STATEMENT

OF

THE HONORABLE JOANN M. JOHNSON
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

ON

"FINANCIAL SERVICES FOR DISADVANTAGED COMMUNITIES"

BEFORE THE

APPROPRIATIONS SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT

U.S. HOUSE OF REPRESENTATIVES

THURSDAY, MARCH 1, 2007

On behalf of the National Credit Union Administration (NCUA), I am pleased to offer testimony on the subject of "Financial Services for Disadvantaged Communities." This is an important public policy topic that Congress should explore, and I commend Chairman Serrano, Ranking Member Regula and the other members of the Subcommittee for your active interest in learning more about the parameters of the problems facing these communities, as well as some of the steps that are being taken, and should be taken, to mitigate the situation.

The NCUA is the independent federal agency that charters and regulates federal credit unions and insures accounts in federal and the overwhelming majority of state-chartered credit unions across the country through the National Credit Union Share Insurance Fund (NCUSIF). NCUA receives no operating appropriations from Congress, and is funded by credit union fees.

A credit union is a member-owned, not-for-profit cooperative financial institution. There are 8,462 federally insured credit unions, which hold $701 billion in assets, as of December 31, 2006. There are approximately 87 million credit union members in the United States.

I. Disadvantaged Communities

Consumers in disadvantaged communities can be described by law and regulation in various ways. For the purpose of this testimony, the term "low income" will be used to describe consumers in these communities and shall be considered synonymous with the terms "unbanked", "underbanked", "distressed", and "underserved". NCUA describes "low-income" as members who make less than 80% of the average for all wage earners as established by the Bureau of Labor Statistics; or whose annual household income falls at or below 80% of the median household income for the nation as established by the U.S. Census Bureau.[1]

The Center for Financial Services Innovation (CFSI), an affiliate of the ShoreBank Corporation, a Chicago institution whose mission is to encourage financial services industry efforts to serve un-and underbanked consumers, reported to NCUA in August 2006 that as many as 28 million people are "unbanked." Another 45 million people or 19.4% of all U.S. households have an account relationship with a traditional financial institution (for the purpose of this testimony we are defining traditional financial institutions as credit unions, banks, and thrifts), but continue to use a broad array of

[1] The Office of the Comptroller of the Currency uses a similar standard to determine the needs of the "unbanked" in the study, "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities" that was presented to the Federal Reserve System Conference "Changing Financial Markets & Community Development" held on April 5-6, 2001, in Washington, DC.

nontraditional financial services to meet their needs.[2] These nontraditional financial services are accessible, but are usually provided at a higher cost to the consumers.

A 2005 study, "*Banking the Unbanked: Helping Low-Income Families Build Financial Assets,*" delineated the reasons consumers use nontraditional services or remain "unbanked." Those reasons include: limited traditional financial institution options; desire for immediate access to financial services; reluctance to maintain a stipulated balance in a depository account; lack of information regarding access to a traditional financial institution; distrust of mainstream financial institutions; inability to understand the costs or evaluate options; belief that evidence of asset accumulation may negatively impact eligibility for public assistance; and difficulty in managing debt. A strategy identified by this report to encourage low-income consumer use of traditional banking services entailed basic financial education accompanied by information regarding the benefits of using mainstream financial institutions, tailored to specific consumer needs (e.g., cultural and language-sensitivity).[3]

Financial Service Options in Disadvantaged Communities

While the above-referenced barriers and disincentives facing consumers in disadvantaged communities have resulted in lower participation in traditional financial institutions, the financial service needs are essentially similar if not identical to those in non-disadvantaged communities. Financial education, transactional services, depository services, short-term credit, business lending, and homeownership products are examples of the types of financial service offerings consumers expect regardless of their income level or net worth.
In particular, low-income consumers most commonly use transactional and short-term credit products to address their immediate financial needs.[4] Transactional products/services include check-cashing, money orders, electronic money transfers, and stored value cards. These services are available from a variety of outlets including nontraditional financial institutions, places of employment, supermarkets, currency exchanges, post offices, and check-cashing outlets. The fee to cash a payroll or

---

[2] Director Jennifer Tescher's "Credit Unions and the Underserved: Opportunity and Innovation" presentation [slide 6], August 30, 2006, NCUA Regional Conference.

[3] "Banking the Unbanked – Helping Low-Income Families Build Financial Assets" by Pamela Friedman released by The Finance Project on September 2005. Findings and strategies mentioned throughout the report. The Finance Project was founded in 1994 with support from a consortium of national foundations interested in ensuring the viability and sustainability of promising initiatives that contribute to better futures for children, families, and communities. Their mission is to support decision-making that produces and sustains good results for children, families, and communities. The Finance Project develops and disseminates research, information, tools, and technical assistance for improved polices, programs, and financing strategies.

[4] "Banking the Poor" by Michael S. Barr, University of Michigan Law School – A Working Paper Prepared for The Brookings Institution Center on Urban and Metropolitan Policy dated July 2003 page 6.

government check varies from no cost to 3% of the check amount.[5] Personal checks are cashed at an average cost of 15% of the amount of the instrument.[6] It is significant to note that traditional financial institutions generally do not charge account holders fees for cashing checks.

