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TESTIMONY

OF

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ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON

EXAMINING REGULATORY RELIEF PROPOSALS FOR COMMUNITY FINANCIAL INSTITUTIONS

DECEMBER 4, 2013

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Chairman Capito, Ranking Member Meeks and Members of the Subcommittee:

Thank you for inviting me here to testify at today's hearing. My name is Rose Bartolomucci, and I am President and Chief Executive Officer of Towpath Credit Union, a state-chartered credit union with total assets of $113 million, serving 21,000 members, headquartered in Akron, Ohio. Our field of membership is principally telephone workers and educators in the Greater Akron marketplace. I am testifying today on behalf of the Credit Union National Association (CUNA), the largest credit union advocacy organization in the United States, representing nearly 90% of America's 6,800 state and federally chartered credit unions and their 98 million members. I am also currently a member of the CFPB's Credit Union Advisory Council and would like to state that the views expressed in my testimony today are my own, and those of the

Credit Union National Association, and not the Credit Union Advisory Council, the Consumer Financial Protection Bureau, or the United States.

The credit union system is pleased to testify before the Subcommittee in support of each of the bills under consideration today: H.R. 3584, a bill to permit privately insured credit unions to apply for membership in the Federal Home Loan Bank (FHLB) system; H.R. 2672, the Consumer Financial Protection Bureau (CFPB) Rural Designation Petition and Correction Act; and a new bill to direct federal financial regulators to determine whether new regulations or orders are duplicative or inconsistent with existing Federal regulations.

Authorizing Privately Insured Credit Unions to Become Members of a Federal Home Loan Bank

CUNA supports H.R. 3584, bi-partisan legislation introduced by Representatives Steve Stivers (R-OH) and Joyce Beatty (D-OH), which would allow state-chartered, privately insured credit unions, to apply for membership in the Federal Home Loan Bank System. Importantly, this does not guarantee any institution the right to be a member, simply the ability to apply for membership. This legislation would affect a small group of state-chartered, privately insured credit unions across the Unites States. We are grateful to them both for introducing this bill. We are also grateful to a former Member of the Committee, Andre Carson (D-IN) who was an original co-sponsor of this bill in the last Congress and this Congress as well.

Let me discuss the necessity of this bill for this small group of credit unions. I will also more generally discuss the present status of private insurance for credit unions.

Very simply, credit unions exist to serve the financial needs of their members. The Federal Home Loan Bank System permits certain financial

institutions to apply for membership, helping those institutions meet lending demand with respect to home mortgages, farm loans or other loans that satisfy the collateral requirements of the Federal Home Loan Bank System. Some state-chartered credit unions are privately insured and under current law, cannot apply for membership to the Federal Home Loan Bank System. Permitting these few credit unions to apply for membership to the Federal Home Loan Bank System would help them serve the financial needs of their members. Many credit unions keep their loans in portfolio or make loans with unique characteristics that do not always meet the big bank "cookie cutter" models. Federal Home Loan Bank membership is a key option to providing liquidity so we can meet our members' needs.

In 1989, in the wake of the savings and loan crisis, the Federal Home Loan Bank System was opened up for the first time to commercial banks and credit unions. Unfortunately, the bill was drafted in such a way to apply only to an "insured credit union" as defined under the Federal Credit Union Act. If the legislation had used a broader term – such as "state credit union" or "state-chartered credit union" terms that are clearly defined in the 12 USC 1752 of the Federal Credit Union Act, we would not be here today, and this would not be an issue.

This is why, for many years, we have suggested that this was likely an oversight in drafting. Unfortunately, it has meant that this small group of credit unions has been denied the right to even apply for membership in the Federal Home Loan Bank System for over two decades.

The House of Representatives has recognized this as a problem. Twice, in 2004 and 2006, the full House passed legislation to correct this. In fact, the bill before you today is nearly identical to a similar proposal passed by the

House of Representatives on March 8, 2006 as Section 301 of H.R. 3505, the Financial Services Regulatory Relief Act of 2006, by a vote of 415 - 2. In 2008, as part of the Housing and Economic Recovery Act of 2008, Congress made a small change that permits privately-insured, state-chartered credit unions which are designated as CDFIs to apply for membership to the Federal Home Loan Banks; however, of the 132 privately insured credit unions, only two hold CDFI status.

