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National Association of Federally-Insured Credit Unions

November 13, 2023

The Honorable Todd M. Harper, Chairman
The Honorable Kyle S. Hauptman, Vice Chairman
The Honorable Rodney E. Hood, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Proposed 2024-2025 Budget

Dear Chairman Harper, Vice Chairman Hauptman, and Board Member Hood:

Thank you for the opportunity to deliver remarks before you today regarding the 2024-2025 Staff Draft Budget Justification. My name is Curt Long, and I am the Chief Economist and Vice President of Research at the National Association of Federally-Insured Credit Unions (NAFCU). I would like to thank the National Credit Union Administration (NCUA) Board for its leadership and ongoing commitment to ensuring a safe and sound credit union system and improving the lives of 138 million credit union members across the country. Additionally, thank you to the NCUA staff who prepared this budget justification and other budget materials. NAFCU supports the NCUA Board's transparent budget process and appreciates the opportunity to provide feedback.

As NAFCU has emphasized before, the NCUA's dedication to credit unions should motivate them to aim for annual budget reductions rather than increases, especially in these economically uncertain times. NAFCU, its credit unions and members, are keen to observe how the NCUA will adapt and modernize moving forward, ensuring judicious use of credit union funds.

General Comments

The NCUA's budget continues to increase, and this 2024-2025 draft budget once again overlooks opportunities to incorporate more efficient processes with potential cost-savings. In fact, the 2024 Operating Budget would increase by 11 percent and the 2025 Operating Budget would increase by nearly 10 percent, similar to the increases seen in last year's 2023-2024 final budget. 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. NAFCU urges the NCUA to restrain its spending going forward and look for cost savings wherever possible.

NAFCU recommends that the NCUA embrace the importance of cost-efficiency and prudent financial management by cutting unnecessary budget items like the addition of dozens of new examination staff. More specifically, NAFCU offers the following recommendations to enhance the efficiency of the NCUA's 2024-2025 budget:

1. Preserve the strength of the National Credit Union Share Insurance Fund (SIF) 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. Eliminate the proposed addition of dozens of new 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.

Industry Conditions

The credit union industry is strong and well-capitalized. As of June 30, 2023, the industry's net worth ratio was closing in on 11 percent and had risen over 40 basis points from a year prior. CAMELS rated 4 and 5 credit unions represented just 0.3 percent of total industry assets, a figure that is roughly half its pre-pandemic level. Thanks to strong loan growth in 2022 and rising investment yields, credit union net interest margins are up 40 basis points versus a year ago.

Nevertheless, credit unions are facing significant challenges. Rising rates have driven up credit union cost of funds, and this trend will likely persist in 2024 even if market rates decline. Fee income as a percent of assets is down by 25 basis points from 2019, and with pressure on fees coming from multiple angles, the threat of further erosion looms. The normalization of delinquency rates in combination with adoption of the current expected credit loss accounting standard has precipitated a steep increase in provision for loan and lease loss expenses. Meanwhile, credit unions face the constant challenges of meeting the needs of their members with limited resources.

Despite these challenges, the SIF is in a strong position. The equity ratio as of June 30 exceeded the agency's forecast and was comfortably above the statutory minimum. Only two credit unions failed in the first half of 2023, and losses to the fund were minimal. The performance of the SIF stands in contrast with the Federal Deposit Insurance Corporation (FDIC) Deposit Insurance Fund (DIF), which anticipates $3.2 billion in losses due to recent bank failures. There is an additional $19.2 billion estimated cost attributable to uninsured deposits that will be addressed through a special assessment on banks.

NAFCU is encouraged by the sound standing of the SIF. However, given that 62 cents of every dollar in the agency's budget comes from the SIF, the continuing health of the fund depends upon a cost-conscious NCUA.

Operating Fee

NAFCU's member credit unions are justifiably concerned with the sharp increase in the proposed Operating Fee, especially given the many other challenges facing the industry that I already discussed. The proposed Operating Fee rate for 2024 would increases 19.59 percent compared to the rate in 2023. Given credit unions' tight margins, an abrupt increase in the operating fee would place undue financial strain on these entities. As the final 2024–2025 budget is prepared for consideration by the NCUA Board, it is imperative that the agency considers the well-being of the very institutions it oversees. We urge the NCUA to credit the maximum surplus cash possible to the operating fee, thereby alleviating some of the burdens these credit unions face and ensuring that they continue to serve their communities effectively and efficiently.

Exam-Related Expenses

NAFCU applauds the NCUA for proposing a reduction, albeit modest, in 2024 travel expenditures. NAFCU urges the NCUA to continue to utilize hybrid examinations and work to increase the proportion of examination activities conducted offsite and maintaining a more limited onsite presence. The expenses for future travel should be carefully evaluated through a cost-benefit analysis, weighing the advantages of enhancing the agency's virtual examination procedures now against the costs of dispatching examiners nationwide for face-to-face evaluations.

