



NCUA
National Credit Union Administration

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Congressional Testimony

J. Mark McWatters
Chairman
National Credit Union Administration

**Senate Committee on Banking, Housing,
and Urban Affairs**

**Hearing on the Implementation of the
Economic Growth, Regulatory Relief, and
Consumer Protection Act**

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Congressional Testimony

Chairman Crapo, Ranking Member Brown, and Members of the Committee, as Chairman of the National Credit Union Administration (NCUA) Board, I appreciate the invitation to testify today about the NCUA's implementation of S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).¹

The NCUA's mission is to "provide, through regulation and supervision, a safe and sound credit union system, which promotes confidence in the national system of cooperative credit."² This system is vital to the American economy, touching more than one-third of all U.S. households.³ In turn, the NCUA is charged with, and focused on, ensuring the safety and soundness of the National Credit Union Share Insurance Fund (Share Insurance Fund). The agency takes seriously its responsibilities for the regulation and supervision of approximately 5,480 federally insured credit unions with more than 114 million member-owners and more than \$1.4 trillion in assets across all states and U.S. territories.⁴ As an adjunct to that mission, the agency has developed initiatives to make it easier for credit unions to serve their members more effectively, including members of modest means and those in underserved areas.⁵

The first part of my testimony today focuses on the NCUA's implementation of the EGRRCPA. Next, I will discuss the NCUA Board's recent efforts to improve the efficiency and effectiveness of the agency and to reduce the regulatory, reporting, and examination burdens facing credit unions without sacrificing the safety and soundness of the credit union system and, in turn, the Share Insurance Fund. Finally, I will provide recommendations for potential legislative actions that would enhance how the NCUA carries out its safety and soundness mission and allow credit unions to serve their members and communities better, including those of modest means and the underserved.

I appreciate and recognize that changes to the Federal Credit Union Act made possible by this Committee and regulatory changes embraced by the NCUA are improving credit

¹ Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), Pub. L. No. 115-174, 132 Stat. 1296 (2018) [hereinafter EGRRCPA].

² See NCUA Mission and Vision, <https://www.ncua.gov/About/Pages/Mission-and-Vision.aspx>.

³ NCUA calculations using the Federal Reserve's *Survey of Consumer Finances, 2016*.

⁴ Based on June 30, 2018 Call Report Data.

⁵ *Serving the Underserved*, National Credit Union Administration, <https://www.ncua.gov/services/Pages/field-of-membership-chartering/underserved.aspx>. The Federal Credit Union Act, governing this agency and federally insured credit unions, specifies this national system is intended to meet "the credit and savings needs of consumers, especially persons of modest means." Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998).



unions' ability to serve their members. At the same time, technological and other advancements, including credit union relationships with fintechs and other third-party vendors, are changing the way financial services are provided. While these developments can help credit unions meet the needs of all segments of their membership and communities, they also mean that credit unions and the NCUA must evolve to remain effective in the changing financial services landscape.

Implementation of the EGRRCPA

The EGRRCPA includes a number of amendments that apply to credit unions and relieve regulatory burdens placed on them. My testimony will focus on select amendments that have a more substantial impact on the NCUA and credit unions. Specifically, I will address four amendments related to appraisals in rural areas, member business lending, budget transparency, and the Home Mortgage Disclosure Act that apply to federally insured credit unions and the NCUA.⁶ Since passage of the EGRRCPA, the NCUA has begun to update its examiner guidance and examination procedures to reflect the statutory changes introduced. The agency will review credit union compliance with these changes, as warranted, as part of our risk-focused examination program. Additionally, the NCUA will work cooperatively with state supervisory authorities and the other federal regulators to implement these amendments.

Exemption from Appraisals in Rural Areas

Section 103 of the EGRRCPA amends the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to exempt from appraisal requirements certain federally related, rural real estate transactions valued below a specified limit if no state-certified or state-licensed appraiser is available.⁷ Specifically, the EGRRCPA provides an exemption to the appraisal requirements for certain transactions with values of less than \$400,000 involving real property or an interest in real property that is located in a rural area, as specified in Section 103 of the EGRRCPA. At its September 2018 Board meeting, the NCUA Board proposed an amended appraisals rule that incorporates the provisions of the EGRRCPA amendments and proposed additional changes to reduce regulatory burden and make compliance easier for regulated entities.

Member Business Lending (Loans for Non-primary Residences)

Prior to the passage of the EGRRCPA, the Federal Credit Union Act defined a member business loan in relevant part as any loan, line of credit, or letter of credit, the proceeds

⁶ The EGRRCPA contains other amendments, generally in the area of compliance and financial literacy, which apply to the NCUA and credit unions. The Consumer Compliance Task Force of the Federal Financial Institutions Examination Council has assembled a working group, in which the NCUA participates, to ensure a consistent and non-duplicative approach to implementation of these amendments.

⁷ Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989).



of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose, but does not include an extension of credit that is fully secured by a lien on a one-to-four-family dwelling that is the primary residence of a member.⁸ Section 105 of the EGRRCPA removed from that definition the words “that is the primary residence of a member,” addressing a statutory disparity in the treatment of certain residential real estate loans made by credit unions and banks.

