America's Credit Unions

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The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Tim Scott
Ranking Member
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

Re: Today's Hearing: "Oversight of U.S. Financial Regulators: Accountability and Financial Stability"

Dear Chairman Brown and Ranking Member Scott:

On behalf of America's Credit Unions, I am writing regarding today's hearing entitled "Oversight of U.S. Financial Regulators: Accountability and Financial Stability" to share our thoughts on issues regarding the National Credit Union Administration (NCUA) and the submitted testimony of NCUA Chairman Todd Harper as they pertain to credit unions. America's Credit Unions is the voice of consumers' best option for financial services: credit unions. We advocate for policies that allow the industry to effectively meet the needs of their nearly 141 million members nationwide.

Chairman Harper has missed an opportunity to tell policymakers all the good work that credit unions are doing and instead is creating such an overregulation of the industry that we will not have any credit unions left if we remain on this path. In his written testimony, Chairman Harper acknowledges the strength of the credit union industry, and that both the industry and its insurance fund are well run and well capitalized. However, he then highlights his desire for Congress to enact a number of statutory changes that will increase costs and regulatory burdens for credit unions.

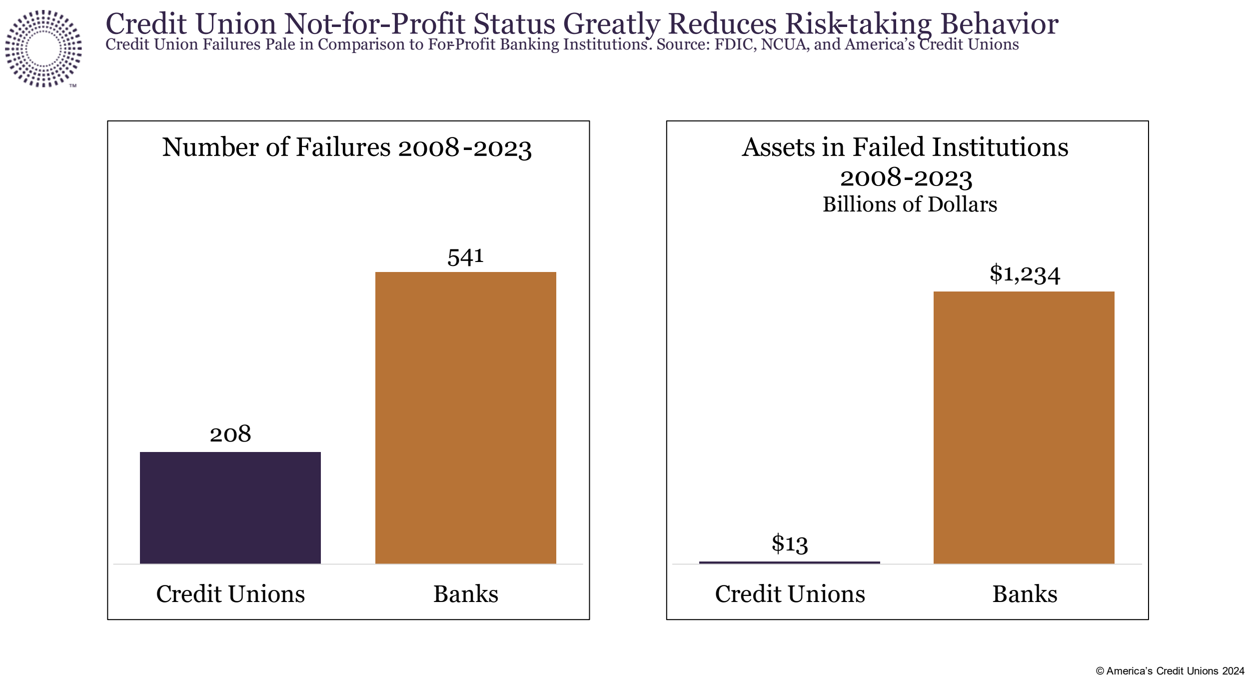
The credit union industry remains a strong, well capitalized, and safe place for consumers. As not-for-profit, member-owned cooperatives, credit unions focus on serving their members, not chasing profits. Below you will find several instances where the recommendations in Chairman Harper's testimony are missing the full story, lacking statistical support, or simply detrimental to the overall credit union industry.

The Share Insurance Fund Is Strong and Structural Reform Is Not Needed

Unlike the banking system where roughly 50 percent of deposits were uninsured by the Federal Deposit Insurance Corporation (FDIC) before the failures last year, over 90 percent of credit union deposits are insured by the NCUA and its National Credit Union Share Insurance Fund

(NCUSIF). That number is even higher when private and supplemental insurance offerings are taken into account.

