NCUA
National Credit Union Administration

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Congressional Testimony

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Hearing on Regulatory Relief for
Community Banks and Credit Unions

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 more than 98 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

At MyCreditUnion.gov and Pocket Cents, NCUA also educates the public on consumer protection and financial literacy issues.

Congressional Testimony

Chairman Shelby, Ranking Member Brown, and Members of the Committee, the National Credit Union Administration appreciates the invitation to testify about regulatory relief.[1] I am Larry Fazio, Director of NCUA's Office of Examination and Insurance.

Today, three-quarters of credit unions have less than $100 million in assets and the median asset size of a credit union is $24 million.[2] Smaller credit unions in particular have fewer resources available to respond to marketplace, technological, legislative, and regulatory changes. NCUA, therefore, is acutely aware of the need to calibrate our rules and examinations to remove any unnecessary burden on these smaller credit unions.

NCUA scales our regulatory and supervisory expectations for smaller credit unions. NCUA also seeks to provide broader regulatory relief when it is sensible and within the agency's authority to do so. Over the past three years, we have taken many actions to cut red tape and provide lasting benefits to credit unions. This includes relaxing eight regulations and streamlining three processes.

Where regulation is necessary to protect the safety and soundness of credit unions and the National Credit Union Share Insurance Fund, NCUA employs a variety of strategies to ensure our regulations are effectively targeted.[3] These strategies include fully exempting

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[1] NCUA's primary mission is to provide, through regulation and supervision, a safe and sound credit union system. NCUA performs this important public function by:

- Examining all federal credit unions;
- Participating in the supervision of federally insured, state-chartered credit unions in coordination with state regulators; and
- Insuring accounts up to $250,000 at federally insured credit unions.

As required by the Federal Credit Union Act, NCUA also serves as the administrator of the $12 billion National Credit Union Share Insurance Fund. In this role, NCUA provides oversight and supervision to 6,350 federally insured credit unions. Of these credit unions, NCUA directly supervises 3,981 federal credit unions chartered by the agency.

[2] The term "credit union" is used throughout this testimony to refer to federally insured credit unions. NCUA does not oversee approximately 132 state-chartered, privately insured credit unions. As of September 30, 2014, federally insured credit unions represent 98 percent of all credit unions in the United States and serve 98.7 million credit union members.

As a policy matter, in 2007 NCUA issued a report to Congress concluding that the federal government should be the sole provider of primary deposit insurance. Federal deposit insurance has played an important role in maintaining confidence in the financial system and the stability of our economy, and the lessons learned from failures of private deposit insurance schemes should not be forgotten. See http://www.ncua.gov/Legal/Documents/DepositInsuranceStudyReporttoCongress-Ver6-4.pdf for more details.

[3] 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.

small credit unions from certain rules, using graduated requirements as size and complexity increase for others, and incorporating practical compliance approaches in agency guidance. In short, we work to balance maintaining prudential standards with minimizing regulatory burden.

My testimony will discuss elements of NCUA's current rulemaking process, including recent and prospective efforts to tailor regulation and supervision based on credit unions' size and complexity. I will also comment on NCUA's efforts to reduce examination burdens. Finally, I will offer legislative recommendations related to regulatory relief.

Regulatory Flexibility Act

Under the Regulatory Flexibility Act, NCUA must publish an analysis in the *Federal Register* and give special consideration to the regulatory burden and alternatives for small credit unions whenever a proposed or final rule would impose a significant economic burden on a substantial number of small credit unions.[4]

In recognition of the operational and financial challenges faced by smaller credit unions, the NCUA Board in January 2013 reviewed the threshold used to identify which credit unions qualify as small entities under the Regulatory Flexibility Act. Based on credit union system percentages carried forward from the last update in 2003 and corresponding risks to the Share Insurance Fund, the Board determined credit unions with less than $50 million in assets, up from the prior $10 million threshold, were small entities for purposes of the Regulatory Flexibility Act.

At the time of the 2013 adjustment, the number of credit unions classified as small for purposes of the Regulatory Flexibility Act nearly doubled. Today, 4,124 institutions representing 65 percent of all credit unions are covered by the small credit union definition.

At the same time it revised the small credit union definition, the NCUA Board provided immediate regulatory relief by exempting credit unions under $50 million from several regulatory requirements. First, the Board increased from $10 million to $50 million the threshold that defines which credit unions are complex, narrowing the category of credit unions that could be subject to risk-based net worth requirements and the associated prompt corrective action mandates. Second, the Board increased from $10 million to $50 million the threshold used to exempt credit unions from our interest rate risk rule.

