Testimony of George Latham
Deputy Commissioner of Financial Institutions
Virginia Bureau of Financial Institutions
On behalf of the
National Association of State Credit Union Supervisors
Before the Subcommittee
on Financial Institutions and Consumer Credit
United States House of Representatives
June 9, 2005

NASCUS History and Purpose

Good morning, Chairman Bachus, and distinguished members of the Subcommittee. I am George Latham, Deputy Commissioner of Financial Institutions for the Bureau of Financial Institutions for the state of Virginia. I appear today on behalf of the National Association of State Credit Union Supervisors. NASCUS represents the 48 state and territorial credit union supervisors and is advised by the NASCUS Advisory Credit Union Council, composed of more than 600 state-chartered credit unions dedicated to defending the dual chartering system for credit unions.

The mission of the National Association of State Credit Union Supervisors (NASCUS) is to enhance state credit union supervision and regulation and advocate policies to ensure a safe and sound state credit union system. We achieve those goals by serving as an advocate for a dual chartering system that recognizes the traditional and essential role that state government plays as a part of the national system of depository financial institutions.

NASCUS applauds the Subcommittee's continued commitment to providing ongoing regulatory relief, ensuring a safe and sound environment for credit unions and the consumers they serve. We appreciate the opportunity to share our legislative priorities for regulatory relief to help alleviate the regulatory burden for state-chartered credit unions, while ensuring a safe and sound state credit union system.

National Association of State Credit Union Supervisors (NASCUS)
1655 North Fort Myer Drive, Suite 300
Arlington, Virginia 22209
(703) 528-8351 • (703) 528-3248 Fax
E-mail: offices@nascus.org

NASCUS Priorities for Regulatory Relief

NASCUS priorities for regulatory relief legislation focus on the reforms that will strengthen the state system of credit union supervision and enhance the capabilities of state-chartered credit unions. The ultimate goal is to meet the financial needs of consumer members while assuring that the state system is operating in a safe and sound manner.

In this testimony, I will address the following regulatory relief issues vital to credit unions:

- capital reform including amending the current Prompt Corrective Action (PCA) provision for credit unions, risk-based capital reform and amending the definition of net worth to include the retained earnings of a merging credit union when calculating net worth;
- member business lending, expanding the lending provision and amending the definition of a member business loan;
- regulatory modernization that provides parity for credit unions with other financial institutions;
- allowing non-federally insured credit unions to join the FHLBs;
- preservation of the dual chartering system and protection against the preemption of state laws.

Capital Reform

Capital reform continues to be a critical concern for the nation's credit unions. We believe three areas of capital reform need to be addressed to provide a safer capital system for credit unions.

NASCUS strongly urges the Subcommittee to amend the Prompt Corrective Action (PCA) provision of the Federal Credit Union Act (FCUA) to obligate federally insured credit unions to include all forms of capital when calculating the required net worth ratio. Under the current federal statute, credit union net worth is defined as and limited to retained earnings. The exclusive reliance on retained earnings limits a credit union's ability to implement new programs or expand services to meet the changing needs of American consumers in its membership. The failure to obligate these credit unions to include all forms of capital in their PCA net worth calculation distorts the credit union's actual financial position.

More importantly, amending the definition of net worth cures the unintended consequences for credit unions of the Financial Accounting Standards Board (FASB) business combination accounting rules. FASB's Financial Accounting Standard No. 141 requires the acquisition method for business combinations and effectively eliminates the pooling method for the combinations of mutual enterprises. Chairman Bachus and members of the Subcommittee, NASCUS applauds the introduction H.R. 1042, which amends the definition of net worth to include the net retained earnings of a merging credit union with that of the surviving credit union. We recognize and appreciate that a similar provision was introduced in H.R. 2317, the Credit Union Regulatory Improvement Act, commonly called CURIA.

In short, as NASCUS testified before this Subcommittee in April, 2005, the acquisition accounting method would require the valuation of the target credit union at fair value, the recognition of identifiable intangibles (i.e., core deposit intangibles and/or goodwill), when relevant, and the application of a market-based acquisition model to a non-bargained transaction. The retained earnings of the merging institution would no longer be combined with those of the continuing credit union, creating a potentially significant dilution of statutory net worth and an unintended impediment to credit union mergers. Mergers are a safety and soundness tool regulators use to protect funds deposited by American consumers and to preserve the National Credit Union Share Insurance Fund.

