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## **Congressional Testimony**


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**Debbie Matz  
Chairman  
National Credit Union Administration Board**

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**House Financial Institutions and  
Consumer Credit Subcommittee**

**Hearing on National Credit Union Administration  
Operations and Budget**



NCUA is the independent federal agency created by the U.S. Congress to regulate, charter, and supervise federal credit unions. With the backing of the full faith and credit of the United States, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of 100 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

At [MyCreditUnion.gov](https://www.mycrreditunion.gov) and [Pocket Cents](#), NCUA also educates the public on consumer protection and financial literacy issues.



## Congressional Testimony

Chairman Neugebauer, Ranking Member Clay, and Members of the Subcommittee, the National Credit Union Administration appreciates the invitation to appear before you today. I am Debbie Matz, NCUA Board Chairman.

When I returned to the NCUA Board in August 2009, in the wake of the Great Recession, the credit union system was on the brink of collapse.<sup>1</sup> To prevent this, we developed an unprecedented mechanism to securitize \$50 billion in toxic corporate credit union assets.

Additionally, 351 consumer credit unions holding \$51.6 billion in assets were close to failing by May 2010. Compounding this situation, NCUA's budget and staffing in the years leading up to the crisis had not kept pace with credit unions' growth and increasing complexity. In fact, during the seven years leading up to the crisis, NCUA had cut a total of 91 staff positions—even though credit union assets had increased by over 70 percent. During this same period, NCUA's budget as a percentage of credit union assets declined by 35 percent. NCUA was understaffed and under-resourced.

Now, nearly six years later, we've rectified these problems for corporate credit unions and consumer credit unions.

The corporate credit union system has experienced transformational changes. A series of NCUA rules beginning in 2010 will prevent corporate credit unions from taking the level and type of risk that caused the corporate credit union crisis. Regulations now prohibit purchases of private-label mortgage-backed securities, set clear investment concentration limits according to risk, increase incentives to diversify portfolios, and require higher-quality capital.

Under a strong regulatory framework, corporate credit unions have changed their business model. After reducing reliance on investment yields, corporate credit unions now generate most earnings through transaction services and payments systems. Corporate credit unions are also gradually reducing reliance on capital contributions from member credit unions. They are instead building retained earnings.

As a result of these changes, the 12 remaining corporate credit unions are collectively stronger and pose much less risk to the Share Insurance Fund today than their predecessors did during the crisis.

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<sup>1</sup> The term "credit union" is used throughout this testimony to refer to federally insured credit unions. As of March 31, 2015, the 6,206 federally insured credit unions represent 98 percent of all credit unions in the United States. NCUA does not oversee 128 privately insured, state-chartered credit unions.

The consumer credit union system is also once again on a strong footing. It has recovered to pre-crisis levels.

Nationally, consumer credit unions are experiencing lower delinquency and charge-off rates, as well as rising earnings and net worth. Perhaps most significantly, the percentage of assets in troubled credit unions—which peaked at 5.8 percent of assets in May 2010—has dropped to just 1 percent of assets.

This turnaround has resulted, in part, from an improving economy. Credit is also due to the CEOs, managers, and boards who made tough choices to keep their credit unions solvent, as well as NCUA staff who supervised credit unions under very difficult circumstances.

The experiences of the recent financial crisis have also informed NCUA’s current budgeting decisions. Budgets cannot be aimed at consistent staff cuts, as was the case for seven consecutive years leading up to the Great Recession when the agency held budget hearings. Instead, NCUA’s resources and staffing need to keep pace with the risks and complexity of the credit union system. The NCUA Board has now achieved that appropriate balance, while preventing any unnecessary budget and staffing growth.

The financial crisis also demonstrates why NCUA must maintain needed resources in positive economic cycles to prepare for downturns. As the crisis hit, NCUA quickly needed to augment our pool of examiners to address significant increases in the number of credit unions experiencing balance sheet and operational problems. However, developing fully seasoned examiners requires several years of training and experience, and there were limited talent pools from which to draw these experts. Moreover, other banking agencies were competing for this same talent as the crisis took hold.

NCUA’s budget increases as a result of the crisis took place more gradually than at comparable financial institutions regulators. However, in the aggregate, the agencies’ operating budgets have increased by comparable amounts since the crisis.

NCUA has also diligently worked during the last six years towards greater budget transparency. As a result, NCUA now leads financial institutions regulators in budget transparency. Our website contains a dedicated budget resource center with detailed information about the agency’s spending plans, annual fund audits, and a wealth of other budget information.<sup>2</sup>

## **Credit Union System Performance and Trends**

The credit union system continues to experience steady growth in members and assets. As of March 31, 2015, there were 6,206 credit unions serving 99,969,794 consumers and member businesses. Together, these credit unions hold in excess of \$1.1 trillion in assets.

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<sup>2</sup> See <http://www.ncua.gov/about/Pages/budget.aspx>.

### System Performance Improves

The credit union system has recovered from the Great Recession and is performing well. Between the second quarter of 2009 and the first quarter of 2015, credit unions experienced improvements in earnings, asset quality, capital, and lending as follows:

- **Earnings.** Return on average assets for the credit union system has nearly tripled during this timeframe, rising from 0.27 percent to 0.78 percent.
- **Asset Quality.** Credit union asset quality has also improved. The delinquency ratio fell by more than half, decreasing from 1.60 percent to 0.69 percent.
- **Net Worth.** The net worth ratio for the credit union system climbed from 10.0 percent to 10.8 percent.
- **Lending.** Total loans at credit unions grew by \$151.9 billion, more than 25 percent during this time period. Over half of the growth in credit union loans was in first mortgages.

The performance of larger and smaller credit unions, however, varies significantly. The table below provides a summary of federally insured credit unions' current ratios and growth during the first quarter of 2015 by asset size for selected metrics.<sup>3</sup>

**Credit Union Performance by Assets, First Quarter 2015**

	Above \$500 million	\$100 million to \$500 million	\$10 million to \$100 million	Under \$10 million
Number of Credit Unions	468	1,048	2,780	1,910
Net Worth Ratio	10.7 percent	10.8 percent	11.7 percent	14.7 percent
Net Worth Growth	▲ 8.7 percent	▲ 5.8 percent	▲ 3.1 percent	▲ 1.1 percent
Loan Growth	▲ 7.1 percent	▲ 3.2 percent	▼ 0.5 percent	▼ 5.9 percent
Membership Growth	▲ 4.6 percent	▲ 2.5 percent	▲ 0.1 percent	▼ 1.7 percent
Return on Average Assets	91 basis points	54 basis points	33 basis points	19 basis points

Source: Call Reports

As shown above, the 468 federally insured credit unions with more than \$500 million in assets continued to lead in most performance measures in the first quarter of 2015. With \$817.1 billion in combined assets, the largest credit unions held more than 70 percent of the system's total assets at the end of the first quarter and had a return on average assets of 91 basis points.

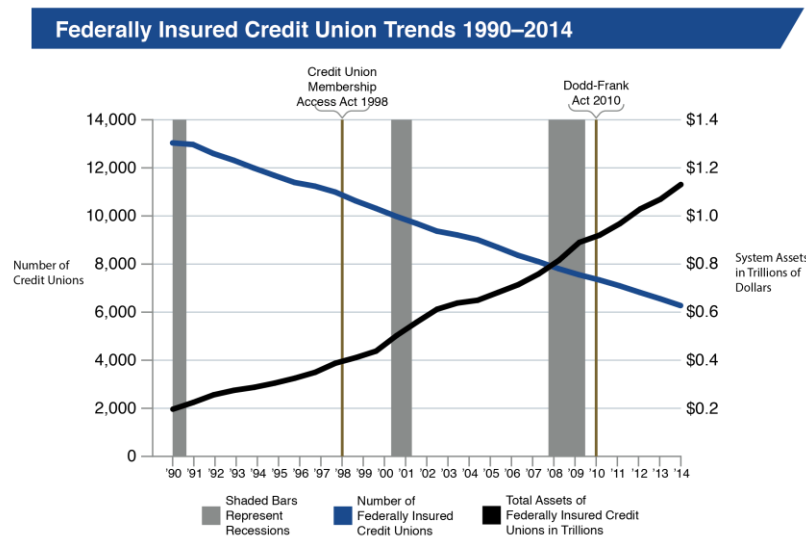
At the other end of the system, 1,910 credit unions with assets under \$10 million had a return on average assets of 19 basis points. Lending by the smallest credit unions declined by almost 6 percent for the year ending in the first quarter of 2015, while rising by 7.1

<sup>3</sup> See page 10 of <http://www.ncua.gov/Legal/Documents/Reports/FT20150331.pdf> for more information about other metrics.

percent for the largest credit unions. Membership growth declined by 1.7 percent for credit unions with assets under \$10 million during the first quarter of 2015, while the largest credit unions collectively grew their membership by 4.6 percent.

