

**NCUA BOARD RESPONSE TO QUESTIONS FROM
THE SUBCOMMITTEE ON FINANCIAL
INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON BANKING AND FINANCIAL SERVICES
US HOUSE OF REPRESENTATIVES
FEBRUARY 1, 1999**

1. Please state how many applications to add new groups to existing credit unions the NCUA has received and acted upon between December 15, 1998, and January 31, 1999. Please provide data regarding the number of applications processed by each region and the average time spent by the regions reviewing and processing such applications. Please breakdown the applications based on the size of the groups being added with break points at 200, 500, 1000, 1500 and 2000.

The effective date for IRPS 99-1 was January 1, 1999. NCUA approved the first select group expansion on January 3, 1999.

The following table lists credit union expansions under IRPS 99-1 between January 4 and January 29, 1999.

REGION	I	II	III	IV	V	VI	TOTAL
Number of Credit Unions	37	45	132	41	53	30	338
Total Groups Approved	148	124	341	132	138	95	978
200 or less	137	121	322	115	130	83	908
201-500	8	2	17	12	5	10	54
501-1000	2	0	2	2	2	2	10
1001-1500	1	0	0	1	1	0	3
1501-2000	0	0	0	1	0	0	1
2001-3000	0	1	0	1	0	0	2
over 3000*	0	0	0	0	0	0	0
Potential New Members	12,615	9,376	21,239	13,380	10,975	8,554	76,139 average: 78 per group
Total Deferrals	17	37	41	3	114	5	217
Applications Denied	0	6	9	0	3	0	18
Largest Group Approved	1,115	2,539	727	2,239	1,100	750	

*NCUA has approved no expansions for groups of over 3,000. Only one credit union applied to add a group of more than 3,000 members, and this request was denied.

Average Processing Time

The estimated average time spent processing applications varied widely, depending on the size of the group and the credit union's submission. Each Region's average reported time is listed below.

Region I	60 minutes
Region II	60 minutes
Region III	120 minutes
Region IV	186.6 minutes (range of 173.4 to 420 minutes)
Region V	92.2 minutes (range of 90 to 180 minutes)
Region VI	76.8 minutes (range of 73.5 to 90 minutes)

2. Please discuss how the NCUA is carrying out its statutory duty to encourage the formation of new separately chartered federal credit unions and how this duty is integrated into the processing of applications to add a group to a credit union's field of membership.

NCUA's statutory duty to encourage the formation of new charters is stated as the first goal in the Chartering Manual. In NCUA's training of regional staff, it has been emphasized that NCUA must fulfill its duty to encourage the formation of new charters. Most importantly, regional staff have been provided written and oral guidance on how to determine if the group can become a separately chartered credit union. Regardless of the size of the occupational or associational group, NCUA must ascertain whether the group can or cannot form its own credit union. For example, the same economic advisability criteria apply whether the group has a primary potential membership of 5,000 or 2,000. NCUA, therefore, has the responsibility to determine if the group, regardless of size, has a reasonable opportunity to succeed. We note, however, that historical experience and other chartering data have been analyzed, and the NCUA Board has determined that groups of 200 or less do not possess a reasonable opportunity to succeed.

Congress specified that those groups with over 3,000 members should form their own credit union, but it also recognized that there may be exceptions to this general policy. Accordingly, NCUA must make an economic advisability determination to see if the exceptions apply. Congress further specified that groups of 3,000 or fewer members are eligible to be added to a multiple common bond credit union if the statutory criteria are satisfied, including the inability to form their own credit union. Likewise, as with groups over 3,000 members, NCUA must make an economic advisability determination. In either instance, the determination must balance the Congressional requirement to encourage the formation of new credit unions with the responsibility to assure that the

policies relative to the formation of new credit unions do not conflict with reasonable operational safety and soundness standards necessary to protect the National Credit Unions Share Insurance Fund ("NCUSIF"). The chartering and field of membership polices reflect these requirements.