If a credit union cannot be merged due to PCA concerns caused by the inability to add the capital of the merged credit union, then credit unions in a weakened condition might face liquidation. There may also be more requests for NCUA to provide financial assistance in merger transactions. An increase in liquidations may cause greater reputation risk, severe loss of confidence for the credit union industry, greater losses to the deposit insurance fund and increased costs to the industry and ultimately to consumers. This scenario spells disaster for credit unions. NASCUS supports both H.R. 1042 and Section 104 in H.R. 2317.

Risk-Based Capital

NASCUS endorses and has a long-standing policy supporting risk-based capital for credit unions. Risk-weighted capital reform should be flexible. NASCUS believes that any new regulations should be progressive and not designed to regulate to the lowest common denominator.

We believe risk-based capital is a sound and logical approach to capital reform for credit unions. We support a risk-based capital plan, such as presented in Title I of H.R. 2317, and believe additional enhancements would provide for a stronger bill, with even greater safety and soundness for credit unions. We further believe that alternative capital authority and a risk-based system are complementary capital reforms.

Alternative Capital Authority for Credit Unions

We support capital reform beyond the risk-weighted capital and FASB merger fix. NASCUS believes that an important part of capital reform is providing credit unions access to alternative capital. The combination of current PCA requirements and a changing economic landscape have created a regulatory dilemma for many state-chartered credit unions. As noted above, the FCUA defines credit union net worth as retained earnings. The NCUA has determined that it lacks the regulatory authority to broaden the net worth definition to include other forms of capital as a part of PCA calculations. Thus, credit unions require an amendment to the Act to rectify this statutory deficiency.

We firmly believe alternative capital is necessary for credit unions to continue meeting the financial needs of their members. This is especially true for credit unions providing services such as financing for home ownership, or financial education and credit counseling—each an important part in achieving the American dream. We believe, even with the lower leverage ratio and risk-based capital proposed in H.R. 2317, that some state-chartered credit unions may not be able to rely solely on retained earnings to meet the capital base required by PCA standards. As credit unions grow and serve more consumers in their fields of memberships, their assets will grow. As assets grow, credit unions experience reduced net worth ratios as earnings retention lags growth in assets.

As a regulator, it makes sound economic sense for credit unions to access other forms of capital to improve their safety and soundness. We should take every financially feasible step to strengthen the capital base of this nation's credit union system.

Strong capital reform requires that state and federal regulators work together. In 1998, the Credit Union Membership Access Act, H.R. 1151, provided that NCUA consult and cooperate with state regulators in constructing PCA and member business lending (MBL) regulations as required by the FCUA. NASCUS always stands ready to discuss and assist in the implementation of new regulations. We firmly believe that cooperation results in better regulation and a stronger and safer credit union system.

Member Business Lending

Regulatory relief is important for consumers in the area of member business lending. In today's fast-paced economy, it is vital that lending is available to consumers who want to start a new business. Entrepreneurship is part of fulfilling the American dream. NASCUS has a vision of providing well-thought-out regulations to best position credit unions to make members' dreams become reality.

Title II of H.R. 2317 provides an opportunity for economic growth for credit unions. Credit unions should be given greater authority to meet their member business lending needs. Raising the statutory limit on credit union member business loans to 20 percent of total assets, as proposed in Section 201 of CURIA, facilitates member business lending without jeopardizing safety and soundness at participating credit unions.

Further, we support Section 202, which amends the current definition of a member business loan by granting NCUA the authority to exempt loans $100,000 or less. This increases the definition of business loans subject to the current amount of $50,000 to $100,000. Prior regulatory relief bills have similarly expanded for federal savings institutions. We urge that the statutory definition of a credit union MBL be changed from the current $50,000 limit contained in the FCUA. In fact, we support redefining credit union MBLs to the Fannie/Freddie conforming loan limit of $359,650, increased in January 2005. We believe this is a safe and sound, well established and readily understandable index that has served lenders and the public interest well for many years.

Both of these provisions provide credit unions with regulatory relief as it concerns member business lending, and were included in H.R. 3579, introduced in the 108th Congress.

Regulatory Modernization

It is time to update regulations reflecting parity of treatment between credit unions and other financial institutions. It makes sound business sense and provides for equitable competition; parity of treatment is only logical.