### *Consolidation Continues as Assets Grow*

As a result of the challenges that smaller credit unions continue to face, long-time consolidation trends within the system continue. As the chart below shows, the pace of credit union consolidation has been steady over more than two decades and across a variety of economic cycles, including the recession of the early 1990s, the bust of the technology boom in the early 2000s, and the recent Great Recession.



The trend has remained relatively constant after the passage of landmark laws such as the Credit Union Membership Access Act of 1998 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This long-term credit union trend is very similar to the consolidation trends occurring among banks and thrifts.

Despite the steady decline in the number of credit unions during the last 25 years, the assets within the credit union system have risen substantially over the same timeframe. Overall, assets have experienced a more than five-fold increase since 1990. Credit union membership also has nearly doubled over the same period.

Within the system, consolidation is primarily occurring among small credit unions. During the past five years, 1,308 consumer credit unions have voluntarily merged.<sup>4</sup> More than 90 percent of these former credit unions had assets of \$50 million or less at the time of the merger, and another 6 percent held assets between \$50 million and \$100 million.

<sup>4</sup> The five years stated here cover the last quarter of 2009 through the first quarter of 2015.

Small credit union viability is being challenged by the convergence of a number of circumstances. The financial services sector is evolving rapidly, and it is difficult for less-resourced, smaller credit unions to keep pace with marketplace and regulatory developments. Additionally, small credit unions face challenges in attracting and retaining talent. Often when a long-term credit union manager of a small credit union retires, there is no successor.

Another critical factor contributing to the decline in the number of small credit unions is an inability to take advantage of economies of scale. This results in higher operating costs and weaker earnings. Lack of size and scope also makes it difficult for smaller credit unions to adopt the technological and product innovations demanded by consumers.

Today, just under half of credit unions with less than \$50 million in assets provide the combined services of checking accounts, real estate loans, ATM and debit cards, and home banking services (including mobile banking), essential in today's market. In contrast, all of these services are provided by virtually all credit unions with assets greater than \$50 million. These differences have persisted over the past ten years, underscoring the competitive challenges small credit unions confront.

Other factors contributing to the decline of smaller credit unions include the lack of adequate succession planning to replace key employees who retire and the inability for a single-sponsor credit union to overcome losing its sponsor. Imprudent management decisions, insufficient internal controls, and fraud also have played a role in the system's consolidation. Fraud was a contributing factor to \$337 million in losses for the National Credit Union Share Insurance Fund between 2010 and 2014 at liquidated credit unions of all sizes.<sup>5</sup>

### **Support for Small Credit Unions**

Together, these statistics demonstrate the continued need for NCUA to support and assist small credit unions. Through our Office of Small Credit Union Initiatives, which I worked to create in 2005 during my first term on the NCUA Board, we offer training, information on successful growth and service strategies, and support opportunities for small credit unions to partner and collaborate. Additionally, the office provides affirmative assistance to small credit unions through free consulting, such as the net worth restoration plan assistance required by the Federal Credit Union Act.<sup>6</sup> The office also awards grants and offers

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<sup>5</sup> Congress established the National Credit Union Share Insurance Fund in 1970 as part of the Federal Credit Union Act (P.L. 91-468) and amended the Share Insurance Fund's operations in 1984 (P.L. 98-369). The fund operates as a revolving fund in the U.S. Treasury under the administration of the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state-chartered credit unions that request federal insurance. Funded by federally insured credit unions, the Share Insurance Fund is backed by the full faith and credit of the United States.

<sup>6</sup> 12 U.S.C. 1790d(f)(2).

reduced-rate loans to low-income credit unions, many of which are small credit unions.<sup>7</sup> NCUA makes these grants and loans through the Community Development Revolving Loan Fund created by Congress.<sup>8</sup>

Last year, the Filene Research Institute, an independent research firm, analyzed the impact of NCUA programs in helping small credit unions to survive and thrive. The study included data analysis, direct feedback, and a practitioner focus group. Specifically, the firm examined our small credit union initiatives from 2009 to 2013, consisting of:

- 44,738 hours of consulting services, at no charge to the credit unions;
- \$6.5 million in grants and \$21.7 million in loans; and
- Training to 7,000 credit union employees and volunteers.

The study demonstrated that our Office of Small Credit Union Initiatives was particularly effective in helping credit unions with assets from \$1 million to \$10 million grow into larger asset categories. Assistance from NCUA empowered many of these smallest credit unions to offer new services, leverage new technology, and market to new membership groups.

The study found discernable effects from our efforts. Based on these insights, we further sharpened our focus. Starting in 2015, we switched entirely from onsite training to digital formats including videos, webinars, white papers, and an e-newsletter. Participation in our small credit union initiatives has increased more than tenfold.

Looking forward, we intend to further research the 600 credit unions that successfully transitioned from small to large during the study timeframe. Those thriving credit unions will offer lessons for small credit unions and NCUA.

Finally, where possible, NCUA seeks to keep regulatory and examination burdens as low as possible, by exempting small credit unions from certain rules and providing them with simplified compliance approaches for others. As discussed in greater detail later in this testimony, 2015 is the year of regulatory relief at NCUA. We are diligently working to

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<sup>7</sup> A low-income credit union is one in which a majority of its membership (50.01 percent) qualifies as low-income members. Low-income members are those members who earn 80 percent or less than the median family income for the metropolitan area where they live, or the national metropolitan area, whichever is greater. In non-metropolitan areas, the qualification threshold is a median family income at or below 80 percent of the state median family income for non-metropolitan areas, or, if greater, the national median family income for non-metropolitan areas. Under the Federal Credit Union Act, the low-income designation offers certain benefits and regulatory relief, such as an exemption from the statutory cap on member business lending, eligibility for Community Development Revolving Loan Fund grants and low-interest loans, the ability to accept deposits from non-members, and authorization to obtain supplemental capital.

<sup>8</sup> Created and funded by Congress, the Community Development Revolving Loan Fund enables low-income credit unions to provide financial services and stimulate economic activities in underserved communities, as well as reach members who have limited access to basic financial services. In 2014, NCUA awarded more than \$1.5 million in grants to 276 low-income designated credit unions, of which 170 were first-time awardees. Demand for these grants has consistently and significantly exceeded available appropriations.



increase regulatory flexibility and provide enhanced powers within the framework of the Federal Credit Union Act.

## **Regulatory Review Efforts**

NCUA is ever mindful of the impact of our regulations on credit unions, especially smaller ones. We are proactive in our efforts to identify outdated, ineffective, or excessively burdensome regulations. We also continually review and take appropriate steps to eliminate or ease burdens, whenever possible, without compromising safety and soundness. We take these actions through NCUA's long-standing rolling regulatory review process, voluntary participation in the interagency Economic Growth and Regulatory Paperwork Reduction Act review process, and my Regulatory Modernization Initiative.

### ***Rolling Regulatory Review***

Since 1987, NCUA has followed a well-delineated and deliberate process to continually review our regulations and seek comment from stakeholders, such as credit unions and trade associations. Through this agency-initiated process, NCUA conducts a rolling review of one-third of our regulations each year—meaning that we review all of our regulations at least once every three years.

This long-standing regulatory review policy helps to ensure NCUA's regulations:

- Impose only the minimum required burdens on credit unions, their members, and the public.
- Are appropriate for the size of the credit unions regulated by NCUA.
- Are issued only after full public participation in the rulemaking process.
- Are clear and understandable.