Additionally, non-traditional financial service providers typically charge high fees for money orders and electronic money transfer services.[7] On the other hand, NCUA is aware of numerous credit unions offering free or low cost money transfers.[8]

Another type of short-term credit product is primarily known as a "payday loan." A 2005 study indicated that the cost of payday loans typically ranges from $15 to $22 per $100 for a two-week loan, an annualized 391% to 572% interest rate.[9]
In 2004, there were 22,000 payday loan stores extending about $40 billion in loans.[10]

Other examples are "rent to own" credit products, which allow consumers to acquire goods by installment, and tax refund anticipation loans (RALs), which are short-term cash advances against a customer's anticipated income tax refund. The Brookings Institute reports that the rate of interest on these RALs generally exceeds 200%, and can be higher in some cases.[11] It is important to note that the Federal Credit Union Act (FCU Act) imposes an 18% usury ceiling, which limits the rate federal credit unions can charge on loans.

---

[5] "The Role of Banks and Nonbanks in Serving Low- and Moderate-Income Communities" presented to the Federal Reserve System Conference "Changing Financial Markets & Community Development" held in Washington, DC on April 5/6, 2001, by Constance R. Dunham, Senior Financial Economist of the Office of the Comptroller of the Currency.

[6] "Banking the Underbanked Helping Low-Income Families Build Financial Assets" by Pamela Friedman, September 2005, Page 3.

[7] "Distributing Prepaid Cards through Worker Centers: A Gateway for Asset Building for Low-Income Households" by The Center for Financial Services Innovation by Janice Fine, Lauren Leimbach, and Katy Jacob dated October 2006, Page 17. Amounts were reduced to reflect current fees as reflected by providers.

[8] Found at the World Council of Credit Unions, Inc.'s (WOCCU) International Remittance Network (IR*net*) website. IR*net* is a platform to provide credit unions with a tool to reach and serve members and potential members around the world, providing them with access to safe and affordable international and domestic money transfers (remittances). The network was created to respond to an increased demand for money transfer services and high fees being charged to utilize such services.

[9] A Report by the Isenberg School of Management, University of Massachusetts at Amherst Prepared by the Annie E. Casey Foundation "Low Cost Payday Loans: Opportunities and Obstacles." dated June 2005, Page 3.

[10] Id.

[11] "Step in the Right Direction: Recent Declines in Refund Loan Usage Among Low-Income Taxpayers" by Alan Berube and Tracy Kornblatt released by the Brookings Institution dated April 1, 2005, Page 2.

All consumers, including those located in disadvantaged communities, want financial services and products that are affordable, accessible, and focused on their needs. The costs for transactional and short-term credit products from nontraditional financial sources are not affordable for low-income consumers and in many cases exacerbate their economic distress. The challenge for traditional financial institutions is to make these products accessible and affordable to low-income consumers.

II. NCUA and Industry Outreach Efforts

The NCUA and the credit union industry have historically devoted resources to addressing the needs of disadvantaged communities. The following are examples of those outreach efforts.

Low-Income Designation and Community Development Revolving Loan Fund (CDRLF)

A 1970 amendment to the FCU Act provided a framework for low-income designated credit unions. For the purpose of implementing the amendment, Congress specifically directed NCUA to define "low income." NCUA's definition of a low-income individual is one who earns less than either 80% of the average for all wage earners, as established by the Bureau of Labor Statistics, or whose household income is at or below 80% of the median household income as established by the U.S. Census Bureau. The NCUA's 2007 National Median Household Income Standard is set at $39,858 and the NCUA's 2007 Wage Earner Standard for an individual is set at $23,857.

NCUA has made an aggressive effort to educate qualifying credit unions on the benefits of the low-income designation. As a result, the number of low-income designated credit unions (LICUs) increased from 645 credit unions at year-end 2000 to 1,053 credit unions as of December 31, 2006. These credit unions represent 12% of the total number of federally insured credit unions and held $23.6 billion in assets, or approximately 3.4% of the total assets in the credit union system. Low-income designated credit unions serve 4.4 million members.

NCUA has issued regulations implementing the statutory provisions to allow low-income designated credit unions to receive deposits from nonmembers, accept secondary capital accounts, provide exemption from the aggregate member business loan limit, and participate in the CDRLF program.

In 1979, Congress created the CDRLF to provide low interest loans and Technical Assistance Grants (TAGs) to low-income designated credit unions. The creation of this fund recognized the financial assistance some low-income designated credit unions required to be successful.

NCUA has administered the CDRLF since 1987. This program, which is available only to low-income designated credit unions, provides technical assistance grants and low-cost loans to those low-income designated credit unions interested in enhancing service to their membership. Since inception, the CDRLF granted 278 loans totaling $43.1 million and more than 2,100 grants totaling $6.9 million, as outlined in the following chart.

Fiscal Year	Appropriations		Approvals	
	Loans[12]	TAGs	Loans	TAGs[13]
1979 to 1996	$6,000,000	$0	$16,400,000	$ 696,000
1997	$1,000,000	$0	$ 2,261,000	$ 215,461
1998	$1,000,000	$0	$ 2,365,000	$ 357,224
1999	$2,000,000	$0	$ 1,900,000	$ 343,549
2000	$1,000,000	$0	$ 5,583,000	$ 292,729
2001	$650,000	$350,000	$ 2,657,000	$ 369,815
2002	$650,000	$350,000	$ 3,259,000	$ 668,044
2003	$700,000	$300,000	$ 1,004,997	$ 460,242
2004	$200,000	$1,000,000	$ 1,797,458	$1,225,565
2005	$200,000	$800,000	$ 1,669,000	$ 949,219
2006	$0	$950,000	$ 4,214,000	$1,371,130
Total	**$13,400,000**	**$3,750,000**	**$43,110,455**	**$6,948,978**

The 2007 budget request for the CDRLF is $950,000 in TAGs. In 2006, NCUA approved $1.3 million in grants to 294 credit unions. These low-income designated credit unions used the grant and loan funds to touch the lives of the members of their communities by:

- Overcoming the language barrier with translated financial service materials;
- Offering free income tax return services;
- Opening offices to better serve their members;
- Providing financial education opportunities; and
- Providing loans to develop alternative loan programs to combat predatory lending.