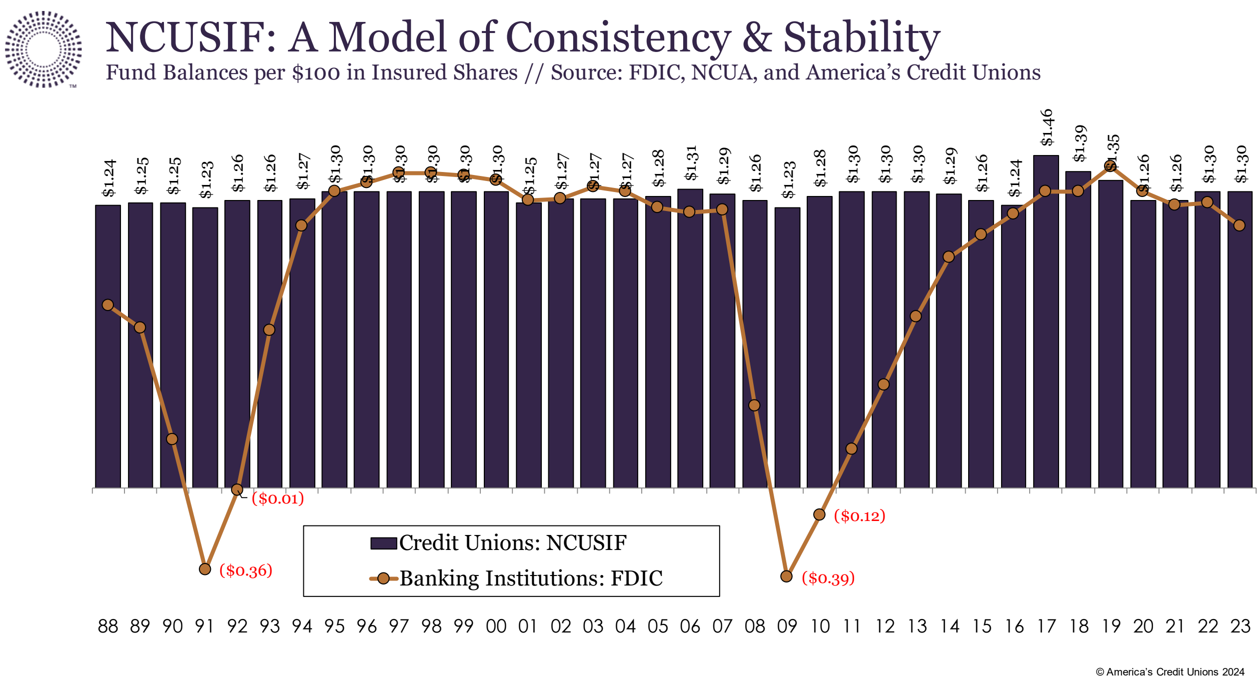
The high-profile failures in the banking sector last year sparked discussion of the issue of deposit insurance reform. As was the case in the 2008 Financial Crisis, credit unions did not engage in behavior that led to the crisis but were impacted from the downstream effects of institutional and market disruptions. Yet, once again, they successfully weathered the storm. As outlined in the chart below, credit unions' not-for-profit nature reduces their risk-taking behavior, helping mitigate impacts of downturns.



America's credit unions are well capitalized with a 10.93 percent net worth-to-asset ratio and a 9.1 percent equity capital ratio. The loan-to-savings ratio stands at 85.4 percent. The liquidity ratio (the ratio of surplus funds maturing in less than one year to borrowings plus other liabilities) was 15.7 percent in March of 2024, up from 12.9 percent in March 2023. These statistics indicate that credit unions are healthy and stable.

As such, we were disappointed to see the NCUA once again ask for expanded ability to charge credit unions premiums and change a system that has proven to be resilient over the last half century. The equity ratio of the NCUSIF stands at 1.30 percent as of as of year-end 2023, even higher than Chairman Harper predicted in his testimony last fall. While this is below the target Normal Operating Level (NOL) of 1.33 percent, it is above the 1.20 percent threshold that would require the Board to institute a formal Fund restoration plan.

In his written testimony, Chairman Harper repeats his call for Congress to specifically change the Federal Credit Union (FCU) Act to remove the 1.50 percent statutory ceiling on the Fund's capitalization and permit premium assessments when the Fund's equity ratio exceeds 1.30 percent. We strongly disagree with each of these suggested amendments, as we believe such drastic changes are unnecessary given the reliability, consistency, and strength of the NCUSIF over the years, as outlined in the chart below.



