Testimony of

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On behalf of
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"Consideration of Regulatory Relief Proposals"

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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 almost 800 federal credit unions—member owned financial institutions across the nation—representing nearly 26 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.

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 86 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 8,945 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 seven years since Congress passed the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) federal credit unions have added almost 1,000 underserved areas resulting in low cost financial services being made available to over 87 million people. 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. 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 ever 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.

I currently serve as the President and CEO of The Summit Federal Credit Union headquartered in Rochester, New York, a position I have held for ten years. Established in 1941, The Summit FCU is a multi-SEG credit union with over 600 groups, approximately 47,000 members and more than $340 million in assets. I have been involved in the credit union movement for more than 25 years, the last 21 of which have been at The Summit FCU.

I also presently serve as the Vice-Chair of the National Association of Federal Credit Unions' Board of Directors, and will become the Board Chair in July of this year. I am also a former Chair of the Association's Legislative and Political Action Committees. I am a past President of the New York State Telephone Credit Union Association and still serve on that Board. I am active with Syracuse University as a member of the School of Management Advisory Council, Alumni Board and Athletic Policy Board. I serve on the local United Way Executive Committee, and am a former Chairperson of the March of Dimes Walk America.

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 only 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. CUMMA 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 added in haste 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.

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 either converted to a state chartered credit union or mutual savings bank) to begin work on developing well-reasoned proposals to enhance the federal credit union charter and 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 the session and in subsequent meetings:

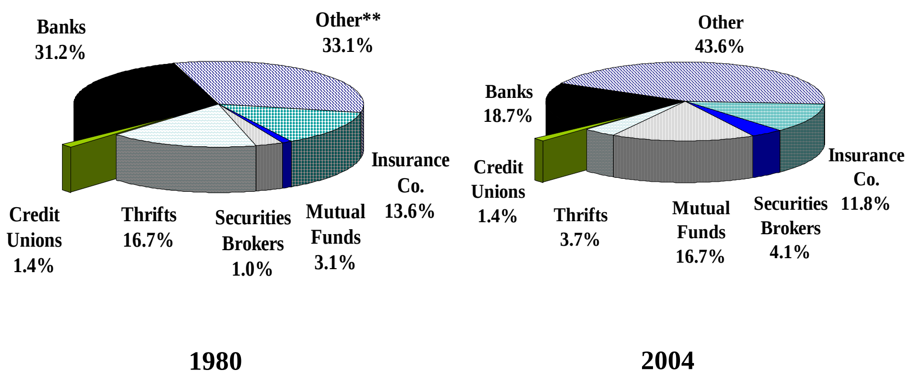
- NCUA should work to eliminate unnecessary regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- Mergers seem to be a practical and necessary way of creating financially viable credit unions that can survive in today's financial 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 86 million Americans—more than at any time in history. At the same time, it is important to note that over the past 24 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 24 year period from 1980 to 2004 the percentage of total financial assets held by credit unions remained constant at only 1.4%.