The procedural requirements for adding a group to an existing credit union do not solely rely on the assertion of the group that it cannot form its own credit union. Although the desire of the group is a key factor to be considered, the chartering manual requires NCUA to independently evaluate whether the group can form its own credit union. When NCUA reviews an application to add a new group with over 200 primary potential members to a credit union's field of membership, NCUA must determine whether the group can form its own credit union consistent with reasonable standards for the safe and sound operation of a credit union. If NCUA determines that the group can form a credit union consistent with reasonable standards for safety and soundness, NCUA will encourage the group to form its own credit union.

However, if the group does not meet the standards for safety and soundness necessary to exist as a separate charter, NCUA will add the group to an existing applicant credit union, assuming all other statutory and regulatory criteria have been met. If the group is in excess of 3,000 primary potential members, NCUA presumes, as set forth in the statute, that it can form its own credit union and will encourage the group to seek a separate charter provided the group is economically advisable. If this same group does not desire to form its own credit union, NCUA will not allow the group to join an existing multiple group credit union unless the statutory and regulatory exceptions apply.

3. The CUMAA prohibits the NCUA from allowing a group of 3,000 members or more to be added to an existing credit union unless narrow exceptions are met. The NCUA's final rule provides that as a general matter groups with fewer than 3,000 members may not be economically advisable to form a new credit union. NCUA policy on economic advisability prior to the enactment of CUMAA had been that groups should have at least 500 members. Please discuss why the economic advisability level was changed and how the change is consistent with Congressional intent, and the duty of the NCUA, to encourage the formation of new credit unions.

The 3,000 primary potential member threshold number is consistent with congressional intent as well as NCUA experience and is not intended to undermine the statutory requirement to encourage the formation of new credit unions. Rather, it was established to provide potential new charters necessary advice and guidance to charter a successful credit union. Any group desiring to form its own credit union will be given every opportunity to demonstrate it has met the economic advisability requirements. Additionally, any group not desiring to charter its own credit union, but wanting to be added to another credit union, will be reviewed to determine if in fact it can be separately chartered. At no time has NCUA indicated that groups of less than 3,000 members will not meet the economic advisability requirements. Based on historical

experience, the NCUA Board determined that “groups with fewer than 3,000 members may not be economically advisable.” (Emphasis added.)

IRPS 94-1 established the economic advisability threshold as 500 primary potential members. Notwithstanding this threshold number of 500, NCUA staff opinion has long been that the 500 primary potential members threshold was extremely low, particularly in view of the fact that only approximately one-third of the primary potential members join. Accordingly, there were numerous recommendations that the 500 threshold number should be increased.

Since 1994, NCUA has chartered 45 new federal credit unions. Eight of these new charters had a primary potential membership that was less than 3,000. However, the average primary potential membership of these 45 credit unions was 37,470, a number which obviously far exceeds 3,000. While there are many factors impacting why the number of new charters since 1994 is low, experience has indicated that one critical factor is the financial service expectation of the potential members. That is, what type of financial service will the new credit union provide? If the financial service is limited, then it will not meet the members’ financial service expectations and, as a result, the credit union will not be fully supported. The analysis of whether a new group can form a new credit union must take the members reasonable expectations into consideration. Failure to do so would put the NCUSIF at risk.

The Board’s view is that the 3,000 primary potential membership threshold is an economically advisable number for potential new charters, but not an absolute requirement. This distinction is important. For example, there are approximately 3,100 federal credit unions with primary potential members of less than 3,000. Approximately 700 of those have primary potential members of 500 or less. For the most part, however, at the time of their charter, economic conditions and the financial service expectations of the credit union members were different. In fact, 2,980 of these credit unions were chartered prior to 1982. In other words, there has been a dramatic decline in the number of new charters since credit unions were allowed to add groups to their field of memberships. Due to these different economic expectations, as well as the pre 1982 regulatory environment, credit unions became established and developed a loyalty base under marketplace expectations that significantly differ from those of today. The Board, therefore, considered the evolving nature of the financial marketplace and determined that a lower threshold number which worked in the past was no longer reasonable in light of the vastly different financial marketplace of today.