Moreover, this rolling review is fully transparent. NCUA publishes on our website a list of the applicable regulations up for review each year and invites public comment on all of the regulations.<sup>9</sup>

### ***Economic Growth and Regulatory Paperwork Reduction Act***

Additionally, NCUA is once again voluntarily participating in the ongoing interagency review process created by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.<sup>10</sup> EGRPRA requires the Federal Financial Institutions Examination Council and its member federal banking agencies to review their regulations at least once every 10 years to identify any rules that might be outdated, unnecessary, or unduly burdensome. NCUA is not required to participate in this process, but the agency has elected to do so.

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<sup>9</sup> See <http://www.ncua.gov/Legal/Regs/Pages/Regulations.aspx>.

<sup>10</sup> 12 U.S.C. 3311.

Under the EGRPRA review, each agency is issuing several categories of rules for public comment at regular intervals over two years—with an eye toward streamlining, modernizing, or even repealing regulations when appropriate. The categories developed and used by NCUA are:

- Agency Programs;
- Applications and Reporting;
- Capital;
- Consumer Protection;
- Corporate Credit Unions;
- Directors, Officers, and Employees;
- Money Laundering;
- Powers and Activities;
- Rules of Procedure; and
- Safety and Soundness.

In May 2014, consistent with the other participating agencies, the NCUA Board released for review 33 regulations in the Applications and Reporting and Powers and Activities categories. NCUA subsequently received five comments. In response to these comments, I established two internal working groups to consider possible changes in the areas of field of membership, as well as secondary and supplemental capital. The working groups conducted extensive outreach by consulting with multiple groups of stakeholders who expressed interest in these issues. The working groups are now reviewing stakeholders' suggestions from the first notice, as well as other ideas, and will make recommendations on potential regulatory and legislative changes in both areas before the end of 2015.

In the agency's second EGRPRA notice in December 2014, NCUA opened 17 rules for comment in three additional categories: Agency Programs, Capital, and Consumer Protection. In response to this notice, NCUA received eight comments from stakeholders.

After the first two EGRPRA notices, we received several actionable comments—and we have already taken action to address six important issues:<sup>11</sup>

- ***Easing Burdens on Small Credit Unions.*** NCUA was urged to raise the asset threshold for defining a small credit union under the Regulatory Flexibility Act from \$50 million to \$100 million. In February, the NCUA Board unanimously approved a proposed rule with the intent to consider regulatory relief for three-fourths of all credit unions in future rulemakings.
- ***Expanding Fields of Membership.*** We received several ideas to enhance federal credit union charters. Our final rule on associational common bonds was approved by a majority of the NCUA Board in April. The final rule authorizes federal credit unions to automatically add 12 categories of associations to their fields of membership.
- ***Raising Capital.*** EGRPRA commenters asked NCUA to facilitate secondary capital for low-income credit unions. We made secondary capital more attractive to

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<sup>11</sup> More details on responses to EGRPRA comments are included in the section headed "2015: The Year of Regulatory Relief."

investors by posting timely revisions to NCUA's *National Supervision Policy Manual* in April.<sup>12</sup>

- **Extending Share Insurance Coverage.** Several EGRPRA commenters also urged NCUA to provide pass-through share insurance for escrow accounts similar to lawyers' trust accounts. In April, the NCUA Board unanimously approved a proposed rule to provide pass-through coverage for accounts managed by realtors and funeral directors. The proposal specifically sought comments on whether to extend pass-through coverage to stored-value and prepaid cards.
- **Consumer Complaints.** EGRPRA commenters also suggested changing the way NCUA's Office of Consumer Protection handles consumer complaints. In June, I announced NCUA's new consumer complaints process in a letter to credit unions.<sup>13</sup> The new process refers each complaint back to the credit union, which will have 60 days to resolve the issue with its member before our Office of Consumer Protection considers whether to intervene.
- **Member Business Lending.** Finally, we received a wide variety of comments to ease regulatory limits on member business loans. At our open meeting in June, the NCUA Board unanimously approved a proposed rule to remove unnecessary regulatory limits and permit credit unions to set their own prudent member business lending policies, consistent with the requirements of the Federal Credit Union Act.

Clearly, we are not waiting until the end of the EGRPRA process. We are responding to comments and taking action wherever warranted as soon as possible.

NCUA's third notice, covering an additional ten rules in three categories—Corporate Credit Unions; Directors, Officers, and Employees; and Money Laundering—was published on June 24, 2015. Comments are due by September 22. We are eager to hear new ideas about these rules, and we will consider every recommendation to improve them.

Our final notice, covering the remaining two categories—Rules of Procedure and Safety and Soundness—will be published before the end of the year.

As part of NCUA's voluntary participation in the latest EGRPRA review, NCUA is evaluating the burden on credit unions for those regulations within NCUA's control. The agency has included in the EGRPRA review all rules over which NCUA has drafting

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<sup>12</sup> The changes to the *National Supervision Policy Manual* will expedite the approval of secondary capital requests by NCUA regional offices and make it possible for low-income credit unions with secondary capital to return portions of the loans that no longer count towards net worth. The changes were also designed to provide investors greater clarity and confidence. See <http://www.ncua.gov/News/Pages/NW20150406NSPMSecondaryCapital.aspx> for more information about the low-income credit union secondary capital announcement.

<sup>13</sup> See <http://www.ncua.gov/Resources/CUs/Pages/LCU2015-04.aspx>.

authority, except for certain rules that pertain exclusively to internal operational or organizational matters, such as our Freedom of Information Act rule.

As our notice makes clear, however, credit unions also are subject to certain rules issued or administered by other regulatory agencies, such as the Consumer Financial Protection Bureau and the Department of the Treasury's Financial Crimes Enforcement Network. Because we have no independent authority or ability to change such rules, our notices—as do the joint notices prepared by the federal banking agencies—simply advise that comments submitted to us but focused on a rule administered by another agency will be forwarded to that other agency for appropriate consideration.

### ***Regulatory Modernization Initiative***

In September 2011, I launched the agency's Regulatory Modernization Initiative. The initiative balances two principles:

- Safety and soundness—strengthening regulations necessary to protect credit union members and the Share Insurance Fund; and
- Regulatory relief—revising and removing regulations that limit flexibility and growth, without jeopardizing safety and soundness.

In implementing this initiative, I have held regular in-person and online town-hall meetings to solicit feedback from stakeholders. These events have identified regulatory relief issues on which the agency has since acted.

During its first three-and-a-half years, the initiative has resulted in 18 actions to cut red tape and provide lasting benefits to credit unions of all sizes.<sup>14</sup> Specifically, NCUA worked to ease 10 regulations, providing regulatory relief to thousands of credit unions. NCUA also streamlined four processes, such as facilitating more than a thousand new low-income credit union designations and establishing an expedited process for examinations at smaller credit unions. NCUA additionally issued four legal opinions, allowing more flexibility in credit union operations.

### **2015: The Year of Regulatory Relief**

Earlier this year, I announced NCUA's continuing commitment to the Regulatory Modernization Initiative's efforts to provide regulatory relief.<sup>15</sup> As such, NCUA is working to ease burdens and expand powers in at least six areas in 2015, including expanding regulatory relief consideration to even more small credit unions, facilitating access to supplemental capital for risk-based capital purposes, streamlining field-of-membership

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<sup>14</sup> See Appendix I for a complete list of these actions.

<sup>15</sup> See <http://www.ncua.gov/News/Documents/SP20150309MatzGAC.pdf>.

requirements, eliminating unnecessary fixed-assets limits, allowing qualified credit unions to securitize assets, and removing prescriptive provisions on member business lending.

During their speeches at the same conference, NCUA Board Vice Chairman Rick Metsger and Board Member J. Mark McWatters also expressed support for providing credit unions with prudent regulatory relief.<sup>16</sup> This relief will help credit unions of all sizes to better compete in a rapidly evolving marketplace.

