ATTACHMENT 1.
Supplemental Information and Interest Rate Statistics

Background

Congress established a 12 percent interest rate ceiling for loans made by federal credit unions in 1934. Public Law 96-221, enacted in 1980, raised the loan interest rate ceiling for FCUs from one percent per month (12 percent per year) to 15 percent per annum.[1] The law also authorizes the Board to set a higher limit for up to 18 months after consulting with Congress, the Department of Treasury, and other federal financial agencies.

To set a higher interest rate ceiling, the Board must determine that: 1) Money market interest rates have risen over the preceding six months; and 2) Prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in growth, liquidity, capital, and earnings.

In December 1980 the NCUA Board voted to raise the ceiling to 21 percent. In May 1987, the ceiling was reduced to the current level of 18 percent.

The 18 percent interest rate ceiling applies to all federal credit union lending, excepting originations under the Payday Alternative Loan program. The current rate limit on Payday Alternative Loans is 28 percent, which is determined by adding 1,000 basis points to the interest rate ceiling set by the Board. The maximum allowable rate on Payday Alternative Loans will fall to 15 percent if the interest rate ceiling reverts to the limit specified by the Federal Credit Union Act.[2]

Current state of the credit union industry in respect to holdings of high rate loans

A reduction in the interest rate ceiling could affect a large number of federal credit unions and the volume of loans. A significant number of federal credit unions in all asset-size cohorts do some lending at rates above 15 percent. The percentage of federal credit unions that make such loans rose from 36.01 percent in the 3rd quarter of 2006 to 65.95 percent in the 3rd quarter of 2016. The average interest rate on such loans was 17.11 percent, and 42.19 percent of those lenders charged rates averaging above 17 percent. Moreover, the ratio of unsecured FCU loans to total assets – a measure of potential exposure to a ceiling reduction – was 8.12 percent.

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[1] 12 U.S.C. §1757(5)(A)(vi)(I).

[2] The number of credit unions that offer these loans increased from 386 (March 2011) to 521 (September 2016). Average Payday Alternative Loan balances outstanding at federal credit unions has grown from $13.5 million (March 2011) to $38.91 million (September 2016). A reduction to the statutory 15 percent level would make the Payday Alternative Loan program no longer feasible for federal credit unions.

More importantly, a reduction in the interest rate ceiling could limit low-income borrowers' access to credit. As of the 3rd quarter of 2016, 56.30 percent of federal credit unions that make loans with an interest rate higher than 15 percent were formally designated as providers of financial services to low-income communities. Of the low-income federal credit unions that make loans with an interest rate higher than 15 percent, 45.02 percent charged average rates higher than 17 percent. An adverse shock to loan profitability could result in low-income credit unions reducing lending to preserve safety and soundness.

Net interest income – a key driver of credit-union earnings – currently benefits from a steep yield curve. The November 2016 term spread is 192 basis points (see Attachment 1, Figure 4); the average term spread between 1982 and 2007 was 168 basis points. If the term spread narrows and returns to long term average levels, net interest income will come under pressure. A reduction in the interest rate ceiling could add to this pressure. At the same time, credit unions may be forced to keep share rates low, which could cause disintermediation and lead to liquidity concerns.

A significant number of federal credit unions depend on loans with interest rates that would be affected by any reduction in the interest rate ceiling. As of the 3rd quarter of 2016, 86 federal credit unions had loans with interest rates above 15 percent exceeding 10 percent of total assets. These credit unions have less opportunity to replace lost earnings by diversifying across geographic or product lines because of their relatively small size. The median asset size of these credit unions was $6.27 million, compared with a median for all federally insured credit unions of $23.2 million.

Reducing the general interest rate ceiling would also impact previously issued NCUA Board actions. The current 18 percent general interest rate ceiling is the foundation for NCUA's Payday Alternative Loan program ceiling of 28 percent (the general interest rate ceiling plus 1,000 basis points). Decreasing this ceiling at a time when interest rate expectations are uncertain may limit federal credit union's ability to properly price future Payday Alternative Loans and create an adverse impact on the credit union's financial condition and soundness.