The Board believes it has reasonably implemented the intent of Congress that every group being added to a multiple common bond credit union should be analyzed to determine whether it has the capability and desire to support an independent operation. This requirement, however, must be balanced with operational feasibility. To overlook the complexities of providing financial services will only lead to additional supervisory problems. The regulatory approach to determine the economic viability of a new charter must incorporate known economic factors and the likelihood of success in

establishing and managing a new credit union in today's marketplace. To this end, the Board's intent is that a group desiring a separate charter should have every reasonable opportunity to form a new credit union. As stated earlier, the 3,000 primary potential member threshold is not an absolute. There are numerous examples where smaller groups can and should have a separate credit union. For example, faith based credit unions may be uniquely positioned to operate separate economically viable credit unions. However, NCUA experience has shown that the smaller the group, the more difficult it is to form an economically viable credit union. Consistent with its long-standing practice, NCUA must closely examine the economic viability of a group to determine whether such a group could support a financially sound credit union.

The Board believes it must not only encourage new charters, but also ensure to the fullest extent possible that those groups receiving a separate charter will have a reasonable basis for success and thereby avoid unnecessary risks to the NCUSIF. Accordingly, the field of membership rules on economic advisability reflect known economic factors and the potential risks to the NCUSIF. It is essential, therefore, that the approval process incorporate the necessary regulatory analysis to make these determinations. This is an economically and operationally sound approach to chartering new credit unions.

In order to effectively achieve Congressional intent, that is, provide a regulatory environment in which American consumers have access to credit union services, the Board established rules that were not unnecessarily burdensome. The Board adopted the 3,000 primary potential member threshold factor, which recognizes that newly chartered credit unions in today's financial marketplace have unique challenges. Those groups that can or should be able to meet those challenges, regardless of size, will be required to form a separate credit union unless they meet the common bond requirements. As the legislation directs, the Board will encourage the formation of separately chartered credit unions if it is prudent and economically advisable. Important factors in making this determination, however, are the desire and intent of the group and the sponsor support. In other words, to ignore the group's administrative capability may lead to unnecessary supervisory problems in the future.

While the intent of the group and sponsor support cannot be ignored and will carry great weight, they are not the sole factors in the determination. The final decision must be based on an independent regulatory analysis in consideration of the remaining factors specified in the regulation. In this regard, written guidance has been issued to the Regional Directors concerning the economic advisability criteria. Regional staff will consider the following factors when determining economic advisability:

- Member location – whether the membership is widely dispersed or concentrated in a central location.

- Demographics – the employee turnover rate, economic status of the group's members, and the nature of the group in terms of potential savers and/or potential borrowers.
- Market competition – the availability of other financial services.
- Desired services and products – the type of services the group desires in comparison to the type of services a new credit union could offer.
- Sponsor subsidies – the availability of operating subsidies.
- Employee interest – the extent of the employees' interest in obtaining a credit union charter.
- Evidence of past failure – whether the group previously had its own credit union or previously filed for a credit union charter.
- Administrative capacity to provide services--will the group have the management expertise to provide the services requested.

4. Please discuss how the NCUA encourages the formation of new, separately chartered credit unions for groups with less than 3,000 members.

NCUA's statutory duty to encourage the formation of new charters is stated as the first Chartering Manual. In NCUA's training of regional staff, it has been emphasized that NCUA must fulfill its duty to encourage the formation of new charters. Most importantly, regional staff have been provided written and oral guidance on how to determine if the group can become a separately chartered credit union. Regardless of the size of the occupational or associational group, NCUA must ascertain whether the group can or cannot form its own credit union. For example, the same economic advisability criteria apply whether the group has a primary potential membership of 5,000 or 2,000. NCUA, therefore, has the responsibility to determine if the group, regardless of size, has a reasonable opportunity to succeed. We note, however, that historical experience and other chartering data have been analyzed, and the NCUA Board has determined that groups of 200 or less do not possess a reasonable opportunity to succeed.

