Testimony of

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on Behalf of

The National Association of Federal Credit Unions

Regulatory Relief for Credit Unions

Before the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

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Introduction

Good afternoon, Chairman Bachus, Ranking Member Sanders and Members of the Subcommittee. My name is Bill Cheney and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the President/CEO of Xerox Federal Credit Union, headquartered in El Segundo, California. Xerox FCU is a multiple common bond credit union with approximately 77,000 members and more than $760 million in assets. Xerox FCU serves employees of the Xerox Corporation and related companies nationwide through 17 credit union offices in eight states. My credit union has recently expanded to include underserved communities in Rochester, NY; Dallas, TX; St. Petersburg, FL; and Chicago, IL. I have a broad background in financial services, including more than 17 years working in the credit union industry. I joined Xerox FCU in 1997 after 10 years with Security Service Federal Credit Union in Texas.

I also serve as the Legislative Committee Chairman and a Director-at-Large and Board Secretary for the National Association of Federal Credit Unions; I am a member of the Board of Directors for Western Corporate Federal Credit Union (WesCorp), as well as a member of the Diversity Committee for the California Credit Union League. Finally, I am Chairman of the Board of XCU Capital Corporation, a broker/dealer owned and controlled by 17 credit unions.

I am also a Director and a member of the Executive Committee of the American Red Cross of Greater Los Angeles, and I volunteer with numerous charitable organizations such as Heal the Bay and the Boy Scouts of America. I earned my Bachelor of Business Administration degree from The University of Texas at Austin in 1982.

NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU is comprised of more than 800 federal credit unions—member owned financial institutions across the nation—

representing approximately 25 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 this discussion regarding regulatory relief for America's financial institutions and particularly its impact on federal credit unions.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created and has been recognized as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. 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 85 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 over 70 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 5,700 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—than banks that exist to make a profit for a limited number of shareholders. 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 they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for profit stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit Unions have an unparalleled safety and soundness record. Credit unions—unlike banks and thrifts—have never cost the American taxpayer a single dime. Unlike the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loans Insurance Corporation (FSLIC) which were both started with seed money from the United States Treasury, every dollar that has ever gone into the National Credit Union Share Insurance Fund (NCUSIF) has come from the credit unions it insures. And unlike the thrift insurance fund that unfortunately cost American taxpayers hundreds of billions of dollars, credit unions have never needed a federal bailout.

Although not the subject of this hearing today, I would like to respond to comments made by several banker witnesses at a hearing before this subcommittee last May. At the hearing, a number of witnesses expressed some common misperceptions or "myths" about the credit union community and today I would like to cover what the reality really is:

Myth: Credit unions pay no taxes.

Reality: Credit unions pay many taxes and fees, among them payroll and property taxes, but Congress has determined that credit unions should be exempt from federal and state income tax. Congress granted this exemption in 1937, recognizing credit unions' unique differences from commercial banking institutions: chiefly, that credit unions are member-owned, not-for-profit institutions, and that taxing member-owned shares would place a "disproportionate and excessive" burden on credit unions. Congress reaffirmed its support for the tax exemption in 1998, and the Bush administration has endorsed continuing the exemption.

Myth: Credit unions have changed over the years and today are really no different than banks, which pay corporate income tax.

Reality: The defining characteristics of credit unions remain unchanged. Credit unions are not-for-profit cooperatives that serve defined fields of membership, generally have volunteer boards of directors and cannot issue capital stock. They are restricted in where they can invest their members' deposits; they are also subject to stringent capital requirements and a cap on business lending.

A key difference between credit unions and banks is that a credit union's shareholders are its members (and each member has one vote), while a bank is owned by its stockholders. A bank earns profits and distributes those profits to its stockholders; a credit union's "earnings" are returned to its members in the form of lower fees, higher dividends, better rates or more services.

Surprisingly, a large number of banks do not pay corporate income tax because they have converted to a Subchapter S corporation. As of December 2003, there were over 2,000 Sub S banks, with the largest at $9 billion.

Myth: Credit unions keep getting bigger and now compete head-to-head with banks.

Reality: Credit unions have grown steadily in members and assets, but in relative terms, they are quite tiny compared to banks. Federally insured credit unions had $610 billion in assets as of year-end 2003. By comparison, FDIC-insured institutions held $9.1 trillion in assets, and last year these institutions grew by an amount that exceeds the *total* assets of credit unions. The average size of a credit union is $65 million compared to just under $1 billion for banks. Over one-half of credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, just 1.6 percent as of June 2003.

