



Testimony of

Bill Cheney
President/CEO of Xerox Federal Credit Union

on Behalf of
The National Association of Federal Credit Unions

Regulatory Relief

Before the

Committee on Banking, Housing and Urban Affairs

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Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of more than 800 federal credit unions—member owned financial institutions across the nation—representing approximately 25 million individual credit union members. NAFCU—member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in this discussion regarding regulatory relief for America's financial institutions and particularly its impact on federal credit unions.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created and has been recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have no access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 85 million Americans. Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 USC 1752(1)). While nearly 70 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

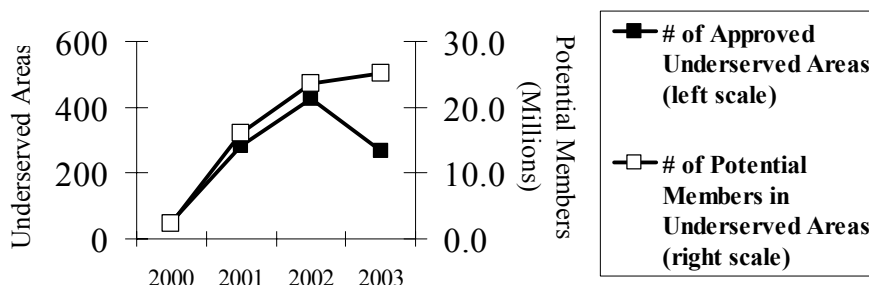
Credit unions are not banks. The nation's approximately 5,700 federally insured credit unions serve a different purpose and have a fundamentally different structure,

existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—“one member, one vote”—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for profit stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

Credit Unions have an unparalleled safety and soundness record. Credit unions—unlike banks and thrifts—have never cost the American taxpayer a single dime. Unlike the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) which were both started with seed money from the United States Treasury, every dollar that has ever gone into the National Credit Union Share Insurance Fund (NCUSIF) has come from the credit unions it insures. And unlike the thrift insurance fund that unfortunately cost American taxpayers hundreds of billions of dollars, credit unions have never needed a federal bailout.

America’s credit unions have always remained true to their original mission of “promoting thrift” and providing “a source of credit for provident or productive purposes.” In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219). In the “findings” section of that law, Congress declared that, “The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue[s] to fulfill this public purpose.” Since the passage of CUMAA in 1998, federal credit unions have added over 1,000 underserved areas, resulting in low-cost financial services being made available to over 67 million people.

UNDERSERVED AREAS ADDED TO FEDERAL CREDIT UNIONS MEMBERSHIP



Source: National Credit Union Administration

A 2004 Filene Research Institute study entitled “Who Uses Credit Unions” found that the average household income of those who hold accounts solely at a credit union was \$42,664, while the average household income for those who only hold accounts at a bank was \$76,923. Even of those who used multiple financial services providers, those that primarily used a credit union had an average household income of \$67,475, while those who used multiple financial services providers but primarily used a bank had an average household income of \$74,303. Credit unions also represent a very small portion of today’s financial marketplace, holding only 1.6 percent of all household financial assets.

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed with the resulting de-personalization in the delivery of financial services by banks, the emphasis in consumers’ minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2003 American Banker/Gallup Consumer Survey, credit unions had the highest rated service quality of all surveyed financial institutions. This has held true each year since the survey was initiated.

I serve as the President/CEO of Xerox Federal Credit Union, headquartered in El Segundo, California. Xerox FCU is a multiple common bond credit union with approximately 77,000 members and more than \$760 million in assets. Xerox FCU serves employees of the Xerox Corporation and related companies nationwide through 17 credit union offices in eight states. My credit union has recently expanded to include underserved communities in Rochester, NY; Dallas, TX; St. Petersburg, FL; and Chicago, IL. I have a broad background in financial services, including more than 17 years working in the credit union industry. I joined Xerox Federal Credit Union in 1997 after 10 years with Security Service Federal Credit Union in Texas.

Currently I also serve as an at-large director and board secretary for the National Association of Federal Credit Unions; I am a member of the board of directors for Western Corporate Federal Credit Union (WesCorp), as well as a member of the Diversity Committee for the California Credit Union League. Finally, I am chairman of the board of XCU Capital Corporation, a broker/dealer owned and controlled by 17 credit unions.