Here are just a few specific examples of CDRLF fund use by low-income designated credit unions:

- Coastal Waters Federal Credit Union, a $7 million institution located in Alabama, has a membership that includes the underserved community of Mobile, Alabama. The credit union installed an ATM machine that charges no fees for credit union members. This ATM and the credit union office are accessible to residents using public transportation.

- Desert Sage Federal Credit Union, a $1.6 million institution, located in Idaho, provides ATM/debit card services for members who are seasonal migrant workers.

[12] The Community Development Credit Union Transfer Act (of 1986) transferred the CDRLF's administration to NCUA. The program was dormant prior to the transfer.

[13] NCUA started the TAG program in 1993.

- Houston Teamsters Federal Credit Union partnered with TransUnion and the Gulf Coast Community Services Association to create a Credit Score Enhancement Program. This program provides a process for community residents to receive their personal credit score, advice on how to improve their score, automated home valuations and auto pricing reports.

NCUA Outreach Efforts

Over the years, NCUA initiated a number of programs focused on assisting low-income designated credit unions. These initiatives provide increased opportunities for FCUs to diversify their membership profile and to assist low-income designated and small credit unions as they manage their operations in accordance with ever increasing and complex laws and regulations. The ultimate objective is to increase the number of low-income individuals joining credit unions and receiving valuable, affordable services. This process is made more difficult because credit unions that typically attempt to serve this population are themselves small and possess minimal resources.

The Access Across America initiative, announced in February 2002, incorporated the agency's activities for low-income designated and small credit unions, as well as federal credit unions expanding into underserved areas. The program has been designed to partner with federal government agencies and other organizations to identify and facilitate the use of resources available for credit unions to assist in their efforts to serve individuals in underserved areas. Workshops continue to provide partnering opportunities with federal government agencies, as well as non-profit and private organizations.

NCUA specifically promotes financial education initiatives in the Access Across America program, an ongoing effort by the NCUA to encourage credit unions to proactively work with a wide array of federal programs in an effort to improve service to members, particularly in low-income and underserved areas. Access Across America is emblematic of NCUA's commitment to fostering economic empowerment through credit union membership, and in over a dozen programs in every region of the United States, credit unions have received practical, useful information on how to reach more low-income consumers. The next Access Across America Summit, to be held March 6, 2007, in Tampa, Florida, will focus on the Volunteer Income Tax Assistance (VITA) program, as well as alternatives to payday lenders and high-cost check cashers.

As an adjunct to the Access Across America initiative, the Partnering and Leadership Successes (PALS) program was introduced in 2003 to provide best practices in serving members and marketing to potential members in underserved areas and communities. The agency coordinated widely attended workshops where a mix of credit unions presented programs focused on serving those in the lower economic strata. These programs included partnering opportunities with the Neighborhood Reinvestment Corporation, Latino outreach, and micro-business lending opportunities with the Small Business Administration. NCUA has incorporated the most successful aspects of PALs into the Access Across America programs and plans to continue to offer these valuable efforts in the future.

In 1993, NCUA created the Office of Community Development Credit Unions dedicated to ensuring the long-term viability of small and low-income designated credit unions. Today this activity is handled by the Office of Small Credit Union Initiatives (OSCUI), which has expanded from a staff of six and a budget of $756,000 in 2004, to 24 staff and a $3.9 million budget in 2007.

OSCUI conducts regional and national training workshops on a variety of topics to help small and low-income designated credit unions succeed. For example, in 2006, OSCUI held 20 national workshops covering subjects such as establishing financial literacy programs, disaster recovery planning, and compliance with the Bank Secrecy Act. Approximately 1,900 credit union representatives from 1,060 credit unions attended these workshops. NCUA has scheduled another 20 workshops in 2007. Marketing to potential members and developing products designed for low- to moderate-income members will be discussed at this year's workshops.

Additionally, OSCUI coordinates with NCUA's regional offices to conduct smaller roundtable training sessions focused on the needs of small and low-income designated officials. More than 2,000 credit union officials received training at these OSCUI events nationwide last year.

Finally, OSCUI's 15 economic development specialists (specialists) provide one-on-one direct assistance and training to officials of small and low-income designated credit unions around the country. The specialists assist with areas such as strategic planning, adding new products and services, board and supervisory committee training, policy development, and grant writing. They also facilitate partnerships within the credit union system. For example, a specialist facilitated a partnership between low-income designated NCP Community Development FCU in Norfolk, VA, and ABNB FCU in which ABNB is providing back office operational support, as well as financial counselors and other services to NCP members.

Office of Economic Opportunity (OEO) Initiative

Although credit unions have been and continue to be very successful in helping their traditional membership base to secure and enjoy the benefits of fairly-priced financial services delivered in a cooperative structure, a concerted effort to specifically deploy credit unions to alleviate poverty ended with indifferent results. In the 1960s, as part of President Lyndon Johnson's "War on Poverty," a new type of credit union was established specifically to serve identified low-income groups. The Bureau of Federal Credit Unions (NCUA's predecessor agency) set up over 700 credit unions, with assistance from the Office of Economic Opportunity (OEO), to serve fields of membership comprised exclusively of low-income groups.