The Federal Home Loan Bank System was created in the midst of the Great Depression, notably before the existence of federal deposit insurance. Its purpose was to help small savings institutions in rural areas access credit to facilitate home lending. We feel that privately insured credit unions are exactly who this System was designed to serve. Insurance companies, which are not federally insured, were original members of the System and they remain so today. In fact, 119 insurance companies presently borrow from the Federal Home Loan Bank System and report borrowings of nearly *twice* that of the 427 federally insured credit unions that also currently have advances outstanding, according to the Combined Financial Report of the Federal Home Loan Bank System for the Quarter ending on September 30, 2013.

It has never seemed fair to our small institutions that some of the largest banks in the world, or insurance companies (which are not federally insured), or a foreign bank's U.S. subsidiary can borrow billions of dollars from the Federal Home Loan Bank System, but teachers in Ohio and Texas, firefighters in California, postal and county workers in Illinois and farmers in Indiana cannot. We think passing H.R. 3584 would be a just result to remedy this inequity.

Issues related to private share insurance

Let me also take this opportunity to discuss private insurance for credit unions, and address some of the issues that might be raised by those unfamiliar with private insurance.

Private deposit insurance has been available to credit unions since 1962, well before the establishment of a federal deposit insurance fund for credit unions. Credit unions did not have federal insurance until the National Credit Union Share Insurance Fund was created in 1970 – nearly 37 years after the creation of the FDIC. The Federal Credit Union Act in 12 USC 1781 states, in part, that the National Credit Union Administration (NCUA) "shall insure the member accounts of all Federal credit unions and it *may* insure the member accounts of (1) credit unions organized and operated according to the laws of any State." Thus, for state-chartered credit unions, federal insurance was optional, and many did not have any form of deposit insurance until into the early 1980s.

Presently, there are 132 privately insured credit unions that operate in nine states, representing approximately 14.5% of the total state-chartered credit unions in those respective states. The states are: Ohio, Illinois, Indiana, Maryland, Alabama, Idaho, Nevada, California and Texas. Collectively, these institutions hold $11.9 billion in insurable deposits and approximately $13.3 billion in total assets, averaging just over $100 million each. Combined by asset size, these institutions barely satisfy the definition of just *one small bank.* Congress has often set a $10 billion threshold as defining a relatively small institution. Only a few of the privately insured credit unions are over $500 million in assets, and only one is over $1 billion in assets.

The company that insures these credit unions, American Mutual Share Insurance Corporation (ASI), is based in Dublin, Ohio. It has been in operation since 1974, beginning just a few years after the start of federal insurance for credit unions. ASI is a credit union-owned share guaranty corporation, duly licensed by the Ohio Department of Insurance and dual-regulated in Ohio by the Ohio Department of Insurance and the Ohio Department of Financial Institutions. ASI only insures deposits at credit unions.

In nearly 40 years of operation, no depositor has ever lost money in an ASI-insured credit union. The insurance fund has endured all of the economic swings in the last four decades, including the savings and loan crisis, the bank and real estate crisis in the early 1990s and this latest and worst of economic times that started in 2008. To meet the needs of depositors, the company reports a strong capital base and an equity ratio of 1.60%, determined by independent actuaries to be sufficient to cover claims under various economic conditions. ASI has experience addressing its problems and resolving challenges to the benefit of credit union members and the financial services industry. During this most recent financial crisis, ASI came to the aid of one of its largest insured credit unions at the epicenter of the recession, Las Vegas, Nevada. With ASI's help, the credit union did not have to close and today 70,000 members (mostly teachers and others) in Nevada still enjoy quality service from a viable institution.

Under state and federal law, the company is subject to an annual audit by an independent "Big Four" certified public accounting firm, and under Ohio law, any qualifications to the auditors' opinion must be remedied in order to continue operating. For the record, ASI has never received a qualification to its audited financial statements. Furthermore, under Ohio law, ASI must have the adequacy of its guaranty loss reserves annually reviewed and attested to by an independent actuary, and every three years, it must have an actuary render an opinion as to the sufficiency of ASI's total capital and reserves under various economic scenarios. As of the close of last year, an internationally recognized actuarial firm considered both reserves and capital to be sufficient by industry standards. Finally, state regulators from each of the nine states where ASI is authorized to offer their insurance, participate in an annual joint examination of ASI.

Understandably, a number of questions arise when considering privately insured financial institutions. I would like to address these issues in the context of this legislation.