As a result, the revised member business loan definition now excludes all extensions of credit that are fully secured by a lien on a one-to-four-family dwelling regardless of the borrower’s occupancy status. Because these loans are no longer considered member business loans, they do not count towards the aggregate member business loan cap imposed on most federally insured credit unions by the Federal Credit Union Act.⁹ The amendment was effective upon the EGRRCPA’s enactment. Less than one week later, the NCUA Board issued a final rule to incorporate the amendment into the NCUA’s commercial and member business lending regulation.¹⁰

While this amendment is an important change and one I support, I would like to emphasize the NCUA’s longstanding and continued support for additional legislative action to provide further relief in this area, including an additional exemption for loans to small businesses. Small businesses are a critical job-creating segment of the U.S. economy that, especially at start-up and in the early phases of their development, have difficulty obtaining affordable credit. I look forward to working with Congress and the credit union community to enhance credit unions’ ability to serve small businesses.

Budget Transparency

Section 212 of the EGRRCPA amended the Federal Credit Union Act to require the NCUA to annually make publicly available and publish in the *Federal Register* a draft of the NCUA’s detailed business-type budget. It also requires the NCUA to hold a public hearing, with public notice provided of the hearing, during which the public may submit comments on the draft budget. As discussed in greater detail below, I am pleased to report that the NCUA has been compliant with the spirit of the provisions in Section 212 of the EGRRCPA for the last two years.

Throughout my tenure on the NCUA Board, including as Chairman, I have worked to increase transparency and accountability throughout all agency levels. One of my first initiatives was to increase transparency around the NCUA’s budgetary process. The NCUA Board is mindful that the finite resources of federal and state-chartered credit unions and their member-owners finance the agency’s budget. Consequently, we should only allocate these funds following thoughtful consideration on the expenditure

⁸ 12 U.S.C. 1757a(c)(1).

⁹ 12 U.S.C. 1757a(a).

¹⁰ 83 FR 25881 (June 5, 2018).



and whether it can be undertaken in the most efficient, effective, transparent, and fully accountable manner. Through a bipartisan effort, we restarted public budget hearings and posted a significant level of budget detail in respect of the last two budget cycles.¹¹ Last month, we released a proposed staff budget for 2019–2020 and its supporting documents and published the draft budget in the *Federal Register*. A public budget briefing is planned for October 17, 2018.

Home Mortgage Disclosure Act (HMDA)

Section 104 of the EGRRCPA provides partial exemptions for some insured credit unions from certain HMDA requirements. The partial exemptions are generally available for: closed-end mortgage loans, if the credit union originated fewer than 500 closed-end mortgage loans in each of the two preceding calendar years; and open-end lines of credit, if the credit union originated fewer than 500 open-end lines of credit in each of the two preceding calendar years.

In May, the NCUA sent a notice to all field staff notifying them of the change and instructing them to use the amended thresholds when reviewing HMDA compliance. The agency is also in the process of updating its examiner guidance and examination tools for reviewing HMDA compliance at credit unions.

The NCUA’s Efforts to Improve its Efficiency and Reduce Regulatory and Examination Burden

The NCUA’s primary mission is to protect the safety and soundness of the credit union system and the Share Insurance Fund. As an adjunct to that mission, the agency has developed initiatives to facilitate credit unions more effectively serving their members and communities, including the underserved and those of modest means.

It is essential the NCUA Board develops a regulatory environment that meets our safety and soundness mission, but does not inhibit flexibility and innovation within the credit union system and allows credit unions to continue to serve all of their members. As the financial services landscape evolves, the NCUA must evolve with it to promote continued financial stability within the credit union system. In so doing, it is imperative the agency continues to fulfill its mission in a fully transparent, accountable, and efficient manner. In my view, the NCUA Board is obligated to consider the compliance burdens and the costs our institutions shoulder on a day-to-day basis. As a result, we must reduce, streamline, or eliminate outdated or overly burdensome regulations where possible, so credit unions can simultaneously stay competitive in the changing environment and continue to provide financial services to their members and communities.

¹¹ See NCUA Budget and Supplementary Materials, <https://www.ncua.gov/About/Pages/budget-strategic-planning/supplementary-materials.aspx>.



Over the last two years, the NCUA has undertaken initiatives to improve the efficiency and effectiveness of our operations. Through consistent bipartisan collaboration, the NCUA Board has revised the agency's regulations to relieve regulatory, reporting, and examination burdens on federally insured credit unions, which we believe enables them to continue to provide competitive financial services to all of their members. I wish to thank my Democratic colleague, Rick Metsger, for diligently working with me in a collegial and collaborative manner for over 28 months to accomplish our shared regulatory agenda.

Initiatives Aimed at Decreasing Regulatory Burdens

Since I became Chairman in 2017, I tasked the agency with reviewing and modernizing its rules to create a transparent and fully accountable regulatory framework that acknowledges the need for flexibility, creates new avenues for growth, and strengthens the system's resiliency, while simultaneously reducing the regulatory burden where prudent and appropriate.