Apparently credit union "competition" has not prevented banks from enjoying record profits. At the end of 2003, banks posted their fourth straight quarter and third straight year of record profits, with the return on assets for the nation's largest banks reaching a record level of 1.4 percent. Annual bank profits alone equaled nearly one-fifth of the total assets of credit unions. In addition, *Economist* magazine reported that banks and their subsidiaries earned one-third of all U.S. corporate profits in 2003.

Further, when the Department of Treasury studied potential credit union competition in the business lending arena, it concluded that, "Overall, credit unions are not a threat to the viability and profitability of other insured depository institutions." What Treasury found, instead, was that banks had failed to penetrate many of the markets that credit unions typically serve.

Banks are free to switch to a credit union charter. However, to date, not a single shareholder-owned bank has done so, an indication that banks do not take the "threat" of credit unions very seriously.

Myth: The credit union tax exemption costs the Treasury billions of dollars in lost revenue while banks pay their fair share of income tax.

Reality: The government has calculated that the credit union tax exemption will reduce revenue receipts by $1.43 billion in FY 2005, but that figure is miniscule compared to projected total government receipts for 2005 of $2.04 trillion.

There is also a loss to the Treasury when banks convert to Subchapter S corporations. NAFCU calculates the annual loss of revenue from Subchapter S banks at roughly $600 million; however, if banks continue to grow at their current rate and the number of Subchapter S banks increases, this figure could rise dramatically over the next few years—to the point where the loss of revenue from Sub S banks is greater than the loss from credit unions.

The Consumer Federation of America, in its October 2003 study, "Credit Unions in a 21st Century Marketplace," concluded that "[t]he benefits that credit unions deliver to the public far exceed the costs, as measured by the tax exemption, through lower cost services and the payment of higher interest rates." That same study found that the value of tax breaks enjoyed by banks is "far greater, in absolute and relative terms, than the value of the credit union tax exemption."

Myth: It's the big credit unions—those over $1 billion in assets—that should be taxed.

Reality: Size has no bearing on a credit union's structure or adherence to the credit union philosophy of service to members and community. While credit unions have grown, their relative size is tiny when compared to banks. Even the world's largest credit union, with $20 billion in assets, is dwarfed by the nation's biggest banks with hundreds of billions in assets. (JP Morgan Chase Bank has $628.7 billion in assets.)

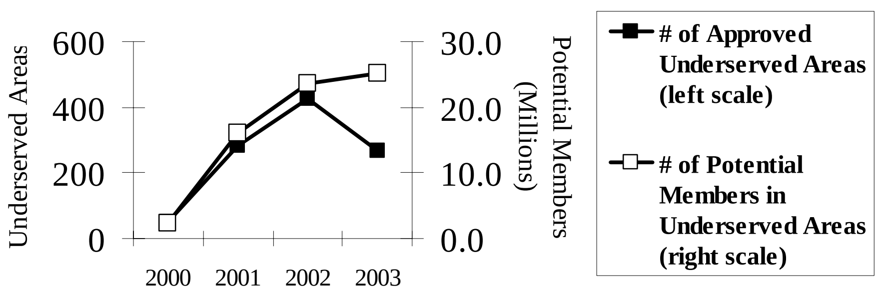
All credit unions are subject to higher capital standards than banks. Taxing the net income, which reduces the growth of retained earnings for a credit union, large or small, would thus have a very detrimental effect on its operations. In fact, the credit unions' regulator, NCUA, has warned for this very reason that credit union taxation could raise safety and soundness concerns.

Myth: Credit unions aren't regulated as well as banks.

Reality: Credit unions are highly regulated financial institutions, and their members' deposits enjoy identical protection to FDIC coverage (up to $100,000 per account) under the National Credit Union Share Insurance Fund. Credit unions also have the distinction of not costing the American taxpayer a penny in bailouts. By contrast, the S&L failures in the 1980s and '90s cost taxpayers approximately $124 billion. The Government Accountability Office (GAO), after completing a comprehensive study of credit unions in 2003, found that "[c]redit unions have a greater proportion of assets available to cover potential losses than banks and thrifts."

As you can see, America's credit unions have always remained true to their original 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." Since the passage of CUMAA in 1998, federal credit unions have added over 1,000 underserved areas, resulting in low-cost financial services being made available to over 67 million people.

