



Written Testimony of  
William Cheney

President/CEO of  
Xerox Federal Credit Union

On Behalf of  
The National Association of Federal Credit Unions

Subcommittee on Financial Institutions and Consumer Credit  
United States House of Representatives

“Financial Services Regulatory Relief Act of 2002”  
H.R. 3951

April 25, 2002

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## Introduction

The National Association of Federal Credit Unions (NAFCU) is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of approximately 900 federal credit unions -- financial institutions from across the nation -- representing approximately 22 million individual credit union members. NAFCU-member credit unions collectively account for approximately two-thirds of the assets of all federal credit unions. NAFCU and the entire credit union community appreciate this opportunity to participate in the discussion regarding regulatory reform and other important issues affecting our nation's credit unions.

Historically, credit unions have served a unique function in the delivery of financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was recognized as a way to promote thrift and to make financial services available to people, many of whom otherwise would have no access to credit. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for over 80 million Americans. Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 USC 1752(1)) While more than 65 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain totally committed to providing their members with efficient, low cost personal service; and,
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 10,000 federally insured credit unions serve a different purpose and have a fundamentally different structure, existing solely for the purpose of providing financial services to their members. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union — “one member, one vote” — regardless of the dollar amount members have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Unlike their counterparts at banks and thrifts, federal credit union directors, motivated solely by a desire to be of service to others, serve without remuneration — a fact epitomizing the true “volunteer spirit” permeating the credit union community.

Also, unlike banks, membership in a credit union is not open to the general public; a credit union may serve only those individuals within its field of membership. Federal credit unions have an independent federal regulator (the National Credit Union Administration - NCUA) and an insurance fund (the National Credit Union

Share Insurance Fund - NCUSIF) separate from the bank and thrift insurance funds managed by the FDIC.

Unlike thrifts, credit unions have never cost the American taxpayer a dime. Unlike the FDIC and the FSLIC – the precursors to BIF and SAIF – that were started with seed money that came as taxpayers’ dollars from the United States Treasury, every dollar that has ever gone into the NCUSIF has come from the credit unions it insures. And unlike the thrift insurance fund, credit unions have never needed a federal bailout.

America’s credit unions have remained true to their mission of “promoting thrift” and providing “a source of credit for provident or productive purposes.” In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219). In the “findings” section of that law, Congress declared that, “The American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue [s] to fulfill this public purpose.”<sup>1</sup>

Today, credit unions play an important role in the lives of millions of Americans from all walks of life. As the package of financial services offered by various financial institutions becomes ever more homogenized, the emphasis has begun to shift from types of service to quality and cost of service. Credit unions are

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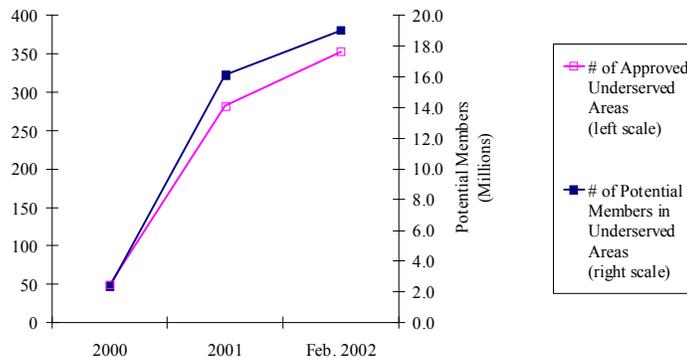
<sup>1</sup>12 USC 1752(1).

second to none in providing their members with quality personal service at the lowest possible cost. According to the 2001 *American Banker*/Gallup Consumer Survey, credit unions had the highest rated service quality of surveyed financial institutions. This has held true each year since the survey was initiated -- a trend that shows no sign of change.

In addition, credit unions continue to serve those of modest means. Since the



## UNDERSERVED AREAS ADDED TO CREDIT UNION MEMBERSHIP



*Source: National Credit Union Administration*

passage of CUMAA in 1998, federal credit unions have added over 350 underserved areas, providing low cost financial services to an additional 19 million individuals that now have at least one option in obtaining much needed financial services.

Xerox Federal Credit Union was chartered under California law in 1964 as the Scientific Data Systems Credit Union. In 1970, after Xerox Corporation acquired Scientific Data Systems, the credit union was granted a federal charter and changed its name to Xerox Federal Credit Union. In 1975, the NCUA approved a charter expansion allowing Xerox FCU to serve Xerox employees throughout the United States. Xerox FCU currently serves over 72 thousand members nationwide with assets of over \$550 million. We currently have 18 offices in nine States. We are the only credit union chartered to serve Xerox employees in the United States.

Through the first quarter of 2001, we accepted only "Xerox-related companies" into our field of membership, in an effort to remain "single sponsor". However, given changes in legislation, regulation, and Xerox business from 1975-2000, NCUA has reclassified Xerox Federal Credit Union as "multi-sponsor".

Since that time, we have added two groups of note -- The Seneca Park Zoo Society in Rochester, New York, and an underserved area in Lewisville, Texas. All other groups that we have added have been Xerox related or very closely associated with Xerox.

### **CUMAA and Beyond**

Credit unions have been under assault by the banking industry for nearly two decades. The Supreme Court's decision in 1998 in the *AT&T Family Federal Credit*

*Union* field of membership case brought the issue to a head. Congress' prompt passage of CUMAA in the summer of 1998 was seen by many as a significant victory for credit unions. When Congress sent that bill to President Clinton to be signed into law it overturned in six short months a decision that had encompassed eight years of litigation.

Make no mistake about it, CUMAA was a necessary piece of legislation for credit unions at the time of its enactment. Was it perfect? No. Would NAFCU liked to have changed various provisions in the bill? Yes. But CUMAA was an important piece of legislation at the time because it codified a number of fundamental credit union concepts embraced by both federal and state-chartered credit unions. These include:

- the multiple-group policy that NCUA had initiated in 1984;
- the “once a member always a member” principle followed by virtually every credit union in the country; and,
- the “family member” concept followed by so many credit unions.

Yet CUMAA came with some provisions that were not widely supported by the credit union community. These include:

- limitations on member business loans;

- imposition of a bank-like Prompt Corrective Action or “PCA” requirement that, given the structure of credit unions, serves in many respects as an overly restrictive constraint on growth; and
- various other artificial and arbitrary limitations on growth.

Following the passage of CUMAA, NAFCU recognized that there was still more important work to be accomplished. In January of 2000, the NAFCU Board of Directors, recognizing a growing trend of credit union conversions from federal to state charter singled out the erosion of the federal charter as a critically important issue for NAFCU and the nation. In February of 2000 NAFCU convened a “task force” of federal credit union and former federal credit union CEOs, including those who had converted to federally insured state-chartered credit unions and mutual thrifts. This group met at NAFCU’s headquarters to discuss their concerns related to the federal charter in the post-CUMAA environment. Below are highlights of some of the comments heard at that session and e-mails that we received:

- If NCUA wants to do anything that will help smaller credit unions they should work to eliminate unnecessary and needless regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- The (charter expansion) process has a chilling effect on Select Employee Group (SEG) acquisition efforts.

