



Testimony of

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On behalf of

The National Association of Federal Credit Unions

“Consideration of Regulatory Relief Proposals”

Before the

Committee on Banking, Housing, and Urban Affairs

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Introduction

The National Association of 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. We would like to thank Chairman Shelby, Ranking Member Sarbanes, Senator Crapo and Members of the Committee for having us here today. NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of over 800 federal credit unions—member owned financial institutions across the nation—representing over 27 million individual credit union members. NAFCU—member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions in the United States.

I am Greg McClellan and I currently serve as the president and CEO of MAX Federal Credit Union headquartered in Montgomery, Alabama. Prior to taking over as CEO, I spent over 20 years as the executive vice president and chief operations officer at the credit union. MAX FCU is a community credit union with over 106,000 members and more than \$650 million in assets. I have been involved in the credit union movement for more than 20 years, and I have more than 30 years experience in the financial services industry.

I am a member of the Millbrook Chamber of Commerce and a board member of the Boys & Girls Club of South Central Alabama. I currently serve as the president of the Montgomery Chapter of the Alabama Credit Union League, vice chair of the Alabama Credit Union Executive Society Council and vice chair of the Credit Union Coalition of Alabama, in addition to serving on NAFCU's NAFCU/PAC Committee.

Historically, credit unions have served a unique function in the delivery of necessary financial services to all 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 limited access to necessary 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 87 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 over 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 8,695 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. In the eight years since Congress passed the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) federal credit unions have added over 1,400 underserved areas, resulting in low-cost financial services being made available to over 100 million Americans. 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. In fact, while the average bank director is paid approximately \$14,000 per year, the average credit union board member is paid \$0.

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

Looking Beyond CUMAA

Credit unions have been the target of criticism by some in the banking industry for more than two decades. Over the past few years, 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 the forefront. CUMAA overturned in eight short months a decision that had encompassed eight years of costly litigation initiated by the banks.

CUMAA was an important and 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 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 added and not widely supported by the credit union community. These include:

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

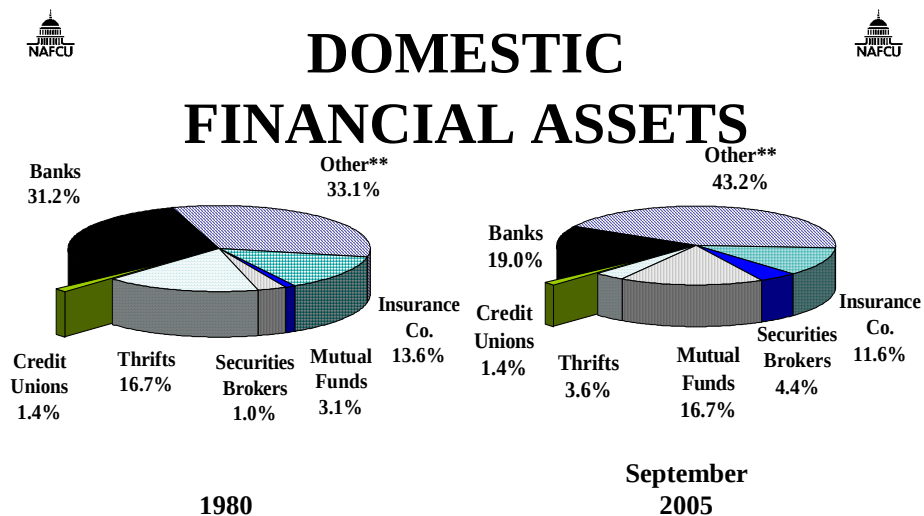
In the wake of CUMAA, NAFCU and its membership concluded the following:

- NCUA should work to eliminate unnecessary 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 services marketplace.
- It is important that the regulatory environment 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 87 million Americans—more than at any time in history. At the same time, it is important to note that over the past 25 years, the credit union market share, as a percentage of financial assets, has not changed and, as a consequence, credit unions provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the 25 year period from 1980 to September 2005, the percentage of total financial assets held by credit unions remained constant at only 1.4%.



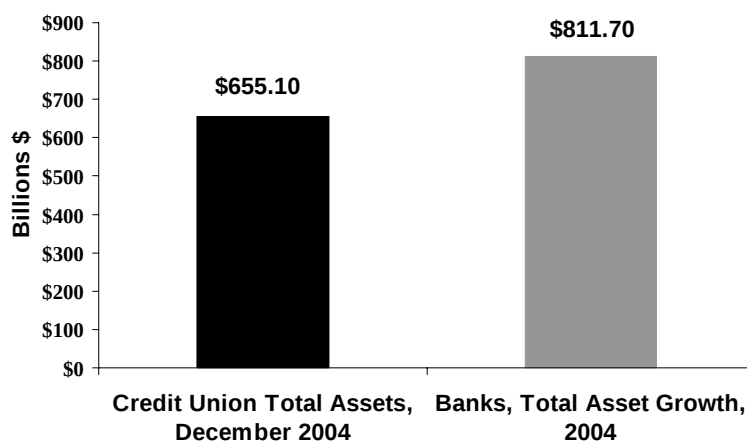
**Other includes items such as private pension funds, mortgages, asset-backed securities, finance companies, and investments in bank personal trusts.

