THE OFFICE OF
SMALL CREDIT UNION
INITIATIVES
Committed to small credit union success.

Maximizing the Low-Income Designation

February 2015

National Credit Union Administration
The Office of Small Credit Union Initiatives
1775 Duke Street, Alexandria VA 22314
www.ncua.gov/oscui

Table of Contents

Introduction

Credit unions are unique depository institutions created not for profit but to serve their members as credit cooperatives. Like banks, credit unions offer a wide variety of financial products and services, but what makes credit unions different is who owns them. Banks are owned by their shareholders and profits are shared among the owners–the shareholders. On the other hand credit unions are owned by their members and profits are also shared among the owners–the members of the credit union.

Credit unions serving predominately low-income communities face unique challenges in meeting the special needs of this segment of the population. They are often required to provide labor-intensive products and services. Finding ways to supply quality financial services to low-income individuals is no small task and in many cases may be more expensive.

NCUA's low-income designation is a significant recognition available to credit unions that serve a majority low-income members. The low-income designation provides special benefits and some regulatory relief to help these credit unions more effectively serve their members. This paper describes the benefits of the designation, discusses the challenges and ways to better serve low-income members, provides guidance on obtaining the low-income designation and includes links to resources for more information.

The Low-Income Designation

Let's start with what the low-income designation does not do. It does not:

- Change your charter type
- Expand your field of membership or change who is eligible for credit union service
- Subject the credit union to more regulatory scrutiny or more frequent visits from your examiner
- Require additional reporting
- Need to be advertised
- Carry a stigma–it simply means most of your members are low-income
- Reflect on the credit union's financial performance

Simply put the designation is a recognition available to credit unions that predominately serve low-income members. The designation entitles credit unions to legislated benefits and special regulatory relief.   A credit union qualifies for the designation when a majority of its members (50 percent, plus one member) meet the income threshold defined in NCUA's Rules and Regulations. Use this link to go directly to the section of this paper that outlines how to obtain the low-income designation.

Credit unions retain the low-income designation for as long as they meet the criteria required to obtain it. If NCUA determines a credit union no longer meets the criteria for the designation NCUA will notify the credit union in writing and allow the credit union a period of up to five years to requalify.

Benefits of the Low-Income Designation

Low-income credit unions have access to benefits designed to help them effectively serve their members most of whom are recognized as having challenges accessing mainstream financial products and services. The main benefits of the low-income designation for federally chartered credit unions are outlined below. State-chartered, low-income designated credit unions may not be afforded some of the benefits, listed below, if laws in their state do not allow these benefits.

- ### Eligible for NCUA Grants

  Low-income credit unions are eligible for NCUA grants. Grant funding rounds are typically held once or twice a year, but grants for urgent needs are available year round. Use this link to view up-to-date information and grant application material.

- ### Eligible for Low Interest Loans

  Low-income credit unions are eligible for low interest rate loans through NCUA's Community Development Revolving Loan Fund. The purpose of the loan program is to assist low-income credit unions in providing basic financial services and stimulating economic activities in the communities they serve including, but not limited to:

- Development of new products or services for members including new or expanded share draft and credit card programs;
- Partnership arrangements with community-based service organizations or government agencies;
- Loan programs including but not limited to, micro business loans, alternatives to payday loans, educational loans and real estate loans;
- Acquisition, expansion or improvement of office space or equipment, including branch facilities, ATMs, and electronic banking facilities;
- Operational programs such as security and disaster recovery, and
- Investing in U.S. Treasury Securities.

NCUA will consider other proposed uses of funds that it determines are consistent with the purpose of the loan program and the requirements of the regulations.

Generally loans are limited to $300,000 with a maturity of five years or less, however, NCUA will consider larger funding requests under certain circumstances. Loan program requirements and terms can change annually. Use this link to view up-to-date information, including the latest terms and conditions and a sample loan agreement, promissory note and a loan application.

- ### Eligible for OSCUI Consulting Services

NCUA's Office of Small Credit Union Initiatives offers free consulting services to groups seeking to charter a credit union, small (based on the current NCUA definition), newly chartered (less than 10 years old), minority, and low-income credit unions. Consulting service is delivered by Economic Development Specialists on a broad range of operational and strategic issues. Visit our webpage for more information on the OSCUI Consulting Program and to access the consulting nomination form.