### ***Updating the Small Credit Union Definition***

As noted earlier, NCUA issued a proposed rule in February to raise the asset threshold from \$50 million to \$100 million in assets for defining “small” credit unions under the Regulatory Flexibility Act. Under the proposal, a credit union could have up to \$100 million in assets and still be small enough for consideration of regulatory relief in future rulemakings. The \$100 million threshold includes 76 percent of all credit unions. The proposed threshold would also be 10-times more than the \$10 million asset threshold which was in place in 2009 when I returned to the agency.

### ***Counting Supplemental Capital for Risk-Based Capital Purposes***

Over the years, NCUA has received many comments about supplemental capital. In fact, under current law, NCUA may count certain forms of debt as supplemental capital for the risk-based capital ratio. For example, subordinated debt could be issued to members and non-members, but it would be uninsured. This would require three changes beyond implementing risk-based capital.

First, we would need to provide consumer and investor protections. Second, we would need to change the order of Share Insurance Fund payout priorities to recognize that supplemental capital accounts are not insured. And third, we would need to set prudent standards for credit unions offering subordinated debt to supplement their risk-based capital. This includes setting minimum redemption periods to ensure the capital is available to cover losses during times of stress.

NCUA understands the need for supplemental capital in certain circumstances. As part of modernizing NCUA’s risk-based capital rule, I am committed to allowing supplemental capital to be counted toward the risk-based capital ratio. The effective date of this change would coincide with implementation of NCUA’s modernized risk-based capital rule.

### ***Expanding Fields of Membership***

NCUA is also working to provide regulatory relief by modifying our field-of-membership rules. In April 2015, a majority of the NCUA Board approved a final rule on associational

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<sup>16</sup> See <http://www.ncua.gov/News/Documents/SP20150309MetsgerGAC.pdf> and <http://www.ncua.gov/News/Documents/SP20150310McWattersGAC.pdf>, respectively.

common bonds granting automatic qualification to certain categories of associations the agency has routinely approved for federal credit union membership.

In all, 12 types of associational groups will receive pre-approval, including alumni associations, religious organizations, electric cooperatives, and homeowner associations, among others. With the adoption of these streamlined field-of-membership procedures, federal credit unions will now spend less time filling out unnecessary paperwork and more time fulfilling their missions by serving their members.

This final rule is the first of several significant field-of-membership improvements NCUA is pursuing this year. While remaining faithful to the Federal Credit Union Act, NCUA will propose new rules for more expansive community charters, underserved areas, and occupational charters by the end of 2015. These changes will enhance the ability of federal credit unions to serve new members.

### ***Removing the Fixed-Assets Cap***

Earlier today, federal credit unions gained relief from current limits on fixed assets under a final rule approved by the NCUA Board. Specifically, the rule eliminates the five-percent aggregate limit on investments in fixed assets for all federal credit unions and provides other targeted relief. As a result, credit unions will be able to make decisions to upgrade technology, facilities, or other fixed assets without NCUA involvement.

### ***Permitting Asset Securitization***

As the credit union system grows in size and complexity, many credit unions have adopted more sophisticated financial innovations. Later this year, NCUA will consider a final rule to permit larger, qualified credit unions to securitize their assets. Securitization would provide these credit unions a new tool to manage liquidity and interest rate risk.

### ***Easing Member Business Lending Burdens***

Finally, within the parameters of the Federal Credit Union Act, NCUA is moving away from highly rigid, one-size-fits all member business loan underwriting requirements. Last month, the NCUA Board released a proposed rule to modernize our member business lending rules. The proposal incorporates input from credit unions engaged in business lending that requested further clarity on aspects of NCUA's member business lending rules. It also addresses several issues NCUA identified as often problematic—such as the member business lending waiver process and rigid lending limits—to allow credit unions to better serve their members' individualized business lending needs.

Although NCUA's regional offices approve many waivers, the waiver process can sometimes prevent a credit union from making a timely business loan. Determining whether to exempt a borrower from a personal guarantee or a loan-to-value limit is a decision for credit union loan officers, based on prudent underwriting criteria. That's why

the proposed rule eliminates the business loan waiver process and lifts unnecessary limits on construction and development loans.

The proposed amendments would also modernize the regulatory requirements that govern credit union business lending activities by replacing the current rule's prescriptive requirements and limitations—such as collateral and security requirements, equity requirements, and non-statutory loan limits—with a broad principles-based regulatory approach.

NCUA recognizes that credit unions know their members' needs better than regulators do. Business lending rules need to reflect that. Of course, NCUA will continue to provide guidance and supervise effectively for sound commercial lending practices.

### **Improvements in the Examination Program**

Beyond issuing regulatory exemptions, expanding powers, adopting tailored rules, and removing rigid restrictions, NCUA is providing targeted regulatory relief by cutting burdens in the examination process.

#### ***Small Credit Union Examination Program***

Since 2002, NCUA has followed a risk-focused exam program. This approach is designed to efficiently allocate agency resources to credit unions and areas of operations exhibiting the greatest potential risk exposure to the Share Insurance Fund. The program relies on examiner judgment to determine the areas needing review. Over time, NCUA has adjusted this approach by adding minimum scope requirements and establishing the *National Supervision Policy Manual* to ensure consistency of supervisory actions across the country.

In 2011, we determined the resources used to complete examinations were not in balance with the credit union system's risks. NCUA was spending more exam hours on the smallest credit unions rather than on the largest credit unions that have the greatest concentration of the system's assets and the greatest potential risk exposure to the Share Insurance Fund.

NCUA has since reallocated resources and concentrated supervision on credit union activities posing the most risk. The agency has put in place a targeted, streamlined examination program for financially and operationally sound federal credit unions with less than \$30 million in assets. NCUA field staff also have the discretion to choose a similarly streamlined, defined-scope examination for federal credit unions with \$30 million to \$50 million in total assets that received a composite CAMEL rating of 1, 2, or 3 at their last examination.<sup>17</sup>

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<sup>17</sup> The CAMEL rating system is based on an evaluation of five critical elements of a credit union's operations: Capital adequacy, Asset quality, Management, Earnings, and Liquidity. The CAMEL rating system is designed to take into account and reflect all significant financial, operational, and management factors that examiners assess in their evaluation of a credit union's performance and risk profile. CAMEL ratings range from 1 to 5, with 1 being the highest rating.

Through the Small Credit Union Examination Program, NCUA spends less time, on average, in small, well-managed federal credit unions. This decreased examination burden reflects a reduced overall scope but is more precisely focused on the most pertinent areas of risk in small credit unions—lending, recordkeeping, and internal control functions. As a result, between 2012 and 2014, exam and off-site supervision hours allocated to credit unions with less than \$50 million in assets decreased by nearly 15 percent. During the same time period, hours allocated to large credit unions with more than \$500 million in assets increased by more than 12 percent.

NCUA implemented the new procedures during the first quarter of 2015. For larger, more complex credit unions, NCUA continues to perform risk-focused exams.

### ***Broader Examination Reforms***

NCUA is further working to streamline the examination process for all credit unions by harnessing technology. Improvements in computers, software, and security are allowing NCUA to design a new Automated Integrated Regulatory Examination System and revise our Call Report system. These advancements will improve NCUA's off-site monitoring capabilities, thereby generally reducing the overall time NCUA spends onsite at credit unions conducting examinations in the future.

To improve consistency in the way field staff develop and use documents of resolution, NCUA also revised our policy and procedures in 2013 to clarify how and when documents of resolution should be used.<sup>18</sup> The new policy states documents of resolution should only be used to address issues significant enough that a credit union's failure to correct the problem would necessitate the examiner recommending an enforcement action. In addition, examiners must cite the appropriate law, regulation, or authoritative NCUA policy when including an issue as a finding or document of resolution in the examination report.

These procedural changes have resulted in clearer expectations for credit unions and NCUA field staff, as well as greater consistency nationwide in the examination process. As a result of these changes and an improved economy, the agency has experienced a decline in the number of documents of resolution issued.

