JEB HENSARLING, TX, CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

MEMORANDUM

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: April 5, 2013

Subject: April 10 Subcommittee on Financial Institutions and Consumer Credit Hearing on "Examining Credit Union Regulatory Burdens"

The Subcommittee on Financial Institutions and Consumer Credit will hold a hearing on "Examining Credit Union Regulatory Burdens," at 2:00 p.m. on April 10, 2013, in Room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- Mr. Robert D. Burrow, President and CEO, Bayer Heritage Federal Credit Union, on behalf of the National Association of Federal Credit Unions
- Ms. Pamela Stephens, President and CEO, Security One Federal Credit Union, on behalf of the Credit Union National Association
- Mr. Mitchell Reiver, General Counsel, Melrose Credit Union

Background

Credit unions are non-profit, cooperative depository institutions chartered to provide low-cost credit to their members who are linked by a common bond. Organized as mutual institutions, credit unions have no stockholders; thus, they can only raise capital through retained earnings. Because they are non-profit institutions, credit unions are exempt from federal taxation, which allows them to offer lower interest rates on loans and higher interest on deposits than other depository institutions.

Following the proliferation of credit unions across the country and the enactment of credit union legislation in 32 states, Congress passed the Federal Credit Union Act of 1934, which established a national system for chartering and supervising federal credit unions. In 1970, Congress created the National Credit Union Administration (NCUA) to regulate federal credit unions. The NCUA also manages the National Credit Union Share Insurance Fund (NCUSIF), which insures the deposits of members of both federally and state-chartered credit unions. As of 2011, there were approximately 7,000 federally insured credit unions, with nearly 92 million members and $961 billion in assets.[1]

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[1] National Credit Union Administration, "2011 Annual Report," available at http://www.ncua.gov/Legal/Documents/Reports/AR2011.pdf.

Federally insured state-chartered credit unions are primarily regulated and supervised by state supervisory authorities; however, because the NCUA is responsible for administering applicable federal laws and regulations and ensuring the NCUSIF's solvency, the NCUA often participates in joint examinations.

Credit union charters are granted by the NCUA or state regulators on the basis of a common bond among the credit union's members, which determines the credit union's field of membership. The NCUA recognizes three types of credit unions: (1) "single common bond credit unions," for groups that have a common occupation or association; (2) "multiple common bond credit unions," composed of more than one group with common occupations or associations, so long as the number of members in each group does not exceed 3,000; and (3) "community credit unions," composed of people or organizations within a defined geographic area.

Regulatory Compliance Costs

Regulatory compliance costs fall into two categories: costs that result from regulations that prevent an institution from engaging in certain activities, and costs that result when regulations require an institution to perform certain actions. For instance, when a regulation is proposed, an institution may incur legal expenses from hiring lawyers to interpret the regulation and comment upon its possible impact. After the regulation has been finalized, an institution may continue to incur legal expenses to hire lawyers to review its procedures and forms to ensure that it complies with the regulation; administrative expenses for coordinating compliance activities and designing internal audit programs; training expenses; information technology expenses for programming and testing of software; compliance costs for designing, printing and mailing new forms and other disclosures; and managerial expenses for monitoring employees' compliance with the regulations and making records and employees available for examinations by regulatory agencies.

Because smaller institutions do not have the same economies of scale of larger institutions, these costs can disproportionately impact a smaller institution's ability to offer competitive pricing for their services. For decades, financial institutions have registered concerns with policymakers about compliance costs, claiming these costs are ballooning rapidly and threatening the economy by diminishing their ability to offer loans and discounted services to their customers. Despite these complaints, Congress has increased the regulatory burdens on financial institutions over the years by enacting more laws, while efforts to rationalize and streamline existing regulations have remained a low priority.

Expansion of Regulations since the Financial Crisis

In the wake of the financial crisis, financial institutions have been subject to even more regulations promulgated under laws like the Credit Card Accountability Responsibility and Disclosure Act (P.L. 111-24) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203). The Dodd-Frank Act established several new government agencies—such as the Consumer Financial Protection Bureau (CFPB), the Office of Financial Research (OFR), and the Financial Stability Oversight Council (FSOC)—and directed these new agencies and existing ones to promulgate more than 400 new rules. The Dodd-Frank Act also mandated changes to several business practices, such as limiting the amount that financial institutions could charge for processing debit card transactions. Proponents of these regulations contend that although financial regulations may impose costs on financial institutions and reduce the availability of credit, the alternative is a bigger cost borne by the public in the form of financial institution failures and credit busts that follow booms fueled by imprudent lending.

Nonetheless, many in the financial services industry believe these increased regulatory costs could lead to depressed revenues, increased operating costs, and tighter profit margins. As evidence that these new laws will add even more complexity to regulatory compliance, financial institutions point to the 2012-2013 edition of the Bureau of Labor and Statistics' Occupational Outlook Handbook, which states that "employment of financial examiners is projected to grow 27 percent from 2010 to 2020, faster than the average for all occupations."[2]

Long-Term Impact on Credit Unions

Smaller financial institutions are more sensitive to increased compliance costs than larger financial institutions, particularly those perceived by the market and regulators as being "too big to fail." These increased compliance costs, along with the recent economic instability, have fueled overall declines in financial institutions' net-interest income. Many financial institutions have responded by increasing their fees and eliminating customer services such as free checking.

Financial institutions find themselves facing not only more regulations but more aggressive enforcement by regulatory agencies, which further increases compliance costs. According to trade associations that represent community banks and credit unions, supervisory agencies have been more critical in their examinations, less tolerant of minor compliance infractions, and quicker to downgrade examination ratings. As a result, more financial institutions have been subject to enforcement actions in recent years. Defending against negative supervisory findings and implementing the required remediation absorbs management time and financial resources. If compliance costs increase past the point of economic sustainability, many smaller credit unions may merge with larger credit unions or convert their charters. Between 1969 and 2012, the number of credit unions fell from nearly 24,000 to 7,000, representing an annual merger rate of approximately three percent.[3]

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[2] Bureau of Labor Statistics, U.S. Department of Labor, *Occupational Outlook Handbook, 2012-2013 Edition*, Financial Examiners, *available at* http://www.bls.gov/ooh/business-and-financial/financial-examiners.htm.

[3] In all but three years since 1984, credit unions merged at an annual rate of 2.5 – 3.5 percent. *See* Wilcox, James A. and Luis G. Dopico, "Credit Union Mergers: Efficiencies and Benefits," September 12, 2011, *available at* http://www.frbsf.org/publications/economics/letter/2011/el2011-28.html.