NASCUS supports Section 311 of H.R. 2317 that provides all federally insured credit unions the same exemptions as banks and thrift institutions from Federal Trade Commission pre-merger notification requirements and fees. In fact, we believe this provision should be expanded to include all state-chartered credit unions.

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Additionally, NASCUS is pleased Section 312 is part of CURIA. We support providing federally insured credit unions and savings institutions parity treatment with commercial banks with regard to exemptions from SEC registration requirements that banks were provided in the Gramm-Leach-Bliley Act.

Our major concern is that, if state-chartered credit unions are not accorded the same SEC treatment as commercial banks and savings institutions, the powers granted to credit unions by state legislatures and state regulators might be unnecessarily preempted by SEC regulation. Unless appropriate regulatory relief is provided, credit unions offering these services may be subject to redundant and costly examination. We urge that credit unions be accorded similar regulatory treatment as other financial institutions.

The 108th Congress recognized these provisions when they were included in H.R. 1375 as Sections 312 and 313, respectively.

Privately-Insured Credit Unions Should Be Eligible to Join Federal Home Loan Banks (FHLBs)

At this time, all credit unions do not operate with access to the same benefits. Federally insured credit unions have access to the FHLBs, while privately-insured credit unions do not. NASCUS supports non-federally insured credit unions being eligible to join the FHLBs. While this is not included in H.R. 2317, this provision was included during the 108th Congress in H.R. 1375.

Today, there are approximately 375 credit unions that are non-federally insured. All of these credit unions are regulated and examined by state regulatory agencies to ensure they are operating in a safe and sound manner. Regulatory functions are a primary determinant of the safety and soundness of the credit union system. The function of the credit union regulator is to assure consumers that their deposits are safe. The credit union regulator performs this mission by:

- issuing rules to assure safe and sound financial practices in credit unions;
- ensuring that violations of those safety and soundness rules are corrected;
- performing safety and soundness examinations of credit unions under their supervision;
- requiring correction of financial and operational deficiencies identified during the examination process; and
- taking enforcement actions to assure that financial remedies are implemented by the credit union (including letters of understanding and agreement, closure of the credit union, etc.).

Federal and private share insurance systems have been established to protect credit union shareholders. To manage and price insurance risk, each share insurer relies significantly on the examination reports of the institution's primary regulator. Most state credit union agencies use the NCUA/AIRES examination platform when they examine state-chartered credit unions for safety and soundness purposes. NASCUS agencies participate in the development and testing of NCUA's examination program and procedures. In short, there is an excellent working relationship and substantially similar examination standards for both federally and state-chartered credit unions.

The private insurers, primarily American Share Insurance in the United States and a cooperative insurance fund in Puerto Rico, have established additional solvency standards to minimize risks in their insured credit unions.

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements both for entities that offer private deposit insurance to credit unions and for credit unions which would opt for private deposit insurance.

FDICIA also requires that privately insured credit unions must be certified to meet eligibility requirements for federal deposit insurance. Specifically, the Act states that no depository institution, which lacks federal deposit insurance, may use “the mails or any instrumentality of interstate commerce to receive or facilitate receiving deposits, *unless* the appropriate supervisor of the State in which the institution is chartered has determined that the institution meets all eligibility requirements for Federal deposit insurance … .” (Emphasis added.) As a practical matter, this requirement applies to every state-chartered, privately insured credit union, as every such credit union uses some instrumentality of interstate commerce or the mails.

FDICIA also dictates the manner and extent to which institutions opting for private deposit insurance disclose fully that their deposits are privately insured. Therefore, there should be no concern that these credit unions are not operated in a safe and sound manner.

Permitting non-federally insured institutions to join the FHLBank system would not establish a new membership principle for the system. More than 50 insurance companies, chartered and regulated by state governments with no federal oversight or insurance, are now members of these Banks. Allowing FHLBank membership for privately-insured credit unions would provide additional opportunities for housing finance and not inflict any new or unusual exposure on the Bank System.

Moreover, an additional layer of financial discipline would be introduced. Each Federal Home Loan Bank has a sophisticated credit screening system to assure that any borrower, federally insured or not, is credit worthy. In addition, every advance is secured by marketable collateral. Indeed, even during the savings and loan debacle, we understand that no Federal Home Loan Bank suffered a loss on advances extended to their members.