In a coordinated policy change, the Board nearly doubled the number of credit unions eligible to apply for NCUA's Office of Small Credit Union Initiatives' individualized

[4] The Regulatory Flexibility Act provides NCUA with the opportunity to define which credit unions fall under the law's coverage. 5 U.S.C. 601(4).

consulting services by increasing the eligibility threshold to $50 million.[5] Subsequently, the NCUA Board extended relief at the same level in new rules requiring certain liquidity contingencies and creditor notices in voluntary liquidations.

In January 2013, the NCUA Board also committed the agency to revisit the Regulatory Flexibility Act threshold in 2015 and every three years thereafter.[6] The Board took this action to ensure the definition of a small credit union would keep pace with changes in the marketplace.

As a result, next week the Board will consider a proposed rule to include hundreds of additional credit unions under the definition of a small entity. Increasing the threshold from $50 million to $100 million would provide special consideration for regulatory relief for an additional 745 credit unions in future rulemakings.

Should the Board adopt a $100 million threshold, 77 percent of all credit unions would be covered in future considerations of regulatory relief.[7] Taking this action also would recognize the challenges encountered by credit unions below $100 million in assets, which have slower deposit growth rates, slower membership growth rates, and higher operating costs than peer credit unions above the threshold.

Regulatory Review Efforts

NCUA is ever mindful of the impact of 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.

Rolling Regulatory Review

Since 1987, NCUA has followed a well-delineated and deliberate process to continually review its 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 its regulations each year, meaning that we review all of our regulations at least once every three years.

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[5] Created in 2004, NCUA's Office of Small Credit Union Initiatives fosters credit union development and the effective delivery of financial services for small, new, and low-income credit unions, as well as minority depository institutions. The office provides individualized consulting, loan and grant opportunities, targeted training, and valuable partnership and outreach services to help viable small credit unions thrive.

[6] This triennial review of the small credit union definition under the Regulatory Flexibility Act is in addition to NCUA's rolling three-year review of all regulations.

[7] Credit unions with less than $100 million in assets hold 11 percent of the system's assets.

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.

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 any or all of the regulations.[8]

Economic Growth and Regulatory Paperwork Reduction Act

Further, NCUA is voluntarily participating in the interagency review process created by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.[9] 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, ineffective, unnecessary, insufficient, or excessively burdensome. NCUA is not required to participate in this process, but the agency has elected once again to do so.

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

- Agency Programs,
- Applications and Reporting,
- Capital,
- Consumer Protection,
- Corporate Credit Unions,
- Directors,
- Officers and Employees,
- Money Laundering,
- Powers and Activities,

[8] See http://www.ncua.gov/Legal/Regs/Pages/Regulations.aspx.

[9] 12 U.S.C. 3311.

- Rules of Procedure, and
- Safety and Soundness.

In May 2014, 33 NCUA regulations in the Applications and Reporting and Powers and Activities categories were released for review. In a second notice in December 2014, NCUA opened 17 rules for comment in three additional categories: Agency Programs, Capital, and Consumer Protection.

As part of NCUA's voluntary participation in the latest EGRPRA review, NCUA will evaluate the burden on credit unions for those regulations within NCUA's control. NCUA, however, has no authority to provide relief from requirements imposed by other regulators.

Regulatory Modernization Initiative

In 2011, NCUA Board Chairman Debbie Matz 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.

- Regulatory relief—revising and removing regulations that limit flexibility and growth, without jeopardizing safety and soundness.

In implementing this initiative, NCUA also has 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.

Ultimately, NCUA under the initiative has taken 15 actions to cut red tape and provide lasting benefits to credit unions.[10] Specifically, NCUA during the last three years has worked to ease eight regulations, providing regulatory relief to thousands of credit unions. NCUA has also streamlined three processes—facilitating more than a thousand new low-income credit union designations, increasing blanket waivers for member business loans, and establishing an expedited process for examinations at smaller credit unions.[11] NCUA has additionally issued four legal opinions, allowing more flexibility in credit union operations.

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[10] See Appendix I for a complete list of these actions.

[11] 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 cap on member business lending, eligibility for Community Development Revolving Loan Fund grants and low-interest loans, ability to accept deposits from non-members, and authorization to obtain supplemental capital.

Rulemaking Process

In developing any regulation, NCUA strives to ensure the agency's rulemakings are reasonable and cost-effective. NCUA additionally conducts an analysis to inform the agency's decisions in advance of regulatory actions. The analysis also ensures that regulatory choices are made after appropriate consideration of the likely consequences.