- ### Ability to Accept Nonmember Deposits from any Source

All credit unions are able to accept limited amounts of nonmember deposits from public units and other credit unions. However credit unions with the low-income designation can accept nonmember deposits from any source (including local banks and individuals or groups that share the credit union's mission). They are not limited to public units and other credit unions for nonmember deposits. The amount of nonmember deposits they can accept is limited, as outlined in Part 701.32 of the NCUA Rules and Regulations, to 20 percent of shares or $3 million, whichever is greater, unless a larger amount is approved by an NCUA Regional Director.

- ### Raise Supplemental Capital that Counts as Net Worth

Low-income designated credit unions can raise supplemental or secondary capital that can, under certain conditions, count as net worth. Secondary capital is an uninsured account, best described as a subordinated loan. In the event of a credit union's liquidation, secondary capital claims are subordinate to all other claims on the assets of the credit union, including claims of shareholders, creditors and the National Credit Union Share Insurance Fund. Part 701.34 of NCUA's Rules and Regulations outlines secondary capital requirements. Key points to consider are:

- Secondary capital is uninsured and at risk. Each investor must execute a disclosure to this effect.
- The credit union must have a written secondary capital plan approved by the Regional Director prior to accepting secondary capital accounts.
- There is a minimum five-year term.
- The amount of secondary capital that can be counted as net worth declines 20 percent each year for the last five years until maturity.
- The portion of secondary capital that no longer counts as net worth may only be redeemed with written approval of NCUA.
- Secondary capital can be accepted from non-natural person (organizations, not a single-individual) members and non-members.

For guidance and more information on secondary capital, view OSCUI's Will Secondary Capital Work for You? webinar.

Member Business Loan Exception

Low-income credit unions are not subject to the general aggregate limitation on member business loans which is the lesser of 1.75 times net worth or 12.25 percent of total assets. Refer to Part 723 of NCUA Rules and Regulations for detailed information on member business loans. Part 723.16 of the regulation sets the general aggregate limit and Part 723.17 outlines the exception for low-income credit unions.

The NCUA Board may exempt federally insured, state-chartered credit unions from NCUA's member business loan rule if the Board approves the state's rule. State-chartered credit unions should contact their state regulator for guidance.

Access to Resources from Other Federal Government Agencies

Low-income credit unions can access resources of other federal government agencies such as:

Community Reinvestment Act – Low-income credit unions can use their low-income status to obtain grants or other assistance from banks that provide the assistance to help them meet their Community Reinvestment Act requirement. Access bank CRA ratings on the FDIC's website and from this link you can obtain contact information for your local FDIC Community Affairs Officer who can provide further guidance.

U.S. Department of the Treasury Community Development Financial Institutions Fund – The CDFI provides financial assistance in the form of grants, capital reserves, nonmember deposits, loans and technical assistance for a wide range of purposes including, but not limited to:

- Purchasing equipment;
- Paying for consulting or contracting services;
- Paying the salaries and benefits of certain personnel; and
- Training staff or board members.

Generally, credit unions must obtain certification from CDFI to partake in their programs, and having the low-income designation helps credit unions meet one of the certification requirements. Access the CDFI Fund's website for additional information.

Assets for Independence - This office administers the Individual Development Account program run by the U.S. Department of Health and Human Services Administration for Children and Families, Office of Community Services. Target credit union participants for this program are low-income designated or CDFI-certified credit unions. Review the Assets for Independence Fact Sheet for additional information.

For more details on the benefits of the low-income designation, view our Benefits of a Low-Income Credit Union Designation webinar.

Serving the Low-Income Member

Serving low-income members requires a solid business plan with appropriate measures to mitigate risk. Low-income individuals have needs that are often not met by traditional financial institutions. Many of these individuals do not have strong credit profiles or have no credit profile at all. They may also have one or more of the following circumstances or characteristics:

- Unsteady employment, often temporary jobs with long hours;
- Part-time employment with multiple jobs or side businesses;
- Unstable residency, often renting or living in public or subsidized housing;
- No health insurance;
- Lack of affordable day care;
- Receive supplemental security income or social security disability benefits;
- English is often a second language;
- Lack of a regular banking relationship;
- Low share account balances;
- Need for small dollar loans;
- Limited financial resources; and
- A need for labor-intensive services, such as money orders, financial education and counseling, and check cashing.

Low-income designated credit unions must take these challenges into consideration when designing services and products for their members. While low-income credit unions are not restricted in their product and service offerings, savvy low-income credit unions typically offer products and services designed to help members rebuild or establish credit. For more information, refer to OSCUI's [Strategic Uses of the Low-Income Designation] webinar for specific strategies credit unions can employ to meet the needs of their low-income members.