UNDERSERVED AREAS ADDED TO FEDERAL CREDIT UNIONS' MEMBERSHIP



Source: National Credit Union Administration

A 2004 Filene Research Institute study entitled "Who Uses Credit Unions" found that the average household income of those who hold accounts solely at a credit union was $42,664, while the average household income for those who only hold accounts at a bank was $76,923. For households that used multiple financial services providers, those that primarily used a credit union had an average income of $67,475. For households who used multiple financial services providers but primarily used a bank had an average income of $74,303. Credit unions also represent a very small portion of today's financial marketplace, holding only 1.6 percent of all household financial assets

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed with the resulting de-personalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. Credit unions are second to none in providing their members with quality personal service at the lowest possible cost. According to the 2003 American Banker/Gallup Consumer Survey, credit unions had the highest rated service quality of all surveyed financial institutions. This has held true each year since the survey was initiated.

Looking Beyond CUMAA

Credit unions have been the target of criticism by some in the banking industry for more than two decades, and the criticisms that the bankers are lodging today are nothing new. Over the past year, the banker attacks have intensified. The Supreme Court's decision in 1998 in the AT&T Family Federal Credit Union field of membership case followed by Congress' prompt passage of CUMAA in the summer of 1998, which was seen by many as a significant victory for credit unions, brought the issue to a head. The fact of the matter is that when CUMAA was signed into law it overturned in eight short months a decision that had encompassed eight years of costly litigation initiated by the banks.

CUMAA was a necessary piece of legislation for credit unions at the time of its enactment because it codified a number of fundamental credit union concepts embraced by both federal and state-chartered credit unions. In addition to the previously mentioned "Findings" section, 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 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 artificial and arbitrary limitations on growth.

Following the passage of CUMAA, NAFCU recognized the need for additional credit union legislation. As a result, NAFCU convened a task force of federal credit unions and former federal credit unions (that had converted to a state charter) to begin work on developing well-reasoned proposals to enhance the federal credit union charter and to ease the regulatory burdens of all credit unions.

This group met to discuss their concerns related to the federal charter in the post-CUMAA environment. Below are highlights of some of the comments NAFCU heard at that session and in subsequent meetings:

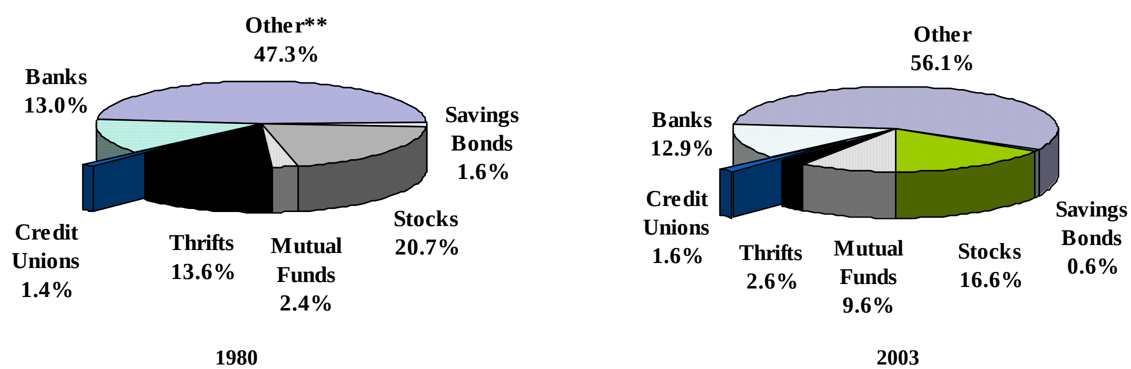
- NCUA should work to eliminate unnecessary and needless regulations and work with Congress to repeal laws which are only serving to drive small financial institutions out of business.
- Mergers seem to be a practical and necessary way of creating financially viable credit unions that can survive in today's financial marketplace.
- It is important that the regulatory environments allow for credit union growth and not impair the ability of credit unions to remain competitive.