Activities of State-Chartered Credit Unions with Private Insurance

Can these privately insured credit unions engage in riskier activities than federally insured institutions? No. State-chartered, privately insured credit unions are licensed and regulated in the exact same manner as state-chartered, federally insured credit unions. In each state where there are privately insured institutions, there are also federally insured institutions. State regulators apply the same rules and standards to all state-chartered credit unions under their supervision, thus, privately insured institutions are not engaged in any activities that are not normally conducted by federally insured, state-chartered institutions. Further, ASI monitors its larger insured credit unions monthly and others quarterly, and conducts on-site examinations at credit unions representing nearly 90% of total insured deposits each year. These on-site examinations are routinely done in concert with the state credit union authorities.

Impact on the Federal Home Loan Bank System

Is there a risk to the Federal Home Loan Bank System from this legislation? No. All advances from the Federal Home Loan Bank System must be fully collateralized and subject to their strict uniformly applied standards. Also, the legislation, H.R. 3584, makes it clear that the FHLB will have a superior lien over any assets it holds as collateral, irrespective of how the credit union's deposits are insured. In addition, under any scenario, the number of privately insured institutions that would likely join the FHLB, and dollar amount of advances associated with them, would be a small fraction of the combined outstanding advances of the FHLB System. There is no risk of loss to any

Federal Home Loan Bank as a result of a credit union's form of deposit insurance.

Currently, the Federal Home Loan Bank System has approximately $465 billion in outstanding advances. When all the assets of privately insured credit unions are combined, it approximates nearly $13.3 billion. Even under the most extraordinary circumstance, assuming 20% of the assets of *all* these credit unions were pledged as collateral for advances, the new advances would amount to approximately one-half of one percent of all the current advances outstanding of the combined branches of the Federal Home Loan Banks. As you can see, this change would result in nothing more than a very minor addition to the Federal Home Loan Banks' membership base and advances outstanding.

Impact on the NCUSIF

Will this change cause a significant number of credit unions to switch from federal to private insurance? No. First, and most importantly, ***federally insured credit unions can already join the FHLB***. Therefore, there is no benefit for a federally insured credit union to change insurance just because of this change in the law. Second, the NCUA Board has final approval authority over any federally insured credit union switching from federal to private insurance. Finally, no federally insured credit union can convert to private share insurance without also satisfying extremely rigid regulatory requirements of the NCUA which includes the voting of the credit union's entire membership under federally scripted balloting and notice provisions. Historically, very few credit unions switch from private to federal insurance or vice versa in any one year. A mass exodus is not likely or practicable. As evidence, over the past ten years, a total of 11 institutions have switched from federal to private deposit insurance (other than through merger), and 10 have switched from private to federal deposit insurance (other than through merger), for a net annual average change

of zero. Further, ASI's governing statute limits any inordinate growth to less than 25 average-sized credit unions over any short period of time, so as not to dilute its capital and reserves. This legislation will clearly not impact the balance of credit unions in either insurance fund.

Consumer Protection

Are consumers protected when an institution is privately insured? Not commonly known to most observers is that Section 43 of the Federal Deposit Insurance Act, enacted in 1991, has extensive statutory requirements governing disclosures to consumers in privately insured credit unions. As a result of Dodd-Frank, authority over this Act was transferred from the FTC to the CFPB, and CFPB regulations are currently in place to govern consumer disclosures of privately insured credit unions. The statute requires that the institution "include conspicuously in all periodic statements of account, on each signature card, and on each passbook, certificate of deposit, or share certificate a notice that the institution is not federally insured, and that if the institution fails, the Federal Government does not guarantee that depositors will get back their money." Further, it provides that in all advertising, websites, branches, teller windows, etc., that there are similar conspicuous disclosures.

I hope that I have explained the need for H.R. 3584 for institutions like mine and imparted to the Subcommittee more information about the niche of privately insured credit unions. Credit unions are different. We are member-owned cooperatives, with volunteer Boards of Directors. While some want to raise unwarranted fears, we seek this authority for no other reason than to help our members meet their financial needs and improve the prospects of broader home ownership.

CFPB Rural Designation Petition and Correction Act

CUNA supports H.R. 2672, introduced by Representative Andy Barr (R-KY), the CFPB Rural Designation Petition and Correction Act. This legislation would direct the CFPB to establish an application process determining whether a county should be designated as a rural area if the CFPB has not designated it as one.

Designation of "rural" by the CFPB has many implications for credit unions, particularly with respect to the type of products credit unions may offer their members in these areas. For instance, the Escrow Requirements under the Truth in Lending Act Rule requires certain lenders to create an escrow account for at least five years for higher-priced mortgage loans. If those loans are made by small lenders that operate predominately in rural or underserved counties, they are exempt from this requirement. Another example includes the Ability to Repay and Qualified Mortgage (QM) Standards Under the Truth in Lending Act rule by which mortgage loans with balloon payments do not meet the QM standard. Like the Escrow Rule, small lenders that operate predominately in rural areas are eligible to originate balloon-payment QMs. The CFPB has defined "rural" by using the U.S. Department of Agriculture Economic Research Services' urban influence codes.