• General Profile of Products and Services Offered

Low-income credit unions typically offer many of the traditional financial products and services offered by non-low-income designated credit unions, as well as others. Low-income credit unions tend to offer products that are smaller in terms of dollars, but essential in terms of need for low-income members. OSCUI's webinar [Profiling Products and Services for Underserved Members] provides case studies from credit unions that offer an array of products and services tailored to the needs of their low-income members.

Share Products - Credit unions serving low-income members are accustomed to offering share products that are labor intensive. Many members may not have access to direct deposit or share draft accounts resulting in increased teller transactions and office expenses. Share accounts often have small minimum-balance requirements, and account balances are often low and need frequent monitoring.

However, not all members of a low-income credit union are low-income. Because of this, many low-income designated credit unions offer products designed to maintain the share base, including draft accounts, share certificates, and even money market accounts and individual retirement accounts.

Loan Products - Low-income credit unions offer a wide array of loan products to meet the needs of the entire membership. Generally, traditional products like auto loans and personal loans are offered. Larger low-income credit unions may offer real estate loans if appropriate. Generally, these offerings tend to be smaller in nature with shorter repayment terms.

A low-income credit union requires a sound and tactful collection program. Delinquencies tend to be higher as many members fall behind on their payments, however loan losses are not necessarily as high. Often low-income members build a relationship with their credit union and want to maintain it so they can continue to borrow at a lower cost and avoid predatory lenders. Many of these members need that friendly reminder to make their payments.

Risk-based pricing where loans are priced according to risk, helps a credit union offset collection costs on higher risk loans, while allowing it to offer attractive loan rates to lower risk borrowers.

- ## Products and Services

Below is a list of products and services typically offered by low-income designated credit unions:

Capacity Building Services

- Financial education
- One-on-one or group financial counseling
- Free tax preparation
- Bilingual services

Share Products and Services

- Prepaid debit cards or ATM cards
- Second chance share drafts
- Low balance account requirements
- Low-cost money transfer services
- International remittances
- Money orders
- Individual development accounts

Loan Products

- Share secured loans
- Small dollar, short-term loans (payday alternative lending)
- Citizenship loan (checks made payable to Homeland Security)
- Risk-based pricing
- Second chance auto loan refinance program
- Skip a pay loan options
- Credit-builder loan programs
- Share secured credit cards
- Life strategy loans, such as vacation, burial, wedding, or furniture
- Parent-child credit card, small balance card allowing child to build credit but with the parent primarily responsible for repayment)
- First and last month rent loans
- Refund anticipation loans
- Micro business loans (defined as less than $50,000)

- ## Small Dollar Lending

The NCUA Board established a program that allows federal credit unions to create short-term, small dollar loans that serve as an alternative to payday loans. The program allows federal credit unions to offer loans that allow borrowers to:

- Access funds between $200 and $1,000, if they have been members of a credit union for at least one month.

- Pay affordable interest rates capped at 28 percent, a number that is a fraction of what predatory lenders charge, but high enough for credit unions to account for the higher risk associated with making this type of loan.
- Pay reasonable application fees that are capped at $20 to help recoup the actual cost associated with processing the application. This is unlike many payday lenders, who use exorbitant application fees to make money and offset risk.
- Repayment terms from one to six months, which is longer than the payback period of most payday loans. And credit unions are prohibited from rolling over these loans or making more than one loan at a time (or three in any rolling six-month period) to a member, a practice that often allows borrowers to become overextended.

For more information on this loan program access NCUA Regulatory Alert, 10-RA-13, "Short-term, Small Amount Loans", and NCUA Rules and Regulations Part 701.21c7iii. Also view OSCUI's Small Dollar Lending webinar that provides guidance and the criteria for the payday alternative type loan product.

Qualifying for the Low-Income Designation

A credit union qualifies for the low-income designation when a majority of its membership (50 percent, plus one member) meet the low-income threshold defined in the NCUA Rules and Regulations. Generally, low-income members are defined as members whose income is at or below 80 percent of comparable median-family income or median earnings for individuals in their geographic area, their state or the nation. Members enrolled as students in a high school, college, university or vocational school are also considered low-income. For the full definition refer to Part 701.34 of the NCUA Rules and Regulations. Credit unions seeking the low-income designation should also become familiar with Appendix B to Part 701 of the NCUA Rules and Regulations and the Low-Income Designation Fact Sheet.