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

The Current Situation

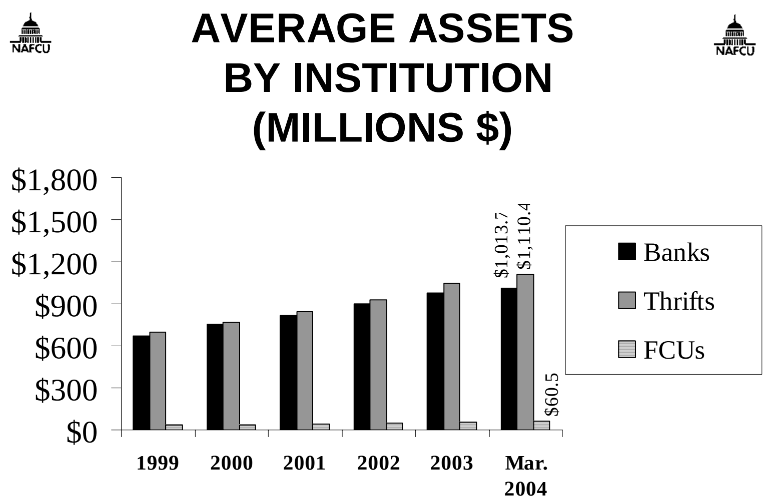
NAFCU is pleased to report to the Committee that credit unions today are vibrant and healthy. Membership in credit unions continues to grow with credit unions serving over 85 million Americans—more than at any time in history. At the same time, it is important to note that over the past 23 years credit unions have increased their market share only minimally and, despite what you may have heard at earlier hearings, provide little competitive threat to other financial institutions. According to data obtained from the Federal Reserve Board, during the 23 year period from 1980 to 2003 the percentage of total household financial assets held by credit unions increased from 1.4% to 1.6% or merely 0.2% over the course of 23 years.

HOUSEHOLD FINANCIAL ASSETS



****Other includes items such as life insurance reserves, pension fund reserves, mortgages, security credit, equity in noncorporate (e.g. farm) business, open market paper, and investments in bank personal trusts.**

The above chart only tells part of the story. Credit unions remain small financial institutions. The chart below indicates that the average credit union has $60.5 million in assets.



As you can see, a number of individual banks have total assets greater than the entire credit union community combined. The annual growth of the commercial bank sector in recent years is almost equal to the size of the entire credit union community—with banks growing in just one year by a magnitude that it took credit unions nearly a century to achieve.

As is the case with the banks and thrifts, there has been consolidation within the credit union community in recent years. The number of credit unions has declined by more than 59 percent over the course of the past 30 years, from an all-time high of 23,866 in 1969 to 9,709 at year-end 2003. Similar to the experience of all credit unions, the number of federal credit unions has declined by just about 56 percent over that same period, from a high of 12,921 in 1969 to 5,732 today.

Despite what you may hear, the reality is that credit unions are more heavily regulated than any other regulated consumer financial services provider. Restrictions on the operations of credit unions limit not only who can avail themselves of credit union services, but also how credit unions can raise capital—an issue that I know has been an interest to certain members of this Subcommittee and others on the full committee. While banks and their trade associations claim that about one-third of banks and thrifts have fewer than 25 employees, I must point out that over three-fourths of credit unions have fewer than 25 employees and almost two-thirds have fewer than ten employees.

As members of this Subcommittee realize, neither NAFCU nor the credit union community at large—which includes a number of credit unions serving parts of the federal government such as the military, the Federal Reserve, the FDIC and Members and staff of both the House and Senate among others—hesitated from embracing the increased regulatory burden imposed upon us with the passage of the USA Patriot Act and we willingly and faithfully accepted those burdens to benefit our national security.

NAFCU Meets with Policymakers to Enhance the Federal Charter

Over the past four years NAFCU has been working with former NCUA Board Chairman Dennis Dollar, current NCUA Chairman JoAnn Johnson, Board Member Deborah Matz and their staffs in a good faith effort to improve the regulatory environment for federal credit unions. We are pleased to see that these efforts have been fruitful in several respects.

On the legislative front, NAFCU has been meeting with legislators on both sides of the aisle to compile a package of initiatives to help credit unions better serve their members in today's sophisticated financial marketplace. An important part of that effort has involved identifying areas in which we believe Congress should provide what is now overdue regulatory relief. NAFCU has suggested a series of recommendations designed to enhance the federal charter, several of which are contained either in whole or in part within the House-passed *Financial Services Regulatory Relief Act of 2004*, H.R. 1375, and in the *Credit Union Regulatory Improvements Act* (CURIA), H.R. 3579, which has been introduced in the House. Both of these bills recognize the fact that today's credit unions exist in a very dynamic environment and that the laws and regulations dealing with credit union issues are currently in need of review and refinement.

Financial Services Regulatory Relief Act of 2004 **and CURIA**

NAFCU believes that the *Financial Services Regulatory Relief* is a positive step in addressing many of the regulatory burdens and restrictions on federal credit unions. We were pleased with the overwhelming bipartisan vote of support for this legislation when it passed the House on March 18, 2004, by a vote of 392-25.

