National Credit Union Administration

November 20, 2007

Office of the Chairman

The Honorable Henry M. Paulson, Jr.
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Paulson:

The National Credit Union Administration (NCUA) is responding to your request for comments on TREAS-DO-2007-0018 "Review by the Treasury Department of the Regulatory Structure Associated with Financial Institutions." NCUA's comments are limited to those issues that directly impact the credit union system.

The National Credit Union Administration (NCUA) regulates the 5,068 federally-chartered credit unions and insures 8,163 federally-insured credit unions with total assets of $744 billion.[1] Credit unions provide loans to people of modest means for provident purposes, serving the savings and transaction needs of approximately 87 million[2] credit union members.

NCUA believes that the demonstrated success of the current regime, combined with the unique nature of the credit unions under supervision, supports the maintenance of the current regulatory framework. NCUA's comments can be summarized into five primary positions:

1) Several facts concerning the structure and operation of credit unions segregate credit unions, and by extension the credit union regulatory system, from the core concerns raised in this study.

2) The multiple regulator structure of the U.S. depository system effectively meets the needs of the American consumer and provides benefits by fostering creativity and innovation in financial services.

3) Federal deposit insurance plays a key role in stabilizing the U.S. economy by instilling public confidence in the financial system. The primary way to accomplish this purpose is through federally-backed deposit insurance. While the two federal deposit insurers are fundamentally different in their structure, their federal-backing allows them to fulfill their core purpose.

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[1] This total does not include privately-insured credit unions, which are allowed within the credit union system. As of September 30, 2007, 169 state-chartered, privately-insured credit unions reported $15.8 billion in assets. Privately-insured credit unions are regulated by their respective state supervisory authorities.
[2] The number of members is consolidated based upon the membership data reported by each credit union. This does not represent total people with accounts in credit unions since some individuals are members of multiple credit unions.

4) The credit union charter provides a true democratic system that allows for a level of oversight and control by its members that is unmatched by other charters.

5) NCUA supports some incremental regulatory reforms to provide regulatory relief and enhance efficiency in the credit union system. NCUA recommends changes to the Federal Credit Union Act related to Prompt Corrective Action (PCA) and the authority to allow all types of federal credit unions to add underserved areas to their fields of membership.

Credit Union Regulatory Structure

NCUA believes the current regulatory system is effective in meeting the needs of credit union members. However, with the changing operational needs of credit unions, some modifications are in order.

The credit union system is not impacted by many of the issues involving international competition, complexity, and product convergence noted in several of the questions posed in the study. Federal credit unions are member-owned cooperatives. Federal credit unions cannot invest in the shares of an insurance company or control another financial depository institution. Thus, they cannot be part of a financial services holding company and cannot become affiliates of other depository institutions or insurance companies.

A rules-based closely regulated approach is necessary to maintain the safety and soundness of the credit union system, since the market discipline pillar is structurally lacking in credit unions. As cooperatives, credit unions do not issue stock and few issue marketable debt instruments. Because credit unions are not publicly traded entities, the use of meaningful disclosures does not result in the same level of market discipline applied to other types of depository institutions.

The current regulatory structure for all depository institutions has effectively met the needs of the regulated industries and resulted in innovation, leading ultimately to better products, services, and choice for the American consumer. One concern with the structure, as noted in the U.S. Government Accountability Office (GAO) Report *GAO-05-61,* is the blurred lines of oversight due to changes in the financial industry. The regulators have made changes to address the blurred lines between services and are working together through interagency committees to address common issues.

The current structure allows depository institutions of all sizes and types to be fairly represented in the marketplace due to the specialized attention provided by each regulatory agency. Since each regulator oversees a specific group, the business needs and risks of those groups can be fully understood and regulated accordingly.