NCUA's safety and soundness regulations protect credit unions and the members who own them, as well as strengthen the credit union system the agency supervises and insures.[12] The benefit of these regulations is that they reduce the likelihood of credit union failures and, in doing so, promote stability and protect the Share Insurance Fund.

Any loss to the Share Insurance Fund is ultimately borne by surviving credit unions, which may be required to pay increased premiums. As member-owned cooperatives, this means the members, who are the owners and consumers of the credit unions, may ultimately have to repay these costs. As the developments of the last decade have demonstrated, the cost of regulatory inaction can result in failures that impose a greater cost to credit unions and society than the cost of action.[13]

Through the public comment process, the NCUA Board gains insights on potential costs, unintended consequences, and alternative strategies directly from the credit unions the agency supervises and insures, as well as other interested stakeholders. The Board then uses this information to make adjustments before issuing a final rule. A good example of this process in action is NCUA's October 2013 final rule on emergency liquidity and contingency funding.

The proposed liquidity rule applied to all federally insured credit unions with more than $50 million in assets, but the public comment period yielded a number of important observations about the compliance requirements associated with establishing emergency lines of credit. Based on this information, the NCUA Board reconsidered the balance between costs and benefits specifically for credit unions between $50 million and $250 million in assets. The final rule exempted credit unions with assets up to $250 million from establishing emergency lines of credit with the Federal Reserve's Discount Window, or NCUA's Central Liquidity Facility, or both. Instead, the Board only required credit unions of this size to

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[12] NCUA has a number of regulations that address issues other than safety and soundness, such as those rules related to field of membership, the Community Development Revolving Loan Fund, payday alternative loans, the organization of federal credit unions, agency procedures, and examiner post-employment restrictions, among others.

[13] The collapse of five corporate credit unions during the 2007–2009 financial crisis best illustrates this point. To date, credit unions have paid $4.8 billion in assessments and experienced $5.6 billion in losses in the form of contributed capital. These costs incurred during the financial crisis reduced credit union earnings and assets and, as a result, during that time may have decreased interest paid on share deposits, increased loan rates, and constrained credit union services for their members.

develop contingency funding plans that clearly set out strategies for meeting emergency liquidity needs.

Examples of Scaled Regulation

In addition to calibrating the liquidity and contingency funding rule, NCUA has recently scaled other regulations based on the asset size of the credit union. Examples of such tailored regulations include the agency's 2012 interest rate risk rule and the revised proposed risk-based capital rule issued last month.[14]

Interest Rate Risk Rule

NCUA's focus on interest rate risk management has been constant and pronounced for more than 15 years, as evidenced by a steady issuance of guidance to examiners and credit unions on asset-liability management. Since 2010, interest rate risk management has been a heightened focus for NCUA, and it is a primary supervisory focus for the agency again in 2015.

NCUA's focus on interest rate risk exposure has increased due to the extraordinary low level of interest rates and the overall lengthening of asset durations in the credit union system. NCUA is mindful that a period of rapidly rising rates could be a particularly challenging scenario for some credit unions. To stay ahead of the curve and maintain stable earnings, credit unions need to have policies in place to survive adverse rate environments.

These concerns led the NCUA Board to issue a final rule three years ago aimed at managing interest rate risk. Generally, the rule categorizes credit unions based on size, which is correlated to risk exposure, to determine the need to adopt a written policy on interest rate risk. Consistent with the Board's policy to exempt small credit unions from regulations when prudent, the size and exposure criteria in the interest rate risk rule exempt credit unions with less than $50 million in assets, while protecting the Share Insurance Fund by covering most of the system's assets.

The NCUA Board exempted smaller credit unions because they customarily have very low interest rate risk profiles as they are not as active in residential mortgage lending or long-term investing.[15] Also, smaller credit unions typically have much higher capital levels and hold relatively more cash and short-term investments on their balance sheets.[16]

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[14] See Appendix II for a more complete listing of efforts to scale regulations, calibrate examinations, and provide assistance designed to address the unique circumstances of smaller credit unions.

[15] As of September 30, 2014, real estate loans at credit unions with more than $50 million in assets accounted for 33.2 percent of total assets, compared to 15.8 percent at credit unions below this threshold.

[16] As of September 30, 2014, credit unions with $50 million or less in assets maintained cash and short-term investment balances at 22.9 percent of total assets, compared to 12.5 percent for credit unions above this threshold.