NAFCU is also pleased to see the growing support in the House for CURIA, introduced last November by Representatives Ed Royce (CA) and Paul Kanjorski (PA). The provisions in CURIA, while leaving in place the necessary burdens imposed by the USA Patriot Act, would nevertheless be a positive step in reducing a number of other unnecessary or outdated regulatory constraints and restrictions currently imposed on federal credit unions, some of which date to the early days of the FCUA. In addition to having a number of credit union provisions that are also included in the Financial Services Regulatory Relief Act of 2004, CURIA addresses several new issues for credit unions that have not been previously addressed. We support this legislation and hope that the Subcommittee will consider and pass this bill.

Twelve provisions in particular that would ease the regulatory burden on credit unions have been included in both bills:

<u>Leases of land on federal facilities for credit unions</u>

NAFCU supports the 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. Those 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 credit unions 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 $2,000 a month. For non-profit cooperative credit unions, this change in leasing costs will inevitably lead to higher fees and/or fewer services for the men and women they serve.

Investments in securities by federal credit unions

NAFCU supports this effort to increase investment options for federal credit unions by allowing certain limited investments in securities. The current limitations in the FCUA unduly restrict federal credit unions in today's dynamic financial marketplace and have the potential of adversely impacting both safety and soundness in the future. We believe that the track record of safe and sound performance by credit unions warrants expanded investment authority in accordance with regulations promulgated by the NCUA Board.

Increase in general 12-year limitation of term of federal credit union loans

NAFCU supports increasing the general 12-year limit on federal credit union loans to 15 years or longer as permitted by the NCUA Board. The current 12-year limit is outdated and does not conform to maturities that are commonly accepted in the market today. We believe that it is also important that the NCUA Board have the discretionary authority to extend this limitation beyond 15 years when necessary in order to appropriately address marketplace conditions.

Increase in one-percent investment limit in credit union service organizations

NAFCU supports this provision to increase the one percent investment limit in credit union service organizations (CUSOs). However, in lieu of just raising the limit to three percent, as found in both the *Financial Services Regulatory Relief Act of 2004* and CURIA. NAFCU recommends that Congress give the NCUA Board authority to establish an appropriate investment limit recognizing that as time goes on, that limit may legitimately warrant further adjustment.

Member business loan exclusion for loans to non-profit religious organizations

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.

Check-cashing and money-transfer services offered to those within the credit union's field of membership

NAFCU supports efforts to allow federal credit unions to offer check-cashing and money-transfer services to anyone within the credit union's field of membership. We believe this new authority, which would be discretionary and not mandatory, will allow credit unions to help combat abuses by non-traditional financial institutions that prey on our nation's immigrants and others who live and work in underserved communities.

Voluntary mergers involving multiple common bond credit unions

Current law imposes a numerical limitation of 3,000 on the size of a group that can go forward with a credit union merger before considering spinning off the group and requiring it to form a separate credit union. There is no sound reason for this restriction and NAFCU believes the 3,000 limit is arbitrary. 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 at the time of 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.

Community charter conversions involving employee group credit unions

NAFCU supports efforts that give NCUA the authority to allow credit unions to continue to serve and add members from their select employee groups (SEGs) after a credit union converts to a community charter.

Credit union governance

The FCUA contains many antiquated "governance" provisions that, while perhaps appropriate in 1934, are outdated, unnecessary and inappropriate restrictions on the day-to-day operations and policies of a federal credit union. For example, credit unions are not allowed to expel disruptive or threatening members without a two-thirds vote of the membership. NAFCU supports other provisions in the House-passed *Financial Services Regulatory Relief Act of 2004* which would:

- allow credit unions to limit the length of service of members of the board of directors to ensure broader representation; and
- allow credit unions to reimburse volunteers on the board of directors for wages they would otherwise forfeit by participating in credit union-related activities.

In addition, NAFCU also believes that there are many more governance provisions in the *Federal Credit Union Act* that are out-of-date and that could be better addressed by the NCUA Board. These include:

- Allow the NCUA Board to set the amount at which the credit union board of directors must approve a loan to, or guaranteed by, a director or member of the credit union supervisory or credit committee (currently the Act sets it at $20,000); and,
- Allow the NCUA Board to determine policies for review of approved or pending applications for membership to the credit union (currently the Act stipulates that the Board must review approved or pending applications monthly).

<u>Providing NCUA with greater flexibility in responding to market conditions</u>

NAFCU supports the idea of giving NCUA the authority to adjust interest rates depending on market conditions. Under current law, federal credit unions are the only type of insured institutions subject to federal usury limits on consumer loans.