Consistent with the spirit of President Trump's regulatory reform agenda and Executive Order 13777, the NCUA established a Regulatory Reform Task Force to oversee the implementation of the agency's own regulatory reform agenda. Although the NCUA, as an independent agency, is not required to comply with Executive Order 13777, the agency chose to comply with its spirit by undertaking a comprehensive review of all of the NCUA's regulations. The Regulatory Reform Task Force published the NCUA's first report for public comment in August 2017.¹² This reform agenda proposed a four-year, three-tiered regulatory relief plan with approximately 40 regulatory relief recommendations.

Since the report's publication, the NCUA has completed nine of the initial regulatory relief recommendations and proposed rules or commenced action on five others. Specifically, the NCUA issued final regulations or took other final actions designed to:

- Provide additional flexibility to corporate credit unions' capital standards;¹³
- Improve the NCUA's emergency merger process;¹⁴
- Recognize that federal credit unions may securitize the loans they make;¹⁵

¹² 82 FR 39702 (Aug. 22, 2017), available at <https://www.ncua.gov/About/Pages/board-actions/comments/Documents/regulatory-review-notice-2017.pdf>.

¹³ 82 FR 55497 (Nov. 22, 2017).

¹⁴ 82 FR 60283 (Dec. 20, 2017).

¹⁵ Asset Securitization Authority, NCUA OGC Op. Ltr. 17-0670 (June 21, 2017), available at <https://www.ncua.gov/regulation-supervision/Pages/rules/legal-opinions/2017/asset-securitization-authority.pdf>; and 82 FR 29699 (June 30, 2017).



- Improve the NCUA's appeals process for examination determinations to ensure due process and fairness;¹⁶
- Improve and centralize the NCUA's appeals procedures in one section of the NCUA's regulations;¹⁷
- Provide greater transparency regarding the calculation of each eligible financial institution's pro rata share of a declared equity distribution from the Share Insurance Fund;¹⁸
- Decrease the burden and improve the efficiency of the NCUA's capital planning and stress testing rules;¹⁹
- Decrease burden and add flexibility to the NCUA's advertising requirements;²⁰ and
- Add flexibility to the NCUA's field-of-membership processes.²¹

Additionally, the NCUA proposed or sought advanced comment on amendments that would provide regulatory relief by:

- Improving the NCUA's regulations governing federal credit union bylaws;²²
- Making clarifying and technical changes to improve the user-friendliness of the NCUA's loan maturities requirements;²³
- Clarifying the NCUA's limits on loans to a single borrower or group of associated borrowers;²⁴
- Proposing a delay in the effective date of the NCUA's risk-based capital rule and a decrease in the number of credit unions covered by the rule;²⁵ and
- Improving the NCUA's appraisals regulation to reduce burden and make compliance easier.

The NCUA plans to publish its second Regulatory Reform Task Force report in the coming months. This report will provide an updated blueprint for the agency's regulatory reform agenda and a formal means of measuring the agency's regulatory relief efforts moving forward.

¹⁶ 82 FR 50270 (Oct. 30, 2017).

¹⁷ 82 FR 50288 (Oct. 30, 2017).

¹⁸ 83 FR 7954 (Feb. 23, 2018).

¹⁹ 83 FR 17901 (Apr. 25, 2018).

²⁰ 83 FR 17910 (Apr. 25, 2018).

²¹ 83 FR 30289 (June 28, 2018).

²² 83 FR 12283 (Mar. 21, 2018).

²³ 83 FR 39622 (Aug. 10, 2018).

²⁴ *Id.*

²⁵ 83 FR 38997 (Aug. 8, 2018).



Finally, the NCUA will continue its annual regulatory review to provide stakeholders with a means of providing feedback on the regulatory burden they face. As part of this process, the agency reviews and solicits public comment on one-third of the agency's regulations each year. Agency staff then provides the NCUA Board with regulatory recommendations, based in part on the comments received. The NCUA will open the comment period for the first one-third of its regulations in January 2019.

Capital

Given the critical importance of capital to the safety and soundness and viability of any financial institution, I would like to highlight the NCUA's recent actions in this area. I believe that, while we should, of course, thoughtfully consider the lessons learned from the recent financial crisis, it is incumbent on regulators to focus on the changing financial landscape and adopt targeted regulations to address the actual risks presented. Accordingly, the NCUA Board recently finalized or proposed a number of amendments to the agency's capital rules to be commensurate with the safety and soundness risks currently present in the credit union system.

- *Risk-based Capital* — In August 2018, the NCUA issued a proposed rule to delay the effective date of the NCUA's 2015 final risk-based capital rule for one year, from January 1, 2019 to January 1, 2020.²⁶ The proposal also amended the definition of a "complex" credit union for risk-based capital purposes adopted in the 2015 final rule by increasing the threshold level from \$100 million to \$500 million. These proposed changes would provide covered credit unions with additional time to prepare for the rule's implementation, and exempt an additional 1,026 credit unions from the rule without, as described in detail in the proposed rule, subjecting the Share Insurance Fund to undue risk. Under the proposal, the NCUA's current prompt corrective action requirements remain in effect during the implementation period.
- *Capital Planning and Stress Testing* — In April 2018, the NCUA issued a final rule amending its regulations regarding capital planning and stress testing for federally insured credit unions with \$10 billion or more in assets.²⁷ The final rule also made the NCUA's requirements more efficient by authorizing covered credit unions to conduct their own stress tests in accordance with the NCUA's requirements. The change reflects the NCUA's experience in implementing the previous rule's requirements, while also taking into consideration the systemic risk that covered credit unions pose to the Share Insurance Fund. Both the capital planning and stress testing requirements in this rule were tiered to reflect

²⁶ 83 FR 38997 (Aug. 8, 2018).