- Mergers seem to be a viable and necessary method to create a substantial number of financially strong credit union entities that can compete with each other as well as with banks and other financial institutions. The business about greater or less than 3000 potential members is a serious obstacle.... The solution may well be in additional legislation.
- It is important that the regulatory environments allow for ...continued growth and not impair our ability to remain competitive.

As a result of that meeting, it became clear that both regulatory and legislative action was needed in the post-CUMAA environment.

In the wake of this meeting, NAFCU wrote to the NCUA Board on February 18, 2000 recommending proposed changes to the agency's Chartering and Field of Membership Manual (IRPS 99-1). (As NCUA has reconstituted its field of membership task force, a subsequent letter was sent on April 5, 2002.) On March 1, 2000, NAFCU sent a separate letter to each of the NCUA Board members expressing concern that "the value of the federal charter is being eroded" and urged each Board member "to consider the long-term implications of [the trends in charter conversions] and take immediate steps to reverse these trends." NAFCU further stated that "*now* is the time to address ... [the] concerns" set forth in the letter and

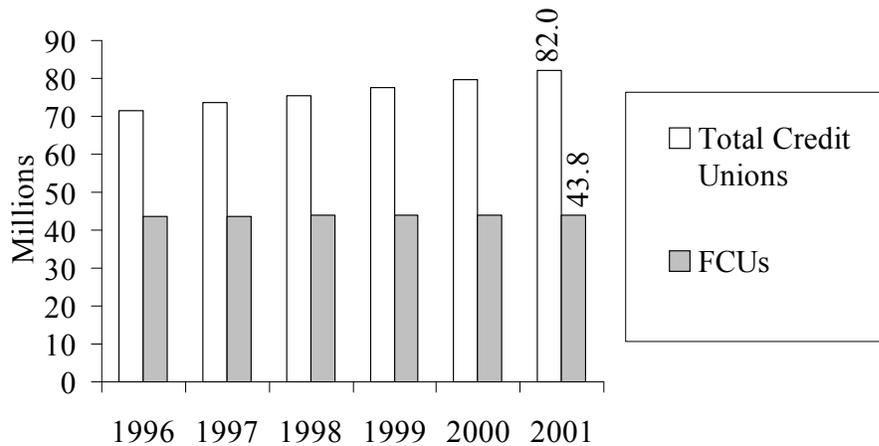
asked for each Board member’s “strongest support in preventing the erosion of the federal charter.”

### The Current Situation

NAFCU is pleased to report to the Subcommittee that America’s credit unions



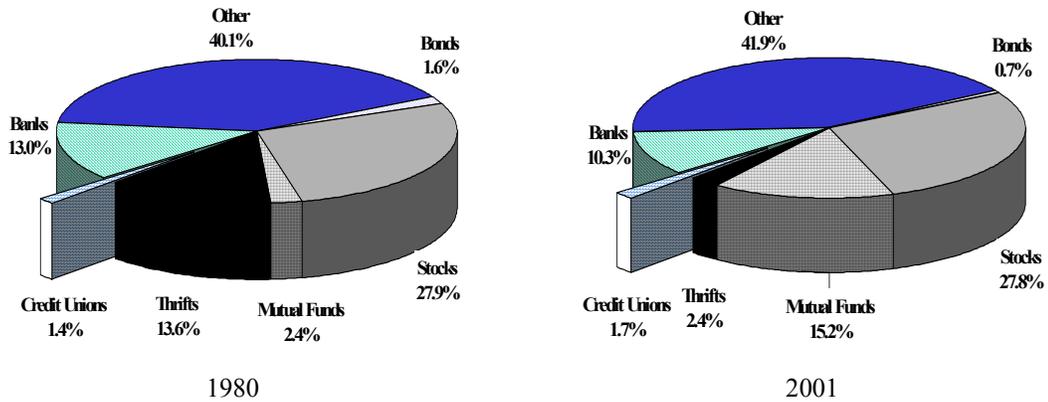
## CREDIT UNION MEMBERSHIP (MILLIONS)



are vibrant and healthy and that membership in credit unions continues to grow with credit unions serving over 80 million Americans--more than at any time in history. At the same time, it is important to note that while credit union membership continues to grow, over the past 21 years credit unions have increased their market share only minimally and as a consequence provide little competitive threat to other financial

institutions. According to data obtained from the Federal Reserve Board, during the 21 year period from 1980 to 2001 the percentage of total household financial assets held by credit unions increased from 1.4% to 1.7% or merely 0.3% over the course of 21 years.

### Household Financial Assets\*

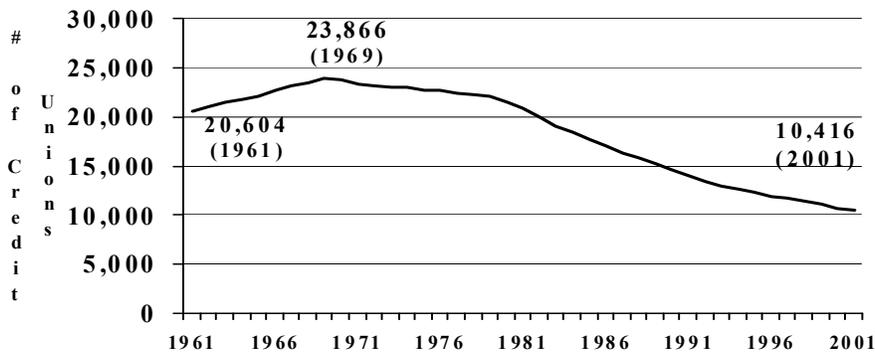


\* Information provided by the Federal Reserve Board and the National Association of Federal Credit Unions (NAFCU).

As is the case with the banks and thrifts, there has been substantial



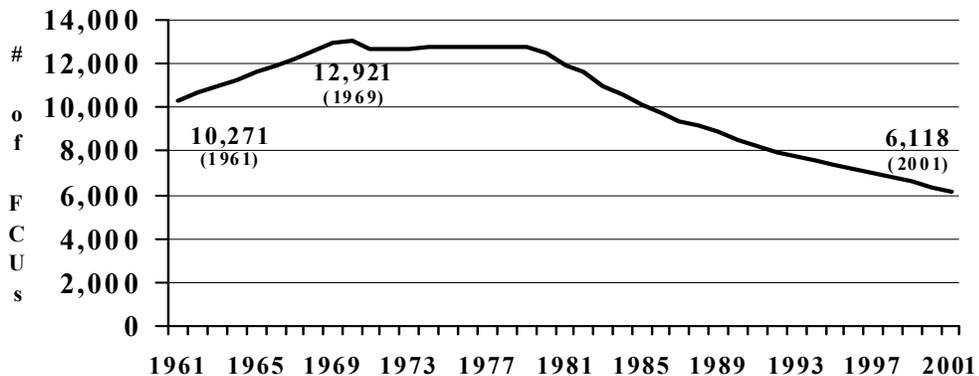
### DECLINE IN THE NUMBER OF CREDIT UNIONS



consolidation within the credit union community in recent years. The number of credit unions has declined significantly – by more than 50% - over the course of the past 30 years, from an all time high of 23,866 in 1969 to 10,416 at year-end 2001. Similarly, the number of federal credit unions has declined as well, declining by just about 50% over that same period, from a high of 12,921 in 1969 to 6,118 at year-end 2001.