Expanded Third-Party Vendor/Credit Union Service Organization Authority Is Not Needed

Over the past several years, the NCUA Board has continued to push for Congressional amendments to the FCU Act to provide the agency with direct supervisory authority over third-party vendors (TPVs) and credit union service organizations (CUSOs).

We strongly disagree with the need for an unlimited grant of such authority. The NCUA has effectively managed risks associated with TPVs/CUSOs within the agency's current regulatory authority. Credit unions are required to perform due diligence on their TPV/CUSO relationships, and this due diligence is already subject to supervision by the NCUA. The NCUA also has the authority to review the books and records of CUSOs. Should the NCUA be granted examination authority over TPVs/CUSOs, we are concerned that a significant increase in the agency's budget will be required to obtain and train qualified, experienced examiners. As credit unions fund the NCUA budget, any increase will come from credit unions and put additional pressure on their ability to serve members.

Instead of this authority, America's Credit Unions supports interagency coordination to mitigate vulnerabilities to the financial system. We believe it is unnecessary for the NCUA to have a duplicative program that has the potential to drastically increase costs for credit unions. Congress should encourage the NCUA to use the Federal Financial Institution Examination Council (FFIEC) to access information on companies, including large technology service providers, that have already been examined by other regulators, and if the other regulators do not comply, Congress should consider compelling them to share this exam information directly with the NCUA. At this time, it is unclear if replicating the existing supervisory authorities of other federal banking regulators will reduce the exploitation of third-party vulnerabilities. Furthermore, the Cybersecurity and Infrastructure Security Agency (CISA) has issued a proposal to compel extensive cyber incident reporting across all critical infrastructure sectors, including the financial sector and credit unions. We believe focusing attention on improving information sharing with the other FFIEC agencies and CISA would adequately address NCUA concerns. As such, we oppose legislative changes to expand NCUA authority over TPVs/CUSOs.

NCUA's Budget

The NCUA is funded by regulated credit unions and their members, not by taxpayers. Credit unions and their members remain willing to pay for their own regulator provided there is sufficient transparency, including with regard to the agency's budget. For the last several years, even before it was statutorily required to do so, the NCUA has held an annual hearing on its budget, and as a result, the agency's budget transparency has improved.

Unfortunately, the NCUA's budget continues to increase despite industry consolidation, and the agency's 2024 budget once again overlooked opportunities to incorporate more efficient processes with potential cost-savings. In fact, the 2024 budget is an increase of 7 percent over 2023, and the 2025 budget is tentatively set to include a 12.3 percent increase over 2024. In contrast, the average annual budget growth in the eight years prior to 2020 was a much more restrained 3.8 percent.

Continuing this trajectory of substantially increased budgets is unsustainable and will have serious consequences for the credit unions that fund the NCUA and their ability to serve their members. We urge the NCUA to restrain its spending going forward and look for cost-savings wherever possible. If the agency does not, Congress must use its oversight authority to demand further justification for such increases.

We have recommended that the NCUA continue to focus on implementing lessons learned from the pandemic and not ignore the achievements that have been made towards cost-savings. We recommend that the NCUA embrace the importance of cost-efficiency and prudent financial management by refraining from hiring additional, unnecessary staff, which unfortunately was not the case this year.

As the agency works on its 2025-2026 budgets, we reiterate our previous recommendations as guiding principles:

1. Preserve the strength of the NCUSIF without overburdening credit unions with exorbitant Operating Fees and return surplus cash from the Operating Fund to credit unions;
2. Continue to prioritize offsite examination activities, revise the threshold for extended examination cycles to achieve further efficiencies, and provide greater transparency for expenses related to the Modern Examination and Risk Identification Tool;
3. Refrain from hiring even more specialized examiners that are not justified by a measurable industry need; and
4. Adopt a more transparent and accountable methodology for tracking and evaluating the efficacy of cybersecurity and IT-related expenses.

FCU Act Modernization

As the Committee examines the current regulatory environment for credit unions, we would like to flag a few areas where the FCU Act needs modernization. We were pleased to see quick action in the House on H.R. 582, the Credit Union Board Modernization Act, earlier this Congress. Another area of the FCU Act in need of modernization is investment authorities. Federal credit unions are more limited than other types of institutions and even state-chartered credit unions as to where they can invest their funds to earn a return. An increase in deposits on hand during the pandemic, combined with a limited ability to earn a return, presents a series of challenges for FCUs, especially in terms of liquidity. Although the NCUA has some authority to adjust investment options, it is relatively limited in what it can do to offer more investments absent amendments to the FCU Act. We encourage you to consider legislative action on these issues and to allow the NCUA to provide a broader set of investment options for FCUs.