²⁷ 83 FR 17901 (Apr. 25, 2018).



credit unions' size, complexity, and financial condition. As a result, certain covered credit unions will have their regulatory burden reduced.

- *Corporate Credit Union Capital Standards* — When the NCUA Board last made comprehensive revisions to its rules governing corporate credit unions in 2010, it focused on stabilizing the corporate system and improving their ability to function and provide services to natural-person credit unions. Since then, the corporate system contracted and consolidated, with assets declining from approximately \$81.7 billion prior to 2010 to approximately \$24.9 billion in 2017. During that same period, the number of corporates declined from 26 to 11. Given these developments, the Board determined it was appropriate to revisit the capital standards for corporate credit unions in 2017. The resulting final rule primarily clarified the capital requirements for corporate credit unions and expanded what constitutes Tier 1 capital.²⁸
- *Alternative Forms of Capital* — Under the Federal Credit Union Act, only low-income credit unions are able to accept secondary capital (a form of alternative capital).²⁹ However, since joining the NCUA Board, one of my goals has been to increase credit union access to capital, provided the form of such capital is consistent with the system of cooperative credit. In January 2017, the NCUA Board issued an advance notice of proposed rulemaking on potential changes to the rules governing alternative forms of capital that credit unions could use to meet their risk-based net worth requirements. The notice asked stakeholders for their views on a range of topics, including any regulatory changes that would be necessary to facilitate greater use of alternative capital, potential tax implications related to issuing alternative capital, particularly for state-chartered credit unions, and the impact of alternative capital on the mutual ownership structure of credit unions, among others. After evaluating the comments received on that proposal, the NCUA included alternative capital as part of its regulatory reform agenda.

²⁸ 82 FR 55497 (Nov. 22, 2017).

²⁹ Alternative capital includes two different categories: secondary capital and supplemental capital. Secondary capital is currently permissible under the Federal Credit Union Act only for low-income designated credit unions to issue and to be counted toward both the net worth ratio and the risk-based net worth requirement of NCUA's prompt corrective action standards. The Board is considering changes to the secondary capital regulation for low-income designated credit unions. There are no other forms of alternative capital currently authorized. However, the Board is also considering whether or not to authorize credit unions to issue supplemental capital instruments that would only count towards the risk-based net worth requirement.



Additional Flexibility in Credit Union Lending

Over the last two years, the NCUA Board has, through consistent bipartisan collaboration and effort, adopted regulatory changes to provide federal credit unions with increased flexibility in their lending activities. These changes are intended not only to reduce regulatory burden, but also to allow credit unions to offer lending products that serve the credit needs of their members and communities better, including those of modest means and the underserved.³⁰

- *Payday Alternative Loan Program* — To provide credit union members with a safe and less expensive alternative to high-cost, traditional payday loans, the NCUA’s regulations permit federal credit unions to offer small-dollar loans called payday alternative loans (PALs).³¹ As of the end of 2017, 524 federal credit unions reported that they made PALs loans during the year. These credit unions reported making 191,216 loans amounting to \$132.8 million in PALs during the year. In comparison, in 2012, 476 federal credit unions reported that they made 115,809 loans amounting to \$72.6 million of lending during the year.³²

Strong and consistent demand continues for short-term, small dollar loans, and credit unions can present consumers with a viable alternative to predatory lenders. In June, the NCUA Board proposed amendments to the NCUA’s PALs regulation to provide federal credit unions with an additional payday alternative loan option.³³ The new proposed payday alternative loan option (PALs II) would not replace the current payday alternative loan program (PALs I), but would serve as an additional market-based alternative. The proposed PALs II option has features to enable federal credit unions to meet the needs of certain borrowers not met by the current program and encourage additional federal credit unions to offer PALs.

The NCUA Board also sought public comment on a possible third option (PALs III), asking, in particular, for feedback on interest rates, maximum loan amounts, loan terms, and application fees. To gain additional industry insight into this program, I recently met with representatives of the Pew Charitable Trusts and the Center for Responsible Lending. They offered sharply differing analyses, both from each other and from the NCUA, of our programs and their views on

³⁰ The Federal Credit Union Act, governing this agency and federally insured credit unions, specifies this national system is intended to meet “the credit and savings needs of consumers, especially persons of modest means.” Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998). Also, see *Serving the Underserved*, National Credit Union Administration, <https://www.ncua.gov/services/Pages/field-of-membership-chartering/underserved.aspx>.

³¹ 12 CFR 701.21(c)(7)(iii).

³² 83 FR 25583 (June 4, 2018).