Lawrence J. White, Professor of Economics at the Stern School of Business (NYU), wrote that healthy regulatory competition "creates safety valves, alternative forums, bases of comparison, sources of new ideas, and potential arenas for innovation." He also concluded that "Most important, this multiple agency structure ensures regulatory competition – each agency generally wants to expand its domain of chartering and jurisdiction – that is generally beneficial for the financial system and for the health of the American economy."[3]

While some believe that a single regulator would resolve duplication of efforts and overlap, then Federal Reserve chairman Alan Greenspan spoke to this issue in 1994:

> A consolidated single regulator would deprive our regulatory structure of what the Board considers to be current invaluable restraint on any one regulator conducting inflexible, excessively rigid policies. The dual banking system and multiple Federal regulators have facilitated diversity, inventiveness and flexibility in our banking system, so important to a market economy subject to rapid change.[4]

Role of Deposit Insurers & NCUA's Model

Based on NCUA's experience as both the regulator and insurer of federally-chartered credit unions, NCUA concludes that a well coordinated effort and open communication between the regulator and federal insurer is of paramount importance to properly balance regulation with safety and soundness considerations. NCUA defers to others on how this relationship should be structured for other depository institutions, but offers the NCUA model as one that has been successful.

NCUA has a successful record of regulating federal credit union charters and also serving as insurer. This structure has stood the test of time, including various adverse economic cycles. At no time under this structure has the credit union system cost the American taxpayers any money in a bailout or capitalization need.

One of the questions that emerges from the series of issues posed by Treasury is whether there is a need for both federal deposit insurance funds. The National Credit Union Share Insurance Fund (NCUSIF) should remain independent of the Deposit Insurance Fund (DIF). The two federal deposit insurers utilize significantly different models. The current health and performance of the NCUSIF is strong, demonstrating the current system as structured is effective and meets the purpose of instilling public confidence.

The U.S. Department of Treasury's December 1997 Study of Credit Unions concluded the NCUSIF is best served by remaining independent of the bank fund. The study included a review of the NCUSIF and NCUA's dual role as regulator and insurer for federally-chartered credit unions. Treasury discussed the unique capitalization structure of the NCUSIF and how it fits the cooperative nature of credit unions and offered the following:

- ✓ "We found no compelling case for removing the Share Insurance Fund from the NCUA's oversight and transferring it to another federal agency such as the FDIC. The NCUA maintains some level of separation between its insurance activities and its other responsibilities by separating the operating costs of the Fund from its non-insurance

[3] Lawrence J. White, *Consolidation or Competition for Financial Regulators?* Global Policy Forum, March, 2002.
[4] Statement by Alan Greenspan, Chairman, Board of Governors of the Federal Reserve System before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, March 2, 1994.

expenses." Treasury, December 1997 Study of Credit Unions, p.52.

- ✓ "Under the current structure, the NCUA can use supervision to control risks taken by credit unions – providing an additional measure of protection for the Fund. We also believe that separating the Fund from the NCUA could: (1) reduce the regulator's incentives to concern itself with insurance costs, should an institution fail; (2) create possible confusion over the roles and responsibilities of the insurer and of the regulator; and (3) place the insurer in the situation of safeguarding the insurance fund without having control over the risks taken by the insured entities." Treasury, December 1997 Study of Credit Unions, p.52.

- ✓ "The financing structure of the Share Insurance Fund fits the cooperative character of credit unions. Because credit unions must expense any losses to the Share Insurance Fund, they have an incentive to monitor each other and the Fund. This financing structure makes transparent the financial support that healthier credit unions give to the members of failing credit unions. Credit unions understand this aspect of the Fund and embrace it as a reflection of their cooperative character." Treasury, December 1997 Study of Credit Unions, p.58.

Charter Choice

NCUA believes charter choice and the multiple types of depository institutions are stabilizing factors for the U.S. economy and directly contribute to the success of the U.S. financial system. The niche the credit union industry fills in the U.S. financial system is an important one and should be preserved to the fullest extent possible.

The credit union charter is a viable and important charter choice due to its pro-consumer structure. The fact that nearly 87 million members choose to hold an account in a credit union speaks to the relevance of the charter. The credit union industry plays a vital role in creating consumer choice and providing services in all the major markets in the United States, as well as nearly all local communities.