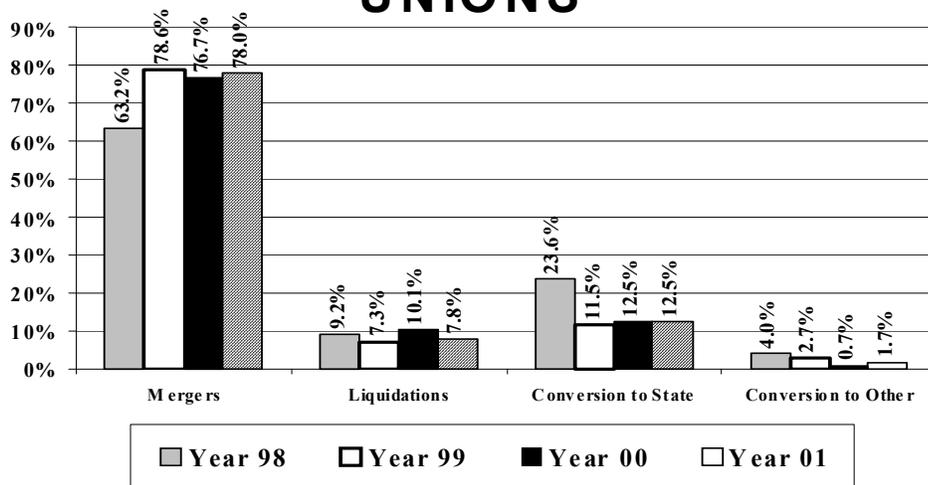
## DECLINE IN THE NUMBER OF FEDERAL CREDIT UNIONS



This decline has been consistent, with each year since the mid-1970's seeing a net decline in the number of credit unions. The experience of federal credit unions in this regard tracks that of all credit unions.



## REASONS FOR THE DECLINING NUMBER OF FEDERAL CREDIT UNIONS



Source: National Credit Union Administration

Looking solely at federal credit unions, the single most significant factor contributing to the decline in the number of federal credit unions is merger activity. Between 1998 and 2001 more than 50% of the decline in the number of federal credit unions was due to mergers. (In fact, 56.3% of the decline in federal credit union charters outstanding was due to mergers in 1998, 78.6% in 1999, 76.7% in 2000 and 78% in 2001). The effect of mergers on the federally chartered credit union system in terms of assets has, however, been significantly smaller totaling just \$0.8 billion in 2001.

The second most significant factor contributing to the decline in the number of federal credit unions over the 1998 to 2001 time period was, however, conversions

from

federal to

state

charter:

33.9% in

1997,

23.6% in

1998,

11.5% in

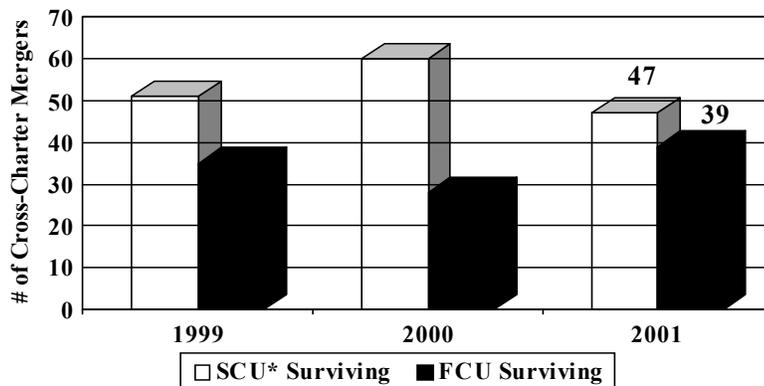
1999,

12.5% in

2000 and



## MERGERS BETWEEN FEDERAL AND STATE-CHARTERED CREDIT UNIONS: 1999 – 2001



\* State Chartered Credit Union (SCU).

Source: National Credit Union Administration.

12.5% in 2001. This translates into 74 charter conversions in 1997, 40 in 1998, 34 in 1999, 32 in 2000 and 27 in 2001. The aggregate five-year total is \$33 billion in assets, representing 12.4% of the total assets of the 2001 federally chartered credit union system.

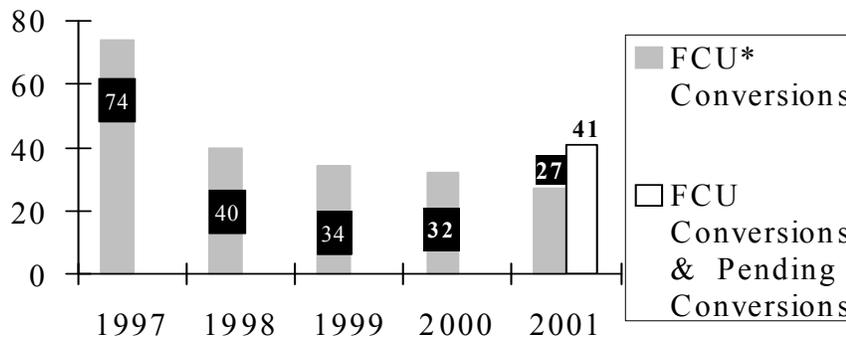
While these numbers might suggest that the conversion trend has peaked, this is hardly the case. According to NCUA there are another 14 federal-to-state conversions reportedly pending. In addition, the size of credit unions converting from federal to state charter, and therefore the total assets involved in such

conversions, is on the increase; the average assets and median assets are dramatically increasing.

It is perfectly normal, if not expected, for conversions to occur in a healthy



## FEDERAL CREDIT UNION CONVERSIONS TO STATE CHARTER#



# Conversion to Federally Insured State Charter.  
\* Federally Chartered Credit Union (FCU).

ent matter when the trend is significantly skewed, as it has been over the past five years in the conversion from federal to state charter. We have found after talking to



## FEDERAL CREDIT UNIONS CONVERTING TO STATE CHARTERED CREDIT UNIONS\*

	TOTAL ASSETS (Billion \$)	AVERAGE ASSETS (Million \$)	MEDIAN ASSETS (Million \$)	NUMBER OF FCUs#
1997	\$5.35	\$72.2	\$28.8	74
1998	\$3.52	\$88.0	\$35.2	40
1999	\$6.55	\$192.8	\$93.7	34
2000	\$9.25	\$289.1	\$92.3	32
2001	\$8.69	\$211.7	\$88.5	41
1997 to 2001 TOTAL	\$33.4			221
1997 to 2001 AVERAGE		\$150.9	\$54.5	

\* Federally Insured State Chartered Credit Unions.  
# Federally Chartered Credit Union (FCU).  
\*\*Includes the 14 cases that are in the process of converting.