³³ *Id.*



the optimal structure for small dollar lending programs that offer robust consumer protection while permitting lenders to earn a reasonable risk-adjusted rate of return.

- *Maturity Limits* — The Federal Credit Union Act places a general 15-year maturity limit on loans made by federal credit unions.³⁴ In August, the NCUA Board issued a proposed rule designed to improve the clarity and user-friendliness of the NCUA’s regulations implementing the current maturity limits.³⁵ The NCUA Board also solicited advanced comment on how it could, in instances when the Federal Credit Union Act authorizes the NCUA Board to deviate from the statutory maturity limits, provide additional flexibility with respect to those limits. The NCUA recognizes that any such additional flexibility will enable federal credit unions to provide lending products that serve the credit needs of their members and their communities better.
- *Maximum Loan Rate Ceiling* — The Federal Credit Union Act caps the interest rate on federal credit union loans at 15 percent. However, the NCUA Board has discretion to raise that limit for 18-month periods, “after consultation with the appropriate committees of the Congress, the Department of Treasury, and the [f]ederal financial institution regulatory agencies, ... if it determines that money market interest rates have risen over the preceding six-month period and that prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth.”³⁶ Since 1987, the NCUA Board has maintained an interest rate cap at 18 percent for virtually all federal credit union lending.³⁷

The NCUA is developing an advanced notice of proposed rulemaking to further explore and solicit public input on alternatives to the current fixed, temporary rate ceiling. Possible alternatives include a higher, variable, or tiered interest-rate ceiling. The agency believes that any interest rate ceiling must protect consumers and help federal credit unions fulfill the needs of their members and communities, especially those of modest means and the underserved. At the same time, such a ceiling should allow federal credit unions to provide competitive products and cannot pose undue risk to the Share Insurance Fund.

³⁴ 12 U.S.C. 1757(5).

³⁵ 83 FR 39622 (Aug. 10, 2018).

³⁶ 12 U.S.C. 1757(5)(A)(vi)(1).

³⁷ Since 1987, the only exception to the 18 percent interest rate cap for federal credit union lending is the current PALs program. That program has an interest rate cap of 1000 basis points above the then-current interest rate cap established by the NCUA Board.



Initiatives Aimed at Increasing Agency Efficiency and Reducing Examination and Reporting Burdens

The NCUA is improving the regulatory environment for credit unions without sacrificing our safety and soundness mission. Upon becoming Chairman in 2017, I commissioned a full review of the NCUA's operations and staffing needs. This review resulted in a plan that reduces the agency's regional structure from five to three regional offices, an 80 percent reduction in the agency's leased space, and reorganizes several central office functions to reduce costs and increase efficiencies. While the majority of the reorganization has been completed, the final phase of the regional consolidation will occur in January 2019.

As part of the agency's broader reform plan, we also undertook a number of initiatives to increase the efficiency in our examination, data collection, and reporting efforts. Specifically, I call your attention to the following programs:

Exam Flexibility Initiative³⁸

This initiative provides greater examination efficiency and flexibility for credit unions and the agency, and improves coordination with state supervisors. Because of this initiative, the NCUA adjusted the frequency of examinations based on a credit union's size, complexity, operating condition, and, in the case of state-chartered credit unions, the frequency of state examinations. This initiative resulted in meaningful regulatory relief for the vast majority of credit unions, led to greater coordination between federal and state regulators, and allowed the NCUA to focus more efforts on troubled credit unions, with the anticipated benefit of addressing some problems earlier when they are easier and less costly to resolve.

The Enterprise Solution Modernization Program³⁹

This multi-year program modernizes the NCUA's technology infrastructure to create an integrated examination and data environment, and further enhances the agency's cybersecurity posture. It incorporates emerging technology solutions that support the NCUA's examination, data collection, and reporting efforts to improve key, integrated business processes and meet applicable security protocols. The program will improve the examination process and ease burdens on credit unions and staff by reducing the amount of examination and supervision time spent onsite in credit unions. The NCUA expects an improved user experience and increased efficiencies when the new systems are in place.

³⁸ See NCUA Exam Flexibility Initiative, <https://www.ncua.gov/About/Pages/open-government/exam-flexibility-initiative.aspx>.

³⁹ See NCUA Enterprise Solution Modernization (ESM) Program, <https://www.ncua.gov/About/Pages/open-government/enterprise-solution-modernization-program.aspx>.



The Call Report Modernization Project⁴⁰

This project complements the Enterprise Solution Modernization Program and involves a comprehensive review of Call Report and Credit Union Profile data content.⁴¹ The NCUA developed a prototype Call Report and Profile that eliminated outdated fields, and simplified the reporting process without sacrificing important information necessary for proper supervision and data analyses. In order to ensure a transparent and collaborative process the agency solicited public comment on the prototype. The NCUA estimates the proposed changes will reduce the number of account codes collected from credit unions. If the proposal is adopted, the agency will revise and improve its Call Report schedules and instructions to make it easier for credit unions to complete this critical regulatory filing.