I am also a director and a member of the Executive Committee of the American Red Cross of Greater Los Angeles, and I volunteer with numerous charitable organizations such as Heal the Bay and the Boy Scouts of America. I earned my Bachelor of Business Administration degree from The University of Texas at Austin in 1982.

Looking Beyond CUMAA

Credit unions have been the target of criticism by some in the banking industry for more than two decades, and the criticisms that the bankers are lodging today are nothing new. Over the past year, the banker attacks have intensified. The Supreme Court's decision in 1998 in the AT&T Family Federal Credit Union field of membership case followed by Congress' prompt passage of CUMAA in the summer of 1998, which

was seen by many as a significant victory for credit unions, brought the issue to a head. The fact of the matter is that when CUMAA was signed into law it overturned in eight short months a decision that had encompassed eight years of costly litigation initiated by the banks.

CUMAA was a necessary piece of legislation for credit unions at the time of its enactment because it codified a number of fundamental credit union concepts embraced by both federal and state-chartered credit unions. These include:

- the multiple-group policy that NCUA had initiated in 1984;
- the “once a member, always a member” principle followed by virtually every credit union in the country; and,
- the “family member” concept followed by many credit unions.

Yet CUMAA came with some provisions that were not widely supported by the credit union community. These include:

- limitations on member business loans;
- imposition of a bank-like Prompt Corrective Action or “PCA” requirement that, given the structure of credit unions, serves in many respects as an overly restrictive constraint on growth; and
- various artificial and arbitrary limitations on growth.

Following the passage of CUMAA, NAFCU recognized the need for additional credit union legislation. As a result NAFCU convened a task force of federal credit unions and former federal credit unions (that had converted to a state charter) to begin work on developing well-reasoned proposals to enhance the federal credit union charter and to ease the regulatory burdens of all credit unions.

This group met to discuss their concerns related to the federal charter in the post-CUMAA environment. Below are highlights of some of the comments NAFCU heard at that session and in subsequent meetings:

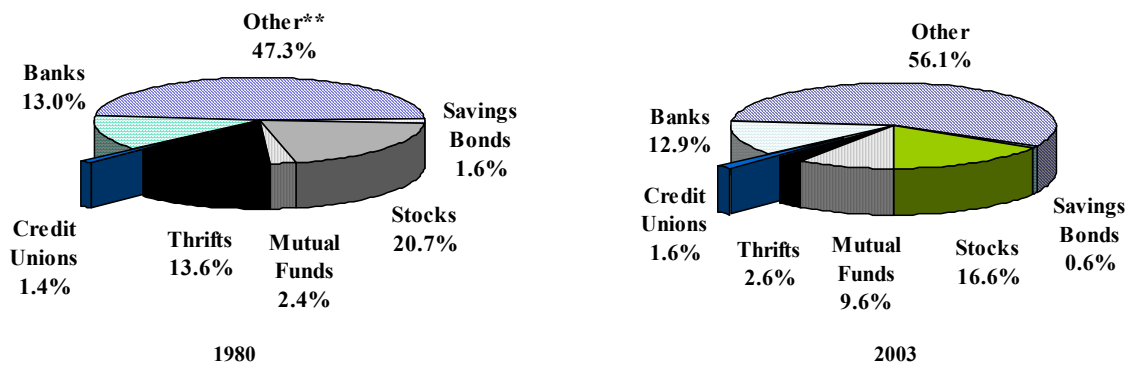
- NCUA should work to eliminate unnecessary and needless regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- Mergers seem to be a practical and necessary way of creating financially viable credit unions that can survive in today's financial marketplace.
- It is important that the regulatory environments allow for credit union growth and not impair the ability of credit unions to remain competitive.

As a result of these meetings, it became clear that both regulatory and legislative action was needed in the post-CUMAA environment.

The Current Situation

NAFCU is pleased to report to the Committee that credit unions today are vibrant and healthy. Membership in credit unions continues to grow with credit unions serving over 85 million Americans—more than at any time in history. At the same time, it is important to note that over the past 21 years credit unions have increased their market share only minimally and as a consequence provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the 23 year period from 1980 to 2003 the percentage of total household financial assets held by credit unions increased from 1.4% to 1.6% or merely 0.2% over the course of 23 years.