An important aspect of modernizing the regulatory environment for credit unions is modernizing lending provisions in the FCU Act. Credit unions proved their importance as a source of credit to small businesses during the pandemic. In many cases credit unions were the only source of Paycheck Protection Program loans for small businesses after they had been turned away by banks. Credit unions would like to continue to provide credit to businesses in their communities; however, they are constrained by the member business lending (MBL) cap in the FCU Act. This provision caps the total amount a credit union can lend to businesses at 12.25 percent of deposits, with loans under a de minimis threshold of $50,000 not counting towards that cap. With the current inflationary environment, this de minimis threshold is out of date and should be increased to allow credit unions to continue to aid businesses in their communities. H.R. 4868, the Member Business Loan Expansion Act, and S. 539, the Veterans Member Business Loan Act, are bipartisan bills which would help provide relief from the MBL cap.

In addition to providing relief from the MBL cap, we urge the Committee to consider legislation expanding the loan maturity limit in the FCU Act. Currently, credit unions are constrained to commercial loans with a maturity limit of 15 years. We would support legislation to increase this limit, such as H.R. 6933, the Expanding Access to Lending Options Act.

Extended Examination Cycle

Efforts to extend the examination cycle for certain credit unions have proven positive, particularly for credit unions for which a 12-month cycle was clearly unnecessary. Since banks are provided an extended examination cycle, credit unions are now at a comparative disadvantage. Section 210 of the Economic Growth, Regulatory Relief, and Consumer Protection Act made qualifying banks with up to $3 billion in assets eligible for an 18-month onsite exam cycle. The NCUA already had authority in this area, and thus was not included in this section. However, the agency has failed to fully act on its existing authority. As a consequence, banks now have greater exam flexibility despite credit unions generally having less complex balance sheets.

The NCUA should reconsider its own exam cycle eligibility policy to align with the changes adopted by the other banking agencies. To better achieve the NCUA's goal of reducing burdens on credit unions during the exam process, future exams should be deployed on an 18-month or longer extended cycle for all low-risk, well-run credit unions under $3 billion in assets, in line with the flexibility currently in place for banks.

Central Liquidity Facility (CLF) Enhancements

We do support NCUA's call to enhance the CLF by, among other things, allowing corporate credit unions to act as agents for smaller (under $250 million in assets), non-CLF member credit unions. Amending the FCU Act to implement this change would be an invaluable and necessary lifeline for smaller credit unions, most of which are not CLF members. As some banks face liquidity problems in these turbulent times, Congress should act now on this provision in the event that a wider crisis develops that might impact the liquidity of America's credit unions.

Operational Issues

The CLF is intended to improve general financial stability by meeting the liquidity needs of credit unions. Per the FCU Act, and the NCUA's regulations, "liquidity needs" covers a range of needs, including short-term credit, seasonal credit, and protracted credit needed for unusual or emergency circumstances. While we understand the CLF is intended to be a backup source of liquidity, we believe it could be utilized by more credit unions with greater frequency if the process to access liquidity (*i.e.*, membership application and request of an advance) were more streamlined and responses to requests were timelier. Understanding there are statutory provisions that limit the agency's ability to modify certain aspects of the CLF (*e.g.*, capital stock subscription requirement), the NCUA should review Part 725 of its regulations to assess where it can streamline and improve the process overall.

Credit unions often point to the Federal Reserve's Discount Window as an easier/quicker way to access liquidity. Again, the FCU Act includes certain constraints related to the extension of credit not applicable to the Discount Window, such as that there must be a valid liquidity need and the credit union must be creditworthy. However, the NCUA can improve certain aspects of the process of receiving funds from the CLF, such as the timing involved. When a credit union experiences an unexpected need for liquidity, time is of the essence. The FCU Act requires the NCUA to approve or deny an application within five working days. Five, or even up to eight days depending on weekends and holidays, can be a prohibitively long period to learn whether a funding request has been approved. This delay can force credit unions to instead pursue other liquidity sources, particularly when sources such as the Discount Window can provide a credit union with same-day liquidity. As such, we ask the NCUA to consider—consistent with the FCU Act—shortening the five-day window provided in Part 725 to two days.

Digital Assets and Emerging Technologies

The NCUA should issue guidance allowing credit unions to offer digital asset custodial services or wallets to credit union members. This authority for credit unions to offer cryptocurrency services directly to their members is necessary to maintain parity and remain competitive with other financial institutions and fintechs. Additionally, the NCUA should work with lawmakers who are writing policy in this area to ensure that whatever laws are enacted put credit unions on equal footing with other financial institutions.