Interest rates on credit cards offer another perspective on potential exposure (see Attachment 1, Figure 2). As of November 2016, the national average credit card rate (across all issuers, not just credit unions) was 15.18 percent, while the average rate on cards for substandard credit was 22.86 percent.[3]

Interest Rate Changes

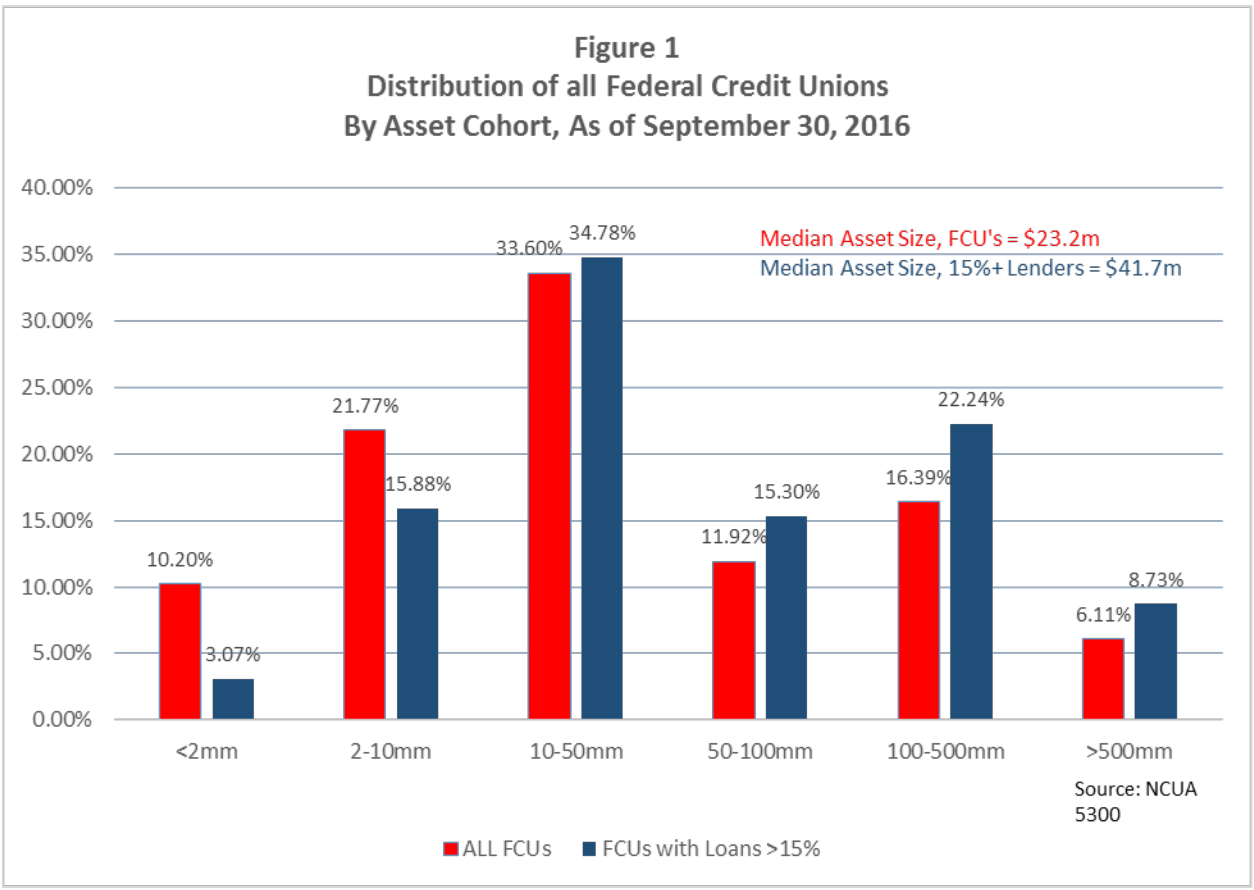
Nominal interest rates are still low from a historical perspective but short term interest rates have recently exhibited a move to higher levels. As **Table 1** shows, money market interest rates (short-term Treasuries and LIBOR) have increased over the last six months.

[3] CreditCards.com 11-17-2016 Rate Survey.