In the past, Congress has expanded the membership eligibility for the Bank System to help local financial institutions meet the housing and home ownership needs of their communities. Enabling state-chartered, privately insured credit unions to be eligible to join the FHLBank system, is merely one more step in bringing home ownership opportunities to these credit union members.

We would appreciate your support by including this proposal in the Regulatory Relief legislation and urge the Committee to approve this provision, helping to achieve our nation's housing and home ownership goals.

Federal Preemption of State Regulation of Consumer Protection Practices

Lastly, as credit union regulators, we have a significant stake in the ongoing controversy between federal banking regulators and the National Governors' Association, the National Association of Attorney's General, the Conference of State Bank Supervisors, the National Conference of State Legislatures and others over the issue of expanding federal preemptions of state laws and regulations.

As a matter of policy, NASCUS does not take public positions on issues that only affect the commercial banking industry. However, we are concerned about the contagion impact on the credit union dual chartering system as the powers of the state banking regulators are significantly curtailed.

OCC and OTS regulations during the past several years have preempted dozens of state banking laws enacted to protect consumers, to provide fair lending and to ensure fair competition. These actions of federal regulatory agencies have a broad impact on the dual chartering system for banks. They may open the door to similar actions by the federal credit union regulator, NCUA, unless Congress intervenes to rein in additional federal preemption powers.

The trend in the last several years is that when an issue is one of consumer protection, some continue to demand that the federal banking authorities preempt state consumer protection. Such initiatives are touted as establishing exclusive national standards for regulating almost all aspects of consumer lending practices.

Historically, states have established predatory lending and other consumer protection statutes applicable to both state and federal depository institutions. In general, the rule has been that national banks are subject to such state statues to ensure the same level of protection for citizens opting to use the services of a federally-chartered financial institution.

In most cases, there are no comparable federal laws. Consumers have instead been left at the mercy of what is sometimes an abusive industry. State authority has been so abridged that state lawmakers are oftentimes powerless to curtail the growing number of new consumer abuses, including predatory lending, payday loans, and excessive fee structures.

NASCUS is not comfortable with such federal rulemaking. What the OCC has adopted overrides state law and concentrates regulatory power at the federal level. The Governors similarly oppose these rules. The National Conference of State Legislatures has expressed its concerns about the impact of these rules on state law. The Conference of State Bank Supervisors has opposed these rules. Consumer groups have opposed federal preemptions that would vitiate hard won victories in state legislatures that provide additional protection to all consumer borrowers in their states.

Determining the extent of such additional federal banking powers is an important matter for those who support the dual chartering system for all depository institutions. Congress should resolve the conflicts rather than delegate these fundamental issues to the federal financial institution regulators to determine.

Conclusion

In conclusion, NASCUS strongly supports the following issues for regulatory relief:

- NASCUS supports amendments to the Prompt Corrective Action (PCA) provision of the FCUA to obligate federally insured credit unions to include all forms of capital when calculating their net worth ratio.

- NASCUS supports both H.R. 1042 and Section 104 of CURIA that amends the definition of net worth to include the retained earnings of a merging credit union with that of the surviving credit union.

- NASCUS supports risk-based capital reform.

- NASCUS believes credit unions should be permitted to issue alternative capital.

- NASCUS supports Title II of H.R. 2317 that focuses on member business lending. Section 201 expands member business lending provisions to 20% of total assets of a credit union, furthering the goal of providing loans for consumer members.

- NASCUS supports Section 202 of Title II of H.R. 2317 that amends the definition of a member business loan from $50,000 to an amount not to exceed $100,000.

- NASCUS supports Section 311 of H.R. 2317 that provides all federally insured credit unions the same exemptions as banks and thrift institutions from pre-merger notification requirements.

- NASCUS supports Section 312 of H.R. 2317 that provides federally insured credit unions parity of treatment with commercial banks with regard to exemptions from SEC registration requirements according to the Gramm-Leach-Bliley Act.

- NASCUS strongly believes non-federally insured credit unions should be eligible to join the FHLBs.

- We encourage Congress to intervene and block continuing preemption of state laws.

NASCUS appreciates the opportunity to testify today on regulatory relief. We support the provisions of CURIA that will ease regulatory burden and enhance the overall safety and soundness of credit unions. We welcome further participation in the discussion and deliberation of legislation that impacts regulatory relief for credit unions. We urge this Subcommittee to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have discussed in our testimony.

Thank you.