Corporate System Resolution
Corporate Credit Unions
Frequently Asked Questions (FAQs)

1. What does this FAQ cover?

This document covers the background and an overview on how corporates have historically served the credit union community.

2. What are corporate credit unions?

Basically, corporates are credit unions created to serve other credit unions. Corporates serve as depository financial institutions for other institutions. Most of the institutions served by corporates are credit unions that serve consumers. Like consumer credit unions, which are often referred to as “natural-person credit unions,” corporate credit unions are member-owned cooperatives. However, at corporate credit unions, the member-owners are consumer credit unions, not consumers themselves.

Corporate credit unions’ primary purpose is to provide consumer credit unions with correspondent banking services, as well as liquidity and investment services. Correspondent banking services are services that help financial institutions, including credit unions, to process and clear checks, process and settle electronic transactions, and move funds through the financial system. Only depository financial institutions may provide these services

One significant benefit corporates offer their members is serving as an aggregator of funds and data. This means that because of the number of consumer credit unions corporates serve and their economies of scale, corporates are able to provide products and services that many credit unions would be unable to provide on their own, or that would cost more to obtain from other sources. The size and scale corporates create by bringing together funds and data from consumer credit unions also provide the credit union system with purchasing power and greater influence when it comes to interacting with other participants in the financial services sector.

3. How did corporate credit unions get started?

As consumer credit unions were growing in the 1970s, leaders of the credit union industry saw a need: Consumer credit unions needed the ability to transfer funds within the credit union system to address the impact of cyclical changes in loan demand and share growth. A key goal of corporate founders was to provide for a “credit union system” answer to this need for liquidity, rather than relying on the banking industry to fill the void. This is how corporates became the "credit union's credit union."

State credit union leagues were heavily involved in creation of the corporate system. When the process of chartering corporates was fully under way in the 1970s and 1980s, nearly every state formed its own corporate to serve its consumer credit unions. About half of the corporates were originally chartered under the requirements set forth in the Federal Credit Union Act; the other half was chartered under regulations set forth in their individual states. At their peak, there were a total of 46 corporate credit unions. Today, as a result of consolidation among corporates through mergers, their number has declined to 27.

4. How did U.S. Central come into being?

While the creation of statewide corporate credit unions allowed for aggregation of funds and data at the state level, leaders understood that even greater economies of scale could be obtained through a liquidity center at the national level. This is why U.S. Central Federal Credit Union (U.S. Central) was created to become the "corporate credit unions' credit union." U.S. Central serves other corporate credit unions as its members.

Based on this structure built up by corporate credit unions, the current credit union system is referred to as a "three-tiered" system:

- Consumer credit unions are the base of the credit union system.
- They obtain services from their corporate credit unions, which comprise the second tier of the three-tiered system.
- And the third tier is U.S. Central, referred to as a wholesale corporate credit union, providing services to the other corporate credit unions.

5. Do corporates have fields of membership like consumer credit unions?

When federal corporates were first established, they were chartered to serve specific fields of membership, or FOMs. The FOMs primarily consisted of credit unions within a specific state or geographic region. Most state-chartered corporates were chartered with national FOMs, but in practice they limited service to the states in which they were incorporated. In the mid-1990s NCUA permitted federal corporates to expand to national FOMs. The goal was to allow more choice for consumer credit unions on where to obtain their services. However, there was an unintended consequence: The FOM expansion introduced a level of competition in the corporate system that did not previously exist. After the expansion to national FOMs, many consumer credit unions chose to join more than one corporate. Some corporates were better at delivering different services than others, so consumer credit unions shopped the corporate system for the best rates and services.

Consumer credit unions have come to depend heavily on corporate credit unions. Approximately 99 percent of all credit unions have accounts in at least 1 corporate. And 75 percent of consumer credit unions rely on a corporate as their primary settlement agent. This means the corporate system processes transactions from millions of consumers. Approximately 5 million transactions flow through the corporate system every day.

6. How does a corporate credit union work?

A corporate credit union serves its members in several ways that are similar to how a consumer credit union serves its members.

A consumer credit union deposits share funds into a corporate, and the consumer credit union earns dividends on its shares.

The corporate uses the shares to fund loan requests from its member credit unions. The corporate charges a fee for the loans to cover the share dividend expenses, cover operating expenses, and hopefully contribute to building reserves. Corporate shares are also used to fund the settlement of payment services.

Shares on deposit at a corporate usually exceed the loan demands of its member credit unions. The corporate invests these excess funds in the financial market. As with loan income, the corporate uses income on these investments to cover dividend expenses, cover operating expenses, and hopefully have funds left over to build reserves.