However, the CFPB is reexamining the definition of "rural" over the next two years. The concern CUNA has with the definition in the current rule is that many credit unions make loans to those in rural communities, but the credit union itself may not be based in those communities. If the definition of "rural" does not change, these institutions will be limited in the types of products they can offer their members in these areas.

That is why Rep. Barr's legislation is welcomed at this time. This bill would allow a person who lives in or does business in a state, with respect to a

county in such state that has not been designated by the CFPB as a rural area for purposes of a Federal consumer financial law, to apply for such county designation. To make a determination of whether a county should be designated as rural, the CFPB must take into account in its definition of "rural" criteria used by: the Bureau of the Census for classifying geographical areas as rural or urban; the Office of Management and Budget to designate counties as metropolitan, micropolitan or neither; the Secretary of the Agriculture to determining property eligibility for rural development programs; the Department of the Agriculture rural-urban commuting codes; a written opinion provided by the State's banking regulator; and, population density.

CUNA supports this legislation, and we encourage Congress to enact it.

Directing Federal Financial Regulators to Address Duplicative or Inconsistent Rules

As CUNA has testified in the past, credit unions face a crisis of creeping complexity with respect to regulatory burden. It is not just one new law or revised regulation that challenges credit unions, but the cumulative effect of all regulatory changes. Credit unions are small community based financial institutions. Nearly 78% of all credit unions are under $100 million in assets and nearly 50% of all credit unions are under $20 million in assets. Credit unions of these sizes typically employ a small staff. For instance, my credit union is just over $100 million and employs 17 staff members. However, with the onslaught of rules and regulations from various regulators as the result of Dodd-Frank and other enacted legislation, small credit unions are expected to comply as quickly and efficiently as large financial institutions with hoards of compliance officers. While the elimination of one duplicative rule or regulation may not seem like much, to a compliance officer in a credit union, it is. Without one more rule to

comply with that employee can now spend time with a credit union member, helping to serve their financial needs.

The CFPB sought comments on streamlining inherited regulations on November 20, 2011.[1] CUNA submitted comments to the Bureau.[2] Our letter included suggestions that would establish ongoing regulatory review mechanisms and establish a reasonable review and implementation cycle for all consumer protection rule changes (i.e. which would have prevented the multiple amendments of rules in a short period of time with regard to the CARD Act and mortgage regulations). Small changes such as these make a significant difference in our member-owned cooperatives. However, two years later, the CFPB has yet to act on the comments they sought.

The legislation that Chairman Capito is working on would help to whittle away at unnecessarily burdensome, outdated and/or duplicative rules by directing the federal financial regulators when promulgating new regulations to "assess other related Federal regulations to determine the interaction between the proposed regulation or order and other related Federal regulations." The considerations the regulator would be required to make under this legislation include assessing whether the proposed regulation or order is in conflict, inconsistent or duplicative with other Federal regulations and orders or if it is simply outdated. The legislation also directs the regulators to take all available measures under current law to resolve any duplicative or inconsistent existing regulation or order with any proposed regulation or order before issuing the final regulation or order.

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[1] https://www.federalregister.gov/articles/2011/12/05/2011-31030/streamlining-inherited-regulations

[2] http://legacy.cuna.org/download/cl_030512.pdf

CUNA supports this legislation. If enacted, we believe that it could help ensure that future rulemaking is not unnecessarily burdensome. We appreciate the sponsors' introducing this bill and encourage Congress to enact the legislation.

Conclusion

Madam Chairman, for those operating community based financial institutions, the crisis of creeping complexity with respect to regulatory burden is very real. The bills that the subcommittee is hearing today are commonsense proposals that individually may seem like small steps, but taken collectively will contribute to expanded access to capital for homeowners and small businesses and reduced regulatory burden for credit unions, banks and other financial institutions.

Frankly, there is a lot more work to be done to address the unnecessary, outdated and duplicative regulatory burden facing community based financial institutions. We applaud the Subcommittee for its continued efforts to address regulatory burden, and we look forward to working with you on additional measures in this regard.

On behalf of America's credit unions and their 98 million members, thank you very much for allowing me to testify at today's hearing. I am happy to answer any questions the Members of the Subcommittee may have.