Initiatives Aimed at Increasing Agency Effectiveness in Maintaining Safety and Soundness of the Credit Union System and the Share Insurance Fund

The NCUA has undertaken a variety of initiatives to improve the agency's effectiveness in fulfilling our core mission: protecting the safety and soundness of the credit union system and the Share Insurance Fund. These initiatives complement the NCUA Board's efforts to reduce regulatory, examination, and reporting burdens for federally insured credit unions.

Improved Risk Identification Techniques

The NCUA is developing new and advanced risk identification and monitoring capabilities and techniques. These new data and analytical techniques will facilitate more data-driven supervision and enable the agency to better identify and address risk outliers. Additionally, the NCUA incorporated advances in identifying credit unions with an elevated risk of fraud. This further supports the objective to spend less time onsite at credit unions and leverage technology to maximize efficiency.

Increased Use of Specialists

With the increasing complexity of the financial services landscape, the NCUA has expanded its use of specialists within its examination ranks. We added additional disciplines and subject matter experts to our examination teams to address a broader range of financial products, services, and risks effectively.

Expanded Examiner Training and Guidance

The NCUA recognizes the importance of identifying undue risk exposures timely and relies on both specialized staff and techniques to do so. The agency updated its subject

⁴⁰ See NCUA Call Report Modernization, <https://www.ncua.gov/About/Pages/open-government/call-report-modernization.aspx>.

⁴¹ The NCUA uses the Call Report and Profile to collect financial and nonfinancial information from federally insured credit unions. The resulting data are integral to risk supervision at institution and industry levels, which is central to safeguarding the integrity of the National Credit Union Share Insurance Fund.



matter examiner training to ensure specialists maintain current knowledge sets and are consistent in the analysis of risk and determination of safety and soundness concerns. The NCUA has also conducted a comprehensive update to its core examiner training. Additionally, the NCUA's *Examiner's Guide* is undergoing an extensive update to expand and clarify risk management expectations for the growing range of financial services credit unions engage in.

Enhanced Examination Quality Control

The NCUA is improving its quality control program to strengthen the examination and supervision process. These improvements will increase our consistency when assessing risk. It will also enable the agency to better identify and address safety and soundness issues.

Recommendations for Legislative Action

While the NCUA Board can provide federally insured credit unions with meaningful regulatory relief, congressional action is required to provide additional flexibility in some areas. Today, I would like to highlight four areas where congressional action can provide new avenues for credit union growth, without sacrificing the safety and soundness of the credit union system. These include modifying the Federal Credit Union Act's provisions related to field of membership, granting the NCUA vendor authority, authorizing alternative forms of capital, and giving the NCUA Board broader authority to establish a maximum loan rate ceiling for federal credit unions.

Field of Membership

The Federal Credit Union Act currently permits only federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership.⁴² Modification to the Federal Credit Union Act to permit all types of federally chartered credit unions to add underserved areas to their fields of membership would allow such institutions to offer financial services to those with no or limited access to federally insured financial institutions.

Specifically, we suggest Congress allow all federal charter types, not just multi-common bond charters, to add a local community, neighborhood, or rural district that is an investment area or underserved, as determined by the NCUA Board, if the credit union establishes and maintains an office or facility. Allowing federal credit unions with a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change also could enable more credit unions to participate in programs offered through the congressionally established Community Development Financial Institutions Fund, thus increasing the availability of affordable

⁴² 12 U.S.C. 1759(c)(2)



financial services in distressed areas. The language of H.R. 4665, the Financial Services for the Underserved Act, accomplishes this objective.

We also suggest several other statutory reforms to the Federal Credit Union Act’s field-of-membership provisions. Specifically, we urge Congress to consider allowing federal credit unions to serve underserved areas without also requiring those areas to be local communities. Additionally, we recommend that Congress simplify or remove the “facilities” test for determining if an area is underserved.⁴³

We also request that Congress consider eliminating the Federal Credit Union Act’s requirement that a multiple common-bond credit union be within “reasonable proximity” of the location of a group to provide services to members of that group.⁴⁴ Further, we ask Congress to consider granting explicit authority for web-based communities as a basis for a credit union charter. This authority would better recognize the ways in which people share common bonds today.

Finally, we encourage Congress to consider providing greater flexibility for low-income individuals to join federal credit unions, furthering the credit union mission of meeting “the credit and savings needs of consumers, especially persons of modest means.”⁴⁵ Specifically, we suggest that Congress revise the Federal Credit Union Act to allow the NCUA to permit federal credit unions to add anyone residing in a census tract where current projections indicate he or she qualifies as low-income.

Vendor Authority

The NCUA requests that the Committee consider legislation to provide the agency with examination and enforcement authority over certain third-party vendors — including credit union service organizations (CUSOs). As fintech options increase both in importance and use in credit unions, this request becomes even more crucial to the NCUA’s defense against cybersecurity risks in the credit union system.

⁴³ The Federal Credit Union Act presently requires an area to be underserved by other depository institutions, based on data collected by the NCUA or federal banking agencies. 12 U.S.C. 1759(c)(2)(A)(ii). The NCUA has implemented this provision by requiring a facilities test to determine the relative availability of insured depository institutions within a certain area. Congress could instead allow the NCUA to use alternative methods to evaluate whether an area is underserved to show that although a financial institution may have a presence in a community, it is not qualitatively meeting the needs of an economically distressed population.