The credit union charter is the only financial charter in the United States that gives every member an equal voice in how their institution is operated with its "one member, one vote" cooperative structure. This is a major reason why credit unions consistently lead in customer satisfaction surveys amongst depository institutions, as it relates to pricing and services. The credit union charter provides an important alternative in the financial services industry for American consumers.

The predominant defining characteristic of credit unions has been, and remains, their cooperative structure. Critics note that credit unions, particularly community credit unions, are similar to other depository institution charters. It is inappropriate to equate financial institutions based on product offerings and authorized powers. Credit unions remain fundamentally different from other forms of financial institutions based on their member-owned, democratically operated, not-for-profit cooperative structure. Credit unions have been faithful to their originally conceived cooperative structure, which has remained unaltered since their inception.

Loss of credit unions as a type of financial institution would severely limit access to financial services for many Americans. Credit unions are an important competitive check against for-profit institutions by providing low-cost products and services,[5] and an alternative to abusive and predatory practices.[6] They provide products geared to the average consumer at a reasonable price, such as very small loans and low-minimum balance savings products.

Credit Union Regulatory Reform

To enable credit unions to continue their safe and sound operations and fulfill Congressionally-mandated public policy objectives, NCUA has recommended modifications to the Federal Credit Union Act. Specifically, NCUA has identified amendments that would:

1) Enhance and modernize the system of PCA allowing for the implementation of a more robust risk-based capital standard for credit unions.

2) Allow all types of federally-chartered credit unions to adopt underserved areas.

In June 2007, the NCUA Board formally approved a plan to enhance and modernize the system of PCA while at the same time allowing for the implementation of a more robust risk-based standard for credit unions. While NCUA Board action was intended to establish a public record about the rationale and basis for these changes, modification to the statute is necessary before any alterations can occur. The following link provides access to the full proposal: http://www.ncua.gov/ReportsAndPlans/special/PCAUpdatedSept07.pdf

Currently, only federal credit unions with *multiple* common bond charters are permitted to add underserved areas into their field of membership. The Federal Credit Union Act precludes federal credit unions with both *single-group* and *community* charters from doing so, despite a statutory change in 1998 that was intended to allow all three charter types to adopt underserved areas. The proposed legislative remedy would enable consumers in economically disadvantaged areas to have greater access to credit union service, consistent with longstanding Congressional intent. Legislative language, contained in Title II of the Credit Union Regulatory Improvement Act (H.R. 1537) would accomplish this.

In summary, credit unions serve a vital role in providing Americans access to basic financial services at affordable prices. To ensure that credit unions remain a viable choice for all consumers, NCUA supports enhancing the existing regulatory system for credit unions as noted above, while maintaining the deposit insurance structure.

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[5] Some researchers estimate the competitive presence of credit unions save bank customers $4.3 billion annually. *An Estimate of the Influence of Credit Unions on Bank CD and Money Market Deposits in the U.S.* - Idaho State University, January 2005. Also, *an Analysis of the Benefits of Credit Unions to Bank Loan Customers* – American University, January 2005.

[6] The Woodstock Institute's report *Blindfolded Into Debt: A Comparison of Credit Card Costs and Conditions at Banks and Credit Union* describes the fees, rates, and terms of the largest credit card providers in the U.S. The report documents the highly confusing terms and conditions now used in the credit card industry. It suggests that the deceptive effect of these complexities massively raises the cost of using credit cards and contributes to rising levels of consumer debt. The report also shows that credit cards issued by credit unions have similar purchase interest rates but come with fewer fees, lower fees, lower default rates, and conditions that are much clearer. The details of the credit union card show how credit card lending is sustainable without exorbitant penalties and misleading terms and conditions.

NCUA appreciates the opportunity to comment. Please contact me if you have questions regarding NCUA's comments.

Sincerely,

JoAnn Johnson

JoAnn M. Johnson
Chairman

cc: David G. Nason, Assistant Secretary for Financial Institutions Policy