Revised Proposed Risk-Based Capital Rule

After reviewing 2,056 comments on the original risk-based capital proposal, last month the NCUA Board issued a revised proposed rule. NCUA's primary goals for the revised proposed risk-based capital rule remain the same:

- 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 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, the NCUA Board has 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 over three-quarters of credit unions. Through this targeted improvement, the revised proposed rule covers 1,455 credit unions that hold 89 percent of the system's assets.[17] In comparison, the original proposal covered 2,237 credit unions representing 94 percent of the system's assets.[18] The revised proposal also would result in the downgrade of fewer credit unions.[19]

As requested by stakeholders, including several members of the Senate Banking Committee, the revised proposed rule includes significant changes to the risk weights for investments, real estate loans, member business loans, corporate credit unions, and credit 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.

Finally, the revised proposed rule extends the implementation date to January 1, 2019. This date aligns with the risk-based capital rule implementation deadline for banks. It also allows credit unions covered under the rule ample time to prepare for the change.

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[17] Data as of December 31, 2013.

[18] Same as above.

[19] 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.

Other Regulatory Relief Proposals under Consideration

Going forward, NCUA is already working to provide additional regulatory relief for credit unions. For example, NCUA is drafting a proposal to modernize our member business lending rule. The primary changes being considered involve removing prescriptive underwriting criteria and other outdated restrictions, thereby eliminating the need for credit unions to request waivers from NCUA to conduct business.

In April 2014, the NCUA Board also issued a proposed rule to define more clearly which associational groups do and do not qualify for membership in a federal credit union. The proposed rule would provide automatic approval for seven types of associations. To facilitate greater access to credit union membership, commenters suggested several more categories of well-established associational groups that should also be considered for automatic approval. The Board is now carefully reviewing these suggested regulatory improvements.

NCUA is additionally working to fine-tune a proposed rule on asset securitization. Approved in June 2014, this proposal would allow qualified federal credit unions to securitize loans they have originated under certain conditions. Once finalized, this rule would provide these federal credit unions with greater flexibility to manage interest rate and liquidity risks.

Finally, the NCUA Board in July 2014 proposed to streamline the agency's fixed-assets rule. This proposal would eliminate the current requirement to obtain a waiver from NCUA for a federal credit union with assets of $1 million or more that wants to make investments in fixed assets exceeding 5 percent of shares and retained earnings. The proposed rule also would make it easier for federal credit unions to acquire property to accommodate plans for future expansions.

The NCUA Board is expected to consider a final fixed-assets rule by the end of the second quarter. This rule would allow federal credit unions to make business decisions on upgrading technology, updating facilities, or making other purchases without filing waivers.

Improvements in the Examination Program

Beyond providing targeted relief by issuing regulatory exemptions and adopting tailored rules, NCUA is providing regulatory relief through revisions to our 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 that exhibit the greatest potential risk exposure to the Share Insurance Fund. The program relies on examiner judgment to determine the areas that need 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 all regions of the country.

While the risk-based examination program has generally worked well, in 2011 we determined that 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 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 moved to concentrate supervision on credit union activities that pose the most risk. In recognition that larger, more complex credit unions require more attention, NCUA began streamlining exams for the smallest credit unions and deploying examiners where their work will be most effective in protecting the Share Insurance Fund.

NCUA now has in place a streamlined examination program for financially and operationally sound credit unions with less than $30 million in assets. Through the Small Credit Union Examination Program, NCUA spends less time on average in small, well-managed 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.

NCUA is now expanding the Small Credit Union Examination Program to include federal credit unions with up to $50 million in total assets that received a composite CAMEL rating of 1, 2, or 3 at their last examination.[20] After completing training, NCUA anticipates fully implementing the new procedures by the end of the first quarter of 2015.[21]

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 to improve off-site monitoring capabilities and thereby potentially reduce the overall time NCUA spends onsite inside credit unions conducting examinations.

[20] The CAMEL rating system is based upon 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.

[21] For larger, more complex credit unions, NCUA will continue to perform risk-focused exams.

To improve consistency in the way field staff develop and use documents of resolution, NCUA also revised our policy and procedures in 2013.[22] NCUA clarified how and when documents of resolutions should be used. The new policy states that documents of resolution should be used to address issues significant enough that a credit union's failure to correct the problem would necessitate the examiner recommending an informal or formal 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.

The result has been clearer expectations for credit unions and NCUA field staff, and greater consistency in the examination process. Credit unions generally have supported the change. As a result of these changes and an improved economy, the agency has additionally experienced a decline in the number of documents of resolution issued.

Regulatory Relief Legislation

Finally, the Committee has asked NCUA to identify ways to ease credit union regulatory burdens through legislation.

NCUA is very appreciative of the Senate's efforts last December to enact into law the Credit Union Share Insurance Fund Parity Act and the American Savings Promotion Act.[23] The first law allows federally insured credit unions to offer the same level of insurance on deposits as banks and thrifts for lawyers' trust accounts. The second law permits federally insured financial institutions to offer prize-linked accounts to promote saving.