### **Revised Proposed Risk-Based Capital Rule**

In the wake of the Great Recession, NCUA applied the lessons we learned to put in place new rules addressing corporate credit unions, liquidity and contingency planning, stress testing, and interest rate risk, among others. At this time, modernizing risk-based capital

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<sup>18</sup> Examiners use documents of resolution to outline plans and agreements reached with credit union officials to reduce areas of unacceptable risk. An area of unacceptable risk is one for which management does not have the proper structure for identifying, measuring, monitoring, controlling, and reporting risk.



standards for complex credit unions is the last significant safety and soundness rulemaking outstanding under the Regulatory Modernization Initiative.

The Federal Credit Union Act requires the NCUA Board to adopt by regulation a system of prompt corrective action for federally insured credit unions that is “comparable to” the Federal Deposit Insurance Act.<sup>19</sup> The Federal Deposit Insurance Corporation modernized its risk-based capital system in 2013. The NCUA Board unanimously proposed a comparable risk-based capital rule in January 2014.

After reviewing the comments on the original risk-based capital proposal, the NCUA Board issued a revised proposed rule in January of this year.

NCUA’s primary goals for the revised proposed risk-based capital rule remain the same as the original proposal:

- To prevent or mitigate losses to the Share Insurance Fund by having a better calibrated, meaningful, and more forward-looking capital requirement to ensure credit unions can continue to serve their members during economic downturns without relying on government intervention or assistance; and
- To modernize the risk-based capital calculations and framework, in accordance with the Federal Credit Union Act’s directives.

The new proposal significantly narrowed the proposed rule’s scope by redefining “complex” credit unions. Under this rulemaking, a majority of the NCUA Board proposed to limit the risk-based capital requirement to credit unions with more than \$100 million in assets, rather than the \$50 million threshold contained in the current rule and the earlier proposal.

By increasing the asset threshold, the revised proposed rule exempts more than three-quarters of credit unions. As a result, the revised proposed rule covers 1,455 credit unions that hold 89 percent of the system’s assets.<sup>20</sup> In comparison, the original proposal covered 2,237 credit unions representing 94 percent of the system’s assets.<sup>21</sup> The revised proposal also would result in the downgrade of fewer credit unions.<sup>22</sup>

As requested by stakeholders, including many members of the House Financial Institutions Subcommittee, the revised proposed rule includes significant changes to the risk weights for investments, real estate loans, member business loans, corporate credit unions, and credit

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<sup>19</sup> 12 U.S.C. 1790d(b)(1)(A) and 12 U.S.C. 1831o, respectively.

<sup>20</sup> Data as of December 31, 2013.

<sup>21</sup> Data as of December 31, 2013.

<sup>22</sup> The reformulated risk-based capital proposal would downgrade the capital status of just 19 of 1,455 covered credit unions, based on data as of December 31, 2013. For more information about the revised risk-based based capital proposed rule, see <http://www.ncua.gov/Resources/Pages/risk-based-capital-resources.aspx>.

union service organizations. The risk weights contained in the new proposal are generally comparable to, or more favorable than, the risk weights applied to banks by federal banking agencies.

Overall, 78 percent of credit union assets subject to the revised proposed rule would receive a comparable risk weight to that of the other banking agencies, and 19 percent would receive a lower risk weight. After eliminating assets not directly comparable to banks, just 3 percent of covered credit union assets would receive a more conservative risk weight than that of the other banking agencies. This is primarily due to incorporation of concentration risk, which is required by the Federal Credit Union Act for credit unions, but not required by the Federal Deposit Insurance Act for banks and thrifts.

The extended comment period on the revised proposed risk-based capital rule closed on April 27, 2015, and NCUA is thoroughly reviewing all comments received before the Board moves forward on a final rule.

### **NCUA Operating Budget**

The NCUA Board takes stewardship of the agency's budget very seriously and exercises careful due diligence to ensure the agency prudently uses resources. In developing budgets, the agency's guiding principle is commitment to our dual mission as insurer and regulator—to provide, through regulation and supervision, a safe and sound credit union system which promotes confidence in the national system of cooperative credit.

Set forth in the *NCUA Strategic Plan 2014 through 2017*, the agency's strategic goals and objectives provide a framework to ensure agency priorities and initiatives drive resulting resource needs and allocations. The agency's annual performance plans then provide the framework to execute the multi-year strategic plan and undertake tasks in NCUA's major programs. NCUA uses both the strategic and annual performance plans to develop the agency's Operating Budget.

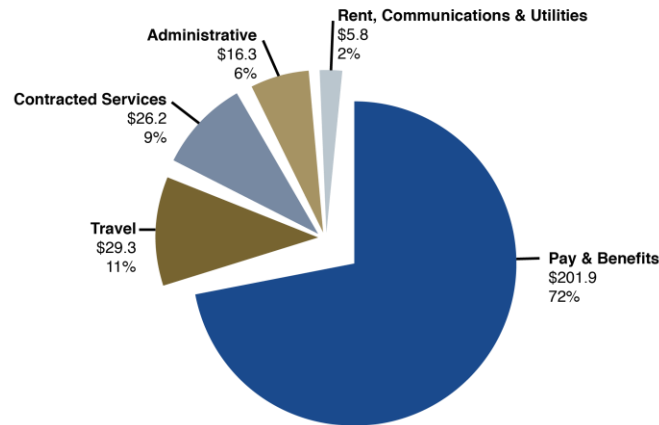
The strategic plan, which is released for public notice and comment, includes the following priorities:

- Manage operational vulnerabilities by implementing a robust supervision framework for financial reform regulations, including interest rate risk and stress testing;
- Prepare for and promote awareness of critical risk issues and related threats such as cybersecurity risks;
- Develop and promote financial literacy education and consumer protection programs;
- Develop and communicate guidance to credit unions to explain regulatory changes and best practices; and
- Strengthen security programs and communications.

As initially approved by the NCUA Board last November, the agency's 2015 Operating Budget is \$279.5 million. As shown in the chart on the next page, 72 percent of NCUA's

budget is used for pay and benefits. Travel costs constitute another 11 percent of the budget, while contracted services account for 9 percent of the budget. The remaining 8 percent of the budget includes administrative expenses, as well as payments for rent, communications, and utilities.

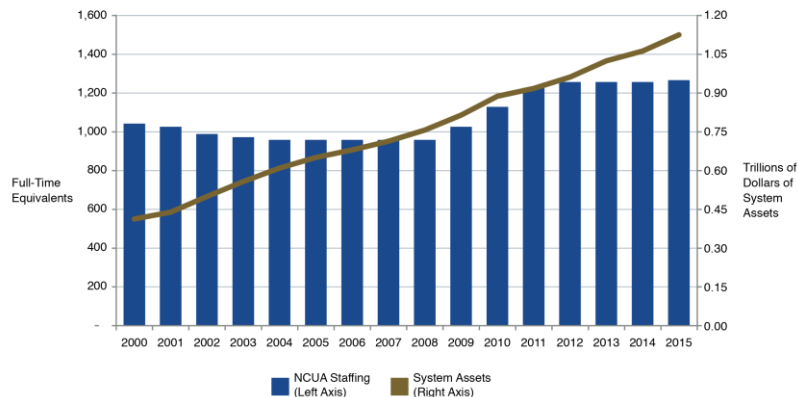
2015 NCUA Operating Budget by Component (in millions)



The 2015 budget also authorizes 1,268.7 full-time equivalent staff. After initially ramping up to respond to the system’s challenges identified during the Great Recession, NCUA’s overall staffing has since remained relatively flat.