HOUSEHOLD FINANCIAL ASSETS

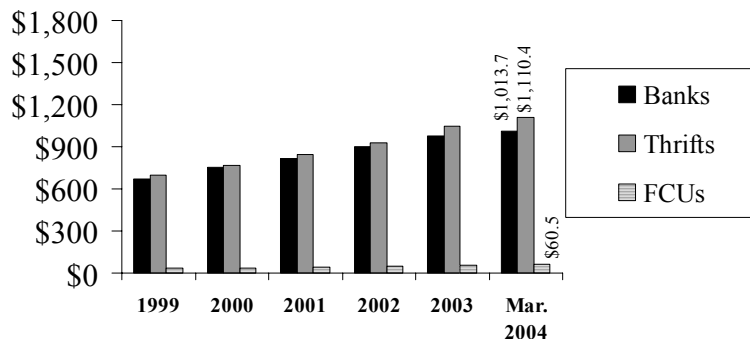


****Other includes items such as life insurance reserves, pension fund reserves, mortgages, security credit, equity in noncorporate (e.g. farm) business, open market paper, and investments in bank personal trusts.**

The above chart only tells part of the story. Credit unions remain small financial institutions. The chart below indicates that the average credit union has \$60.5 million in assets.



AVERAGE ASSETS BY INSTITUTION (MILLIONS \$)



As you can see, a number of individual banks have total assets greater than the entire credit union community combined. The annual growth of the commercial bank

sector in recent years is almost equal to the size of the entire credit union community—with banks growing in just one year by a magnitude that it took credit unions nearly a century to achieve.

As is the case with the banks and thrifts, there has been consolidation within the credit union community in recent years. The number of credit unions has declined by more than 59 percent over the course of the past 30 years, from an all-time high of 23,866 in 1969 to 9,709 at year-end 2003. Similar to the experience of all credit unions, the number of federal credit unions has declined by just about 56 percent over that same period, from a high of 12,921 in 1969 to 5,732 today.

NAFCU Meets with Policymakers to Enhance the Federal Charter

Shortcomings or anachronistic characteristics of federal chartering policies as well as needless or outdated regulatory burdens clearly cannot be remedied without bringing these matters to the attention of policy makers in Washington. Over the past four years NAFCU has been working with former NCUA Board Chairman Dennis Dollar, current NCUA Chairman JoAnn Johnson, Board Member Deborah Matz and their staffs in a good faith effort to improve the regulatory environment for federal credit unions. We are pleased to see that these efforts have been fruitful in several respects.

On the legislative front, NAFCU has been meeting with legislators on both sides of the aisle to compile a package of initiatives to help credit unions better serve their members in today's sophisticated financial marketplace. An important part of that effort has involved identifying areas in which we believe Congress should provide what is now overdue regulatory relief. NAFCU has suggested a series of recommendations designed to enhance the federal charter, several of which are contained either in whole or in part within the House-passed *Financial Services Regulatory Relief Act of 2004*, H.R. 1375, or in the *Credit Union Regulatory Improvements Act* (CURIA), H.R. 3579, which has been introduced in the House. Both of those bills recognize the fact that today's credit unions

exist in a very dynamic environment and that the laws and regulations dealing with credit union issues are currently in need of review and refinement.

Financial Services Regulatory Relief Act of 2004 and CURIA

NAFCU believes that the *Financial Services Regulatory Relief Act of 2004*, H.R. 1375, is a positive step in addressing many of the regulatory burdens and restrictions on federal credit unions. We were pleased with the overwhelming bipartisan vote of support for this legislation when it passed the House on March 18, 2004, by a vote of 392-25.

NAFCU is also pleased to see the growing support in the House for the *Credit Union Regulatory Improvements Act*, H.R. 3579, introduced last November by Representatives Ed Royce (CA) and Paul Kanjorski (PA). This legislation addresses several additional key issues for credit unions that were not addressed in H.R. 1375. We hope that the Senate Banking Committee will consider provisions from both of these bills as it crafts its own regulatory relief bill.

