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STATEMENT

OF

ROBERT M. FENNER
GENERAL COUNSEL
NATIONAL CREDIT UNION ADMINISTRATION

"H.R. 3505 FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005"

BEFORE THE

SUBCOMMITTEE
ON
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
UNITED STATES HOUSE OF REPRESENTATIVES

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Chairman Bachus, Ranking Member Sanders, Representative Hensarling, Representative Moore, and Members of the Subcommittee: on behalf of the National Credit Union Administration (NCUA) I am pleased to be here today to present NCUA's views on H.R. 3505, "The Financial Services Regulatory Relief Act of 2005." This legislation will benefit the consumer and the economy by enabling all financial intermediaries and their regulators to better perform the role and functions required of them.

The Subcommittee on Financial Institutions and Consumer Credit has been taking the lead over the last several years in many areas of interest to consumers and financial institutions, including credit unions and their members. In June of 2005 our Chairman testified in favor of several recommendations made by NCUA and others affecting federally insured credit unions. NCUA is pleased to see that H.R. 3505 includes many of them and that they are being considered by this Subcommittee. I would like to address the NCUA recommendations first.

CREDIT UNION PROVISIONS OF THE FINANCIAL SERVICES REGULATORY RELIEF ACT OF 2005

Section 307: Check Cashing, Wire Transfer and Other Money Transfer Services

The Federal Credit Union Act authorizes federal credit unions to provide check cashing and money transfer services and international remittances to members (12 USC 1757(12)). To reach the "unbanked," Section 307 of H.R. 3505 authorizes federal credit unions to provide these services to anyone eligible to become a member. This is particularly important to federal credit unions in furthering their efforts to serve those of limited income or means. These individuals, in many instances, do not have mainstream financial services available to them and are often forced to pay excessive fees for check cashing, wire transfer and other services. Allowing federal credit unions to provide these limited services to anyone in their field of membership would provide a lower-fee alternative for these individuals and encourage them to trust conventional financial organizations. Representative Gerlach introduced this provision as H.R. 749 in the 109th Congress and it has been passed by the House of Representatives on April 26, 2005.

Section 304: The Twelve-Year Maturity Limit on Loans

Federal credit unions are authorized to make loans to members, to other credit unions and to credit union organizations. The Federal Credit Union Act imposes various restrictions on these authorities, including a twelve-year maturity limit that is subject to only limited exceptions (12 USC 175(5)). This maturity limit should be eliminated. It is outdated and unnecessarily restricts federal credit union lending authority. Section 304 of H.R. 3505 permits Federal credit unions to make loans for second homes, recreational vehicles and other purposes, not to exceed 15 years or such longer periods determined appropriate by the NCUA Board. NCUA rulemaking authority would also be used for safety and soundness considerations.

Section 305: Increase One Percent Investment Limit in CUSOs to Three Percent

The Federal Credit Union Act authorizes federal credit unions to invest in organizations providing services to credit unions and credit union members. An individual federal credit union, however, may invest in aggregate no more than one percent of its shares and undivided earnings in these organizations (12 USC 1757(7)(I)). These organizations, commonly known as credit union service organizations or "CUSOs," provide important services. Examples are data processing and check clearing for credit unions, as well as services such as estate planning and financial planning for credit union members. When these services are provided through a CUSO, any financial risks are isolated from the credit union, yet the credit unions that invest in the CUSO retain control over the quality of services offered and the prices paid by the credit unions or their members. The one percent aggregate investment limit is unrealistically low and forces credit unions to either bring services in-house, thus potentially increasing risk to the credit union and the NCUSIF, or turn to outside providers and lose control. Section 305 of H.R. 3505 increases the one percent limit to three percent and NCUA supports the change.

Section 303: Expanded Investment Options

The Federal Credit Union Act limits the investment authority of federal credit unions to loans, government securities, deposits in other financial institutions and certain other very limited investments (12 USC 1757(7)). This limited investment authority restricts the ability of federal credit unions to remain competitive in the rapidly changing financial marketplace. The Financial Services Regulatory Relief Act of 2005, Section 303 amends the Federal Credit Union Act to provide such additional investment authority conditioned upon limiting such authority to investment in corporate debt securities (as opposed to equity) and further specific percentage limitations and investment grade standards are set out in the legislation. The NCUA Board could still add additional conditions for safety and soundness protections.

Section 308: Voluntary Merger Authority

The Federal Credit Union Act, as amended by the Credit Union Membership Access Act, allows voluntary mergers of healthy federal credit unions, but requires that NCUA consider a spin-off of any group of over 3,000 members in the merging credit union (12 USC 1759(d)(2)(B)(i)). When two healthy federal credit unions wish to merge, and thus combine their financial strength and improve service to their members, they should be allowed to do so. There is no reason to require in connection with such mergers that groups over 3,000, or any group for that matter, be required to spin off and form a separate credit union. A spin-off would most likely undermine financial services to the affected group and may create safety and soundness concerns. These groups are already included in a credit union in accordance with the statutory standards, and that status should be unaffected by a voluntary merger. Section 308 of H.R. 3505 accomplishes these purposes.