Unfortunately, credit unions established in low-income areas, solely dependent on self-generated capital, proved less viable as a financial cooperative. Virtually all of these credit unions were closed or merged out of existence. This experience demonstrated the difficulty of sustaining a credit union structure in which the membership consists exclusively of low-income individuals.

NCUA concluded from this initiative that a financially diverse membership provides a much better opportunity for success in serving low income individuals.

Credit Union Outreach Efforts

Credit unions provide services and products that are affordable, accessible and are focused on the needs of their own membership. In addition, many credit unions voluntarily assume additional responsibilities by partnering with community organizations and other credit unions to provide financial education, and other forms of outreach focused on specific needs of low-income or foreign-born members.

For example:

- The S.C. State Credit Union, a $382 million institution, provides financial counseling for individuals who seek assistance with everyday budgeting or who may be experiencing difficulty paying their creditors. Eight hundred sessions are held each year with 300 members counseled annually. The debt management program enrolls nearly 700 members each year and has paid over $2 million to creditors during its six-year life span.

- A partnership between the Internal Revenue Service's Community Coalition program and 65 credit unions implements outreach, tax preparation, and asset building strategies (e.g., Earned Income Tax Credit (EITC), Individual Development Accounts and financial education) for low- and moderate-income persons. The credit unions are limited by their field of membership to offer financial services and reasonably priced RALs only to their members.

- The New York City Financial Network Action Consortium (consisting of Lower East Side People's FCU, Union Settlement FCU and Brooklyn Cooperative FCU) is part of the New York City EITC Coalition. The Coalition's outreach campaign is provided in 11 languages on public transportation and in fast-food restaurants. The Coalition hosts 45 VITA sites, with a minimum of eight volunteers at all times, which are open days, evenings and weekends. In 2006, the Coalition prepared 65,325 returns and helped consumers apply for nearly $100 million in EITC. The Lower East Side People's FCU and Harlem's Foodchange process Individual Taxpayer Identification Number applications and offer Individual Development Accounts (IDAs) in conjunction with financial literacy training with the Foodchange's site in Harlem touted as the nation's busiest civilian-based free tax preparation site.

In addition to the financial education efforts and coalitions, credit unions form partnerships and operate programs designed specifically for members in disadvantaged communities. Particularly noteworthy examples are:

- Fort Campbell Federal Credit Union, a $231 million financial institution, created the Home Front Mortgage Program to help active duty military personnel stationed at Fort Campbell buy houses in Tennessee or Kentucky by eliminating down payments. First-time home-buyers attend homeownership counseling provided by a non-profit housing organization.

- Bull's Eye Credit Union, a $106 million institution located in Wisconsin, has senior staff personally visit an assisted living facility to cash checks for the residents at an assisted living facility. Many of the residents do not drive and the convenience of cashing a check assists this underserved membership.

- The Founders Federal Credit Union, a $1 billion institution located in South Carolina, serves several underserved areas. The credit union developed new products to better serve the Hispanic market that includes bilingual marketing materials, free money transfers, Spanish Call 24 (account access by telephone), Spanish ATMs, Spanish Founders Online and a Spanish Visa Helpline.

- Hawthorne Credit Union, a $157 million institution located in Illinois, employs bilingual staff in every member contact area. In fact, the credit union can converse with members in more than seven languages. In 2003, they expanded their services to the Hispanic community by offering a bilingual website, financial education, and audio response programs.

- Northeast Community Federal Credit Union in San Francisco, CA works with the Mayor's Office of Business and Economic Development to deliver targeted small business technical assistance to an underserved low income Asian American community focused on starting or expanding small businesses.

- W.C.T.A. Federal Credit Union partnered with the State of New York Mortgage Agency (SONYMA) to offer affordable mortgage loans to first-time home buyers. The SONYMA Partnership Program offers low down payment requirements, flexible underwriting requirements, interest rate lock-in periods that are longer than conventional lock-in periods, and closing cost assistance. As part of this program, the member is required to complete a financial education course through a SONYMA approved source.

- Less than a year after converting to a community charter in 2005 American Heritage Federal Credit Union opened a state-of-the-art branch in the Hunting Park neighborhood of Philadelphia. The new branch has attracted 150 new members each month and over $2 million in new deposits from the underserved area.

<u>Financial Literacy: An Ounce of Prevention</u>

NCUA has identified one obvious area of improvement that could assist all consumers in improving their overall economic health: financial literacy.

By providing basic information about wise use of credit and the advantages of prudent money management, financial education fosters financial stability for individuals and entire communities. The more consumers know about credit and financial services, the more likely they are to increase savings, become homeowners, and improve their financial position. A white paper prepared by the U.S. Department of Treasury's Office of Financial Education released October 2002 found that "four in ten Americans admit that they are living beyond their means primarily because of the misuse and misunderstanding of credit. Studies show that individuals who have received financial education participate in, and make larger contributions to, employer 401(k) programs and have a significantly higher savings rate."[14] Credit unions offer a number of financial education programs, including the National Endowment for Financial Education (NEFE) program at schools, Operation Hope's Banking On Our Future, Credit Union National Association Thrive by Five, Googolplex@school, and the Federal Deposit Insurance Corporation's Money Smart.