Exam Modernization

NAFCU supports NCUA's modernization of its examination system through the implementation of MERIT but is concerned about the high and unclear costs associated with its deployment and ongoing operation. Since the initial rollout in fall 2021, the projected budget for contracted services, including MERIT, continues to significantly increase, with costs rising again in 2024 and 2025. NCUA has not lived up to its commitment to keep credit unions informed about MERIT's progress and has not provided updates or clear cost breakdowns for 2023, leaving stakeholders without insight into one of the agency's largest expenditures. NAFCU is urging the NCUA to manage and clarify MERIT-related costs more effectively and to regularly update credit unions on the program's status and financial details.

Virtual Exams

NAFCU endorses the NCUA's move towards virtual examinations and encourages its continuation, while also seeing the benefits of retaining some in-person elements through a hybrid model. NAFCU appreciates the modest cut in the NCUA's 2024 travel budget and advocates for ongoing travel cost reductions, despite the slight budget increase in 2025 due to inflation and a staff conference. Moving forward, the NCUA should mitigate these costs by leveraging past travel efficiencies and minimizing future travel expenses unless essential.

Exam Flexibility Initiative

NAFCU supports a strong, safe and sound credit union system with appropriate supervision of systemic risk. This can be accomplished while simultaneously lengthening the exam cycle for all well-performing, low-risk credit unions, which would serve to optimize resource allocation for the NCUA. This would allow the NCUA to concentrate on higher-risk credit unions while more efficiently addressing systemic risks. Extended exam intervals would also lessen business interruptions for compliant credit unions, helping them to focus on member service. NAFCU recommends the NCUA adjust its examination frequency threshold to $3 billion to align with the other banking regulators, revising the current, outdated, and purely regulatory $1 billion benchmark set in 2017.

Regional Specialist Examiners and Supervisors

NAFCU supports the modernization of the NCUA examination workforce but is opposed to the proposed addition of 27 specialized and supervisory positions in the 2024 budget. The addition of these new Bank Secrecy Act and consumer compliance specialists and supervisory positions, coupled with 5 extra supervisory roles for credit unions between $10 and $15 billion in assets, is being undertaken too quickly and could lead to a less experienced workforce and inefficiencies, while placing increased financial burden on the credit unions who fund the NCUA.

Although NAFCU has previously heard from its members that examiners often lack the specific BSA expertise necessary to provide consistent exams for compliance with BSA requirements, the budget does not specifically note the number of BSA specialists it seeks to hire. More concerning, nothing in the NCUA's proposed budget adequately justifies the need for 13 additional regional consumer compliance specialists. The budget explains that these additional examiners will focus on institutions with greater consumer impact or indications of potential violations without providing any data regarding the number of credit unions that fall into those categories to substantiate the need for these examiners. With the number of credit unions declining due to consolidation, the rationale for increasing examiner numbers is unclear and NAFCU urges the NCUA to justify these changes more clearly to stakeholders. NAFCU is opposed to adding new positions due to the lack of justification for these positions and the financial burden this would place on credit unions.

Enhance Transparency Around Cybersecurity and IT Related Expenses

NAFCU supports efforts to improve the security and performance of the NCUA's IT systems. However, the NCUA should differentiate similar IT expenses shared across multiple capital projects. The NCUA's budget justification notes that the proposed 2024 budget includes over $20 million for the cost of compliance with various federal IT security standards, of which $4.3 million is budgeted for capital investments. The capital project description for one of these investments, titled "Executive Order on Improving the Nation's Cybersecurity (EO)," notes that the agency will continue to support adoption of cloud-based solutions for "certain storage resources." A separate capital project, titled "IT Infrastructure, Platform, and Security Refresh," appears to have a similar objective: "migrate new data and infrastructure components to the cloud."

Given that cloud migration costs can be significant, and multiple capital projects appear to involve cloud related projects, the NCUA should separately disclose cloud technology costs in its budget to improve transparency and provide greater insight about the extent to which these specific costs are driving overall IT expenditures. Separation of cloud costs would also allow credit unions to more accurately track the share of the budget devoted to security improvements under the EO, such as adoption of multi-factor authentication. As noted in the NCUA's most recent FISMA audit, the NCUA still faces an open recommendation for implementing multi-factor authentication dating back to its FY 2021 FISMA audit.

Small Credit Unions, Minority Depository, and Financial Inclusion

NAFCU commends the NCUA for its commitment to small credit unions and Minority Depository Institutions (MDIs) through the dedicated Support Program, which has a tangible impact on their ability to serve underserved areas. NAFCU approves of the dedicated resources in the 2024 budget for this issue and supports the NCUA's efforts to enhance awareness, support, and partnerships to foster the growth of these institutions. It is crucial to maintain ongoing dialogue with stakeholders to refine these initiatives and NAFCU supports expanding grants and training to help these credit unions thrive amid financial sector changes.

Conclusion

NAFCU urges the agency to carefully consider and adopt the detailed suggestions outlined above in its final 2024-2025 budget. NAFCU thanks the NCUA Board and recognizes the NCUA staff's hard work in preparing this budget justification and other budget materials. Thank you for the opportunity to deliver these remarks before you today.

Sincerely,

Curtis Long

Curt Long
Chief Economist and Vice President of Research