Section 313: Regulatory Relief from SEC Registration Requirements
NCUA is seeking a provision to provide relief from the requirement that credit unions register with the Securities and Exchange Commission as broker-dealers when engaging in certain de minimus securities activities. The Gramm Leach Bliley Act, enacted in 1999, created exemptions from the broker-dealer registration requirements of the Securities and Exchange Act of 1934 for certain bank securities activities. Banks are also exempt from the registration and other requirements of the Investment Advisers Act of 1940. The principle established by these exemptions is that securities activities of an incidental nature to the bank do not have to be placed into a separate affiliate. The provision would provide similar exemptions for federally insured credit unions. NCUA supports these exemptions. Because of significant differences between broker-dealer capital requirements and depository institution capital requirements, it is virtually impossible for depository institutions, including credit unions, to register as a broker-dealer and submit to broker-dealer requirements. Without an exemption credit unions may find that although they are authorized under their chartering statutes to engage in particular securities-related activities, their inability to register as a broker-dealer would keep them from engaging in these activities. Recently, the Securities and Exchange Commission proposed a rule that would exempt credit unions from the definition of broker and dealer for a few of the activities exempted for banks under Gramm Leach Bliley, including third party brokerage arrangements and sweep account arrangements. NCUA supports the SEC proposal. We believe, however, that the SEC's proposal did not go far enough, and we continue to support legislative relief. The relief sought for credit unions would be more limited in scope and application than that which is available to banks and requested by thrifts. Credit union powers are limited by their chartering statutes, and credit unions do not have certain powers, such as general trust powers, that are available to banks and thrifts. The requested parity relief for credit unions, included in Section 313 of H.R. 3505, would apply only to those activities otherwise authorized for credit unions under applicable credit union chartering statutes, currently including third-party brokerage arrangements, sweep accounts, and certain safekeeping and custody activities.

Section 314: Clarification of Definition of Net Worth Under Certain Circumstances For Purposes of Prompt Corrective Action

NCUA anticipates that the Financial Accounting Standards Board (FASB) will act in 2006 to lift the current deferral of the acquisition method of accounting for credit union mergers, thereby eliminating the pooling method and requiring the acquisition method beginning in 2007.[1] When this change to accounting rules is implemented it will require that, in a merger, the net worth of the merging credit union be carried over as "acquired equity," a term not recognized by the" Federal Credit Union Act.

This FASB policy has been in place since mid-2001 for most business combinations and the delay by FASB in implementing it for credit unions has allowed all of us to explore how credit unions could conform to the new financial reporting standards.

Without the changes to the Federal Credit Union Act, only retained earnings of the continuing credit union will count as net worth after a merger. This result would seriously reduce the post-merger net worth ratio of a federally insured credit union, because this ratio would be the retained earnings of only the continuing credit union stated as a percentage of the combined assets of the two institutions. A lower net worth ratio has adverse implications under the statutory prompt corrective action requirements. This result will discourage voluntary mergers and on occasion make NCUA assisted mergers more difficult and costly to the National Credit Union Share Insurance Fund (NCUSIF). Without a remedy, an important NCUA tool for reducing costs and managing the fund in the public interest will be lost.

Chairman Bachus and Ranking Member Sanders, you acted very quickly in 2005 to address this issue by introducing H.R. 1042, the "Net Worth Amendment for Credit Unions Act" which has been approved by House of Representatives on June 13, 2005. NCUA supports including it as Section 314 of H.R. 3505, too, and looks forward to its early enactment.

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[1] Statement of Financial Accounting Standard (SFAS) No. 141, Business Combinations, requiring the acquisition method for business combinations and effectively eliminating the pooling method. The pooling method has typically been used by credit unions to account for credit union mergers. The standards became effective for combinations initiated after June 30, 2001. Paragraph 60 of the standard deferred the effective date for mutual enterprises (i.e., credit unions) until the FASB could develop purchase method procedures for those combinations. In the interim, credit unions have continued to account for mergers as poolings (simple combination of financial statement components).

Section 802: Technical Corrections to the Federal Credit Union Act

This section of the "Financial Services Regulatory Relief Act of 2005" includes twenty-eight needed updates to the Federal Credit Union Act that are not substantive in any way. They have been previously approved by the Subcommittee, Committee on Financial Services and the House of Representatives in H.R. 1375 last Congress. They are purely drafting, numerical and incorrect references without any policy impact.

ADDITIONAL CREDIT UNION PROVISIONS—NO SAFETY OR SOUNDNESS CONCERNS

The "Financial Services Regulatory Relief Act of 2005" includes a number of other provisions that affect federally insured credit unions and/or the NCUA that did not originate with NCUA. NCUA has reviewed all of these additional credit union provisions and the agency has no safety and soundness concerns with these provisions.