NCUA is a member of the Financial Literacy and Education Commission (the Commission), a federal entity established under Title V, the Financial Literacy and Education Improvement Act, as part of the Fair and Accurate Credit Transactions Act of 2003, to improve financial literacy and education of persons in the United States.

The principal duties of the Commission include: (1) encouraging government and private sector efforts to promote financial literacy; (2) coordinating financial education efforts of the federal government, including the identification and promotion of best practices; (3) the development of a national strategy to promote financial literacy and education among all American consumers; (4) the establishment of a website to serve as a clearinghouse and provide a coordinated point of entry for information about federal financial literacy and education programs, grants, and other information; and (5) the establishment of a toll-free hotline available to members of the public seeking information about issues pertaining to financial literacy and education.

In addition to serving as a member of the Commission, Chairman Johnson has served as Chairman of its MyMoney.gov website subcommittee since October 2006. The MyMoney.gov web site was created to provide public access to financial education tools and resources, which will empower Americans to save, invest and manage money wisely to meet personal goals. In this role, the Chairman coordinates the efforts of twenty federal agencies to improve financial education across the nation.

While NCUA does not view financial education as a panacea for the problems confronting consumers in an increasingly complex marketplace, its importance to credit unions and their members is emphasized at every opportunity. The advertising slogan "an educated consumer is our best customer" resonates when it comes to financial literacy, particularly regarding those in the lower echelons of the economic spectrum.

III. Predatory Lending Mitigation

[14] "Integrating Financial Education into School Curricula: Giving America's Youth the Educational Foundation for Making Effective Financial Decisions Throughout Their Lives by Teaching Financial Concepts as Part of Math and Reading Curricula in Elementary, Middle, and High Schools - A White Paper Prepared by the United States Department of the Treasury Office of Financial Education October 2002, Pages 1 and 3.

NCUA and Industry Initiatives

NCUA has worked with the credit union industry to ensure that credit union members are offered short-term loans at reasonable interest rates. From a regulatory perspective, NCUA limits the amount credit unions can be charged for loans by regulating the statutorily mandated 18% interest rate (usury) ceiling that federal credit unions can charge on loans or lines of credit. On September 30, 2006, Congress passed the Financial Services Regulatory Relief Act of 2006, which included a provision to allow federal credit unions to offer money transfer instruments, including international and domestic electronic fund transfers and check cashing services, to persons in the field of membership. NCUA issued a final rule in January 2007 implementing these new provisions in the law.

In addition to the regulations, NCUA has provided guidance about matters of regulatory concern by issuing three Letters to Credit Unions (LCU) on the topic of risk-based and predatory consumer lending. The first, an August 1995 LCU discussed risk-based lending in the form of a comprehensive whitepaper that encourages credit unions to consider risk-based lending as a "tool to reach out to the underserved." A June 1999 LCU discussed Risk Based Lending issues and asserted that the purpose of credit union risk-based lending is to make loans available to members who might not otherwise qualify. Finally, an April 2001 LCU encouraged credit unions to proactively protect their members from predatory lenders and provided information about predatory and payday lending.

Finally, as previously noted, NCUA provides grant and loan funds for low-income designated credit unions attempting to develop alternative loan programs to combat predatory lending.

The credit union industry has encouraged credit unions to provide alternatives for predatory lending. Publications issued by the Credit Union National Association, including *Credit Union Alternatives to Payday Lending* (December 2000), and *Subprime Doesn't Have to be Predatory* (July 2001), are examples of trade association-based initiatives outlining practical methods to combat predatory practices. The National Association of Federal Credit Unions wrote an article for *Military Money* magazine regarding this issue.[15] The National Federation of Community Development Credit Unions also has a program, the Predatory Relief and Intervention Deposit (PRIDE), designed to combat predatory lending by educating credit unions on offering affordable loan alternatives.

Credit unions have developed a number of alternative loan products in response to predatory lending specifically designed to steer members away from predatory lenders and to the traditional financial institution niche. These alternative loan products, known

[15] "Ten Reasons To Join Your Credit Union" issued in the Military Money Magazine published in the Spring 2005 issue on page 20.

as credit builder loans, subprime loans, people helping people loans and micro loans all represent market-driven, practical attempts at providing consumer alternatives.

An example was cited by the Annie E. Casey Foundation's 2005 Low-Cost Payday Loans: Opportunities and Obstacles report that named the (North Carolina) State Employees' Credit Union's *Salary Advance Loan* (SALO) as the largest and most successful payday loan alternative model.[16] This revolving loan has a maximum outstanding balance of $500, offered at an APR of 12% or $2.50 for a two-week loan. One of the most innovative features is that 5% of each advance is placed in a special unrestricted savings account. If the member withdraws the savings, he or she cannot receive another SALO for six months. In addition, members must have their paycheck directly deposited. About 40,000 members use the product and about 70% use it once a month. The average SALO is $367 and the average repayment period is 20 days. SALOs totaling over $305 million have been provided to members.

There are several low-income credit unions in the New York City area (e.g., Bronx, Spanish Harlem, Manhattan, and Bushwick) that offer alternative loan products. Love Gospel Assembly FCU, Neighborhood Trust FCU, Brooklyn Cooperative FCU, and Union Settlement FCU offer consumer loans and micro-enterprise loans to members with unfavorable credit reports and nontraditional sources of income. One of their products is a micro-enterprise loan at a 12% interest. Start-up businesses without two years of financial statements can borrow up to $10,000, while established businesses can borrow up to $50,000 without any additional security. Established businesses can borrow more than $50,000 if secured by real estate. The credit union also offers small personal loans at 14% interest to individuals who would otherwise not qualify for a loan.