Further, the NCUA should add digital asset related services to the list of preapproved permissible activities of CUSOs to allow them to provide cryptocurrency related services, such as facilitating a member's buying, holding, selling, transferring, and exchanging of digital assets.

Additionally, we encourage the NCUA to adopt a form-agnostic approach to assessing credit unions' adoption of digital assets and related technologies and to develop a digital asset adoption sandbox or pilot program in which credit unions and the NCUA may prudently explore more novel digital asset use cases without significant compliance risks. The NCUA's new Office of Financial Technology and Access should quickly establish a transparent program to offer solutions to credit unions seeking to experiment with the implementation of new technologies to streamline and improve their processes and procedures. These sandboxes and tech sprints should be available not only in the adoption of digital assets but also more broadly to other emerging technologies.

The NCUA, as a member of the Financial Stability Oversight Council (FSOC), needs to engage with FSOC members, the President's Working Group, and other interagency working groups on digital assets to ensure the interests of credit unions are strongly represented. It is imperative that the NCUA, and the credit unions it supervises, have a seat at the table when it comes to developing a regulatory framework for the use of digital assets and other emerging technologies.

The Federal Reserve and Regulation II

We want to express that we strongly oppose the Federal Reserve Board's recent proposed rule to drastically reduce the Regulation II debit interchange fee cap. America's Credit Unions and other financial trade associations wrote to the Board in advance of its October 25, 2023, meeting to request additional documentation be made available to the public ahead of the meeting, noting concern that the Board has not collected and published comprehensive and current data about the costs of Regulation II on regulated entities. Additionally, the impact of the Board's recent Regulation II rulemaking to require issuers to offer two unaffiliated card networks for card not present transactions is undetermined at this time and must be thoroughly evaluated before proceeding with this rulemaking. It is insufficient to review the Board's biennial survey of large debit card issuers to assess the impact of the new routing requirements because that data, from 2021, was collected well before the rule was finalized in 2022, let alone became effective in July of 2023.

We echo Governor Bowman's concerns raised at the Board's October 25 meeting regarding the unfair nature of this proposal and the Board's reluctance to consider the impacts that such a drastic reduction could have on smaller issuers, including community-based financial institutions like credit unions. The biggest impact is likely to be on low- and moderate-income (LMI) individuals and families, as this reduced interchange fee cap could lead to higher borrowing costs and limited availability or complete discontinuation of certain products and services that are designed to help these LMI borrowers and their families. The adoption of Regulation II in 2011 significantly decreased the availability of free checking and increased other fees and costs by financial institutions to make up for lost revenue. The proposed cut to the cap will once again force financial institutions to make up for this lost revenue in other areas. This impact is acute for credit unions as not-for-profit cooperatives that do not have the same opportunities to raise capital as banks.

The Board asserts that consumers will likely benefit from cost savings passed through by merchants as a result of lower prices. The Federal Reserve's own research shows that only about one percent of merchants passed their savings onto consumers through reduced prices following the adoption of the Durbin Amendment, and in fact, over 20 percent of merchants increased their prices. This behavior will not change with further cuts. Most importantly, it is not just covered issuers that would feel the impacts of this proposal, but rather all financial institutions would face pricing pressures and be forced to make difficult decisions that could negatively impact the communities they serve.

Conclusion

Finally, it is important that the Committee understand the immense pressure credit unions—large and small—are under in terms of compliance and operational challenges. This is evident by the ongoing consolidation within the industry, which will only be accelerated by ongoing regulatory attacks on fee income such as recent actions on overdraft protection programs, credit card late fees, and the proposed Regulation II changes. Combined, these ultimately pose a long-term threat to the viability of credit unions. As such, we urge the NCUA Board to appreciate the risks to the industry and take appropriate action to ensure its ongoing viability.

Unlike other sectors of the financial services industry, credit unions embody the collaborative, *people helping people* philosophy. We urge this Committee and regulators to work with the credit union industry to pursue an approach, both legislatively and regulatorily, aimed at ensuring credit unions can continue to serve millions of consumers across the country.

On behalf of America's credit unions and their nearly 141 million members, thank you for holding this important hearing. It is unfortunate that Chairman Harper could not appear in person, but we wish him a speedy recovery. We look forward to him appearing before the Committee when he returns to work. Thank you for the opportunity to share our thoughts.

Sincerely,

Jim Nussle, CUDE
President & CEO

cc: Members of the Committee on Banking, Housing, and Urban Affairs