

ATTACHMENT 2. Supplemental Information

The current 18 percent per year maximum loan rate applicable to federal credit unions (FCUs) is scheduled to revert to the statutory level of 15 percent on September 11, 2015 unless otherwise provided by the NCUA Board. The lower 15 percent interest rate ceiling would restrict federal credit unions' ability to respond to potential rapid changes in economic and market conditions, and impair their financial condition and safety and soundness.

Given the current economic conditions and the future prospects for the national economy, staff recommend that the Board maintain the current 18 percent ceiling for loans through March 10, 2017. Staff will advise the Board to reconsider the ceiling at any time should changes in the economic conditions warrant an adjustment.

Background

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.

On December 3, 1980, the Board determined that these conditions had been met, and raised the loan ceiling to 21 percent. The ceiling was subsequently lowered to 18 percent by the Board, effective May 18, 1987, where it has remained to the present.

Staff believe that retaining the current 18 percent ceiling will allow credit unions to continue to meet their current lending programs and permit the necessary flexibility for credit unions to react to any adverse economic developments.

¹ 12 U.S.C. §1757(5)(A)(vi)(I)

Interest Rates

While nominal interest rates are currently near 50-year lows, money market interest rates have recently exhibited some movement higher. As Table 1 shows, money market interest rates (short-term constant maturity Treasuries and Fed Funds) have increased over the last six months.

Table 1

Fund	Rates²		Rate Change
	Oct-14	April-15	
Fed Funds	0.07	0.27	+0.20bps
3M LIBOR	0.23	0.28	+0.05bps
6M LIBOR	0.32	0.41	+0.09bps
6M Treasuries	0.05	0.09	+0.04bps

Financial Implications for Credit Unions

Despite the fact that interest rates are near historic lows, economic and financial market data suggest that the current environment of low inflation and interest rates may change in the next 12 months. This is due to the Federal Open Market Committee’s discussions about potentially “normalizing” the Fed Funds rate within the 18-month window of the requested interest rate ceiling extension.

If the interest rate ceiling is lowered and interest rates rapidly increase, the safety and soundness of some FCUs would be impaired as FCUs face greater asset/liability mismatch challenges than other financial institutions. The ability to increase the interest rate an FCU may charge on assets is critical at times when the cost of liabilities is rapidly increasing. Lowering the general interest rate ceiling would limit the ability of FCUs to match increased deposit prices with increased loan prices. A reduced interest rate ceiling would also constrict an FCU’s ability to appropriately price risk.

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 Loans (PALs) 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 FCUs’ ability to properly price future PALs and create an adverse impact on the credit union’s financial condition and soundness.

² Source: Bloomberg, *Key Rate Histories*, May 6, 2015.

Conclusion

For the reasons outlined in this document, staff conclude that conditions exist to maintain the FCU interest rate ceiling of 18 percent per year for loans made between September 11, 2015 and March 10, 2017. Staff remain prepared to reconsider the 18 percent ceiling for loans and advise the Board at any time during the extension period if changes in economic conditions warrant.

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