Predatory Lending – The Military Experience

Members of this community and their families have been victimized by unscrupulous and abusive lenders. As more fully documented in a study released by the Defense Department in the summer of 2006, products offered by payday lenders, car title lenders, tax refund anticipation lenders and rent-to-own companies have created such financial difficulty for many soldiers and their families as to literally undermine the readiness of the force. In response, Congress included language in the John Warner National Defense Authorization Act for Fiscal Year 2007 imposing several limitations and consumer protection measures for credit products offered by lenders to military personnel and their dependents. The Defense Department, in consultation with the Treasury Department, the Federal Trade Commission, and the federal financial institution regulators, including NCUA, is presently preparing regulations to implement these safeguards.

Federal credit unions have a long history of support and service to members of the military. At present, there are 92 federal credit unions whose field of membership consists primarily of active duty and retired military personnel, including some of the largest credit unions in the country. Credit union membership eligibility is available to

[16] A Report by the Isenberg School of Management, University of Massachusetts at Amherst Prepared by the Annie E. Casey Foundation "Low Cost Payday Loans: Opportunities and Obstacles" Page 3.

virtually every service member and to the members of his or her family. More importantly, credit unions offer the types of products and services, including financial literacy education and financial counseling and loans at reasonable rates, that can help these individuals meet their financial obligations without exacerbating their overall financial condition.

IV. Access to Credit Unions: a Historical Perspective

Despite attempts by credit unions to mitigate or in some cases resolve the financial service access problems confronting disadvantaged communities, the largest and most discernable obstacle to greater credit union involvement is the legal constraint on credit union membership. Not every consumer is eligible to join a credit union. In the case of low-income areas, the opportunities may be even more limited. Given the market reality that the majority of credit unions are employment-based, it is less likely that an unemployed or under employed person will be eligible for membership. This lack of access compounds the economic distress already facing such persons.

Since their inception in the United States, nearly a century ago, credit unions have served as a financial resource and option for consumers.[17] Individuals who have the ability to join a credit union have found tangible financial benefits from membership in these not-for-profit financial cooperatives.

<u>Principal FCU Characteristics</u>

The FCU Act was adopted during the Great Depression, a time when financial distress was commonplace and acutely affected the average working person. Roy Bergengren, a founder of the North American credit union movement, cited the role that credit unions could play in combating predatory lending practices, such as those associated with "loan sharks," in testimony before the U.S. Senate Banking Committee in 1933. He stated that credit unions provide an opportunity for average consumers to learn "what dividends are, what interest is, what money is all about, how to manage it conservatively and for their own best interests." Mr. Bergengren's vision was a credit union industry that could "promote the public good by developing thrift . . . , solving the short-term credit problems of the workingman, the small business man, and the farmer, freeing them from the usurious money lenders, and teaching sound economic lessons at a time when such teaching is very essential."[18]

---

[17] The first credit union in the United States was formed in 1908 in New Hampshire. The first credit union chartering statute was enacted by by the Commonwealth of Massachusetts in 1909.

[18] *Credit Unions:* Hearing before the Subcommittee of the Senate Committee on Banking and Currency, 73d Cong. 35 (1933); (statement of Roy Bergengren).

The FCU Act prescribed the structure of these institutions, including the following requirements and limitations:

- Democratically controlled, each member having one vote, with no proxies allowed. Each member is an equal owner regardless of the dollar amount of shares owned;
- Managed by a volunteer board of directors elected by and from the membership;
- Not-for-profit, designed to provide a safe, convenient place for members to receive prudent and productive financial services; and
- Limited to serving people within a defined field of membership (FOM) based on a common bond of employment, association, or community.

The role that credit unions can and do play in assisting consumers is unchanged, even though the marketplace, technology and consumers themselves have evolved.

<u>History of the Common Bond</u>

There are statutory and regulatory limits to the access that consumers have to credit union service.

Congress has set forth specific criteria regarding eligibility for FCU membership. The limitation is the statutory common bond, or the legally authorized FOM. Every FCU has an FOM, which requires that membership services be limited, in most cases, to those who (1) are within the FOM, and (2) become a member of the FCU.

Since 1934, FCUs have been defined, at least in part, by whom they can serve. This characteristic (i.e., common bond) creates an inherent conflict with the ability of a credit union to affirmatively reach out to individuals and groups that may be in underserved or disadvantaged areas to the extent they are outside the credit union's prescribed FOM. In general, an FCU's common bond has been limited to an occupational group, associational group, or a community. In the decades that have followed the enactment of the FCU Act, dramatic changes in the overall economic environment in which credit unions must operate have occurred. These changes have required that credit unions adapt in order to meet the financial needs and expectations of their members.

<u>Field of Membership Modernization</u>

In reaction to the Supreme Court ruling overturning NCUA's policy allowing multiple common bond credit unions, Congress passed the Credit Union Membership Access Act (CUMAA), Pub. L. 105-219, in 1998. This new law partially reestablished NCUA's multiple common bond policy that had enabled federally chartered credit unions to expand their membership over the preceding two decades.