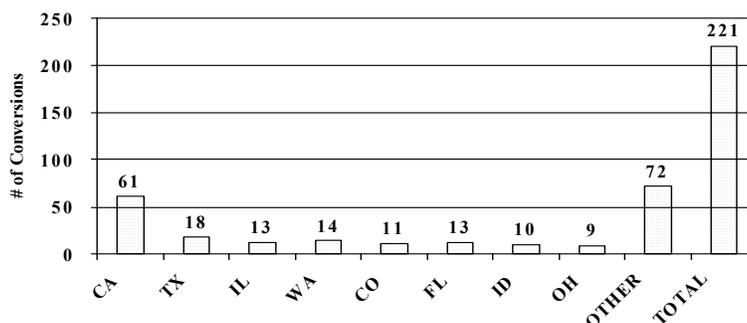
credit unions that the root cause of the current trend is the more rigid field of membership policies and/ or their application at the federal level rather than at the state levels. In this regard, NAFUCU conducted a predictive analysis of federal credit union conversions based on field of membership, state, asset size, membership penetration rate, prior merger activity, county population and the poverty rate. The analysis, which was based on prior conversions, indicated that:

- Growth-oriented multiple common bond federal credit unions with a relatively large asset size and low current field of membership penetration rate in a state with a more liberal field of membership have a greater probability to seek state charter conversion.
- Federal credit unions in suburban versus rural areas with a relatively low percentage of low-income households are likely to convert as a result of community charter restrictions.

The analysis further shows that the states where the greatest number of conversions have occurred, or are most likely to occur, are California, Texas and Florida.



## FEDERAL TO STATE CHARTER CONVERSIONS: 1997- 2001



Source: National Credit Union Administration

As a result of this analysis and the actions

that NAFCU has taken to gather member input, the other reasons for conversions that NAFCU has identified include:

- The desire for regulatory flexibility that is deemed requisite to survive and to grow in the 21<sup>st</sup> century.
- The need to diversify membership and portfolios.
- The elimination of unnecessary and needless regulations.
- The need to innovate and enable credit unions to meet their future membership needs.
- The ability to offer investment and insurance products that meet membership needs.
- The offering of a more favorable business climate.
- The need for a progressive and pro-business regulatory environment.
- Active solicitation by state regulators to encourage federally chartered credit unions to convert to state charter.

Another trend that emerged in NAFCU's analysis is that when both a state-chartered credit union and a federally chartered credit union merge, the resulting credit union more often than not opts to retain a state charter.

A number of these trends are backed up at least anecdotally in news articles from the credit union trade press that cover a number of large conversions and changes in state laws and regulations that allow larger fields of membership

(allowing for greater growth). Some samples of these articles can be found in Appendix A.

### **NAFCU Meets with Policymakers to Enhance the Federal Charter**

Deficiencies in federal chartering policies and/or their application by NCUA cannot be remedied without bringing these matters to the attention of key policy makers in Washington.

Over the past two years, NAFCU has been working with NCUA Board Chairman Dennis Dollar and other NCUA Board members in an attempt to improve the regulatory environment. We are pleased to see that these efforts have been fruitful in several respects:

- A single-sponsor credit union may now retain that status while continuing to serve a spun-off division of the sponsor that was in the federal credit union's field of membership prior to the enactment of the CUMAA.
- A single-sponsor federal credit union may now retain that classification while bringing in groups in which the sponsor has a 10% ownership interest.
- When a group within a credit union's field of membership undergoes a corporate restructuring or reorganization, the credit union may now also serve

any new members of that group without having to go through the SEG addition process.

NAFCU would also note that Chairman Dollar has done a superb job in pursuing regulatory initiatives that are decreasing the regulatory burden on credit unions while maintaining safety and soundness throughout the federal credit union system. This has proven to be a valuable first step in enhancing the federal credit union charter.

On the legislative front NAFCU has spent the past two years meeting with legislators to compile a package of initiatives that would serve to restore the balance between the federal and state chartering systems. NAFCU has, as a “work-in-progress,” developed a series of recommendations designed to enhance the federal charter, several of which are contained either in whole or in part within the *Financial Services Regulatory Relief Act of 2002*. Today’s credit unions exist in a very dynamic environment, and we realize that the laws and regulations dealing with credit union issues will always be in need of further review and refinement. NAFCU’s goal in crafting its recommendations was to ensure the continued viability of the federal charter for credit unions. NAFCU refined its package and released its “guiding principles” for enhancing the federal charter last summer. (See Appendix B: *Enhancing the Federal Charter – Moving Credit Unions into the 21<sup>st</sup> Century*).

### **Financial Services Regulatory Relief Act of 2002**

NAFCU believes that the *Financial Services Regulatory Relief Act of 2002*, H.R. 3951, is a positive step in addressing some of the regulatory burdens and

restrictions on federal credit unions that have caused a number of federally chartered credit unions to consider converting to state charters.

NAFCU applauds the balanced approach evidenced in the bill and commends Representatives Capito and Sandlin for their leadership in introducing it. We would like to offer the following observations, comments, and feedback on what we believe are positive aspects of the legislation (*listed in order of section number*).

**A. Section 302.** NAFCU supports this effort to give credit unions land leases on federal property under the same terms and conditions as credit unions now are provided space allotments under the FCUA. The credit unions that will be impacted by this change are defense (military) credit unions that have tried to expand their service to our men and women in uniform by building (and paying for) their own member service centers on military facilities. Many that have expanded their services by building their own facilities to serve military personnel have had their leases go from a nominal fee (e.g. \$1.00 a year) to a “fair market value” rate of over \$2000 a month. For non-profit cooperatives like credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women on that base.

**B. Section 303.** NAFCU supports this effort to increase investment options for federal credit unions by allowing certain investments in securities.

The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential to adversely impact both safety and soundness in the future. We believe that federal credit unions should have the same investment authority that is approved for other federally regulated financial institutions with regulation by the NCUA Board.

**C. Section 304.** NAFCU supports this provision that would increase the general 12-year limitation of term of federal credit union loans to 15 years or longer as permitted by the NCUA Board. The current 12-year limitation is outdated and does not meet with maturities that are commonly accepted in the market today. We believe that it is important that the NCUA Board should have the rulemaking authority to extend this limitation beyond 15 years in order to address the flexibilities that are necessary in today's market.

**D. Section 305.** NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, we believe that the bill should go further than just raising the limit to three percent and, rather, give the NCUA Board the authority to set the proper investment limit.

**E. Section 306.** NAFCU supports this effort to exclude loans or loan participations by federal credit unions to non-profit religious organizations

from the member business loan limit and urges the Subcommittee's inclusion of this language on H.R. 3951. We also continue to support this exclusion as a stand-alone provision, as introduced by Representative Ed Royce (R-CA) in the *Faith Based Lending Protection Act*, H.R. 760.

**F. Section 307.** NAFCU supports efforts to increase credit union services by allowing federal credit unions to offer check-cashing services to anyone in their field of membership. We do, however, urge the Subcommittee to take a further step and amend this section in mark-up to expand this provision to include wire transfers and other money transfer instruments and technologies as approved by the NCUA Board. By Congress' granting this additional authority, we believe that credit unions can play an important role in fighting abuses by some current providers of remittances to many of our nation's immigrants.