Corporates also provide a variety of other services to consumer credit unions. Some of the more complicated services, like payment and investment services, will be discussed in more detail later in a later question. There are also other wholesale services provided by corporates, including (but not limited to) providing coin and currency, business advisory services, and recordkeeping services, for which the corporate charges consumer credit unions a fee. If the corporate can earn sufficient funds from its lending and investment functions, it may use some of those earnings to charge consumer credit unions lower fees for these other services.

7. How does the aggregation of services at a corporate help consumer credit unions?

A significant benefit that corporate credit unions offer their members is the ability to provide services more efficiently and at a lower cost. Rather than each consumer credit union having to invest in the equipment and staff to provide a specific service, the investment can be made at the corporate credit union level and then can be shared with consumer credit unions for a fee. This arrangement avoids duplication of systems and personnel. It also allows for a higher volume of activity at one location. This higher volume of activity results in greater economies of scale, meaning lower costs per transaction. These savings can be passed down to consumer credit unions.

Remember, corporate credit unions are owned primarily by consumer credit unions, which account for most of the corporates' membership. As members of their corporate, consumer credit unions elect their corporate's board of directors. These representatives of consumer credit unions, who serve on their corporate's boards of directors, develop the policies and set their corporate's business goals and objectives. Through the voting process, just like in your credit union, the members decide the direction that their corporate will take.

The corporate credit union system continues to serve the original purpose for which it was founded. It provides consumer credit unions the ability to obtain financial services from a system that shares the same common interests in serving members through a cooperative structure. For the past 40 years, all credit unions have worked together to maintain a system that has met their specific needs for products and services.

8. What are the primary functions of a corporate credit union?

Corporate credit unions provide three primary functions to consumer credit unions. Corporates offer payment systems processing and settlement, serve as a source of liquidity, and provide investment products.

9. What are "payments system services"?

"Payments system services" is a broad term to encompass the many different ways available in the current financial system to transfer money. Rather than moving cash between different parties, payments system services execute financial transactions by using cash substitutes. Cash substitutes include checks, wire transfers, credit cards, and other alternative forms of payment. The use of cash substitutes allows for timely and efficient financial transactions. In today's financial environment of high technology, payments systems are a major service provided by financial institutions.

Some of the common payments system services offered by corporate credit unions to their members include:

Automated Clearing House (commonly known as ACH) transactions have become very routine in today's financial system. Some examples of ACH transactions include the direct deposit of payroll or social security payments into an individual's credit union account. Other examples include automated mortgage and consumer loan payments. These transactions normally occur on an ongoing basis. ACH allows for the electronic transfer of funds and related information among individuals, businesses, and financial institutions. Corporates serve to aggregate ACH information for consumer credit unions so that the final debits or credits to the members' accounts are made appropriately. Without having to rely on the actual movement of cash, the transactions can be done quickly, efficiently, and safely.

Wire transfers are a method of electronically transferring money from one person or institution to another. These transactions are normally a single, one-time event. The movement of funds is done without resorting to an actual movement of cash. As with ACH transactions, wire transfers can be done quickly, efficiently, and safely. Check processing entails the conversion of the check document into the ultimate payment or collection of the actual funds. Many consumer credit unions offer their members checking accounts. Corporate credit unions act to gather the check information, aggregate the information so that the funds can be cleared through the Federal Reserve Bank System, and provide the information to the consumer credit unions so funds can be deducted from the appropriate member's checking account.

Some large corporate credit unions act as a facilitator and intermediary between consumer credit unions and credit card processors. These corporates break out settlement and data files that come from card processors for consumer credit unions. These corporates also facilitate the ordering and processing of new credit cards. While corporates do not issue credit cards directly, they have been able to assist credit unions in negotiating relationships with credit card issuers and processors.

10. Why are payments system services important to consumer credit unions?

There was a time when consumer credit unions only offered their members a share account and basic loan products. But the financial industry has changed. It has grown much more complex. Today consumers expect their financial institution to provide a checking account, a credit card, an ATM card, a debit card, internet banking, and more sophisticated services. To remain relevant and viable in today's very competitive financial market, credit unions have found they must provide the new products and services their members have come to rely on. Some of these services are expensive to offer. They may require hiring of additional staff expertise and investing in equipment. Many consumer credit unions cannot afford the additional expense on their own.

Corporate credit unions have been able to assist consumer credit unions in providing payment services at an affordable cost. Many of the investments in staff expertise and equipment have been made at the corporate level. Consumer credit unions can "piggyback" on the resources of the corporates and do not have to duplicate the resource commitment.

Corporates act as a central point of payment information and serve as the intermediary for their consumer credit unions with the nation's regional Federal Reserve Banks. Consumer credit unions are able to deal directly with their corporate and obtain assistance in maintaining and monitoring the account with the

Federal Reserve. The process can be complicated. Without corporates serving as the intermediary, the Federal Reserve may not be able to provide the level of assistance many small credit unions need.