Source: *Flow of Funds Accounts of the United States, FRB*

The above chart only tells part of the story. Credit unions remain small financial institutions. As of last September, the average credit union has \$78 million in assets, while the “average” bank and thrift has over \$1.2 billion in assets.

Furthermore, a number of individual banks have total assets greater than the entire credit union community combined. As shown in the chart below, the annual asset growth of the commercial bank sector for the last full year available (2004) exceeded the size of the entire credit union community, i.e. total assets—with banks growing in just one year by a magnitude that it took credit unions nearly a century to achieve.

BANKS’ ONE YEAR ASSET GROWTH = 124% OF TOTAL CU ASSETS



Source: NCUA; FDIC

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 63

percent over the course of the past 36 years, from an all-time high of 23,866 in 1969 to 8,880 this past December. Similar to the experience of all credit unions, the number of federal credit unions has declined by just about 58 percent over that same period, from a high of 12,921 in 1969 to 5,393 today.

NAFCU Efforts to Enhance the Federal Charter

Over the past five years NAFCU has been working closely with former NCUA Board Chairman Dennis Dollar, current NCUA Board Chairman JoAnn Johnson, Board Vice Chairman Rodney Hood and Board Member Gigi Hyland, along with other Board Members and their respective staffs in an effort to improve the regulatory environment for federal credit unions. We are pleased to see that these efforts have been productive 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 were contained either in whole or in part, in previous regulatory relief measures passed by the House. Credit unions exist in a dynamic environment where the laws and regulations dealing with credit union issues are currently in need of review and refinement in order to ensure credit unions can continue to respond to changing market conditions.

NAFCU has been pleased to work with Senator Crapo and the Members of the Committee in crafting the Matrix of Regulatory Relief Proposals and we applaud the Senator and his staff for their efforts. We look forward to regulatory relief legislation being introduced and hope that the Committee will turn to the next step of marking-up legislation.

The House Bill – A Good First Step

NAFCU urges the Committee, when drafting a regulatory relief bill, to start with the credit union proposals found of Title III of the House bill, The *Financial Services Regulatory Relief Act* (H.R. 3505) and included in the Matrix as outlined below:

Leases of land on federal facilities for credit unions (Matrix #16)

NAFCU supports the effort to give credit unions the opportunity to negotiate land leases on federal property under the same terms and conditions as credit unions now able to lease space in federal buildings under the *Federal Credit Union Act* (FCUA). The credit unions that will be impacted by this change are predominantly 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 not-for-profit cooperative credit unions, this increase in leasing costs will inevitably lead to higher fees and/or fewer services for their members- the men and women that serve our country.

Investments in securities by federal credit unions (Matrix #12)

NAFCU supports this effort to increase investment options for federal credit unions by allowing certain limited investments in securities. The current limitations in the *Federal Credit Union Act* unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential of adversely impacting both safety and soundness. 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 (Matrix #10)

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. 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 (Matrix #11, #131)

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 last version of regulatory relief passed by the House, NAFCU recommends that Congress give the NCUA Board authority to establish an appropriate investment limit recognizing that as time goes on, that limit may warrant further adjustment.

Member business loan exclusion for loans to non-profit religious organizations (Matrix #17)

NAFCU supports this effort to exclude loans or loan participations by federally-insured 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 (Matrix #9)

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. The House passed stand-alone legislation to this effect (H.R. 749) on April 26, 2005.

Voluntary mergers involving certain credit unions (Matrix #13)

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, 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.

Conversion of Certain Credit Unions to Community Charter (Matrix #18)

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. 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. We urge that the language from Section 307 of the *Credit Union Regulatory Improvements Act* (CURIA), H.R. 2317, be included for this section.

Credit union governance (Matrix #19, #132)

The *Federal Credit Union Act* contains many antiquated “governance” provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations of modern federal credit unions. We support changes that would remove many of these provisions from the *Federal Credit Union Act* and instead allow the NCUA to use its regulatory authority to oversee these governance issues. For example, one antiquated provision prohibits credit unions from expelling disruptive or threatening members without a two-thirds vote of the membership; we believe the regulator and the credit union board should have some discretion in such cases. Additionally, NAFCU supports the following credit union governance proposals which would:

- allow credit unions to reimburse volunteers on the board of directors for wages they would otherwise forfeit by participating in credit union-related activities;
- 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 committee (currently set by statute at \$20,000); and,
- allow the NCUA Board to determine policies for review of approved pending applications for membership to the credit union (currently required monthly).