**G. Section 308.** NAFCU supports this clarifying provision. The numerical limitation of 3,000 to consider spinning off and forming a separate credit union should not apply to voluntary mergers of healthy credit unions. In addition, a credit union that converts to (or merges into) a community charter should be allowed to retain all employee groups in its field of membership prior to the conversion. Current law does not allow this, penalizing not only the credit union, but also those in its field of membership. In addition, we believe that

the retroactive effective date of August 7, 1998 (the date of enactment of CUMAA), is an important part of this section and must be maintained.

The one section that we believe needs further examination and scrutiny by the Subcommittee before moving forward is Section 301. NAFCU has reservations regarding the provision that would allow privately insured state-chartered credit unions to become members of a Federal Home Loan Bank. As of December 2001, there were 678 credit union members of various Federal Home Loan Banks. Of that number, about half are state-chartered but *all have federal insurance*. In fact, federal insurance is a pre-condition for all regulated depository institutions -- banks, thrifts and credit unions -- seeking membership in the Federal Home Loan Banks. (The sole exception to this requirement under existing law applies to insurance companies for whom there is no federal insurance option.) We have heard from a number of our members with concerns about this provision in light of past failures of some private and/or state insurance funds in the late 1980's and early 1990's.

In addition to our support for the provisions outlined in the above sections, NAFCU is pleased to see that several other provisions included in the bill that, while not directly sought by credit unions, will positively impact credit unions, and/or the regulation and supervision of credit unions. These include:

Section 402. Time for appeals to receivership appointments

Under current law section 207(a)(1)(B) of the FCUA (12 USC 1787(a)(1)(B)) gives federal credit unions placed into receivership or conservatorship only 10

days to appeal liquidation proceedings. NAFCU supports the language found in Section 402(c) extending to 30 days the time to lodge such appeals.

Section 404. Asset limits in *Depository Institutions Management Interlocks Act*

Since the definition of “depository institution” in the *Depository Institution Management Interlocks Act* includes credit unions, we support and assume that the proposed increase in the exemption limit from \$20 million to \$100 million is also extended to credit unions.

While we believe the bill is a balanced approach in its current form and we understand the sponsor’s desire to include only a manageable number of provisions in the legislation, we would like to call the Subcommittee’s attention to some additional issues that fall into the scope of the legislation.

**A. Exempt credit unions from Hart-Scott-Rodino pre-merger application filings and fees the same as all other regulated financial institutions**

We recommend including in the bill language that would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the *Hart-Scott-Rodino Act*. Currently, when the merger of two credit unions exceed certain thresholds they are subject to the pre-merger notification requirements

of the Federal Trade Commission (FTC) and, in the absence of a waiver must pay a filing fee of \$45,000 or higher. Other financial institutions are exempt from FTC review of their merger transactions and filing (and paying the filing fee) of pre-merger notifications with the FTC. Credit unions already have the same exemption from the FTC's enforcement and investigative authority as other financial institutions, and credit union mergers already undergo NCUA review. We urge the Subcommittee to add language that would address this issue and bring NCUA merger review requirements and credit union pre-merger notification requirements in line with those for other financial institutions.

**B. Adjust the Usury Ceiling For Federal Credit Unions**

Federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans. We believe, however, that 12 USC 1757(5)(a)(vi) should be amended to adjust the usury ceiling from 15 to 18 percent (the level it has been at or above for nearly 20 years) and to relax, if not eliminate, the cumbersome consultation requirements and other limitations that could hamper NCUA's management of the usury ceiling. Credit unions are often a borrower's best safeguard against going to a predatory lender, and although counterintuitive, failing to adjust the usury ceiling and allowing it to return to 15 percent could under certain economic conditions have the

real potential to drive marginal borrowers to predatory lending institutions.

**C. Remove "local" from the definition of "community" for purposes of community charters**

Today's dynamic financial marketplace characterized by "cyber-banking" technology rather than bricks and mortar makes the word "local" an extraneous limitation for community-chartered credit unions. In addition, and as previously noted, this provision has accounted for the majority of conversions from federal to state charters. We believe this word should be removed and the NCUA Board should be given the regulatory flexibility to set the definition as it deems fit.

**D. Relax the "Reasonable Proximity" Requirement**

This requirement is an undue burden on credit unions, requiring them to have a physical presence within a reasonable proximity of the location of a group that the credit union wants to add to its field of membership. In the financial marketplace of the 21<sup>st</sup> century that has seen an increase in Internet and remote banking, this requirement serves as an unnecessary burden and restriction on credit unions and those who wish to join them.

**E. Eliminate the preference imposed by CUMAA, for the formation of new credit unions over the addition of groups to an existing credit union**

Oftentimes, an existing credit union is better suited to meet the needs of a SEG and offer it better service than a new credit union would or could. Most SEG applicants do not have the time, money, or critical mass to form their own credit union. According to NCUA, since the passage of CUMAA in 1998 there have not been any SEG groups whose applications have been denied that have gone on to form their own credit union. These individuals have, therefore, been left without credit union services.

**F. Relax the current member business loan restriction imposed by CUMAA**

NAFCU supports including language that would restore credit union member business lending authority to the status it enjoyed prior to the enactment of CUMAA. This would be consistent with findings from the Department of Treasury study (*Credit Union Member Business Lending*) on member business lending authorized by CUMAA and released in January of 2001.

Credit unions have a history of serving those who will not otherwise receive services within the financial marketplace and, as we believe a fair reading of the 2001 Treasury study indicates, there is a market niche that is not being served within the business loan market that credit unions could readily fulfill, enhancing small business in America.

**G. Flexibility in Credit Union Governance Issues**

The FCUA contains many antiquated “governance” provisions that, while appropriate in 1934, are today outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. For example, a member of a federal credit union that has been abusive and/or is deemed to pose a threat to the credit union, its employees, and other members cannot be expelled without a special meeting of the credit union membership – which can be a costly endeavor for the credit union. NAFCU supports including language in the bill that would remove such antiquated governance procedures from the FCUA and give the NCUA Board greater authority in establishing appropriate governance policies and procedures for federal credit unions.

**H. Secondary Capital**

NAFCU supports allowing all insured credit unions, not just “corporate credit unions” and those designated as “low-income,” to include

secondary capital accounts when calculating net worth under regulations promulgated by the NCUA.

We hope that the Subcommittee will consider these issues as the bill moves forward in the legislative process. We have attached proposed legislative language on a number of these issues in Appendix C.

### **Conclusion**

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, we urge the Subcommittee to carefully assess the trend of conversions from federal to state charters. We believe that H.R. 3951 is an excellent first step. We understand that it is a work in progress by the Subcommittee and we urge the Subcommittee to undertake a careful examination of what other measures fall within the scope of this legislation that will address the concerns we have articulated.

NAFCU thanks the Subcommittee for the opportunity to make this statement before you today and commends the House Financial Services Committee for examining these important issues. We look forward to working with you on this important piece of legislation and would welcome your comments or questions.

Appendix A  
Selected Articles

Attached are selected articles and summaries, from various news sources concerning the recent trends that are taking place throughout the credit union community. The articles focus on the increasing number of charter conversion, from federal to state.