Table 1

Fund	Rates[4]		Rate Change
	5/16/16	11/18/16	
1M LIBOR	0.44	0.57	**+13 bps**
3M LIBOR	0.63	0.92	**+29 bps**
6M LIBOR	0.91	1.28	**+37 bps**
6M Treasuries	0.35	0.61	**+26 bps**

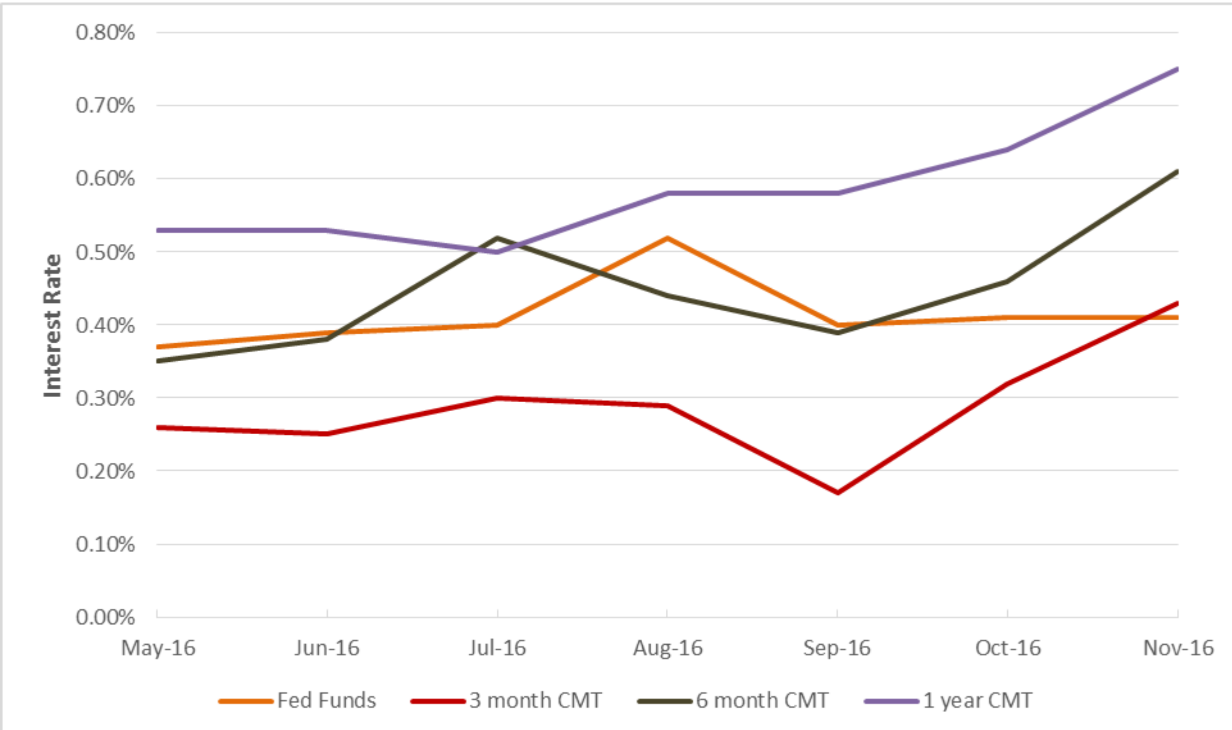
Figure 1 shows the importance of lending above a 15% interest rate across federal credit unions. The average federal credit union with loan rates offered above 15% is larger than the average federal credit union. (Source: NCUA 5300 reports)



[4] Source: Bloomberg, *Key Rate Histories*, November 18, 2016.

<u>Figure 2</u> depicts the recent path of interest rates for several money market indicators. Money-market rates (fixed-income securities with less than one year in maturity) have risen over the past six months.

Figure 2: Short-Term Interest Rates[5]



RECOMMENDED ACTION: Rising money-market rates in the preceding six months, and risks to the continued safety and soundness of credit unions holding significant amount of loans with rates above 15%, justify extension of the current 18 percent interest rate ceiling on federal credit union loans made between March 10, 2017 and September 10, 2018.

[5] Source: Bloomberg *Key Rate Histories*, November 18, 2016.

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