⁴⁴ See 12 USC 1759(f)(1).

⁴⁵ The Federal Credit Union Act, governing this agency and federally insured credit unions, specifies this national system is intended to meet “the credit and savings needs of consumers, especially persons of modest means.” Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998); see also *Serving the Underserved*, National Credit Union Administration, <https://www.ncua.gov/services/Pages/field-of-membership-chartering/underserved.aspx>.



Financial technological innovation is poised to transform the financial services industry by increasing efficiency and convenience, and by providing new and innovative solutions to consumers and businesses. Fintech is revolutionizing financial services, but it also is requiring traditional financial service providers to adapt and embrace new methods, technological innovation, and new technology partners in order to remain competitive in the marketplace.

The rapid movement toward digital financial transactions and services benefits smaller financial institutions like credit unions by improving service to consumers and small businesses and reducing costs. However, fintech also increases potential systemic cybersecurity risks across the financial services landscape. The credit union system is particularly at risk because the NCUA does not have sufficient legal authority to directly identify and address systemic cybersecurity risk and the potential contagion risk that key fintech service providers can pose. Specifically, in order to manage the systemic risk that fintech poses to the credit union system appropriately, the NCUA needs vendor authority comparable to the authority provided to our Federal Financial Institutions Examination Council counterparts.

Currently, the NCUA may only examine CUSOs and third-party vendors with their permission and cannot enforce any necessary corrective actions or share the results of a voluntary review with customer credit unions of the third-party vendor. To underscore the seriousness of this situation, nearly all of the core technology service providers that serve credit unions exclusively declined a voluntary review by the NCUA in recent years. Even though CUSOs are required to give the NCUA access to their books and records, without enforcement authority, they are free to reject the NCUA's recommendations to implement the appropriate corrective actions that would mitigate identified risks. This lack of vendor authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators, a situation noted as a concern by both the Government Accountability Office and the Financial Stability Oversight Council.⁴⁶

For example, the Government Accountability Office has noted that the NCUA has a limited ability to assess and mitigate the risks third-party vendors, including CUSOs, pose for credit unions and ultimately the Share Insurance Fund. In a 2015 report on cyber threats to banks, the Government Accountability Office said that:

⁴⁶ GAO, *Electronic Banking: Enhancing Oversight of Internet Banking Activities*, GAO/GGD-99-91 (Washington, D.C.: July 6, 1999). Also, see GAO-04-91 and See U.S. Gov't. Accountability Office, GAO-15-509, *Cybersecurity: Bank and Other Depository Regulators Need Better Data and Analytics and Depository Institutions Want More Usable Threat Information* 32 (2015), available at <https://www.gao.gov/assets/680/671105.pdf>.



We have long supported granting NCUA such authority. In a July 1999 report, we found that joint regulatory examinations of third-party service providers might increase the economy and efficiency of federal oversight of Internet banking activities. At the time, NCUA's temporary authority to examine third-party providers was set to expire in December 2001. We suggested that Congress consider extending NCUA's temporary examination authority beyond 2001. [47] The authority was not extended. In an October 2003 report, we found that NCUA had adopted a risk focused examination program but faced challenges in implementing it, partly because NCUA lacked authority to examine third-party service providers, on which credit unions increasingly relied to provide services. [48] We asked that Congress consider granting NCUA legislative authority to examine third-party service providers that provide services to credit unions and are not examined through the other federal banking agencies. This matter was never implemented. [49] We maintain that NCUA would benefit from this authority. The services of the third-party providers are integral to the operations of many credit unions, and deficiencies in providers' operations quickly could become deficiencies that produce financial and other harm at credit unions. In its response to our 2003 report, NCUA also stated that because many third-party service providers service numerous credit unions, a failure of a provider posed systemic risk issues. In its 2015 annual report, FSOC calls for granting NCUA examination and enforcement authority over third-party service providers in an effort to close what FSOC describes as a significant regulatory gap. We agree with this assessment. Without authority to examine third-party service providers, NCUA risks not being able to effectively monitor the safety and soundness of regulated credit unions.⁵⁰

Today, the top five technology service providers serve more than half of all credit unions, representing 92 percent of the credit union system's assets. Data from the fourth quarter of 2017 show that credit unions using the services of a CUSO accounted for \$1.375 trillion in assets or 99.7 percent of the system's assets. This figure is up from 88 percent of assets at year-end 2014, and it does not include third-party vendors that are not CUSOs. A failure of even one of these vendors represents significant potential risk to the Share Insurance Fund and the potential for losses from these

⁴⁷ GAO, *Electronic Banking: Enhancing Oversight of Internet Banking Activities*, GAO/GGD-99-91 (Washington, D.C.: July 6, 1999).

⁴⁸ See GAO-04-91.

⁴⁹ [GAO] closed this matter as not implemented in July 2008.