### Articles

(Reprinted with permission of the *Credit Union Journal* and the *Credit Union Times*)

#### ***New York's Up State FCU Converts to State Charter*** *Credit Union Times*

ROME, N.Y. - Up State FCU, chartered in 1951 as a state-chartered credit union which converted to a federal charter in 1979, is once again a state-chartered CU. The \$280 million CU's charter conversion was approved by the State of New York Banking Department on April 19. As of May 1, the credit union will be known as Up State Credit Union. Roxanne Sopchak, vice president of marketing for the credit union said Up State has continually assessed the benefits of the different types of charters to determine which is in the best interest of the credit union's members.

When Up State converted to a federal charter in 1979, it was so the credit union could take in select employee groups. During the months of uncertainty prior to passage of The Credit Union Membership Access Act, the credit union laid out its options again. Sopchak said the ambiguity in the language in the NCUA Field of Membership and Chartering Manual concerning "close proximity" forced the credit union's decision to convert. Up State includes among its nearly 80,000 members about 500 select employee groups throughout an eight or nine county area in central and northern New York.

#### ***California CUs Continue Flight To State Charter*** *Credit Union Journal*

SACRAMENTO, Calif. (05/02/00) - Another four large California-based federal credit unions have applied to the state's Department of Financial Institutions (DFI) to convert to a state charter. That make eight so far this year, on top of 13 last year and 11 the year before. The latest applications for conversion: Rockwell FCU, Downey (\$500 million); American First FCU, La Habra (\$375 million); Water & Power FCU, Los Angeles (\$325 million) and Whittier Area FCU, Whittier (\$165 million). The Water & Power FCU application is significant because that credit union converted from state to federal charter just five years ago.

#### ***More CUs Show Interest In Banking Charters*** *Credit Union Journal*

WASHINGTON (05/19/00) - Increasing numbers of credit unions are expressing interest in converting to mutual savings banks because of concerns over growth limitations under field of membership (FOM) rules and real estate lending caps. So far 19 credit unions have applied to convert to mutual savings banks (thrifts) with 11 having completed the conversion, three abandoning or having their members reject the switch, and four more in the application stages. Several more are expected to file applications to convert by year-end, sources told The Credit Union Journal.

### ***California CUs Continue To Seek Broad FOMs*** *Credit Union Journal*

SACRAMENTO, Calif. (06/05/00) - State chartered credit unions continue to expand their horizons to take advantage of the state's liberal FOM statutes. Documents obtained by The Credit Union Journal from the state's Department of Financial Institutions under the Public Information Act show three more state charters have applied for broad FOMs encompassing millions of residents. Those include Valley CU, Jan Jose, which has requested approval to serve 2.4 million residents of Alameda and Contra Costa counties; AEA CU, which has asked to serve 1.2 million residents in Santa Barbara and Venture counties and the city of Folsom; and Merriwest CU, which has requested authorization to serve 2.4 million residents in San Mateo, San Francisco and Contra Costa counties.

### ***Resource One FCU Approved to Convert to State Charter*** *Credit Union Times*

DALLAS - Resource One FCU has become the eleventh federal credit union in Texas to convert to a state charter since 1997 and the fourth so far this year. The state Credit Union Division approved the \$151 million credit union's charter conversion application on May 31. Resource One initially applied to convert to a state-charter in 1997. It received NCUA approval to proceed with a member vote, but the credit union's board decided to put off the conversion pending the outcome of H.R. 1151.

When The Credit Union Membership Access Act was signed into law in Aug. 1998, Resource One President Jim Brisendine said the credit union decided to proceed with the charter conversion because "H.R. 1151 places too many limitations on federal credit unions, especially concerning field-of-membership." He said the credit union is "considering" applying for a community charter.

Resource One counts 319 select employee groups among its 48,000 members.

### ***Texas CU Commission approves state's largest FCU-to-state charter conversion*** *Credit Union Times*

AUSTIN, Texas - Vought Heritage FCU, Grand Prairie has become the largest federal credit union in the state to receive approval from the Texas Credit Union Department to convert to a state charter. Texas Credit Union Commissioner Harold Feeney approved the \$330 million, nearly 53,000 member credit union's application on Friday, Apr. 28. Vought Heritage's President/CEO Jim Gray said the credit union applied for the charter conversion late last year so it would have the ability to expand its field-of-membership in Tarrant and Dallas counties.

### ***CUs Score HR 1151 in Move To State Charters*** *Credit Union Journal*

SACRAMENTO, Calif. (05/08/00) - Increasing numbers of federal credit unions, growing frustrated over the new FOM law HR 1151, the CU Membership Access Act, and are calling passage of the new law a victory for banks, instead of credit unions. "They put so many controls in place and extra hoops that credit unions have to jump through that I think we are kidding ourselves by calling it a clear victory," Kerry Lewis, vice president of American First FCU, told The Credit Union Journal. The \$375 million La Habra, California, credit union is one of eight in The Golden State seeking to convert to state charter. "I feel the changes to the Federal Credit Union Act have become more restrictive

instead of more open in order to serve the consumers in this new business economy and is one of the key drivers in all the changes."

***New York CU Approved To Convert To State Charter***  
*Credit Union Journal*

ALBANY, N.Y. (05/16/00) - The state Department of Banking said it approved an application by Up State FCU in Rome, N.Y., to convert to a state charter, the 13th federal credit union to convert this year. The \$320 million credit union said it switched charters to obtain the more liberal FOM allowances. Up State is the sixth New York credit union to convert to state charter since January 1, 1997.

***Six more FCUs lost to states in May***  
*Credit Union Times*

ALEXANDRIA, Va. - Four federally chartered credit unions were lost to the state charters from merger activity in May and two changed sides as a result of a charter conversion, recently released NCUA regional director activity data indicated. In addition, the May "Regional Directors' Actions Taken Under Delegation of Authority" report showed that a region-wide total of another 8 multiple-SEG FCUs converted to federal community charters in the month for a total potential membership of almost 950,000 people.

Year-to-May 31 there have been 28 multiple-SEG-to-federal community charter conversions approved at the regional level and four at the NCUA Board level for a total potential membership of 3.5 million. The May regional director figures now bring the year-to-May 31 FCU-to-FISCU conversion total to seven and the total federal charter losses from merger activity for the same period to 15. During that period only one FISCU converted to a federal charter.

***Oregon Enacts New Community Charter Rules***  
*Credit Union Journal*

SALEM, Ore. (05/08/00) - State credit union regulators have finalized and made effective new rules governing community chartered credit unions, allowed for the first time last year under a rewrite of the state's CU statute. The rules, which became effective March 31, will allow credit unions to apply for a community charter that consists of one or more cities, towns, counties or other political subdivisions already recognized by local government. There is no population limit under the rules. State officials said there have been several expressions of interest from state credit unions but no applications yet under the new rules.

***California Senate approves cross-border CU services bill***  
*Credit Union Times*

SACRAMENTO, Calif. - The state Senate May 24 approved a bill sponsored by the California Credit Union League that would implement a legislative and regulatory framework for state-chartered credit unions to open branches in foreign countries.