Looking ahead, NCUA has several proposals to share with the Committee related to regulatory flexibility, field of membership requirements, member business lending, supplemental capital, and vendor authority.

Regulatory Flexibility

Today, there is considerable diversity in scale and business models among financial institutions. As noted earlier, many credit unions are very small and operate on extremely thin margins.[24] They are challenged by unregulated or less-regulated competitors, as well as limited economies of scale. They often provide services to their members out of a commitment to offer a specific product or service, rather than a focus on any incremental financial gain.

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[22] 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.

[23] P.L. 113-252 and P.L. 113-251, respectively.

[24] See Appendix III for a breakdown of credit union performance by asset class over time.

The Federal Credit Union Act contains a number of hard-coded provisions that limit NCUA's ability to revise regulations and provide relief to such credit unions. Examples include limitations on the eligibility for credit unions to obtain supplemental capital, field of membership restrictions, curbs on investments in asset-backed securities, and the 15-year loan maturity limit, among others.[25]

To that end, NCUA would encourage Congress to consider providing regulators like NCUA with flexibility to write rules to address such situations, rather than imposing rigid requirements. Such flexibility would allow the agency to effectively limit additional regulatory burdens, consistent with safety and soundness. As previously noted, NCUA continues to modernize existing regulations with an eye toward balancing requirements appropriately with the relatively lower levels of risk smaller credit unions pose to the credit union system. By allowing NCUA discretion on scale and timing to implement new laws, we could more flexibly mitigate the cost and administrative burdens of these smaller institutions while balancing consumer and prudential priorities.

Field of Membership Requirements

The Federal Credit Union Act currently only permits federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership. We recommend that Congress act to modify the Federal Credit Union Act to give NCUA the authority to streamline field of membership changes and permit all federal credit unions to grow their membership by adding underserved areas.

Allowing federal credit unions that have a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change could also eventually enable more credit unions to participate in the programs offered through the congressionally established Community Development Financial Institutions Fund, thus increasing the availability of credit and savings options in distressed areas.[26]

Congress also may want to consider other field of membership statutory reforms. For example, Congress could allow federal credit unions to serve underserved areas without also requiring those areas to be local communities. Congress may also want to simplify the "facilities" test for determining if an area is underserved.[27] NCUA stands ready to work

[25] 12 U.S.C. 1751 and what follows.

[26] Located within the U.S. Department of the Treasury, the Community Development Financial Institutions Fund's mission is to expand the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and communities in the United States.

[27] The Federal Credit Union Act presently requires an area to be underserved by other depository institutions, based on data collected by NCUA or federal banking agencies. NCUA has implemented this provision by requiring a facilities test to determine the relative availability of insured depository institutions within a certain area. Congress could instead allow

with the Committee on these ideas, as well as other options for adjusting field of membership requirements.

Outside of the legislative process, Chairman Matz recently established a working group to discuss existing regulatory field of membership constraints and options for ensuring the federal credit union charter remains relevant in today's marketplace. This group is requesting candid feedback from stakeholders to help the agency identify potential regulatory or procedural changes to enable federal credit unions to more readily promote access to populations with limited alternatives for financial services.

Member Business Lending

NCUA reiterates the agency's support for legislation to adjust the member business lending cap, such as the Small Business Lending Enhancement Act from the 113th Congress. This bill 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 12.25 percent of assets or 1.75 times net worth, unless the credit union qualifies for a statutory exemption.[28] 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 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.

NCUA additionally supports the Credit Union Residential Loan Parity Act introduced in the House during the 113th Congress. This legislation addresses a statutory disparity in the treatment of certain residential loans made by banks and credit unions.

When a bank makes a loan to purchase a 1- to 4-unit, non-owner-occupied residential dwelling, the loan is classified as a residential real estate loan. If a credit union were to

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NCUA to use alternative methods to evaluate whether an area is underserved to show although a financial institution may have a presence in a community, it is not qualitatively meeting the needs of an economically distressed population.

[28] 12 U.S.C. 1757a.

make the same loan, it is classified as a member business loan and therefore subject to the member business lending cap. To provide policy parity between banks and credit unions for this product, this bill would exclude such loans from the cap. The legislation also contains appropriate safeguards to ensure NCUA will apply strict underwriting and servicing standards for these loans.

Supplemental Capital

NCUA supports legislation to allow healthy and well-managed credit unions to issue supplemental capital that will count as net worth. This legislation would help protect the Share Insurance Fund by adding a new layer of capital, in addition to retained earnings, to absorb losses at credit unions.