As a central point, corporates leverage the volume of transactions to negotiate lower "per-transaction" costs for their member credit unions. While some large consumer credit unions may have the transaction volume to negotiate a reasonable "per-transaction" cost with the Federal Reserve, the "per-transaction" cost for a small credit union with low transaction volume would be very high.

Payments systems are probably the most critical service that corporates provide to consumer credit unions. In 2009, the corporate credit union system processed over 2 billion payment systems transactions (ACH, checks, and wires) with a total dollar amount exceeding $2.5 trillion.

11. What do you mean when you say "liquidity"?

Corporate credit unions fulfill the need to move liquidity through the credit union system. Liquidity can be moved as cash or funds. Liquidity demand can be very cyclical. Corporates serve as "absorbers" of liquidity from consumer credit unions during times of low loan demand. When the cycle is reversed, corporates serve as "providers" of liquidity to consumer credit unions as loan demand increases. The availability of funds depends on what is happening at the global, national, and local levels.

The specific composition of an individual credit union's members may also affect its liquidity needs. For example, consumer credit unions whose members are teachers tend to have an inflow of funds during the school year and an outflow of funds during the summer months, when schools are out of session. The corporate credit union system provides a mechanism for moving funds from consumer credit unions that have excess liquidity to consumer credit unions that have a need for additional funds.

For consumer credit unions with excess liquidity, aggregating their funds at the corporate level allows for the ability to access investment products that may be beyond the capabilities of some credit unions. We will discuss this point in more detail when we get to the slide on investments.

For consumer credit unions that have a demand for liquidity, corporates can use their excess funds on deposit to provide loans and lines of credit. Much of consumer credit unions' demand for liquidity is very short-term in nature, often just overnight. The short-term funds are generally used to cover the consumer credit unions' settlement of various payment transactions as we discussed in an earlier question.

While most borrowing by consumer credit unions from corporates is short-term, there is some longer-term borrowing available. Generally, the cost is lower than consumer credit unions can obtain from other borrowing sources, and the collateral requirements at corporates may be somewhat less stringent.

12. Do corporate credit unions fluctuate in size?

Historically, corporate credit unions have been able to shrink and grow in conjunction with the need for funds at the consumer credit union level. When there is a very low demand for loans at the consumer credit union level, some of the excess funds at consumer credit unions flow into corporates. As the demand for loans at consumer credit unions increases, funds flow back out of corporates.

Over the past decade, total assets in corporate credit unions were as low as $53 billion in October 2000 and as high as $129 billion in January 2007. From month to month, assets may fluctuate up and down by billions of dollars.

To meet the ever-changing demand for funds, corporates must generally keep the maturities of assets on the balance sheet very short-term. They must be able to convert the assets to cash very quickly.

13. Are corporates the only source of liquidity for consumer credit unions?

Corporate credit unions are not the only sources of liquidity for consumer credit unions.

Federal Home Loan Banks, or FHLBs, provide low-cost funding to American financial institutions. There are 12 banks that comprise the Federal Home Loan Bank System. Similar to the role that corporate credit unions play for consumer credit unions, FHLBs do not provide loans to individuals, only to financial institutions. The FHLBs are owned by the financial institutions with which they do business. As such, to utilize the FHLBs as a liquidity source, a consumer credit union would need to purchase stock and become a member. The stock subscription is tied to mortgage loans on the consumer credit union's balance sheet, and the consumer credit union would need to have 10 percent of its assets in mortgage loans. Many consumer credit unions do not have such a high level of real estate loans on their balance sheets to allow them to utilize the FHLBs. The primary assets held by the FHLBs are loans secured by real estate mortgages. The current real estate crisis has had an impact on a number of FHLBs, threatening their ongoing ability to pay dividends.

The Federal Reserve Discount Window was established by the Federal Reserve Board of Governors (often referred to as the "Fed") as a means by which financial institutions can borrow funds to meet temporary short-term liquidity needs. The Fed does not want financial institutions relying on the Reserve Banks as a regular source of liquidity. Financial institutions have traditionally been expected to view the Fed as a "lender of last resort" contingency liquidity source. This means they should have other sources of liquidity they can attempt to utilize before coming to the Fed. In addition, borrowing funds through the Federal Reserve's Discount Window requires the posting of highly rated securities as collateral. Based on the types of loans or investments a consumer credit union holds, it may not have adequate collateral to meet the Fed's requirements. The purpose of the Fed Discount Window to meet temporary short-term liquidity needs and the requirement to post highly rated securities as collateral may make this liquidity option incompatible with the needs of many consumer credit unions.