<u>Exemption from pre-merger notification requirement of the Clayton Act</u>

NAFCU supports the inclusion of this language which would exempt credit unions, just as banks and thrifts are already exempt, from the pre-merger notification requirements of the *Hart-Scott-Rodino Act*.

<u>Treatment of credit unions as depository institutions under securities laws</u>

Gramm-Leach-Bliley provided banks with registration relief from certain enumerated activities, and section 201 of the *Financial Services Regulatory Relief Act* provides similar relief to thrifts. NAFCU supports providing credit unions regulatory relief along those same lines from the requirement that they register with the Securities and Exchange Commission as broker/dealers when engaging in certain activities.

There are also additional regulatory relief provisions included in CURIA that are not included in the *Financial Services Regulatory Relief* as it passed the House:

Risk-based capital

NAFCU supports this effort to modernize credit union capital requirements by redefining the net worth ratio to include risk assets. This would result in a new, more appropriate measurement to determine the relative risk of a credit union's assets and improve the safety and soundness of credit unions and the National Credit Union Share Insurance Fund.

Limits on member business loans

NAFCU supports elimination of the current asset limit on member business loans at a credit union from the lesser of 1.75 times actual net worth or 1.75 times net worth required for a well-capitalized credit union, and replacing it with a flat rate of 20 percent of the total assets of a credit union. NAFCU believes this provision would facilitate member business lending without jeopardizing the safety and soundness of participating credit unions. While the current cap was first imposed on credit unions as part of the *Credit Union Membership Access Act* in 1998, CUMAA also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study entitled "Credit Union Member Business Lending" in which it concluded that "credit unions' business lending currently has no effect on the viability and profitability of other insured depository institutions." That same study also found that over 50 percent of credit loans were made to businesses with assets under $100,000, and 45 percent of credit union business loans go to individuals with household incomes of less than $50,000. We would urge the Committee to review this study and give it the weight it deserves when considering these provisions. NAFCU also supports revising the current definition of a member business loan by giving the NCUA the authority to exclude loans of $100,000 or less as de minimus, rather than preserving the current threshold of $50,000.

<u>Leasing space in buildings with credit union offices in underserved areas</u>
NAFCU supports the provision in CURIA that enhances the ability of credit unions to assist distressed communities with their economic revitalization efforts. It would allow a credit union to lease space in a building or on property in an underserved area in which it maintains a physical presence to other parties on a more permanent basis. It would permit a federal credit union to acquire, construct, or refurbish a building in an underserved community, and lease out excess space in that building.

Should the Committee decide to consider CURIA, we would like to call the Committee's attention to some additional issues that we believe should be added to the legislation:

<u>Modify the statutory definition of "net worth" to mean "equity" rather than the "retained earnings balance" of the credit union as determined under generally accepted accounting principles</u>
Currently, credit union mergers are accounted for by using the "pooling method," meaning that the net worth of each merging credit union is combined to form the net worth of the surviving credit union: $5M (net worth of credit union A) + $5M (net worth of credit union B) = $10M (net worth of credit union AB). However, the Financial Accounting Standards Board (FASB) has proposed eliminating pooling and imposing the "purchase method" of accounting on credit union mergers. Using this method and the current definition of net worth which is "retained earnings" as required by PCA, the net worth of the surviving credit union is only $5M ($5M (net worth of credit union A) + $5M (net worth of credit union B) = $5M (net worth of credit union AB)). Therefore, under the purchase method of accounting, only the surviving credit union's retained earnings count as net worth for PCA purposes. As a result, the surviving credit union may have trouble meeting PCA requirements, unless credit union net worth is redefined to mean equity. It should also be noted that the FASB has reviewed this proposed amendment and has noted in a letter to NAFCU that they "have an interest in supporting

an expedited resolution of this matter" and that this amendment "proposes a way to resolve this matter."

Relax the "reasonable proximity" requirement

This requirement imposes 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 today's financial services marketplace, the increase in Internet and remote banking has rendered this requirement unnecessary.

We hope that the Committee will consider these issues as the bill moves forward in the legislative process.

Conclusion

NAFCU believes that the state of the credit union community is strong and the safety and soundness of credit unions is unquestionable. Nevertheless, there is a clear need for easing the regulatory burden on credit unions as we move forward into the 21st century financial services marketplace. We urge the Committee to consider the important provisions we have outlined in this testimony for any future effort to provide regulatory relief for credit unions. We look forward to working with you on this important matter and would welcome your comments or questions.