⁵⁰ See U.S. Gov't. Accountability Office, *GAO-15-509, Cybersecurity: Bank and Other Depository Regulators Need Better Data and Analytics and Depository Institutions Want More Usable Threat Information* 32 (2015), available at <https://www.gao.gov/assets/680/671105.pdf>.



organizations are not hypothetical. Continued consolidation in the number of service providers and credit unions only heightens this risk. Without vendor authority, the NCUA cannot accurately assess the actual risks present in the credit union system, and determine if current CUSO or third party vendor risk-mitigation strategies are adequate to protect the system from a systemic risk. This leaves thousands of credit unions, billions in assets, and millions of credit union members potentially exposed.

Some parties have cited potential budget increases as justification for opposing the NCUA's vendor review authority. However, since 2008, CUSOs have caused more than \$500 million in losses to federally insured credit unions, and they have contributed to the failure of 11 credit unions. The agency believes that any budget increase resulting from granting vendor review authority pales in comparison to losses sustained without it. In addition, more than half of the NCUA's institutions hold less than \$33 million in assets and average approximately three to four full time employees per institution. These institutions are heavily dependent on third-party outsourced services and do not possess the resources to independently perform full due diligence on all of their critical services providers. The NCUA can add value to the industry through organized and professional oversight of key critical service providers and effectively reduce the administrative and regulatory burden for these small institutions.

If granted this authority, I assure the Committee that any costs associated with the new authority would be transparently accounted for in the NCUA's public budget documents. Instead of regularly examining every third party, the NCUA would focus on examining those vendors with red flags or those that pose the greatest risk to the credit union system. When the agency identifies material or widespread safety and soundness issues, we would have the authority to mitigate the risk and reduce losses to the Share Insurance Fund.

This authority would actually provide a small measure of regulatory relief for credit unions, especially smaller ones. The ability to address weaknesses at the source — the service provider — could easily save the NCUA and credit unions time and valuable resources by eliminating the need to mitigate the same issue at hundreds of credit unions. In other words, credit unions will no longer be stuck in the middle of trying to resolve problems between their vendors and their regulator and insurer. Further, the NCUA could remove current regulations requiring credit unions to maintain and modify contracts with CUSOs to govern certain aspects of these operations, helping to provide additional measures of regulatory relief to credit unions.



Alternative Forms of Capital

As previously discussed in this testimony, under the Federal Credit Union Act, only low-income credit unions are able to include secondary capital (a form of alternative capital) in the calculation of their statutory net worth ratio.⁵¹ However, since joining the NCUA Board, one of my goals has been to increase credit union access to capital, provided the form of such capital is consistent with the system of cooperative credit.

In January 2017, the NCUA Board issued an advance notice of proposed rulemaking on potential changes to the rules governing alternative forms of capital that credit unions could use to meet their risk-based net worth requirements. The notice asked stakeholders for their views on a range of topics, including any regulatory changes that would be necessary to facilitate the greater use of alternative capital, potential tax implications related to issuing alternative capital, particularly for state-chartered credit unions, and the impact of alternative capital on the mutual ownership structure of credit unions, among others. After evaluating the comments received on that proposal, the NCUA included alternative capital as part of its regulatory reform agenda.

While this proposal is an important step in the NCUA Board's development of market-based rules that will allow credit unions to count supplemental capital for purposes of risk-based capital, only Congress can authorize alternative forms of capital that would count towards the statutory net worth ratio of a credit union without a low-income designation.

The need for this action is demonstrated with a real example. I recently met with a group interested in forming a credit union with a proposed field of membership consisting of the members of an overwhelmingly African American religious denomination. The credit union would not qualify as low-income and, accordingly, would not have access to supplemental capital for the statutory net worth ratio or, under present NCUA regulation, the risk-based capital ratio. The group was adamant in their desire to form a not-for-profit cooperative and had no interest in a shareholder model. Unfortunately, without congressional action in this area, the group is unlikely to be able to form a viable cooperative.

⁵¹ Alternative capital includes two different categories: secondary capital and supplemental capital. Secondary capital is currently permissible under the Federal Credit Union Act only for low-income designated credit unions to issue and to be counted toward both the net worth ratio and the risk-based net worth requirement of NCUA's prompt corrective action standards. The Board is considering changes to the secondary capital regulation for low-income designated credit unions. There are no other forms of alternative capital currently authorized. However, the Board is also considering whether to authorize credit unions to issue supplemental capital instruments that would only count towards the risk-based net worth requirement.



Loan Rate Ceiling

Finally, congressional action to give the NCUA Board broader authority to establish a maximum loan rate ceiling for federal credit unions based on financial criteria and for periods as the NCUA Board may determine would dramatically simplify the administration of interest rate changes and make it much easier for credit unions to comply. Providing the NCUA with this authority would allow the agency to provide much more flexibility to credit unions, while simultaneously protecting consumers and the credit union system. It would also allow the NCUA flexibility to establish loan rate ceilings that permit and encourage credit unions to continue to offer products with rates that appeal to and help those of modest means and the underserved as interest rates change.

Conclusion

In closing, I thank the Committee for the opportunity to provide the NCUA's perspectives on the EGRRCPA and detail the steps the agency has taken to implement its relevant provisions. As always, the NCUA stands ready to work with members of this Committee and with Congress on these legislative recommendations and other proposals that further the agency's safety and soundness mission, and ensure consumers have greater access to affordable financial services.