Supplemental Information

Introduction

The current 18 percent per year maximum loan rate applicable to federal credit unions is scheduled to revert to 15 percent after September 10, 2009, unless otherwise provided by the NCUA Board (Board). A 15 percent ceiling would restrict certain categories of credit and adversely affect the financial condition of a number of federal credit unions.

Given the current economic conditions, staff recommends that the NCUA Board continue an 18 percent ceiling for loans. The staff will advise the Board to reconsider the ceilings at any time should changes in economic conditions warrant.

Background

Public Law 96-221, enacted in 1980, raised the loan interest rate ceiling for federal credit unions from one percent per month (12 percent per year) to 15 percent per year. 12 U.S.C. 1757(5)(A)(vi). The law also authorized the Board to set a higher limit, after consulting with Congress, the Department of Treasury and other federal financial agencies, for a period not to exceed 18 months, if the Board determined that: (1) money market interest rates have risen over the preceding six months; and (2) prevailing interest rate levels threaten the safety and soundness of individual credit unions as evidenced by adverse trends in growth, liquidity, capital, and earnings.

On December 3, 1980, the Board determined that the foregoing conditions had been met and raised the loan ceiling to 21 percent. The Board lowered the loan rate ceiling from 21 percent to 18 percent, effective May 18, 1987. The ceiling has remained at 18 percent to the present. Staff believes retaining the 18 percent ceiling will permit credit unions to continue to meet their current lending programs and permit the necessary flexibility for credit unions to react to any adverse economic developments.

The Board position has been that it would prefer not to set loan interest rate ceilings for federal credit unions. Credit unions are cooperatives and establish loan and share rates consistent with the needs of their members, prevailing market interest rates and the credit risk of the loans granted. The Board supports free lending markets and the ability of federal credit union boards of directors to establish loan rates that reflect current market conditions and the interests of their members.

Interest Rates

As Table 1 below shows money market interest rates (1 month/3 month/6 month Treasuries/Fed Funds Effective) have increased in the most recently reported six month period

December 31, 2008 through June 30, 2009.

Table 1
Change in Money Market Rates
December 31, 2008 – June 30, 2009

Maturity	Rate 12/31/08	Rate 6/30/09	Change
1-month Treasuries	0.11%	0.17%	.06
3-month Treasuries	0.11%	0.19%	.08
6 month Treasuries	0.27%	0.35%	.08
Fed Funds Effective	0.14%	0.22%	.08

Source: Federal Reserve H. 15

Financial Implications for Credit Unions

For 372 federal credit unions, representing 7.7 percent of reporting federal credit unions, the most common rate on unsecured loans was above 15 percent as of March 2009. While the bulk of credit union lending is below 15 percent, small credit unions and credit unions that have implemented risk-based lending programs require interest rates above 15 percent to maintain liquidity, capital, earnings, and growth. Loans to members who have not yet established credit histories or have weak credit histories have more credit risk. Typically, credit unions charge higher rates to cover the higher credit risk for such loans.

Credit unions must either charge an interest rate high enough to cover the expected losses for high-risk secured loans (and to cover the higher expected losses for high-risk unsecured loans) or subsidize these loans by charging every member more for other loans and services, or by paying lower dividend rates on shares. The NCUA Call Reports only capture “the most common unsecured loan rate” which may exclude the higher rates charged on “credit builder” or “credit rebuilder” type of loans. Lowering the interest rate ceiling would discourage these credit unions from making these types of loans to people of modest means and many of the affected members may have no alternative but to turn to other lenders who charge higher rates.

Small credit unions would be particularly affected by lower loan rate ceilings since they tend to have higher levels of unsecured loans, typically with lower loan balances. These smaller credit unions generally maintain a higher expense ratio, since many are involved with high-transaction accounts requiring higher personnel costs and related operational expenses, and a lack of economy of scale. For these federal credit unions (FCUs), reverting to lower loan rate ceilings would threaten their liquidity, capital, earnings, and growth.

Table 2 shows the number of FCUs in each asset group where the most common rate is more than 15 percent for unsecured loans. Of the 372 FCUs with interest rates greater than 15%, 55 percent of the FCUs belong to the asset size no greater than $10 million; of the 112 FCUs with interest rates equal to 18%, 66% of the FCUs belong to the asset size no greater than $10 million. The Board would provide these small FCUs the much needed help by maintaining an 18% ceiling for loans.

Table 2
Active Federal Credit Unions with some portion of their Loan Portfolios
at Loan Interest Rates (> 15 Percent and/or = 18 percent) Effective March 2009

Group by Asset Size	Total # of FCUs	# of FCUs Charging Higher Than 15% on Some Portion of Unsecured Loans	% of FCUs Charging Higher Than 15% on Some Portion of Unsecured Loans	# of FCUs Charging 18% on Some Portion of Unsecured Loans	% of FCUs Charging 18% on Some Portion of Unsecured Loans
$0-2 million	764	67	18%	27	24.1%
$2-10 million	1341	138	37.1%	47	42%
$10-$50 million	1541	94	25.3%	17	15.2
$50 million+	1165	73	19.6%	21	18.7%
Total	4811	372	100.0%	112	100.0%

Conclusion

Staff notes that these results are comparable to those of the FDIC’s Small-Dollar Loan Pilot Program which is designed to offer affordable alternatives to high cost financial products such as payday loans. Sixty seven percent of the FDIC’s small-dollar pilot program banks offer interest rates of 13-18 percent.[1]

For the foregoing reasons, staff concludes that conditions exist to retain the federal credit union interest rate ceiling of 18 percent per year for loans in the period September 10, 2009 through March 10, 2011. The staff remains prepared to reconsider the 18 percent ceiling for loans and advise the Board at any time during the extension period if changes in economic conditions warrant.

[1] “An Introduction to the FDIC’s Small-Dollar Loan Pilot Program”
http://www.fdic.gov/analytical/quarterly/2008_vol2_3/2008_Quarterly_Vol2No3.html

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