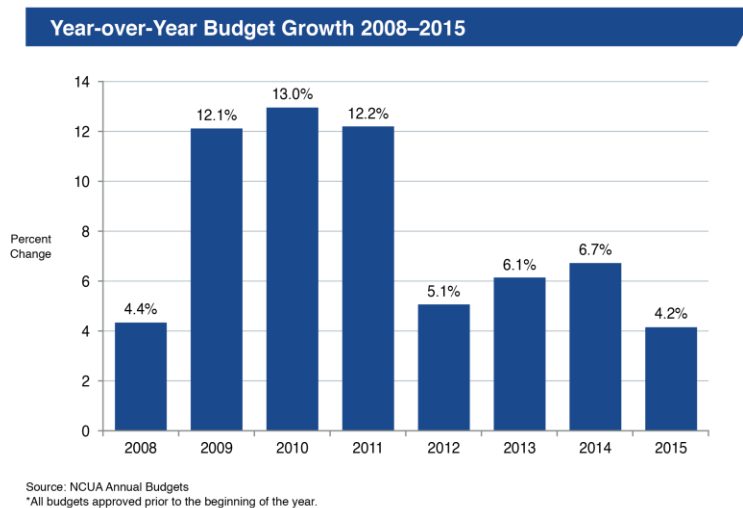
The chart below outlines the Board-approved staffing levels since 2000, in comparison to the growth in the credit union system’s assets. As the chart demonstrates, NCUA during the last five years has worked to efficiently allocate our staff so as to be able to identify and mitigate risks to the system even as the assets of the credit union system have continued to grow.

NCUA Staffing Levels Compared to System Assets 2000–2015

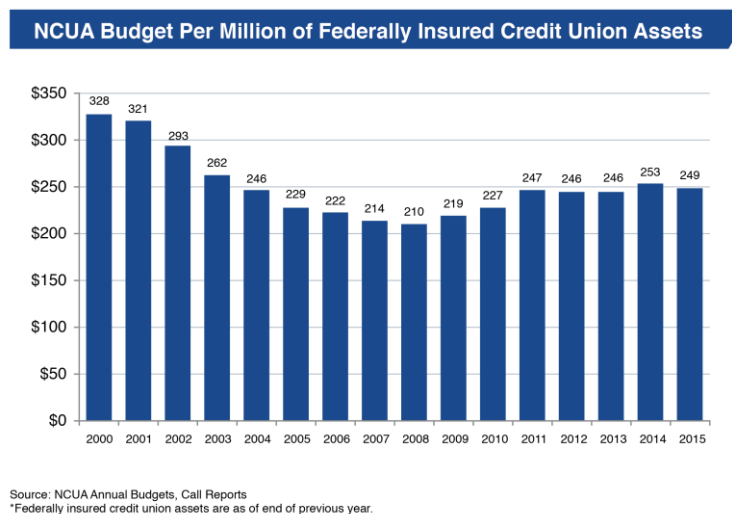


Source: NCUA Annual Budgets, Call Reports  
\*Federally insured credit union assets as of end of previous year.

The 2015 Operating Budget represents a 4.2 percent increase over the prior year. As demonstrated in the chart below, this change was the smallest percentage increase in eight years. And earlier today, during the mid-session budget review, a majority of the NCUA Board voted to reprogram the Operating Budget and Capital Budget with a net savings of more than \$1.3 million for the remainder of the year. This budget savings reflects a concerted effort by every NCUA office to increase efficiencies and reduce line items wherever possible, while still achieving the agency’s mission.



Not only does NCUA prioritize controlling expenditures, the agency is also highly efficient. NCUA spends less than \$250 protecting every \$1 million in system assets. This figure is down significantly since 2000, when the cost per \$1 million in system assets was \$328. The chart below demonstrates the agency’s commitment during the last five years to maintaining operating efficiencies and keeping spending as a portion of credit union system assets flat.



NCUA also achieves budget efficiency by collaborating with our state counterparts to support their oversight of federally insured, state-chartered credit unions. NCUA provides and covers the costs of training and computers for state credit union examiners. We also upload state reports into our databases. Moreover, NCUA works closely with state regulators to minimize exam burdens for 1,915 state-chartered credit unions with less than \$250 million in assets. We primarily rely on state examinations at these credit unions for purposes of assessing risks to the Share Insurance Fund.

### ***Developing the Budget***

The NCUA budget process begins mid-year with each office developing a budget request identifying resources required to support NCUA's mission and strategic goals and objectives. All budgets are developed using a zero-based budgeting process. This bottom-up process means all staffing hours and each expenditure must be justified each year.

One of the primary inputs in the budget development process for NCUA's five regional offices and the Office of National Examinations and Supervision is a comprehensive workload analysis that captures the amount of time necessary to conduct examinations and supervision of federally insured credit unions. Field staff recommend the number of hours to supervise each credit union based on asset size, complexity, and financial trends. Workload estimates are then refined by each level of field management. These analyses cumulatively cover 72 percent of NCUA's total staff.

The budget submission of each office undergoes thorough review by the responsible regional or office director, the Chief Financial Officer and his staff, and executive leadership. NCUA's Information Technology Prioritization Council also meets with regional and central offices to review and prioritize software initiatives and align those information technology investments with NCUA's mission.

Throughout this iterative budget process, the Executive Director and the Chief Financial Officer regularly brief each Board Member on the overall budget proposals that are submitted, updated, and recommended. The budget and its alignment with agency mission and the strategic plan is also thoroughly vetted at each stage of the process at every level of the agency.

After months of work, NCUA's Chief Financial Officer presents the proposed Operating Budget and Capital Budget for approval during the November open meeting of the NCUA Board. As part of this process, NCUA releases a memorandum that describes the proposed budgets in detail and requested staffing levels.

### ***Reallocating Staff***

The evolution of many credit unions into larger, more complex financial institutions poses a greater concentration risk to the Share Insurance Fund. Larger, more complex institutions require more examiners with specialties in certain operations—from sophisticated investments to specialized lending to cutting-edge technology.

To efficiently manage shifting workloads, we work to reallocate existing staff and resources by aligning our budget with credit union system risks, economic trends and the agency's strategic priorities. For example, to address emerging risks, the 2015 budget reallocated 18 existing regional staff from generalists to specialists in capital markets, lending, and information systems.

The 2015 budget added a net of 4.2 full-time equivalents to achieve other important goals and objectives of NCUA's strategic plan. We achieved this change by eliminating five general examiner positions and adding nine slots to enhance supervision, cybersecurity awareness, consumer protection, small credit union assistance, and security programs.

### ***Budget Transparency and Accountability***

NCUA is committed to financial transparency and provides the public with information concerning the agency's budget and spending. As noted at the beginning of my testimony, our website has a dedicated resource center with detailed information on our budget. On this website is a wealth of budget information, including:

- Board memorandums on the budget;
- Budget briefing summaries and slides;
- Answers to budget questions submitted by stakeholders;
- Spending breakdowns by each office for all major budget categories: pay and benefits, travel, contracting, administration, rent, communications and utilities; and
- Fact sheets on: budget and financial transparency, the budget process, the agency's procedures for prioritizing information technology expenditures, the procurement process, and NCUA budget savings.

Annual financial audits of all funds under NCUA management are also posted to our website as soon as they are available. This information enhances transparency by providing detailed disclosures of our budget and budget-making processes. As a result of this online transparency, NCUA's budget disclosures greatly exceed the disclosures of other financial institutions regulators.

Recognizing the value in the exchange of ideas, I also seek insights and input on an ongoing basis from stakeholders in a variety of settings. From one-on-one meetings to town-hall settings, conferences, and coordinated field meetings, I am accessible to discuss the budget and other matters. I routinely crisscross the country speaking to and meeting with tens of thousands of credit union officials representing every state.

To further my commitment to enhanced transparency and effective communications, I have also held 18 in-person Listening Sessions and 11 online town-hall webinars since rejoining the NCUA Board, and I will host another webinar next week. My Listening Sessions and webinars are open to all interested parties.

### *Monthly, Quarterly, Semiannual, and Annual Financial Reports*

The Chief Financial Officer also reports quarterly to the NCUA Board at public meetings on the financial status of the National Credit Union Share Insurance Fund and the Temporary Corporate Credit Union Stabilization Fund. Video, audio, and written transcripts of these reports are posted on NCUA's website for a full year.

In addition, NCUA publicly posts interim reports throughout the year on the fiscal status of the agency's four permanent funds. These funds include the:

- Operating Fund,
- National Credit Union Share Insurance Fund,
- Central Liquidity Facility, and
- Community Development Revolving Loan Fund.