Twelve provisions in particular have been included in both bills, and we would urge that they be included in any regulatory relief bill that is moved by the Committee:

Leases of land on federal facilities for credit unions

NAFCU supports the effort to give credit unions land leases on federal property under the same terms and conditions as credit unions now are provided space allotments under the *Federal Credit Union Act* (FCUA). The credit unions that will be impacted by this change are defense (military) credit unions that have tried to expand their service to our men and women in uniform by building (and paying for) their own member service centers on military facilities. Many credit unions that have expanded their services by building their own facilities to serve military personnel have had their leases go from a nominal fee (e.g. \$1.00 a year) to a “fair market value” rate of over \$2,000 a month. For non-profit cooperative credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women they serve.

Investments in securities by federal credit unions

NAFCU supports this effort to increase investment options for federal credit unions by allowing certain limited investments in securities. The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential of adversely impacting both safety and soundness in the future. We believe that the track record of safe and sound performance by credit unions warrants expanded investment authority in accordance with regulations promulgated by the NCUA Board.

Increase in general 12-year limitation of term of federal credit union loans

NAFCU supports this provision that would increase the general 12-year limit on federal credit union loans to 15 years or longer as permitted by the NCUA Board. The current 12-year limit is outdated and does not conform to maturities that are commonly accepted in the market today. We believe that it is also important that the NCUA Board have the discretionary authority to extend this limitation beyond 15 years when necessary in order to appropriately address marketplace conditions.

Increase in one-percent investment limit in credit union service organizations

NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, in lieu of just raising the limit to three percent, as found in the House-passed version, NAFCU recommends that Congress give the NCUA Board authority to establish an appropriate investment limit recognizing that as time goes on, that limit may legitimately warrant further adjustment.

Member business loan exclusion for loans to non-profit religious organizations

NAFCU supports this effort to exclude loans or loan participations by federal credit unions to non-profit religious organizations from the member business loan limit.

Check-cashing and money-transfer services offered to those within the credit union's field of membership

NAFCU supports efforts to allow federal credit unions to offer check-cashing and money-transfer services to anyone within the credit union's field of membership. We

believe this new authority, which would be discretionary and not mandatory, will allow credit unions to help combat abuses by non-traditional financial institutions that prey on our nation's immigrants and others who live and work in underserved communities.

Voluntary mergers involving multiple common bond credit unions

NAFCU supports this clarifying amendment since there is no sound reason for imposing a numerical limitation of 3,000 on the size of a group that can go forward with a credit union merger before considering spinning off the group and requiring it to form a separate credit union. In addition, a credit union that converts to (or merges into) a community charter should be allowed to retain all employee groups in its field of membership at the time of conversion. Current law does not allow this, penalizing not only the credit union, but also those in its field of membership. In addition, we believe that the retroactive effective date of August 7, 1998 (the date of enactment of CUMAA), is an important part of this section and must be maintained.

Community charter conversions involving employee group credit unions

NAFCU supports efforts that give NCUA the authority to allow credit unions to continue to serve and add members from their select employee groups (SEG's) after a credit union converts to a community charter.

Credit union governance

The FCUA contains many antiquated "governance" provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. For example, credit unions are not allowed to expel disruptive or threatening members without a two-thirds vote of the membership. NAFCU supports other provisions in the House-passed *Financial Services Regulatory Relief Act of 2004* which would:

- allow credit unions to limit the length of service of members of the board of directors to ensure broader representation; and

- allow credit unions to reimburse volunteers on the board of directors for wages they would otherwise forfeit by participating in credit union-related activities.

In addition, NAFCU also believes that there are many more governance provisions in the *Federal Credit Union Act* that are out-of-date and that could be better addressed by the NCUA Board. These include:

- Allow the NCUA Board to set the amount at which the credit union board of directors must approve a loan to, or guaranteed by, a director or member of the credit union supervisory or credit committee (currently the Act sets it at \$20,000); and,
- Allow the NCUA Board to determine policies for review of approved or pending applications for membership to the credit union (currently the Act stipulates that the Board must review approved or pending applications monthly).

Providing NCUA with greater flexibility in responding to market conditions

NAFCU supports the idea of giving NCUA the authority to adjust interest rates depending on market conditions. Under current law, federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans.

Exemption from pre-merger notification requirement of the Clayton Act

NAFCU supports the inclusion of this language which would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the *Hart-Scott-Rodino Act*.