Congress specified that those groups with over 3,000 members should form their own credit union, but it also recognized that there may be exceptions to this general policy. Accordingly, NCUA must make an economic advisability determination to see if the exceptions apply. Congress further specified that groups of 3,000 or fewer members are eligible to be added to a multiple common bond credit union if the statutory criteria are satisfied, including the inability to form their own credit union. Likewise, as with groups over 3,000 members, NCUA must make an economic advisability determination. In either instance, the determination must balance the Congressional requirement to encourage the formation of new credit unions with the responsibility to assure that the

policies relative to the formation of new credit unions do not conflict with reasonable operational safety and soundness standards necessary to protect the National Credit Unions Share Insurance Fund ("NCUSIF"). The chartering and field of membership policies reflect these requirements.

The procedural requirements for adding a group to an existing credit union do not solely rely on the assertion of the group that it cannot form its own credit union. Although the desire of the group is a key factor to be considered, the chartering manual requires NCUA to independently evaluate whether the group can form its own credit union. When NCUA reviews an application to add a new group with over 200 primary potential members to a credit union's field of membership, NCUA must determine whether the group can form its own credit union consistent with reasonable standards for the safe and sound operation of a credit union. If NCUA determines that the group can form a credit union consistent with reasonable standards for safety and soundness, NCUA will encourage the group to form its own credit union.

However, if the group does not meet the standards for safety and soundness necessary to exist as a separate charter, NCUA will add the group to an existing applicant credit union, assuming all other statutory and regulatory criteria have been met. If the group is in excess of 3,000 primary potential members, NCUA presumes, as set forth in the statute, that it can form its own credit union and will encourage the group to seek a separate charter provided the group is economically advisable. If this same group does not desire to form its own credit union, NCUA will not allow the group to join an existing multiple group credit union unless the statutory and regulatory exceptions apply.

When NCUA receives a request from a group on how to form a credit union, staff provides necessary information and guidance to the group and, when appropriate, refers the group to the state credit union league or other officials closely associated with the chartering of new credit unions. Frequently, staff will make an on-site contact with the group to further explore the possibility of chartering a new credit union. Additionally, the NCUA regional offices developed formal programs to assist small credit unions and encourage the formation of new credit unions. NCUA has an office of Community Development Credit Unions that assists and encourages the formation of credit unions. Finally, the regional offices also have economic development specialists that assist and encourage the formation of credit unions.

5. Please discuss how the NCUA's final rule implements Congressional intent with respect to the reasonable geographic proximity requirement for adding groups to existing credit unions. In particular, please discuss the NCUA's definitions of "service area" and "service facilities."

CUMAA reinstated NCUA's multiple common bond policy, as set forth in IRPS 94-1, with significant modifications. A multiple common bond credit union may serve a combination of distinct, definable, occupational and/or associational common bonds, which are called select groups. These groups must be within reasonable proximity of

the credit union. That is, the groups must be within the service area of one of the credit union's service facilities.

The Board has defined a service facility as a place where shares are accepted for members' accounts, loan applications are accepted and loans are disbursed. This definition includes a credit union owned branch, a shared branch, a mobile branch that goes to the same location on a weekly basis, an office that is open on a regularly scheduled weekly basis, or a credit union owned electronic facility that meets, at a minimum, these requirements. This definition does not include an ATM.