The agency maintains an extensive website on the corporate resolution costs and related NCUA Guaranteed Notes used to fund the toxic corporate credit union assets. NCUA continues to update information at least semiannually to provide transparency on both the Corporate System Resolution Costs and NCUA Guaranteed Notes Program sections of our website.<sup>23</sup> All Stabilization Fund financial statements are posted by the Office of the Inspector General on the website, as well.<sup>24</sup> NCUA remains committed to informing stakeholders on the continued progress of the corporate system resolution program and will continue to publish updated information over the life of the Stabilization Fund.

The agency's securitization strategy for the toxic assets is being managed to achieve the lowest possible resolution cost. At the height of the crisis in 2009, the total unpaid principal balance for the toxic assets (mostly private-label, residential mortgage-backed securities) was \$52.7 billion, but their market value was less than \$22 billion. Thus, market losses from the five failed corporates would have exceeded \$30 billion, an amount far in excess of the Share Insurance Fund's then \$11 billion balance available to cover those losses.

As of December 2014, the unpaid principal balance of the toxic assets has declined to less than \$22 billion, and the market value is \$16.7 billion. The midpoint for total projected corporate system resolution costs has decreased to \$8.8 billion from the original 2010 estimate of \$15 billion. The economic recovery and NCUA's diligent pursuit of legal recoveries from Wall Street firms involved in the underwriting and sale of faulty securities sold to the corporates account for the improvements in overall corporate resolution cost projections. To date, NCUA has recovered more than \$1.75 billion from Wall Street firms whose actions caused the failure of five corporate credit unions.

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<sup>23</sup> See <http://www.ncua.gov/Resources/Corps/RCost/Pages/default.aspx> and <http://www.ncua.gov/Resources/Corps/NGN/Pages/default.aspx>, respectively.

<sup>24</sup> See [http://www.ncua.gov/about/Leadership/Pages/page\\_oig.aspx](http://www.ncua.gov/about/Leadership/Pages/page_oig.aspx).

NCUA's audited financial statements for all four of our permanent funds and the Temporary Corporate Credit Union Stabilization Fund, including all notes, provide a comprehensive picture of NCUA's spending and financial performance. NCUA's financial statement presentation and footnote disclosures are presented as required by Generally Accepted Accounting Principles, and all NCUA funds have received clean audit opinions. For the Share Insurance Fund, expenditure data is aggregated within the principal financial statements as required by GAAP, but more detailed information can be found within the financial statement disclosures.

Finally, in compliance with federal law, a portion of NCUA's Operating Budget is reimbursed from the Share Insurance Fund through the overhead transfer. The overhead transfer allocates expenses associated with insurance and regulatory compliance functions. The percentage of the Operating Budget paid for by the Share Insurance Fund is also presented to the NCUA Board for approval each year at the November open meeting.

NCUA's methodology for calculating the overhead transfer rate was validated in 2011 and 2013 by PricewaterhouseCoopers LLP in independent studies which were released publicly.<sup>25</sup> In response to feedback from the credit union community and to obtain more frequent public input on the overhead transfer rate going forward, NCUA will solicit comments on the overhead transfer rate methodology every three years in conjunction with the public review of the agency's strategic plan.

## **Legislative Initiatives**

Before closing my testimony, I would like to reiterate NCUA's support for congressional action in three areas: vendor authority, member business lending, and supplemental capital for net worth purposes.

### ***Vendor Authority***

Since NCUA last testified in April 2015 before the House Financial Institutions Subcommittee, both the Government Accountability Office and the Financial Stability Oversight Council have recommended legislative action to provide NCUA with examination and enforcement authority over third-party technology service providers. Obtaining this authority over third-party vendors—including credit union service organizations, or CUSOs for short—is my top legislative priority.

In its July 2015 report, GAO recommended that Congress consider granting NCUA examination authority over technology service providers.<sup>26</sup> The GAO report notes that NCUA has a limited ability to assess the risks third-party vendors pose for credit unions and

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<sup>25</sup> See <http://www.ncua.gov/about/Documents/Budget/Misc%20Documents/2011PwCOTRReview.pdf> for the 2011 study and <http://www.ncua.gov/about/Documents/Budget/2013/2013ETSAnalysis.pdf> for the 2013 study.

<sup>26</sup> See <http://www.gao.gov/products/GAO-15-509>.



ultimately the Share Insurance Fund, and to respond to any problems.<sup>27</sup> NCUA may only examine CUSOs and vendors with their permission and cannot enforce any recommended corrective actions. This lack of authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators.

FSOC made a similar recommendation in its annual report released in May 2015.<sup>28</sup> Specifically, FSOC supports the granting of examination and enforcement to NCUA and to oversee third-party service providers engaged with credit unions. The report notes that this legislative change would “enhance the security of third-party service providers and the critical services they provide.”

As noted in our most recent testimony before this panel, NCUA is seeking to close a critical regulatory blind spot: non-transparent, ongoing risks to the credit union system from certain types of CUSOs and third-party vendors that either originate loans or are business technology providers or payment system providers.<sup>29</sup> Without vendor authority, NCUA cannot accurately assess the actual risk present in the credit union system. NCUA needs the authority to determine whether current CUSO or third-party vendor risk-mitigation strategies are adequate and can effectively protect the system from a propagated contagion.

NCUA is especially concerned about our ability to effectively mitigate cybersecurity threats without third-party vendor authority. Our cybersecurity concerns predominantly relate to cyber-threats against financial services vendors, some of which may exclusively serve large numbers of credit unions or that have access to extensive personally identifiable information for millions of credit union members. NCUA needs to exercise oversight to ensure proper and robust safeguards are in place to protect such systems and data. With respect to such technology service providers, NCUA would seek information related to their cybersecurity safeguards, ongoing vulnerability assessments, and mitigation strategies in the event of their being compromised.

Today, the top five technology service providers serve more than half of all credit unions representing more than 75 percent of the credit union system’s assets. Thus, a failure of even one vendor represents potential risk to the Share Insurance Fund.

The potential for losses are not hypothetical. Since 2008, nine CUSOs have caused more than \$300 million in direct losses to the Share Insurance Fund and led to the failures of credit unions with more than \$2 billion in aggregate assets. In one such example, one CUSO caused losses in 24 credit unions, some of which failed.

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<sup>27</sup> See page 32 of the report at <http://www.gao.gov/assets/680/671105.pdf>.

<sup>28</sup> See page 9 of the report at <http://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/2015%20FSOC%20Annual%20Report.pdf>.

<sup>29</sup> See discussion starting on page 18 at <http://www.ncua.gov/News/Documents/CT20150423Fazio.pdf>.

If granted this authority, I want to assure Congress there would be no material change in NCUA's budget. NCUA does not intend to use this authority to regularly examine every CUSO or third-party vendor, especially those posing limited risks. NCUA would use this power to focus on examining those vendors with red flags or posing greater risks. When material or widespread safety and soundness issues are identified, we would have the authority to mitigate the risk and decrease losses for the Share Insurance Fund. NCUA would also coordinate with the banking regulators through the Federal Financial Institutions Examination Council to conduct third-party reviews of non-CUSOs.

### ***Member Business Lending***

NCUA also continues to support legislation to adjust the member business lending cap, such as the bipartisan Credit Union Small Business Jobs Creation Act. Sponsored by Congressmen Royce and Meeks, H.R. 1188 contains appropriate safeguards to ensure NCUA can protect safety and soundness as qualified credit unions gradually increase member business lending.

For federally insured credit unions, the Federal Credit Union Act limits member business loans to the lesser of 1.75 times the level of net worth required to be well-capitalized or 1.75 times actual net worth, unless the credit union qualifies for a statutory exemption.<sup>30</sup> For smaller credit unions with the membership demand and the desire to serve the business segments of their fields of membership, the restriction makes it very difficult or impossible to successfully build a sound member business lending program. As a result, many credit unions are unable to deliver commercial lending services cost effectively, which denies small businesses in their communities access to an affordable source of credit and working capital.

These credit unions miss an opportunity to support the small business community and to provide a service alternative to the small business borrower. Small businesses are an important contributor to the local economy as providers of employment, and as users and producers of goods and services. NCUA believes credit union members that are small business owners should have full access to financial resources in the community, including credit unions, but this is often inhibited by the statutory cap on member business loans.