Consumer credit unions may also turn to the banking industry as a source of liquidity. This is a common practice as many consumer credit unions utilize banks as a liquidity provider or a backup liquidity provider. Like the FHLBs and the Fed Discount Window, banks may have collateral requirements that are not compatible with the assets held by some consumer credit unions. Without adequate collateral, consumer credit unions may find it difficult to borrow from a bank. Banks tend to charge commercial loan rates that are generally higher than the rates charged by corporate credit unions. A key goal when creating the corporate credit union system was to allow consumer credit unions to have a funding alternative that was separate from the banking industry. Utilizing banks for borrowing funds was seen as contrary to the goal of a credit union system solution to liquidity.

14. How does the corporate investment service work?

Consumer credit unions put excess funds that are not loaned out to members into investments. This is done so the funds do not lie idle, earning zero interest. Instead, excess funds are invested, so that they generate some income when they are not needed to satisfy members' loan demand. Corporate credit unions do the same with funds that are not needed for consumer credit unions' borrowing needs. Placing excess funds in investments allows the corporate (and in turn the consumer credit union) to earn income to pay dividends and cover operating expenses even in times of low loan demand.

We noted earlier that corporate credit unions are liquidity providers. As such, corporates have historically made investments that can either be easily sold in the market, or can be used as collateral for borrowings. In the event of an increase in loan demand at the consumer credit union level, corporates have traditionally been able to sell their investments, or obtain loans using the investments as collateral. That investment strategy enabled corporates to earn an adequate level of income yet remain flexible to satisfy the need for funds in a timely manner.

Corporates also offer investment products to their members. Many consumer credit unions do not have the ability to employ investment experts or do not have the dollar volume to invest in many market offerings, due to the fact that many market offerings have large minimum offering sizes. As with the payment services function, corporates maintain the equipment and expertise, which saves consumer credit unions from having to acquire those resources on their own. By aggregating their investable funds at corporates, consumer credit unions were able to utilize the corporate system as an intermediary with the financial markets.

Let's consider a simple example. Suppose there is an offering in the financial market with a one-year maturity that can only be purchased in $1 million blocks. The investment pays a much better rate than a one-year offering being sold in $100,000 blocks. There are 10 consumer credit unions that can afford to invest only $100,000. A corporate credit union buys the $1 million investment block. The 10 consumer credit unions each invest $100,000 in a one-year certificate in the corporate. The corporate pays a rate slightly below what the investment earns in order to cover its expenses. While the 10 consumer credit unions don't get the benefit of the full rate being paid on the $1 million investment, they get a better rate than if they bought the $100,000 investment without going through the corporate. They also don't have the added expense that may go along with having the business structure to analyze and monitor the investment.

Historically, over 90 percent of corporate credit union assets were held in investments. Under normal market conditions, most of these investments were liquid and could be easily converted into cash. The income earned on these investments was often used to subsidize the expenses related to member fees. This was another reason why consumer credit unions have been able to obtain services at lower cost through their corporate than at other service providers.

15. Did the corporates have adequate capital?

A corporates member-owners, consumer credit unions have the ultimate control of the corporates. Through the election process for the board of directors, consumer credit unions establish the business strategy of their corporate. The board of directors and management of the corporate need to govern the institution within the requirements set forth in Part 704 of NCUA's Rules and Regulations. Both federally chartered corporates and state-chartered corporates are required to comply with Part 704. Two areas of the corporate regulation that will be of significance in later discussions of regulatory reform are the investment authorities and the capital requirements.

By regulation, corporate credit unions are restricted to investing in only the most highly rated investment products, which are typically referred to as triple-A and double-A rated products. Historically, highly rated investments incurred almost no losses. Corporates frequently used their investments as collateral to borrow funds to meet liquidity needs. Because they were limited to purchasing only highly rated investments, under normal market conditions they had little difficulty using their investments as collateral. The market issues that arose from the current economic crisis are unprecedented.

The capital requirements for corporate credit unions are also set forth by regulation. Corporates have historically had low levels of capital, because the regulations limited investments to those which were typically safer. The less risk in the investments, the lower the income that corporates generated to build capital. Additionally, the credit union philosophy to pass as much income as possible back to the member-owners was applied to the corporate credit unions as well. Because of this, capital did not grow as fast as corporate credit union assets did over the past 40 years.

NCUA recognized the need for stronger capital in corporates and made regulatory changes over the years in efforts to build corporate capital. In the 1990s, paid-in capital (PIC) and membership capital (MC) were introduced in the regulation as a means for consumer credit unions to assist in building the capital of their corporates. PIC and MCs are accounts held by the member-owners. They are available to absorb losses in corporates if those losses exceed retained earnings. Under the regulation, corporates were required to disclose that PIC and MCs were at risk. Despite these disclosures, there has been some confusion that PIC and MCs were available to cover losses at the corporates. By definition, absorbing losses is a key function of capital.