CUMAA restored the ability of FCUs to form multiple common bond credit unions, consisting of groups, such as for employment, each with its own distinguishing characteristics. CUMAA also specifically authorized these credit unions to add underserved areas to their FOMs.[19] Based on its assessment of the legislative history of CUMAA, NCUA also permitted single-sponsor and community credit unions to add underserved areas to their FOMs. The concept reflected a recognition that geographic areas exist in the United States that exhibit certain criteria, such as a declining population base or increasing rates of unemployment, that can result in diminished access by residents and businesses to traditional financial products and services.

Although the "underserved" designation is not strictly a function of income level of the residents, it is expected that over time broader demographic representation among the membership will occur in FCUs that have added underserved areas. As discussed more fully below, data collected recently by NCUA tend to bear this out.

CUMAA partially reconciled the constraints of the occupational common bond with the expectation that FCUs should more affirmatively reach out to individuals who are underserved or lack access to financial services. Specifically, CUMAA provided a mechanism by which certain, but not all, FCUs may fulfill that aspiration. It allowed multiple common bond FCUs to add members outside their traditional FOM, while preserving the overall integrity of the common bond principle. This change allowed such FCUs to provide products and services to those who were otherwise excluded from membership. As stated above, in an effort to assure maximum ability to provide services to lower-income individuals, NCUA initially allowed all charter types of FCUs to add underserved areas to their FOM. Since the adoption of the law, 641 FCUs have added 1,414 underserved areas to their fields of membership.

Banking industry trade associations have opposed NCUA's efforts to enhance or expand FCU outreach to underserved areas. In November 2005, the American Bankers Association and three Utah banks filed suit in federal court and successfully challenged the addition of an underserved area to a specific federal community charter in Utah. In May 2006, the NCUA amended its regulations so that only multiple common bond credit unions can add underserved areas to their FOM.

NCUA's ability to provide greater flexibility for all FCUs to serve individuals outside their traditional membership base is now limited to only one charter type, that of multiple-group credit unions. This limitation appears to be a direct contradiction of congressional intent to reconcile the constraints of the occupational common bond with the expectation that all FCUs should serve more individuals who are disadvantaged or lack access to financial services. This apparent conflict can only be corrected by Congressional action to change the statute.

[19] 12 U.S.C. § 1759(c)(2).

Current Situation

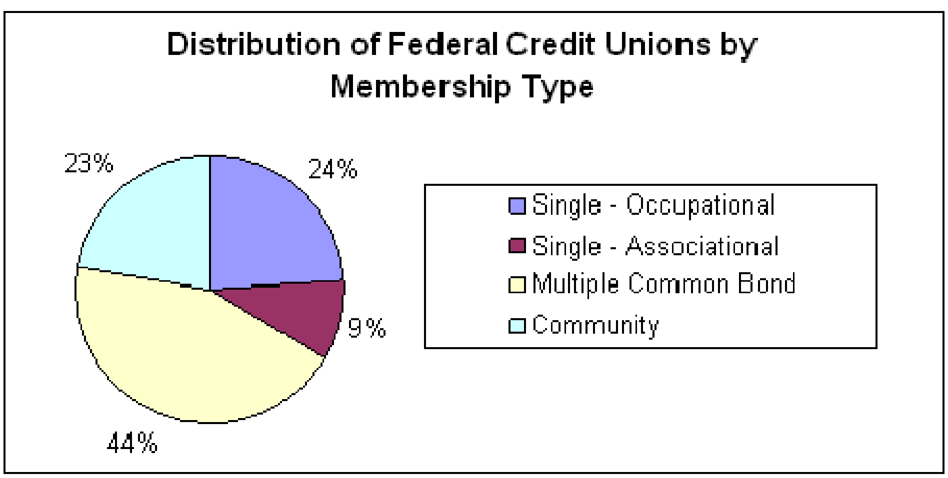
Today, FCUs have three types of charters:

- Single common bond charters limit credit union membership to individuals who qualify under discrete, relatively narrow criteria. A single common bond can be classified as occupational or associational. Occupational common bonds relate to employment; for example, firefighters, soldiers, and nurses share occupational common bonds. Associational common bonds relate to participation in associations; for example, participants in professional societies, labor unions, and religious organizations share associational common bonds.

- Multiple common bond charters including two or more single common bond groups. They generally occur when a single common bond FCU elects to add a second group to its field of membership. The majority of groups added to multiple common bond charters have been small businesses and associations, which would likely not otherwise have had credit union service. Since January 2000, multiple common bond FCUs added 75,969 groups. Of these, 66,921 groups, or 88%, had less than 200 employees or members.

- Community charters are based on a single, geographically defined, local community where individuals have common interests and/or interact. While some FCUs were originally chartered to serve communities, many others have converted to community charters since the 1990s to compensate for the closure of sponsors. For example, in Flint, Michigan, FCUs that originally provided service to the autoworkers converted to a community charter when the automobile industry in Flint declined.

The following chart reflects the percentage of FCUs by charter type as of February 1, 2007. Seventy-seven percent of all FCUs share a common bond of occupation or association.



FCUs have historically focused on serving working or employed individuals, such as small business owners, entrepreneurs, blue-collar workers in manufacturing jobs, laborers, employees in service positions, military personnel, members of labor unions and farmers. Although the FCU system has evolved to meet changing economic and demographic conditions in the United States, its success has not come at the expense of fidelity to its founding principles, which remain unchanged.

As discussed in CUMAA, FCUs remain "member-owned, democratically operated, not-for-profit organizations generally managed by volunteer boards of directors." CUMAA provided a mechanism by which multiple common bond FCUs may deliver financial services to individuals and families living in areas traditionally underserved by other financial institutions. While this important authority only applies to multiple common bond FCUs, it nevertheless will allow for expansion into underserved areas by 44% of FCUs. As stated above, an expanded implementation of this authority will require further action by Congress.