Most federal credit unions only have one way to raise capital—through retained earnings. Without access to other ways to raise capital, credit unions are exposed to risk when the economy falters. Financially strong and well-capitalized credit unions also may be discouraged from allowing healthy growth out of concern it will dilute their net worth ratios and trigger prompt corrective action-related supervisory actions.

A credit union's inability to raise capital outside of retained earnings limits its ability to expand into fields of membership more effectively and to offer greater options to eligible consumers. Consequently, NCUA has previously encouraged Congress to authorize healthy and well-managed credit unions, as determined by the NCUA Board, to issue supplemental capital that will count as net worth. If reintroduced in the 114th Congress, NCUA would again be supportive of the Capital Access for Small Businesses and Jobs Act.

Vendor Authority

Finally, and most critically, NCUA requests that the Senate Banking Committee consider legislation to provide the agency with examination and enforcement authority over third-party vendors—including credit union service organizations, or CUSOs for short. Obtaining this authority is the agency's top legislative priority.[29]

While providing important services and helping smaller credit unions achieve economies of scale, there are inherent risks in some CUSOs. Since 2008, NCUA estimates that 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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[29] NCUA has two other legislative priorities. The first priority would enhance access to emergency liquidity for the credit union system by making targeted changes to the Central Liquidity Facility and expanding the agency's access to the U.S. Treasury. The second priority would permit NCUA to charge risk-based premiums for the Share Insurance Fund much like the Federal Deposit Insurance Corporation charges for the Deposit Insurance Fund. Risk-based premiums would lessen the funding burden on small credit unions, which generally pose less risk to the Share Insurance Fund.

CUSOs provide products and services that can significantly affect financial well-being, and, in the case of technology service providers, the security of credit unions and the members they serve. During the third quarter of 2014, credit unions using the services of a CUSO accounted for $974 billion in assets or 88 percent of system assets. This figure is up from 79 percent of assets at year-end 2009.

The Government Accountability Office has noted that NCUA has a limited ability to assess the risks third-party vendors, including CUSOs, pose for credit unions and, ultimately the Share Insurance Fund, and to respond to any problems. NCUA may only examine vendors with their permission and cannot enforce any corrective actions. NCUA can merely make recommendations and present findings to each vendor's credit union clients. This lack of authority stands in contrast to federal banking agencies and most state regulators.

NCUA's inability to oversee third-party vendors also poses a regulatory burden for credit unions, as the agency must rely on credit unions to report certain information on the vendors with which they do business. Additionally, NCUA must work through each credit union that uses third-party vendors or CUSOs to obtain material about the vendor or CUSO. This duplication of efforts creates a burden on all credit unions, particularly smaller credit unions that rely more heavily on vendors for many products and services.

A legislative fix would close a growing gap in NCUA's authority and provide some regulatory relief for credit unions. Specifically, NCUA would be able to work directly with key infrastructure vendors, including those with a cybersecurity dimension, to obtain necessary information to assess risks and deal with any problems at the source.

The need for NCUA to have vendor authority is best illustrated by the growth of cybersecurity threats, which are a major concern for the agency. The complexity of online communications is growing, as is the number and sophistication of hackers, thieves, and terrorists seeking to exploit vulnerabilities in the system. Moreover, credit unions are increasingly using third-party vendors to provide technological services, including security, and there is a greater interconnectedness among vendors.

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

These vendors also provide an array of products and services to credit unions, and credit unions, like other small and community institutions, rely heavily on third parties to deliver services and manage technology in providing services. Credit unions often use common third-party services designed specifically for small cooperative institutions. Vendors perform functions that include online banking, transaction processing, fund transfers, and loan underwriting. Member data are being stored on these vendors' servers.

NCUA therefore needs the same authority as the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System to examine third-party vendors. To achieve this objective, NCUA has developed a legislative proposal which we believe would afford the agency the appropriate statutory authority. NCUA stands ready to work with the Committee on legislation to effectuate the necessary changes so that all credit unions can responsibly and effectively utilize the services of CUSOs and technology service providers.

Thank you again for the invitation to testify. I am happy to answer any questions.