Among these are provisions that address leases of land on Federal facilities for credit unions (Section 302); member business loans for non-profit religious organizations Section 306); criteria for continued membership of certain member groups in community charter conversions (Section 309) ; credit union governance changes (Section 310); revising the economic factors the NCUA Board must use when considering adjustments to the statutory 15% interest rate that can be charged by federal credit unions on loans (Section 311); and an exemption from pre-merger notification requirements of the Clayton Act (Section 312).

No Position On Section 301 and Section 315
NCUA takes no position on these two provisions that address privately insured credit unions. Privately insured credit unions are outside the purview of this agency since they are neither federally chartered nor federally insured. References to NCUA in Section 301 (b) should be removed because NCUA has no legal authority with regard to privately insured credit unions and there is no legal basis for NCUA to receive audits or examination reports of privately insured credit unions.

Prompt Corrective Action Reforms – Regulatory Relief and Improvement

Reforming the way current law requires federally insured credit unions to comply with Prompt Corrective Action, or regulatory capital standards might also be appropriate in any regulatory relief legislation proceeding through Congress. That is because lower risk federally insured credit unions are required to keep more capital ("net worth") now than they would if their risk profiles were accurately measured under comparable bank-like leverage <u>and</u> risk weighting systems. Excess capital in the credit union system is a regulatory burden that could be used to better serve credit union members, their communities and the American economy.

The guiding principle behind PCA is to resolve problems in federally insured credit unions at the least long-term cost to the National Credit Union Share Insurance Fund (NCUSIF). This mandate is good public policy and consistent with NCUA's fiduciary responsibility to the insurance fund. While NCUA supports a statutorily mandated PCA system, the current statutory requirements for credit unions are too inflexible and establish a structure based primarily on a "one-size-fits all" approach, relying largely on a high leverage requirement of net worth to total assets. This creates inequities for credit unions with low-risk balance sheets and limits NCUA's ability to design a meaningful risk-based system.

For the leverage requirement, NCUA supports a reduction in the standard net worth (i.e., leverage) ratio requirement for credit unions to a level comparable to what is required of FDIC insured institutions. The minimum leverage ratio for a well-capitalized credit union is currently set by statute at 7 percent, compared to the threshold of 5 percent for FDIC-insured institutions. There are important reasons why the leverage ratio for credit unions ratio should be lowered to work in tandem with a risk-based requirement.

First, credit unions should not be placed at a competitive disadvantage by being held to higher capital standards when they are not warranted to protect the insurance fund. For FDIC insured institutions, a 5% leverage requirement coupled with a risk-based system has provided adequate protection for their insurance fund. In comparison, the credit union industry has a relatively low risk profile, as evidenced by our low loss history. This is largely due both to the greater restrictions on powers of credit unions relative to other financial institutions and credit unions' conservative nature given their member-owned structure. In fact, our experience has shown that given economic needs and their conservative nature, the vast majority of credit unions will operate with net worth levels well above whatever is established as the regulatory minimum.

In addition, the current 7% leverage requirement is excessive for low risk institutions and overshadows any risk-based system we design, especially if you consider that under BASEL the risk-based capital requirement is 8% of risk assets. A meaningful risk-based system working in tandem with a lower leverage requirement provides incentives for financial institutions to manage the risk they take in relation to their capital levels, and gives them the ability to do so by reflecting the composition of their balance sheets in their risk-based PCA requirements. The current high leverage requirement provides no such ability or incentive and, in fact, it can be argued could actually contribute to riskier behavior to meet these levels given the extra risk isn't factored into the dominant leverage requirement.

NCUA recognizes, however, that achieving comparability between the federal insurance funds does require us to factor in the NCUSIF's deposit-based funding mechanism. Thus, our reform proposal incorporates a revised method for calculating the net worth ratio for PCA purposes by adjusting for the deposit credit unions maintain in the share insurance fund. However, our proposed treatment of the NCUSIF deposit for purposes of regulatory capital standards in no way alters its treatment as an asset under generally accepted accounting principles, or NCUA's steadfast support of the mutual, deposit-based nature of the NCUSIF.

Enabling NCUA to adopt a PCA system that remains relevant and up-to-date with emerging trends in credit unions and the marketplace provides safety, efficiency, and benefits to the credit union consumer.

Title I of H.R. 2317, the "Credit Union Regulatory Improvements Act of 2005" sets out the specifics required to achieve these goals. It has been introduced by your colleagues, Representative Ed Royce and Representative Paul Kanjorski and many Members on and off the Committee on Financial Services.

Conclusion

Thank you, Mr. Chairman, for the opportunity to appear before you today on behalf of NCUA to discuss the public benefits of regulatory efficiency for NCUA, credit unions and 84 million credit union members. I am pleased to respond to any questions the Committee may have or to be a source of any additional information you may require.