Provide NCUA with greater flexibility in responding to market conditions (Matrix #20)

NAFCU supports the proposal to give NCUA the authority to adjust interest rates depending on market conditions. Under current law, federal credit unions are the only type of insured institution subject to federal usury limits on consumer loans. This provision would still keep that limit, but give NCUA greater flexibility to make adjustments based on market conditions.

Exemption from pre-merger notification requirement of the Clayton Act (Matrix #21)

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*. Credit unions, like other depository institutions, are already exempt from the other provisions of the Act. The extensive review of the merger process by NCUA, makes this an extraneous burden faced by credit unions that other financial depository institutions do not share.

Treatment of credit unions as depository institutions under securities laws (Matrix #14)

Gramm-Leach-Bliley provided banks with registration relief from certain enumerated activities. NAFCU supports providing credit unions regulatory relief along those same lines, eliminating the requirement that credit unions register with the Securities and Exchange Commission (SEC) as broker/dealers when engaging in certain activities.

Modify the statutory definition of “net worth” to include the retained earnings from other institutions that have merged with the surviving credit union (Matrix #167)

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: $\$2\text{M (net worth of credit union A)} + \$2\text{M (net worth of credit union B)} = \$4\text{M (net worth of credit union AB)}$. 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 $\$2\text{M } (\$2\text{M [net worth of credit union A]} + \$2\text{M [net worth of credit union B]} = \$2\text{M [net worth of credit union AB]})$. Therefore, under the purchase method of accounting, only the surviving credit union’s retained earnings count as net worth for PCA purposes. Consequently, the surviving credit union may have trouble meeting PCA requirements, unless credit union net worth is redefined.

It is important to note that this amendment does not legislate accounting practices; credit unions will be required to use the “purchase method” of accounting for mergers in order to receive a clean audit. This amendment does not grant credit unions that currently lack the authority to offer alternative capital accounts the authority to do so, nor does it confer upon NCUA the regulatory authority or discretion to authorize such accounts now or in the future. This amendment is intended to address a narrow and technical accounting issue and in the process simply maintain the status quo so that, in the case of merging credit unions, $2 + 2$ can continue to equal 4. The House has also passed this NAFCU-supported language as stand-alone legislation, H.R. 1042, to address this same issue.

At a House Subcommittee on Financial Institutions and Consumer Credit hearing on H.R. 1042 last April, the Subcommittee heard support for the legislation from NCUA and the National Association of State Credit Union Supervisors (NASCUS). Additionally, Mr. Robert Herz, the Chairman of FASB, testified at the hearing that the legislation does not pose an issue to FASB’s

standard setting activities. The House passed H.R. 1042 under suspension of the rules on June 13, 2005. We would urge the Committee to include the language from H.R. 1042 in any regulatory relief bill.

Additional Regulatory Relief Proposals

Additionally, NAFCU supports including items #1 and #2 from the Matrix - the language from *The Business Checking Freedom Act*, H.R. 1224, which was passed by the House on May 24, 2005 by a vote of 424-1. Among other things, this language would allow the Federal Reserve to pay interest on balances held by depository institutions, including credit unions, at a Federal Reserve Bank.

There are additional provisions in House's *Credit Union Regulatory Improvements Act* (CURIA), H.R. 2317, which are not presently included in the *Financial Services Regulatory Relief Act*, H.R. 3505, that we believe should be included in any regulatory relief bill that the Senate Banking Committee may act on. NAFCU encourages the Committee to review CURIA, which includes updated legislative language on these proposals and include the following provisions:

Risk-based capital/PCA Reform (Matrix #8)

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 NCUSIF. It simply does not make sense that the current capital system

treats a new one-year unsecured \$10,000 loan the same as a 30-year mortgage that is on its last year of repayment. We urge inclusion of the proposal put forth by the NCUA and included as Title I of the House CURIA bill in any regulatory relief legislation.

The American Bankers Association (ABA) expressed three concerns regarding risk-based capital in a letter to NCUA dated November 18, 2004. We believe that these concerns have been addressed in the actual proposal transmitted to Capitol Hill and incorporated into Title I of CURIA. Specifically, the ABA said that:

- (1) CU's need a meaningful leverage ratio;
- (2) there should be no substantive difference between bank and CU leverage ratio standards; and,
- (3) secondary capital would undermine the unique character of credit unions.