### ***Supplemental Capital for Net Worth Purposes***

Finally, NCUA reiterates our support for legislation to allow more credit unions to access supplemental capital, such as H.R. 989, the Capital Access for Small Businesses and Jobs Act. Introduced by Congressmen King and Sherman, this bipartisan bill would allow healthy and well-managed credit unions to issue supplemental capital that will count as net

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<sup>30</sup> 12 U.S.C. 1757a.

worth. This legislation would result in a new layer of capital, in addition to retained earnings, to absorb losses at credit unions.

The high-quality capital that underpins the credit union system is a bulwark of its strength and key to its resiliency during the recent financial crisis. However, most federal credit unions only have one way to raise capital—through retained earnings, which can grow only as quickly as earnings. Thus, fast-growing, financially strong, well-capitalized credit unions may be discouraged from allowing healthy growth out of concern it will dilute their net worth ratios and trigger mandatory prompt corrective action-related supervisory actions.

A credit union's inability to raise capital outside of retained earnings limits its ability to grow its field of membership and to offer greater options to eligible consumers. Consequently, NCUA has previously encouraged Congress to authorize healthy and well-managed credit unions to issue supplemental capital that will count as net worth under conditions determined by the NCUA Board. Enactment of H.R. 989 would lead to a stronger capital base for credit unions and greater protection for taxpayers.

NCUA stands ready to work with Congress on H.R. 989, H.R. 1188, and the agency's legislative proposal on vendor authority.

## **Conclusion**

In closing, the credit union system is now headed in the right direction. Both the credit union system and NCUA are in remarkably better condition than when I became Chairman.

We have ensured that NCUA has the resources needed to effectively oversee credit unions. NCUA has also worked to put in place new rules to protect the credit union system and provide regulatory relief through the Regulatory Modernization Initiative. I will continue working to protect the safety and soundness of credit unions and to safeguard the 100 million credit union account holders who are federally insured by NCUA.

I look forward to your questions.

## APPENDIX I

### National Credit Union Administration Regulatory Modernization Initiative September 2011–June 2015 Results

NCUA ACTIONS	BENEFITS
<b>IMPROVED RULES</b>	
<b>Modernized Definition of “Small” Credit Unions</b>	<ul style="list-style-type: none"> <li>• In 2013, expanded NCUA’s consideration of regulatory exemptions for credit unions with assets of less than \$50 million, up from the previous \$10 million.</li> <li>• Exempted two-thirds of the entire credit union system from NCUA rules on risk-based net worth and interest rate risk management.</li> <li>• Eased the compliance requirement for small credit unions to access emergency liquidity.</li> <li>• Doubled the number of credit unions receiving special consideration for regulatory relief in future NCUA rulemakings.</li> <li>• To further regulatory relief, in 2015 the NCUA Board proposed to double the threshold to \$100 million.</li> </ul>
<b>Eased Troubled Debt Restructurings</b>	<ul style="list-style-type: none"> <li>• Encouraged credit union loan modifications and ended manual reporting.</li> <li>• Prevented unnecessary foreclosures.</li> <li>• Kept more credit union members in their homes throughout the crisis.</li> </ul>
<b>Expanded Rural Districts</b>	<ul style="list-style-type: none"> <li>• Raised potential membership for federal credit unions in rural districts from a hard cap of 200,000 residents to a sliding scale: 250,000 residents or 3 percent of the state population, whichever is larger.</li> <li>• Permitted federal credit unions to serve rural districts and Indian reservations in states experiencing extraordinary population growth, as well as in smaller states.</li> </ul>
<b>Authorized “Plain Vanilla” Derivatives</b>	<ul style="list-style-type: none"> <li>• Encouraged qualified federal credit unions to use “plain vanilla” derivatives to reduce risks.</li> <li>• Permitted approved federal credit unions to continue mortgage lending while offsetting interest rate risk.</li> <li>• Protected the credit union system by providing an extra buffer against potential losses at large credit unions.</li> </ul>
<b>Approved Treasury Inflation-Protected Securities</b>	<ul style="list-style-type: none"> <li>• Offered federal credit unions an additional investment backed by the federal government with zero credit risk.</li> <li>• Provided returns indexed to inflation rates rather than interest rates.</li> </ul>
<b>Established Charitable Donation Accounts</b>	<ul style="list-style-type: none"> <li>• Empowered federal credit unions to safely pool investments designed to benefit national, state, or local charities.</li> </ul>
<b>Eliminated the Fixed-Assets Cap</b>	<ul style="list-style-type: none"> <li>• Eliminated federal credit unions’ 5-percent cap on fixed assets.</li> <li>• Empowered federal credit unions to make their own business decisions on purchases of land, buildings, office equipment, and technology.</li> </ul>
<b>Proposed Asset Securitization</b>	<ul style="list-style-type: none"> <li>• Would let qualified federal credit unions to securitize their own assets.</li> <li>• Offered as an additional tool to manage interest rate and liquidity risks.</li> </ul>

NCUA ACTIONS	BENEFITS
<b>Expedited Field of Membership Expansions</b>	<ul style="list-style-type: none"> <li>• Authorized 12 new types of associational groups to receive automatic pre-approval for inclusion in a federal credit union’s field of membership.</li> </ul>
<b>Proposed Modernizing Member Business Lending</b>	<ul style="list-style-type: none"> <li>• Removed rigid requirements to provide credit unions with greater flexibility and individual autonomy in prudently providing member business loans.</li> <li>• Implemented a principles-based regulatory approach to commercial lending.</li> </ul>
<b>STREAMLINED PROCESSES</b>	
<b>Low-Income Credit Union Designation</b>	<ul style="list-style-type: none"> <li>• Implemented an “opt-in” process whereby eligible credit unions can simply say “yes” to receive the low-income designation.</li> <li>• More than doubled the number of low-income designations, reaching more than 2,300 credit unions serving 30 million members.</li> <li>• Low-income credit unions are authorized by statute to expand member business lending beyond the statutory cap, obtain supplemental capital, raise non-member deposits, and apply for Community Development Revolving Loan Fund grants and loans.</li> </ul>
<b>Blanket Waivers</b>	<ul style="list-style-type: none"> <li>• Released guidance encouraging credit unions to apply for blanket waivers for member business loans meeting certain conditions.</li> <li>• Eliminated the requirement for many business owners to pledge personal guarantees against loans with high-value collateral based on sound underwriting principles.</li> </ul>
<b>Expedited Examinations</b>	<ul style="list-style-type: none"> <li>• Created an expedited exam process for well-managed credit unions with CAMEL ratings of 1, 2, or 3 and assets of less than \$30 million, with the program expanding to \$50 million in 2015.</li> <li>• Enabled these credit unions to dedicate more resources to serving members.</li> </ul>
<b>Facilitated Secondary Capital</b>	<ul style="list-style-type: none"> <li>• Provided policy flexibility for low-income credit unions to redeem secondary capital at investors’ requests.</li> </ul>
<b>ISSUED LEGAL OPINIONS</b>	
<b>Extended Loan Maturities</b>	<ul style="list-style-type: none"> <li>• Permitted loan maturities up to 40 years after loan modifications.</li> <li>• Significantly reduced monthly payments for borrowers in need.</li> </ul>
<b>Expanded Vehicle Fleets</b>	<ul style="list-style-type: none"> <li>• Modernized the definition of “fleet” from two to five vehicles for member business loans.</li> <li>• Provided regulatory relief and expanded access to credit for small businesses and startups.</li> </ul>
<b>Modernized Service Facilities</b>	<ul style="list-style-type: none"> <li>• Included full-service video tellers in the definition of federal credit union service facilities.</li> <li>• Empowered federal credit unions to expand services in underserved areas without necessarily purchasing more brick-and-mortar branches.</li> </ul>
<b>Changing Charters in Mergers</b>	<ul style="list-style-type: none"> <li>• Permitted credit unions to change charters to facilitate voluntary mergers.</li> <li>• Retained credit union service for members of merging credit unions.</li> </ul>