APPENDIX I

National Credit Union Administration
Regulatory Modernization Initiative
2011–2014 Results

NCUA ACTIONS	BENEFITS
IMPROVED RULES	
Modernized Definition of "Small" Credit Unions	• Expanded NCUA's consideration of regulatory exemptions for credit unions with assets of less than $50 million, up from the previous $10 million • Exempted two-thirds of the entire credit union system from NCUA rules on risk-based net worth and interest rate risk management • Eased the compliance requirement for small credit unions to access emergency liquidity • Doubled the number of credit unions eligible for regulatory relief in future NCUA rulemakings
Eased Troubled Debt Restructurings	• Encouraged credit union loan modifications and ended manual reporting • Prevented unnecessary foreclosures • Kept more credit union members in their homes throughout the crisis
Expanded Rural Districts	• Raised potential membership for federal credit unions in rural districts from a hard cap of 200,000 residents to a sliding scale: o 250,000 residents or 3 percent of the state population, whichever is larger • Permitted federal credit unions to serve rural districts and Indian reservations in states experiencing extraordinary population growth, as well as in smaller states
Authorized "Plain Vanilla" Derivatives	• Encouraged qualified federal credit unions to use "plain vanilla" derivatives to reduce risks • Permitted approved federal credit unions to continue mortgage lending while offsetting interest rate risk • Protected the credit union system by providing an extra buffer against potential losses at large credit unions
Approved Treasury Inflation-Protected Securities	• Offered federal credit unions an additional investment backed by the federal government with zero credit risk • Provided returns indexed to inflation rates rather than interest rates
Established Charitable Donation Accounts	• Empowered federal credit unions to safely pool investments designed to benefit national, state, or local charities
Proposed Eliminating Fixed Assets Cap	• Eliminated federal credit unions' 5-percent cap on fixed assets • Empowered federal credit unions to make their own business decisions on purchases of land, buildings, office equipment and technology • Required federal credit unions exceeding the former cap to design a fixed assets management program (rather seeking a regulatory waiver)
Proposed Asset Securitization	• Authorized qualified federal credit unions to securitize their own assets • Offered an additional tool to manage interest rate and liquidity risks

NCUA ACTIONS	BENEFITS
STREAMLINED PROCESSES	
Low-Income Credit Union Designation	• Implemented an "opt-in" process whereby eligible credit unions can simply say "yes" to receive the low-income designation • Nearly doubled the number of low-income designations, reaching more than 2,100 credit unions serving 24 million members • 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
Blanket Waivers	• Released guidance encouraging credit unions to apply for blanket waivers for member business loans meeting certain conditions • Eliminated the requirement for many business owners to pledge personal guarantees against loans with high-value collateral based on sound underwriting principles • Blanket waivers eliminated the need for credit unions to apply for loan-by-loan waivers
Expedited Examinations	• 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 program expanding to $50 million in 2015 • Enables these credit unions to dedicate more resources to serving members
ISSUED LEGAL OPINIONS	
Extended Loan Maturities	• Permitted loan maturities up to 40 years after loan modifications • Significantly reduced monthly payments for borrowers in need
Expanded Vehicle Fleets	• Modernized the definition of "fleet" from two to five vehicles for member business loans • Provided regulatory relief and expanded access to credit for small businesses and startups
Modernized Service Facilities	• Included full-service video tellers in the definition of federal credit union service facilities • Empowered federal credit unions to expand services in underserved areas without necessarily purchasing more brick-and-mortar branches
Changing Charters in Mergers	• Permitted credit unions to change charters to facilitate voluntary mergers • Retained credit union service for members of merging credit unions