S.B. 1472, sponsored by Sen. Deborah Ortiz (D-Sacramento), also includes regulations under which the same credit unions could open branches in other states and under which credit unions in other countries could open branches in California.

The bill passed 39-0.

### ***Florida CU Seeks Huge FOM Grant*** *Credit Union Journal*

MIAMI (11/28/01) - Tropical Financial CU, recently awarded the state's biggest FOM, has its sights set on larger markets still and has applied to state regulators for permission to serve the 2.2 million residents in Dade-Miami County, the state's most populous county. The application was submitted just weeks after the \$500 million credit union was granted permission from the Florida Division of Banking to serve more than two million residents in Broward and Sarasota counties, which is believed to be the largest FOM grant in the Sunshine State for any credit union, state or federally chartered. The vast FOM grants come just four months after Tropical Financial converted from federal to state charter. Gregory Blount, president of Tropical Financial CU, told The Credit Union Journal their aim is to expand into those areas of the state where they are already serving one of their 350 select employee groups. The geographic grants, he said, will enable them to sign and serve new employee groups without time-consuming regulatory approval, he said.

### ***California CUs Continue To Gobble Up FOM*** *Credit Union Journal*

SACRAMENTO, Calif. (02/22/01) - Several large state charters, led by the expansive Patelco CU, have applied to state regulators with the Department of Financial Institutions (DFI) for serve huge population swaths. Documents obtained by The Credit Union Journal under the state's Public Information Act show Patelco has requested permission to serve seven million residents in eight California counties: San Francisco, San Mateo, Sonoma, Santa Clara, Napa, Marin, Solano, Alameda and Contra Costa. Over the last two years the \$1.8 billion credit union has received approval to serve about one million residents in 13 California cities and more than 100 employee groups. Separately, Priority One CU, Pasadena, has requested permission to serve five million residents in four valleys and metropolitan Los Angeles; Pacific Resource CU, Los Angeles (formerly Arco FCU), has asked permission to serve 1.5 million residents in metropolitan Los Angeles; and Sacramento CU, has requested approval to serve 400,000 residents in two counties.

### ***Federal Convert Gobbles Up New FOM*** *Credit Union Journal*

MIAMI (02/11/02) - Tropical CU continued last week to grab for broader FOM with an application to state regulators to serve the 1.1 million residents of Palm Beach County. The \$475 million credit union, which converted from federal charter just six months ago, was granted one of the nation's largest FOMs since then, with permission last month to serve the 2.3 million residents of Miami-Dade County, the state's most populous county. That came after state regulators approved Tropical CU's request to serve the two million people in Broward and Sarasota counties. Credit unions officials told The Credit Union Journal they plan to obtain permission to serve communities surrounding their existing branches.

***Tiny CU Gets Big FOM***  
*Credit Union Journal*

ROCHESTER, N.Y. (02/07/02) -- Rochester Postal Employees CU has obtained approval from the state Department of Banking to convert to a community charter serving the 750,000 residents of Monroe County, one of the largest community FOMs ever approved in the Empire State. The \$18 million, 3,500-member credit union has also changed its name to First Rochester Community CU to reflect its new FOM, which was effective Feb. 1.

***Texas CUs Get Broad FOM Grants***  
*Credit Union Journal*

AUSTIN, Texas (04/03/02) - The state CU Department said Tuesday it approved several large FOM expansions, including an application from San Antonio Teachers CU to serve more than 1.4 million residents of surrounding Bexar County. The state regulator also approved requests from Texans CU, Richardson, to serve more than one million residents in Travis and Williamson counties and another 200,000 students in Collin County; Members First CU, Corpus Christi, to add 325,000 residents of Cameron County; Telco Plus CU, Longview, to serve 170,000 residents of Smith County; Benchmark CU, Midland, to add 130,000 residents of Midland County. The state regulator also approved a request from Community CU, Plano, to remove its exclusionary clauses protecting FOM overlaps in Dallas, Rockwall, Grayson and Collin counties, opening up new competition by the \$1 billion credit union with dozens of credit unions in those four counties.

Appendix B  
NAFCU's Guiding Principles

# ENHANCING THE FEDERAL CHARTER

## MOVING CREDIT UNIONS INTO THE 21ST CENTURY



### NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

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**N**AFCU has spearheaded the effort to enhance the federal charter, seeking both regulatory and legislative changes to preserve the health of federal credit unions and to make the federal charter more attractive. NAFCU's effort comes in the wake of over 180 conversions to state charters since 1997 (involving over \$30 billion in assets) and a perception among some in the credit union community that the federal charter is not as valuable as it should be.

Early in 2000, NAFCU convened a task force of credit union leaders to recommend specific regulatory and legislative initiatives that NAFCU could take to improve the federal charter. These specific recommendations were in response to the changing federal-state dynamic, as well as a proactive approach to clarify and improve the Federal Credit Union Act as we enter the 21st century. NAFCU has pressed its case for charter enhancement before Congress, the White House and appropriate federal agencies, including NCUA, the Treasury Department and the Small Business Administration, to name just a few.

NAFCU has also sought feedback in various forums, as well as from its membership, on the issues originally identified by the task force, as well as other matters of concern such as secondary capital, the composition of the NCUA Board, and private insurance.

In some areas, NAFCU has already achieved success on the regulatory front. Following NAFCU's recommendations, NCUA has ruled that:

- A single-sponsor credit union can retain that status while continuing to serve a spun-off division of the sponsor that was in the federal credit union's field of membership prior to the enactment of the CUMAA.
- A single-sponsor federal credit union can retain that classification while bringing in groups in which the sponsor has a 10% ownership interest.
- When a group within a credit union's field of membership undergoes a corporate restructuring or reorganization, the credit union may serve any new members of that group without having to go through the select employee group addition process.

Building on its successes to date, the NAFCU Board believes it is important to continue pursuing regulatory enhancements while also continuing to present its case to Congress.

At the same time, it should be noted that NCUA is expected to soon issue final rules on RegFlex and Incidental Powers. Going forward, NAFCU believes that the NCUA has the authority to take further actions that would serve to substantially enhance the federal charter. Specific examples include a broader interpretation of local community merger authority and the reimbursement of additional types of board of directors' expenses.

Finally, the NAFCU Board believes that it is also important to set forth guiding principles that address not only specific charter enhancements but also the way credit unions are structured and regulated –in other words, what they will look like in the future. The NAFCU Board has, therefore, adopted the following guiding principles:

## **NAFCU'S GUIDING PRINCIPLES**

### **Preserving credit union uniqueness**

NAFCU is a strong proponent of credit union growth and innovation –to ensure that credit unions remain competitive in the financial marketplace of the 21st century. At the same time, the foundations of service, cooperation, self-governance and common purpose that make credit unions unique must be preserved. Federal credit unions are, by definition, institutions that: are organized and operated for mutual purposes without profit; do not issue capital stock; are governed by volunteer boards; and have fields of membership. NAFCU would oppose any initiatives that might significantly alter these fundamental characteristics and thereby jeopardize the non-profit, unique, and tax exempt status of credit unions.