Reasonable proximity is an essential factor in determining whether a group can be added to a multiple common bond credit union. The Board's interpretation of the legislative intent of CUMAA is that reasonable proximity should be a geographic limitation. That is, the group to be added must be within reasonable proximity geographically to the credit union. The geographic limitation included in the requirement of reasonable proximity assures the ability of the credit union to serve the group. Since reasonable proximity is not specifically defined in the legislation, the terms service area and service facility were defined in an effort to establish the limits of a geographic reasonable proximity.

Past experience with mileage limitations indicated that using distance factors to define reasonable proximity would create numerous inequities. Rural areas obviously differ from urban areas. Small towns differ from large cities. The vast geographic territory combined with the sparse population in the southwest and western mountain areas differ from the rural areas of the east. While mileage limitations often facilitate regulatory decisions, frequently, they are artificial and cause unfair results simply because of minimal geographic differences. Accordingly, mileage limitations were deemed inappropriate and not advisable. Essentially, the service area means that a member can reasonably access the service facility. In rural areas this may include distances encompassing several counties. In a densely populated area, it may be a portion of a city.

6. *Please respond to some industry criticism that the NCUA final rule favors the addition of groups to large credit unions as opposed to the small credit unions.*

The final rule in no way favors the addition of groups to large credit unions as opposed to small credit unions. The five statutory criteria imposed by CUMAA for a credit union to add a select group applies to each credit union regardless of size. In fact, credit unions chartered less than ten years or low-income credit unions may get an exception to the 6 percent net worth requirement if the credit union is making reasonable progress toward becoming adequately capitalized. Some groups applying for credit union service may prefer inclusion in a larger credit union that may have existing expanded financial services. However, the statute requires the groups to make an application. NCUA has no authority to select a credit union for the group.

7. Please describe how the NCUA evaluates the impact of adding a group to a particular credit union versus other credit unions within reasonable geographic proximity. Please explain the NCUA's policy with respect to overlapping fields of membership and protecting the safety and soundness of other local credit unions. In addition, please discuss whether the NCUA has an obligation under CUMAA to place a group with a credit union which would most benefit in terms of safety and soundness even if such credit union did not file the application.

All credit unions have an equal opportunity to add select groups to their fields of membership. A credit union that does not request to add a group is not harmed in any real sense when another credit union adds that group. Therefore, NCUA evaluates the impact of adding a group only to overlapped credit unions since that is the only time there is potential harm to another credit union. An overlap is permitted when the expansion's beneficial effect in meeting the convenience and needs of the members outweighs the adverse effect on the overlapped credit union. In such cases, before the overlap is permitted, NCUA conducts an overlap analysis which is detailed in the chartering manual. After conducting in-depth surveys and studies of federal and state credit unions, the Board determined that overlaps rarely cause safety and soundness problems. In those instances where a newly chartered credit union has been in existence for less than two years and needs critical start-up time to establish a membership base for safe and sound financial operations, the Board has specifically provided overlap protection for a period of 12-24 months. This protective period may be extended if safety and soundness concerns remain present.

NCUA is not aware of any authority under CUMAA to place a group with a credit union if such credit union did not file for the addition. In fact, NCUA placement of such a group would be inconsistent with CUMAA. CUMAA not only requires an application by a group but also that the credit union is adequately capitalized and has the administrative capability to serve the group. Additionally, the credit union to which the group is being added must not have engaged in any material unsafe or unsound practice during the preceding year.

8. Please discuss how the NCUA's final rule defines the terms "family member" and "member of household" and how these definitions are consistent with Congressional intent.

As mandated by CUMAA, the Board was required to define "immediate family or household member." The definition of these terms was designated as a major rule and is subject to Congressional review.

After reviewing the statutory language and legislative history, the Board determined that membership eligibility based on family or household relationships should be segregated and defined separately. Immediate family member was defined and limited to a spouse, child, sibling, parent, grandparent or grandchild if not living in the same residence. Stepchildren, stepparents, stepsiblings and adopted children, as previously

proposed and intended, are included in this definition. Once an immediate family member joins, then that person's immediate family would be eligible to join.