- ### Office of Consumer Protection's Automated Geocoding Tool

There are several ways to assess eligibility for the low-income designation, but the easiest and most popular way is by running a credit union's AIRES share download through NCUA's Office of Consumer Protection automated geocoding database tool. In many cases such an assessment is conducted during the annual examination. Federal credit unions found to be eligible for the designation are notified in writing with instructions for how to officially request the designation.

Through a cooperative effort between NCUA and the National Association of State Credit Union Supervisors, state regulators can elect to provide encrypted member geographic data to NCUA when uploading examinations. NCUA uses that confidential membership data solely to determine which federally insured, state-chartered credit unions are eligible for a low-income designation. NCUA provides a list of these eligible credit unions to state regulators on a quarterly basis.

Credit unions can also contact NCUA's Office of Consumer Protection directly to request an assessment. The Office will request an AIRES share download or other information so they can conduct the assessment. If the credit union qualifies, the Office will immediately issue the designation to federal credit unions. State regulators have the sole authority to confer the low-income designation for state-chartered credit unions, so in cases where the assessment reveals a state-chartered credit union qualifies as low-income, the Office will notify the credit union of their eligibility and direct them to their regulator to officially request the low-income designation.

- **Sampling Procedures**

  Sampling is another method used to determine eligibility for the low-income designation. NCUA Rules and Regulations Section 701.34 allow a credit union to rely on a sample of membership income data drawn from loan files or member surveys provided the credit union can demonstrate the sample is a statistically valid, random sample. This rule eases the burden on credit unions seeking a low-income designation that have lower-income members living in higher-income neighborhoods. It is an alternate approach for credit unions that do not qualify as low-income according to NCUA's Office of Consumer Protection's automated geocoding software.

  The credit union must submit a narrative describing its sampling technique and evidence supporting the validity of the analysis (including the actual data set used in the analysis) to NCUA's Office of Consumer Protection. The sample must be representative of the membership and have a minimum confidence level of 95 percent and a confidence interval of five percent. The credit union must draw the sample either entirely from loan files or entirely from a survey and must not combine a loan file review with a survey. For more information, contact staff within the Office's Division of Consumer Access at 703-518-1150 or dcamail@ncua.gov.

- **Other Methods of Qualifying for the Designation**

  Credit unions may submit other information to NCUA to demonstrate they qualify for a low-income designation. For example, federal credit unions may provide actual member income from loan applications or surveys to demonstrate a majority of their membership is low-income. For more information, go to Part 701.34 of the NCUA Rules and Regulations.

What if We Fall a Little Short of the Majority Threshold?

Credit unions falling a little short of the 50 percent plus one member requirement to obtain the low-income designation should consider the following to help reach the minimum threshold:

- Ensure you have valid and correct physical addresses for all members
- Ensure the AIRES download does not include closed accounts

- Convert P.O. Boxes to physical addresses because P.O. Boxes are not considered in the assessment
- Identify the full and part-time students attending high school, college, university or trade school because they automatically qualify as low-income regardless of their address
- To attract more low-income members ensure that your products, services and office hours meet their needs.
- Consider expanding your field of membership to include low-income areas. The Office of Consumer Protection can provide guidance on the options available to expand your credit union's field of membership

Resources

Serving low-income members is no small task. It requires an understanding of the unique challenges this demographic faces, a solid business plan with appropriate measures to mitigate risk, and a suite of products and services geared towards their particular needs. The low-income designation is a significant recognition that provides some regulatory relief to credit unions serving predominantly low-income members. For additional information, refer to the resources and regulations below.

- ### NCUA Rules and Regulations Section 701.34

  NCUA Regulation 701.34 details the eligibility rules for qualifying as a low-income credit union, describes how to apply for the designation and outlines the benefits of the designation.

- ### Low-Income Designation Fact Sheet

  The Low-Income Designation Fact Sheet provides a summary of the requirements for and benefits of the designation.

- ### Webinars and Videos

  OSCUI offers many webinars and videos to the credit union community. Use this link to access the complete portfolio of webinars and videos. Use the links below for webinars and videos tailored specifically to low-income designated credit unions:

  - Benefits of Low-Income Designation
  - Strategic Uses of the Low-Income Designation
  - Profiling Products and Services for Underserved Members
  - Will Secondary Capital Work for You?
  - Small Dollar Lending