### **Field of membership changes**

NAFCU believes that all Americans should have access to credit union services within the field of membership concept, which remains a defining characteristic of credit unions. The field of membership concept, however, must be flexible to adapt to a changing society and an evolving financial services marketplace. NAFCU believes that changes in this area should include:

- eliminating the term "local" from the definition of "community"
- eliminating the language in the CUMAA that indicates a preference for starting new credit unions, in lieu of permitting employee groups to join an existing credit union.
- allowing community-SEG combinations
- confirming authority for healthy credit unions to merge voluntarily
- easing the ability of FCUs to add low-income groups to their FOMs
- allowing community-based FCUs to serve members in communities merged or spun off into other municipalities – "once a potential member, always a potential member"

### **Lifting MBL restrictions**

NAFCU believes that credit unions have a key role to play in providing needed capital to credit union members who are small business owners, and it has pressed for lifting these restrictions. The recent Treasury Department study on MBL indicates that credit union business loans go primarily to small businesses (many of the loans are for \$50,000 or less); these loans fill a niche oftentimes not served by commercial lenders. In addition, the Treasury Department has noted that it does not view these loans as a competitive threat to banks.

### **Retaining volunteer boards**

NAFCU believes that volunteer boards –elected by a credit union's members –are a hallmark of the Federal credit union system. Volunteer boards, along with "one member, one vote" elections, are unique aspects of Federal credit unions that demonstrate their cooperative and democratic foundation. At the same time, NAFCU supports granting discretionary authority

to boards to approve reimbursement of additional types of appropriate out-of-pocket expenses incurred by directors in fulfilling their duties.

### **Secondary capital**

NAFCU is concerned about the challenge some credit unions face in raising adequate capital to facilitate growth in a "PCA" ("prompt corrective action") environment. NAFCU believes that the best minds in the credit union community can come together to develop workable proposals, consistent with the not-for-profit, mutual structure of credit unions, to provide credit unions the capital needed for growth, much as was done 20 years ago when we recapitalized the National Credit Union Share Insurance Fund. Accordingly, NAFCU supports Congressional action to amend the Federal Credit Union Act to authorize NCUA to promulgate rules and regulations regarding secondary capital accounts for all federally insured credit unions.

### **Maintaining NCUA's independence**

NAFCU believes it is imperative that credit unions have an independent regulator, one that recognizes the unique characteristics of credit unions and serves as an advocate for the preservation of credit unions' unique status under the law. Accordingly, NAFCU strongly supports the continued independence of NCUA and would oppose any proposals to fold NCUA into a larger federal agency as that would dilute the direct impact credit unions have on the formulation of NCUA policy. NAFCU also supports the current NCUA Board structure.

### **Keeping NCUSIF strong**

The National Credit Union Share Insurance Fund (NCUSIF) has an unparalleled record of protecting credit union members' shares. NAFCU does not believe it is necessary at this time to change the way the fund is financed, and it does not support separating NCUSIF from NCUA. While NAFCU does not oppose efforts by credit unions to augment NCUSIF insurance with supplemental private insurance, NAFCU continues to believe that NCUSIF insurance should remain mandatory for all federally chartered credit unions.

### **The federal charter: still valuable**

In conclusion, NAFCU believes the federal charter remains an extremely valuable "franchise" for credit unions. At the same time, NAFCU intends to continue its prudent, measured approach to change –from both a regulatory and legislative perspective –adding value to the charter while preserving the core characteristics that make credit unions the unique financial institutions they are.

Appendix C  
Proposed Legislative Language

## **Legislative Language for NAFCU Suggested Additions to the Financial Services Regulatory Relief Act of 2002**

### **I. Usury Ceiling Adjustment**

12 U.S.C. Section 1757 (5) (A) (vi) is amended to read as follows:

*“ (vi) the rate of interest may not exceed 18 per centum per annum on the unpaid balance inclusive of all finance charges, except that the Board may establish an interest rate ceiling exceeding such 15 per centum per annum rate if it determines that a higher interest rate ceiling is warranted;”*

### **II. Eliminate “local” from the definition of community.**

Amend 12USC 1759(b)(3) as follows:

following the word “well-defined” delete the word “local”

### **III. Eliminate Preference Imposed by CUMAA for the Formation of a new Credit Union**

Amend 12USC 1759(f)(1) as follows:

In subparagraph (A) after the words “credit unions” delete “instead of approving an application to include an additional group within the field of membership of an existing credit union”

In subparagraph (A) at the end delete “; and” and insert “.”

Delete subparagraph (B)

### **IV. Restoration of Pre-CUMAA Member Business Loan Authority**

Section 203(a) of Public Law 105-219 is hereby repealed.

**V. Expulsion of a Credit Union Member for those who pose a threat to the Credit Union, its members and employees**

Amend 12 USC 1764(a) as follows:

in subsection (a) after the words “subsection (b)” insert “and (c)”

change subsection (c) to (d) and insert new subsection (c) which reads:

“(c) The board of directors of a Federal credit union may, by majority vote of a quorum of directors, adopt and enforce a policy with respect to expulsion from membership based on circumstances where the member has been abusive, threatening, and is deemed potentially dangerous to credit union employees and fellow members.”

In new subsection (d) after the words “subsection (a)” delete “or” and add “,(b) or (c)”

**VI. Exempt Credit Unions from Hart-Scott-Rodino pre-merger application filings and fees the same as all other regulated financial institutions**

**VI. Exempt Credit Unions from Hart-Scott-Rodino pre-merger application filings and fees the same as all other regulated financial institutions**

*Section 205(c) of the Federal Credit Union Act (12 U.S.C. Sec. 1785(c)) is amended as follows (new language is underlined; deleted language is):*

(c) In granting or withholding approval or consent under subsection (b) of this section:

(1) The Board shall consider

- (A) the history, financial condition, and management policies of the credit union;
- (B) the adequacy of the credit union’s reserves;
- (C) the economic advisability of the transaction;
- (D) the general character and fitness of the credit union’s management;
- (E) the convenience and needs of the members to be served by the credit union; and
- (F) whether the credit union is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

**(2) For mergers between credit unions that would otherwise be subject to Section 7A(c)(7) of the Clayton Act (15 U.S.C. Sec. 18a(c)(7)), the Board shall not approve -**

(A) any proposed credit union merger transaction which would result in a monopoly, or which would be in furtherance of any combination or conspiracy to monopolize or to attempt to monopolize the business of providing financial services in any part of the United States, or

(B) any other proposed merger transaction whose effect in any section of the country may be substantially to lessen competition, or to tend to create a monopoly, or which in any other manner would be in restraint of trade, unless it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.

**CORRESPONDING PROPOSED AMENDMENT TO THE HART-SCOTT-RODINO ACT:**

Section 7A(c)(7) of the Clayton Act (15 U.S.C. Sec. 18a(c)(7)) is amended as follows (new language is underlined):

(7) transactions which require agency approval under section 1467a(e) of title 12, section 1828(c) of title 12, section 1785(b) of title 12 or section 1842 of title 12, except that a portion of a transaction is not exempt under this paragraph if such portion of the transaction (A) is subject to section 1843(k) of title 12; and (B) does not require agency approval under section 1842 of title 12;