APPENDIX II

Examples of Efforts to Scale Regulation and Support Small Credit Unions

Rule/Program	Description
Small Credit Union Definition	• A credit union with less than $50 million in assets is excluded from certain NCUA rules. • NCUA also must consider the specifically consider the potential regulatory burden and alternatives for small credit union in any rulemaking. • NCUA will review the small credit union definition in 2015 and then every three years. The review will keep the definition up-to-date as the system evolves.
Interest Rate Risk	• Credit unions with $50 million or less in assets are excluded.
Liquidity and Contingency Funding	• Credit unions with less than $50 million in assets must maintain a basic written liquidity policy. • Credit unions $50 million and over in assets must establish and document a contingency funding plan. • Credit unions $250 million and over in assets also must establish and document access to at least one contingent federal liquidity source.
Voluntary Liquidations Creditor Notices	• Federal credit unions with less than $1 million in assets are exempt. • Federal credit unions with less than $50 million in assets but more than $1 million in assets are required to place just one creditor notice.
Risk-Based Capital	• Credit unions with less than $50 million in assets are excluded under the existing risk-based net worth rule. The revised proposed risk-based capital rule would exempt credit unions with less than $100 million in assets.
One-on-One Consulting Services	• Credit unions with less than $50 million in assets are eligible to apply for customized consulting from NCUA.
Net Worth Restoration Plans	• Credit unions with less than $10 million in assets must receive NCUA assistance in developing Net Worth Restoration Plans, if requested.
New Credit Union Support	• Federal credit unions with less than $10 million in assets and less than 10 years in operation are eligible for NCUA consulting assistance. • Federal credit unions with less than $10 million in assets must receive NCUA assistance with business plan revisions, if requested.
Generally Accepted Accounting Principles	• Credit unions with assets under $10 million are exempted from complying with the reporting requirements of Generally Accepted Accounting Principles.
Audits	• Credit unions between $10 million to $500 million in assets may choose one of three lower-cost alternatives for their annual financial statement audits: a balance sheet audit, a report on examination of internal control over Call Reporting, or an Audit per the Supervisory Committee Guide.
Truth in Savings Act	• Non-automated credit unions with $2 million or less in assets after subtracting any non-member deposits are exempted from the Truth in Savings Act.
Operating Fees	• Federal credit unions with less than $1 million in assets are exempted from the annual operating fee that funds federal credit union regulation. • Federal credit unions with more than $1 million in assets pay annual operating fees scaled to size.
Small Credit Union Examination Program	• Operationally sound federal credit unions with less than $10 million in assets received streamlined exams averaging 40 hours. • Operationally sound federal credit unions with assets between $10 million and $30 million receive streamlined examinations averaging 65 hours.
Federally Insured, State-Chartered Credit Union Examinations	• Federally insured, state-chartered with less than $250 million in assets are generally not subject to an annual onsite NCUA examination.
Electronic Filing	• To assist in the migration to electronic filing of quarterly Call Reports, NCUA helped manual filers obtain computers and assigned an Economic Development Specialist to work with small credit unions identified as filing manually each quarter.

APPENDIX III

Historical Performance by Asset Class

	Less than $10 million	$10 million to $50 million	$50 million to $100 million	$100 million to $250 million	Over $250 million
2014, Third-Quarter Median					
Loan Growth Rate (annual)	0.49%	1.97%	3.73%	5.65%	9.04%
Asset Growth Rate (annual)	-0.96%	0.99%	1.93%	2.97%	4.06%
Membership Growth Rate (annual)	-1.45%	-0.92%	-0.05%	1.04%	3.08%
Loan-to-Share Ratio	55.38%	55.10%	61.72%	69.21%	74.93%
Net Worth Ratio	14.04%	11.47%	10.66%	10.18%	10.48%
Return on Average Assets Ratio	0.10%	0.26%	0.42%	0.52%	0.76%
Delinquency Ratio	1.26%	0.86%	0.81%	0.77%	0.66%
Non-Interest Expenses-to-Total Assets Ratio	2.64%	2.59%	2.76%	2.76%	2.49%
Full-Time Equivalent Employees	2	7	22	46	148

	Less than $10 million	$10 million to $50 million	$50 million to $100 million	$100 million to $250 million	Over $250 million
5-Year Median					
Loan Growth Rate (annual)	-0.60%	0.32%	1.83%	2.91%	4.85%
Asset Growth Rate (annual)	0.89%	3.25%	4.11%	4.52%	5.55%
Membership Growth Rate (annual)	-1.47%	-0.67%	0.51%	1.23%	2.79%
Loan-to-Share Ratio	55.94%	56.66%	62.74%	68.51%	71.21%
Net Worth Ratio	14.09%	11.43%	10.38%	9.95%	9.91%
Return on Average Assets Ratio	-0.05%	0.17%	0.33%	0.42%	0.67%
Delinquency Ratio	1.78%	1.14%	1.05%	1.01%	0.99%
Non-Interest Expenses-to-Total Assets Ratio	2.86%	2.79%	2.88%	2.88%	2.59%
Full-Time Equivalent Employees	2	7	21	44	138

	Less than $10 million	$10 million to $50 million	$50 million to $100 million	$100 million to $250 million	Over $250 million
10-Year Median					
Loan Growth Rate (annual)	-0.28%	1.84%	3.64%	4.88%	6.42%
Asset Growth Rate (annual)	0.08%	3.07%	4.65%	5.33%	6.60%
Membership Growth Rate (annual)	-1.53%	-0.41%	0.58%	1.27%	2.91%
Loan-to-Share Ratio	64.02%	64.33%	69.04%	73.89%	76.92%
Net Worth Ratio	14.92%	12.35%	11.09%	10.44%	10.37%
Return on Average Assets Ratio	0.16%	0.36%	0.46%	0.51%	0.68%
Delinquency Ratio	2.05%	1.16%	1.04%	0.96%	0.90%
Non-Interest Expenses-to-Total Assets Ratio	2.93%	2.93%	3.00%	3.00%	2.67%
Full-Time Equivalent Employees	2	7	21	43	131