Household member is defined as persons living in the same residence and who maintain a single economic unit. Included in this definition is any person who is a permanent member of and participates in the maintenance of the household. The definition of household contemplates or intends some permanency. Domestic partners would be included in the household definition, since they share a residence and qualify as a single economic unit, as would anyone who lives in the household and demonstrate a degree of permanency. Legal guardian relationships are considered part of the household member definition.

In adopting the definition of immediate family member, the Board took notice of the fact that Congress intended some limitation of the definition of family member since it defined that term with the qualifier "immediate." Accordingly, an open-ended definition of family member (as was the current practice by credit unions) would not be consistent with the statutory language and, therefore, was deemed inappropriate. A definition that included any family member related by blood or marriage was considered unduly expansive and would not be in keeping with Congressional intent. Without specific guidance from Congress on how to interpret these definitions, the Board reviewed the legislative history and interpreted the legislation to indicate that the definition should be more restrictive than current credit union practice.

9. Please discuss how the NCUA's final rule addresses the community credit union charter and expansion issues. Please discuss the geographic and population limits which the NCUA final rule places on community charters. In addition, please provide information regarding the number of applications the NCUA has received in the last 12 months from credit unions seeking to convert to or expand community charters.

CUMAA requires that a community charter be based on "a well-defined local community, neighborhood, or rural district." The definition of a community charter was designated as a major rule and is subject to Congressional review.

Although Congress did not define what constituted a "local community, neighborhood or rural district," the Board concluded that the addition of the word "local" to the previous statutory language was intended as a limiting factor and that additional clarification was required relative to what would qualify as a community charter. The Board further concluded that a more circumspect and restricted approach to chartering community credit unions appeared to be the Congressional intent. Therefore, the Board set forth the following requirements for a community charter:

- The geographic area's boundaries must be clearly defined;

- The charter applicant must establish that the area is a well-defined "local community, neighborhood, or rural district;" and
- The residents must have common interests or interact.

The term "well-defined" means the proposed area has specific geographic boundaries. A "local community, neighborhood, or rural district" encompasses several factors including interaction and/or common interests. Although NCUA did not precisely define interaction or common interests, it did suggest that a greater burden needs to be met when either the geographic size or the population of the area is large. In determining interaction and/or common interests, a number of factors become relevant. For example, the existence of a single major trade area, shared governmental facilities, local festivals, area newspapers, among others, would be significant indicia of community interaction and/or common interests. Conversely, an area which has numerous trade areas, multiple taxing authorities, or multiple political jurisdictions would tend to diminish the factors that demonstrate the existence of a local community, neighborhood or rural district. These factors are limiting in the sense that they clearly require a community charter applicant proposing to serve multiple trade areas, etc., to demonstrate more definitively how it meets the local requirement.

The Board also adopted a streamlined community chartering process for a well-defined local community, neighborhood, or rural district where the area to be served is (1) a recognized political jurisdiction not greater than a county or its equivalent, and (2) the population of the requested well-defined area does not exceed 300,000. Generally, the single political jurisdiction will most often coincide with a county or its political equivalent. Multiple contiguous smaller political subdivisions within a county or its equivalent, such as a city, township or a school district, may also qualify. The Board also adopted a second streamlined approach for multiple contiguous counties, or multiple political subdivisions thereof, if the population of the well-defined area does not exceed 200,000. For these types of community charters, the applicant must only submit a letter demonstrating how the area meets the indicia for community interaction or common interests. At its discretion, NCUA may request additional documentation demonstrating the area is a well-defined local community, neighborhood, or rural district. In any case, a state or a congressional district would not qualify for a presumptive community.

NCUA has received 66 applications from credit unions seeking to convert to or expand to community charters in the last 12 months. All applications received prior to August 7, 1998, must be considered under IRPS 94-1 criteria, as specified in CUMAA. No community charter applications have been processed under the new chartering rules since that provision is not yet effective.