. 2641 / H.R. 2673 – The Portfolio and Mortgage Lending Access Act

CUNA supports S. 2641, the *Portfolio and Mortgage Lending Access Act*, introduced by Senator Landrieu (D-LA). This legislation allows for mortgages held in a credit union's portfolio to be automatically designated as a Qualified Mortgage, per the CFPB's mortgage lending rules. The House Financial Services Committee approved the companion bill (H.R. 2673) earlier this year.

Designating a mortgage held on a financial intuitions' balance sheet as a QM loan is appropriate, because the lender retains all of the risk involved with these mortgages and is subject to significant safety and soundness supervision from its prudential regulator. Historically, credit unions are portfolio lenders. This bill would allow them to continue in that fashion, extending mortgage credit to their credit worthy members, even if they do not fit the cookie cutter QM box.

S. 2732 – Consumer Financial Protection Bureau Examination and Reporting Threshold Act

In July, Senators Toomey (R-PA) and Donnelly (D-IN) introduced S. 2732, the *Consumer Financial Protection Bureau Examination and Reporting Threshold*

Act of 2014. This legislation would increase the threshold for examination of banks and credit unions by the CFPB from $10 billion to $50 billion.

Raising this threshold would provide significant regulatory relief to the affected institutions and direct Bureau resources to the examination of the institutions that serve the greatest number of consumers. While this change would not significantly change the number of institutions and percentage of assets presently subject to examination by the Bureau, it would allow the Bureau to more efficiently use its examination resources in the coming years. The number of financial institutions approaching $10 billion in total assets is increasing. As these institutions cross the threshold, the Bureau will be required to spend more of its resources examining these newly covered institutions at the expense of other activities.

Institutions affected by this change would continue to be subject to the Bureau's rules and regulations, and they would be examined for compliance with these rules by their prudential regulator. In addition, Section 1026 of the *Dodd-Frank Act* provides the Bureau authority to examine on a sampling basis credit unions, thrifts and banks for which it does not have examination authority and includes language directing coordination between the prudential regulators and the Bureau.

While we support the legislation that has been introduced, we would encourage the Committee to consider adding language to index the threshold for inflation.

CFPB's Exemption Authority

As the Committee considers additional ways to address the regulatory burden facing credit unions, we urge the Committee to ask the CFPB to conduct a review of its regulations to identify and address outdated and unnecessary regulations with an eye toward reducing unwarranted regulatory burden, as directed by Section 1021(b)(3) of the *Dodd-Frank Act*.

Further, we ask the Committee to encourage the CFPB to use the exemption authority Congress conveyed to it under Section 1022(b)(3) of the *Dodd-Frank Act* with alacrity. We believe the CFPB has more authority than it has been exercising to extend relief to credit unions and others from certain compliance responsibilities. We are very concerned that the CFPB seems to be picking and choosing when to use the statutory flexibility Congress provided under the *Dodd-Frank Act*. It is important that Congress aggressively urges the CFPB to utilize the exemption clause so that the weight of compounding regulations that are intended for abusers and the largest financial institutions do not overburden credit unions and other smaller financial institutions. The CFPB's failure to use this authority as Congress intended may ultimately drive good actors out of markets, forcing consumers to do business with those entities that remain – we have seen this already in the remittance transfer market.

We encourage Congress to urge the CFPB to exercise its exemption authority as broadly as possible to protect credit unions from burdensome overregulation, which ultimately impacts consumers. Further, CUNA has urged the CFPB to include an analysis of its exemption authority with every proposal and final rule so that every time the CFPB considers a new regulation, it will also consider whether institutions such as credit unions that are already heavily regulated should be exempted. The default should be exclusion unless an actual need is demonstrated.

Along these lines, we strongly encourage the Committee as it considers additional regulatory relief legislation to consider ways to more directly exempt credit unions and small banks from the CFPB's rulemaking.

Conclusion

Credit unions were established to promote thrift and provide access to credit for provident purposes, but their ability to fulfill this mission is complicated by the ever increasing, never decreasing regulatory burden imposed on them by Congress and regulators. Without meaningful relief, the trend of consolidation in the credit union sector will continue, jeopardizing American's access to affordable financial services from cooperatively run not-for-profit financial institutions. The 100 million members of America's credit unions need Congress to act.

On behalf of the 6,600 credit unions and their 100 million members, thank you very much for holding today's hearing and providing me the opportunity to express my views. I am happy to answer any questions the Members of the Committee may have.