In the past decade, there also has been a growth in the number of credit unions converting to community charters. These conversions of single and multiple common bond FOMs to broader-based community charters are expected to enhance the ability of credit unions to reach disadvantaged individuals, since community charters encompass a relatively more diverse income population than the more traditional membership base.

<u>Member Service Assessment Pilot Program</u>

During 2006, at the direction of the House Ways and Means Committee and in consultation with the Government Accountability Office, NCUA undertook its first ever Member Service Assessment Pilot Program (MSAP). This comprehensive study entailed review of over 14 million records obtained from 448 federal credit unions and was conducted over the course of several months at a cost to the agency of just over $1 million. NCUA provided copies of the report to Congress and the GAO. Our essential findings can be summarized as follows:

- FCU membership is principally comprised of working individuals.

- FCUs designated as low-income, with underserved areas, or with a community base have better opportunities to serve lower income groups and individuals and generally have more diverse membership profiles as compared to FCUs with more restrictive common bonds and fields of membership.

- Changes in membership profiles do not occur immediately – they take time. Consequently, while the percent of FCUs serving a community base has recently increased, the membership profiles cannot be expected to differ from the traditional occupational or associational charter until a considerable period of time has elapsed that allows for the new market penetration.

Additionally, the MSAP results bolster NCUA's long-standing view that the FCU common bond limitation is the overriding factor that impacts membership demographics. Interpreting MSAP data or any other data developed purporting to evaluate the membership of FCUs is best understood and applied within the context of whom FCUs can legally serve, i.e., those within a specified FOM. Relevant to this discussion, it is essential to have an understanding that:

- The common bond constraint, imposed by statute, limits NCUA's flexibility. As a result, the ability of FCUs to serve groups not included in the traditional membership base is also restricted.

- Developing FCU chartering policies that not only comply with the statutory common bond requirement, but also encourage and permit reaching out to those outside the traditional membership base, has been a regulatory challenge.

Congress has recognized the inherent conflict FCUs face in trying to reach out to less advantaged individuals and groups outside the traditional FOM while operating within a statutory framework that clearly defines who FCUs can serve. As a result, some flexibility has been legislated. Nevertheless, the essential characteristics of common bond have been steadfastly retained since 1934. Consequently, the primary membership nucleus for FCUs remains those who historically avail themselves of the financial services offered by FCUs -- working individuals. The chart below provides an illustration of the impact common bond restrictions have on member demographics.

Median Family Income (MFI) as a % of MSA MFI	**Observation of Membership Income Characteristics**					
	Charter Types				**Other Characteristics**	
	Single Occupation	Single Association	Multiple Common Bond	Community	Underserved Areas	Low Income
<70%	10.65%	10.63%	10.81%	10.73%	12.74%	11.62%
<80%	18.37%	14.17%	18.96%	19.13%	21.97%	21.08%
<90%	29.07%	26.74%	30.11%	32.34%	34.49%	41.03%
<100%	41.62%	40.04%	44.87%	47.78%	50.22%	61.21%
<110%	54.45%	56.95%	57.42%	62.81%	63.05%	77.36%
<120%	67.19%	72.16%	68.99%	73.48%	73.13%	85.72%
<130%	76.61%	82.40%	77.59%	81.73%	80.57%	88.55%

As part of NCUA's continuing efforts to improve and support the industry's outreach to individuals and groups outside the traditional field of membership, the Chairman created the NCUA Outreach Task Force. This Task Force, which began its work in December 2006, has a goal to provide a better understanding of and evaluation of the NCUA's efforts to help the expansion of credit union services into persons in all economic strata.

Given that the MSAP specifically recommended that the NCUA Board: 1.) evaluate the effectiveness of NCUA programs focused on assisting low and moderate income individuals; 2.) consider the enhancement and full utilization of the system to monitor FCUs receiving benefits under the CDRLF program; and 3.) consider reassessment of NCUA's formula for determining if an FCU qualifies for low-income designation, the Task Force will be asked to assess the agency's current role and efforts with respect to credit union services to their members, including financial literacy and alternatives to predatory lending practices.

V. Conclusion

Disadvantaged communities suffer from economic hardships that are made more difficult by the types of financial products that appear to be prevalent. The number of predatory lenders has increased exponentially while some traditional financial service providers are unwilling, or in the case of credit unions, prohibited from providing even basic lifeline offerings.

Credit unions have demonstrated to be a low-cost, convenient, member-focused form of financial institution for consumers across the economic spectrum. They play an important role in mitigating the hardships faced by those in disadvantaged communities, and NCUA is confident that they will continue to expand and refine their outreach efforts, within the framework created by Congress.

Despite legal and operational constraints related directly to the history of federal credit union field of membership, credit unions are performing well in fulfilling their statutory mission of meeting the credit and savings needs of their members. Trends in the industry suggest that the broader a credit union's field of membership, and the more inclusive a credit union can be with respect to low-income and underserved areas, the more opportunity low-income consumers have to obtain fairly priced financial services.

There is an additional time element: the longer a credit union has in establishing itself in a disadvantaged community, the more accepted it is by consumers who are unfamiliar with traditional financial service providers.

Credit unions are not the problem in these disadvantaged communities, but they can be a solution by serving as an accessible and affordable alternative for low-income consumers.