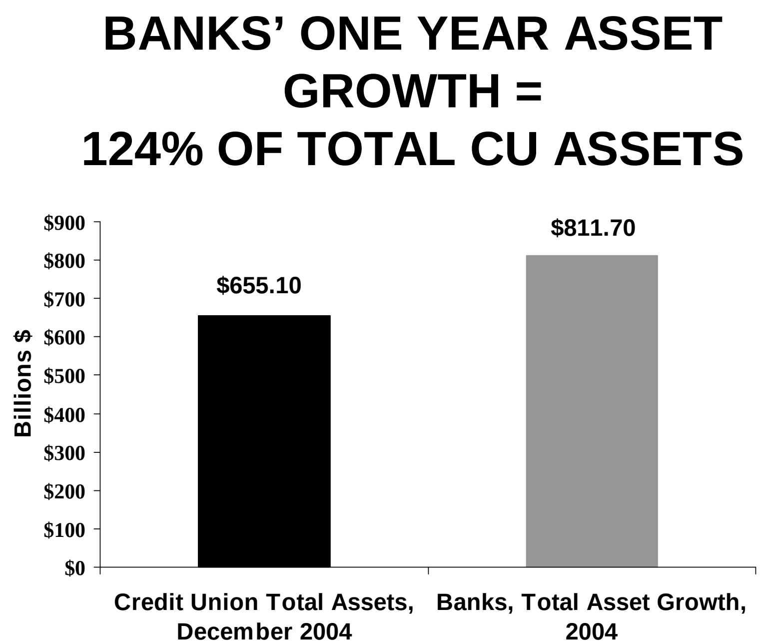
FINANCIAL ASSETS



**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. Today, the average credit union has $71 million in assets, while the "average" bank and thrift has over $1 billion in assets.



Source: NCUA; FDIC

Furthermore, a number of individual banks have total assets greater than the entire credit union community combined. As shown in the chart above, the annual asset growth of the commercial bank sector last year 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.

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 61 percent over the course of the past 30 years, from an all-time high of 23,866 in 1969 to 8,945 this past March. 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 5,534 today.

NAFCU Meets with Policymakers to Enhance the Federal Charter

Over the past four years NAFCU has been working with former NCUA Board Chairman Dennis Dollar, current NCUA Board Chairman JoAnn Johnson, Board Member Deborah Matz 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 very 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.

Regulatory Relief Provisions

NAFCU supports the following twelve provisions, all of which were included in Title III of the *Financial Services Regulatory Relief Act of 2004*—which passed the House last year—and are included in the *Credit Union Regulatory Improvements Act of 2005* (CURIA), H.R. 2317, introduced in the House during 109^{th} Congress. (We would note that H.R. 2317 includes minor technical changes to the language and urge that the updated language from H.R. 2317 be used in any Senate regulatory relief measure.) NAFCU urges that the following provisions be included in any regulatory relief bill that the Committee considers:

<u>Leases of land on federal facilities for credit unions</u>

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 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.

<u>Investments in securities by federal credit unions</u>

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. 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 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

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

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

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

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.

Credit union governance

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 and policies of a 21st century federal credit union. We support changes that would remove many of these provisions from the *Federal Credit Union Act* and instead allow the NCUA its regulatory authority to keep these governance issues current. 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 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.

Provide NCUA with greater flexibility in responding to market conditions

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 institutions 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

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. 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.

Additionally, NAFCU supports including the language from *The Business Checking Freedom Act of 2005*, H.R. 1224, which was passed by the House on May 24, 2005 by a vote of 424-1. Similar language was also included in H.R. 1375 last year and 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 CURIA which were not incorporated in the *Financial Services Regulatory Relief Act of 2004* as it passed the House. NAFCU encourages the Committee to review CURIA which includes updated legislative language. Most notably, Title I of CURIA contains a provision that would alter net worth requirements for PCA purposes; language which was also introduced as a stand-alone bill in the House known as the *Net Worth Amendment for Credit Unions Act*, H.R. 1042. The House passed H.R. 1042 on June 13, 2005.

Modify the statutory definition of "net worth" to include the retained earnings from other institutions that have merged with the surviving credit union

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: $2M (net worth of credit union A) + $2M (net worth of credit union B) = $4M (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 $2M ($2M (net worth of credit union A) + $2M (net worth of credit union B) = $2M (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. We support including the language from H.R. 1042, the *Net Worth Amendment for Credit Unions Act* in any regulatory relief package. 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.

At a House Subcommittee on Financial Institutions and Consumer Credit hearing on H.R. 1042 this past 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.

<u>Risk-based capital/PCA Reform</u>

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. We urge inclusion of the proposal put forth by the NCUA and included as Title I of the 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) CUs 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 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 their 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 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-base capital system for credit unions is, in fact, more stringent than that currently applicable to banks and thrifts.

As you may recall, during last year's (June 22, 2004) Senate Banking Committee 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." (Transcript at page 151).

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, 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

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.

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 21^{st} 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 look forward to working with you on this important matter and would welcome your comments or questions.