Neither the NCUA proposal nor Title I of CURIA would expand the authority for NCUA to authorize secondary capital accounts. As far as leverage ratios are concerned, NCUA's proposal:

- Advocates a system involving complementary leverage and risk-based standards working in tandem;
- For the leverage requirement, NCUA advocates a reduction in the standard net worth (i.e., leverage) ratio requirements for credit unions ***to a level comparable to what is required of FDIC-insured institutions***. In order to achieve comparability between the federal insurance funds, it is necessary to factor in the NCUSIF's mutual deposit-based funding mechanism; and,

- The risk-based proposal tailors the risk-asset categories and weights of BASEL II, as well as related aspects of the FDIC's PCA system, to the operation of credit unions. This approach is consistent with BASEL II and the FDIC's PCA system, addressing credit and operational risks under the risk-based requirement and acknowledging other forms of risk, such as interest rate risk.

The ABA's letter of November 18, 2004, also reiterates the recommendation contained in its April 18, 2000, comment letter to NCUA that said:

“NCUA should adopt a more bank-like risk-weighted capital system and then work with the banking agencies within the umbrella of the Federal Financial Institutions Examination Council to improve the current risk-based capital adequacy standard to better recognize credit quality and the use of internal risk models to manage financial institution risk.”

What NCUA has transmitted to policy makers on Capitol Hill (which is included in Title I of CURIA), in fact, closely resembles the bank-like risk-weighted capital system and was developed with ample input from the Treasury Department. One difference, however, is that NCUA's proposal does not consider any credit union “internal risk models.” While NCUA may in the future make that part of the risk mitigation credit, we have no assurance that this will be the case, so one could objectively conclude that the proposed risk-based capital system for credit unions is, in fact, more stringent than that currently applicable to banks and thrifts.

As you may recall, during the Senate Banking Committee's 2004 hearing on regulatory relief, the panel of industry witnesses discussed the issue of risk-based capital for credit unions and at the conclusion of that discussion a bank witness noted his understanding that the credit union industry "would like to see the leverage ratio eliminated and have only risk-based capital.... [while banks] have several capital ratios that we have to comply with, three to be certain, and that includes a leverage ratio. So if they [credit unions] want equality that does not amount to eliminating the leverage ratio. They can have the risk-based capital ratio too, I suppose, and that might be wise, but we are not eliminating the other ratio." To which NAFCU witness Bill Cheney responded: "... we are not asking to eliminate it." (Hearing Transcript at page 151). NAFCU continues to support the complimentary leverage and risk-based standards proposed by the NCUA.

Limits on member business loans (Matrix #74, #84, #85, #86)

NAFCU supports revision of the current asset limit on member business loans. The current limit restricts member business lending 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. We support the language found in Title II of the House CURIA bill and the Matrix that would revise this restriction, replacing the formula with a flat rate of 20 percent of the total assets of a credit union, as proposed in Title II of the House CURIA bill. 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 CUMAA in 1998, the law 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 (Matrix #121)

NAFCU supports the provision in CURIA that enhances the ability of credit unions to assist distressed communities with economic revitalization efforts. This provision 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.

Credit Union Conversion Voting Requirements (Matrix #83)

NAFCU does not object to a credit union’s right to convert to a mutual savings bank charter, however, we believe transparency and disclosure are paramount in the conversion process, and that the decision to convert should require the approval of a larger percentage of members than is currently the case. With that in mind, NAFCU supports language to require that a minimum of 20% of a credit union’s members eligible to vote should cast a ballot in the vote taken to convert and a majority of those credit union members must vote in favor of the conversion.

In addition to the above provisions from the House CURIA bill, NAFCU also supports the inclusion of Matrix Items #168 (Eliminate or Modify the Limitation on Credit Union Experience for NCUA Board Members) and #176 (Seasoned Customer CTR Exemption - Provided that this would be made to apply to credit unions as well).

Furthermore, we support granting the NCUA parity in the following Matrix items:

- #157) Elimination of Criminal Indictments Against Receiverships;
- #160) Recordkeeping Amendment; and,
- #161) Preservation of Records by Optical Imaging and Other Means.

We should note that we do not support inclusion in any regulatory relief bill of provisions #25 (NCUA Vendor Examinations) and #168(b) (NASCUS – NCUA Board Member have state regulatory experience).

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. Providing credit unions some relief from the regulatory burdens that they face will allow credit unions to better serve their members and meet their needs in a dynamic marketplace. We urge the Committee to consider the important provisions we 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 would like to once again thank Chairman Shelby, Ranking Member Sarbanes, Senator Crapo and the Members of the Senate Banking Committee for this opportunity to testify before you today. We look forward to working with you on this important matter and would welcome your comments or questions.