Treatment of credit unions as depository institutions under securities laws

Gramm-Leach-Bliley provided banks with registration relief from certain enumerated activities, and section 201 of the *Financial Services Regulatory Relief Act of 2004* provides similar relief to thrifts. NAFCU supports providing credit unions regulatory relief along those same lines from the requirement that they register with the Securities and Exchange Commission as broker/dealers when engaging in certain activities.

There are also additional provisions included in CURIA that are not included in the *Financial Services Regulatory Relief Act of 2004* as it passed the House. Given the bipartisan support of the legislation in the House, we hope that the Committee will consider including these provisions in any regulatory relief bill introduced in the Senate:

Risk-based capital

NAFCU supports this effort to modernize credit union capital requirements by redefining the net worth ratio to include risk assets. This would result in a new, more appropriate measurement to determine the relative risk of a credit union's assets and improve the safety and soundness of credit unions and the National Credit Union Share Insurance Fund.

Limits on member business loans

NAFCU supports elimination of the current asset limit on member business loans at a credit union from the lesser of 1.75 times actual net worth or 1.75 times net worth required for a well-capitalized credit union, and replacing it with a flat rate of 20 percent of the total assets of a credit union. NAFCU believes this provision would facilitate member business lending without jeopardizing the safety and soundness of participating credit unions. While the current cap was first imposed on credit unions as part of the *Credit Union Membership Access Act* in 1998, CUMAA also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study entitled "Credit Union Member Business Lending" in which it concluded that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions." We would urge the Committee to review this study and give it the weight it deserves when considering these provisions. NAFCU also supports revising the current definition of a member business loan by giving the NCUA the authority to exclude loans of \$100,000 or less as de minimus, rather than preserving the current threshold of \$50,000.

Leasing space in buildings with credit union offices in underserved areas

NAFCU supports the provision in CURIA that enhances the ability of credit unions to assist distressed communities with their economic revitalization efforts. It would allow a credit union to lease space in a building or on property in an underserved area in which it maintains a physical presence to other parties on a more permanent basis. It would permit a federal credit union to acquire, construct, or refurbish a building in an underserved community, and lease out excess space in that building.

We would like to call the Committee's attention to some additional issues that we believe should be considered in the upcoming regulatory relief legislation:

Modify the statutory definition of "net worth" to mean "equity" rather than the "retained earnings balance" of the credit union as determined under generally accepted accounting principles.

Currently, credit union mergers are accounted for by using the "pooling method," meaning that the net worth of each merging credit union is combined to form the net worth of the surviving credit union: \$5M (net worth of credit union A) + \$5M (net worth of credit union B) = \$10M (net worth of credit union AB). However, the Financial Accounting Standards Board (FASB) has proposed eliminating pooling and imposing the "purchase method" of accounting on credit union mergers. Using this method and the current definition of net worth which is "retained earnings" as required by PCA, the net worth of the surviving credit union is only \$5M (\$5M (net worth of credit union A) + \$5M (net worth of credit union B) = \$5M (net worth of credit union AB)). Therefore, under the purchase method of accounting, only the surviving credit union's retained earnings count as net worth for PCA purposes. As a result, the surviving credit union may have trouble meeting PCA requirements, unless credit union net worth is redefined to mean equity. It should also be noted that the FASB has reviewed this proposed amendment and has noted in a letter to NAFCU that they "have an interest in supporting an expedited resolution of this matter" and that this amendment "proposes a way to resolve this matter."

Relax the “reasonable proximity” requirement

This requirement imposes an undue burden on credit unions, requiring them to have a physical presence within a reasonable proximity of the location of a group that the credit union wants to add to its field of membership. In today’s financial services marketplace, the increase in Internet and remote banking has rendered this requirement unnecessary.

We hope that the Committee will consider these issues as the bill moves forward in the legislative process.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, there is a clear need for easing the regulatory burden on credit unions as we move forward into the 21st century financial services marketplace. We urge the Committee to consider the important provisions we have outlined in this testimony for inclusion in any Senate regulatory relief bill. We understand that this legislation is a work in progress and we urge you to undertake careful examination of any other measures that fall within the scope of this legislation. We look forward to working with you on this important matter and would welcome your comments or questions.