STATEMENT

OF

THE HONORABLE DENNIS DOLLAR

CHAIRMAN

NATIONAL CREDIT UNION ADMINISTRATION

FISCAL YEAR 2005
BUDGET REQUEST

SUBMITTED TO THE HOUSE APPROPRIATIONS
SUBCOMMITTEE ON VA, HUD AND INDEPENDENT AGENCIES

APRIL 15, 2004

Mr. Chairman, Ranking Member Mollohan, and Members of the Subcommittee. As Chairman of the National Credit Union Administration (NCUA), I am pleased to submit testimony that presents NCUA's request for FY 2005 funding of the Community Development Revolving Loan Fund (CDRLF) and to request $1.5 billion in FY 2005 borrowing authority for our Central Liquidity Facility (CLF), and CLF operational expenses for the year.

NATIONAL CREDIT UNION ADMINISTRATION
COMMUNITY DEVELOPMENT REVOLVING LOAN FUND

The National Credit Union Administration (NCUA) would like to thank the Subcommittee for continuing its strong support of NCUA's Community Development Revolving Loan Fund (CDRLF).

NCUA remains committed in our efforts to promote and facilitate the extension of affordable financial services to individuals and communities throughout America as demonstrated by the implementation of the agency's successful Access Across America initiative. The CDRLF plays a vital role in the success of Access Across America, which is designed to reach out to underserved communities and create economic empowerment for people from all walks of life. Low-income designated credit unions use the loans to further community development by providing funding for member loan demand, additional member services, and increased credit union capacity to serve members that has resulted in the overall improvement of the financial condition of low-income credit union members. The grants are used for verifiable and need-based technical assistance purposes by low-income designated credit unions.

Congress established the CDRLF in 1979 to provide low-interest loans to credit unions that have been designated low-income by NCUA. NCUA has administered the CDRLF for 14 years. By yearend 2003, the CDRLF provided to credit unions 224 loans totaling $33.9 million. In 1992, NCUA initiated a technical assistance grant (TAG) program in conjunction with the CDRLF which funded grants from the interest generated from outstanding CDRLF loans. To date, NCUA has provided 1,206 TAGs totaling $2.8 million.

NCUA views the CDRLF as incubation monies for low-income designated credit unions to initiate or develop services for members, thereby providing further opportunities to self-fund or obtain more substantial funding. Low-income designated credit unions use CDRLF loans to further community development efforts by funding member loan demand, providing additional member services, increasing capacity to service members and improving the financial condition of low-income credit union members. TAGs support many of the services low-income designated credit unions provide to their members, including programs such as member financial literacy, electronic delivery vehicles and recordkeeping automation and improvement.

Background

The CDRLF was established by Congress (Public Law 96-124, Nov. 20, 1979) through an initial $6 million appropriation to stimulate economic development in low-income communities. The CDRLF was previously administered by various Federal agencies, including Health and Human Services, and in 1990 was transferred to be solely administered by NCUA.

Congress did not provide additional appropriations for the CDRLF from 1979 to 1996. For fiscal year 1997, Congress appropriated an additional $1 million for the loan program with subsequent appropriations as follows:

FY 1997	$1 million	Loans
FY 1998	$1 million	Loans
FY 1999	$2 million	Loans
FY 2000	$1 million	Loans
FY 2001	$350,000	TAG
	$650,000	Loans
FY 2002	$350,000	TAG
	$650,000	Loans
FY 2003	$300,000	TAG
	$700,000	Loans
FY 2004	$1 million	TAG
	$200,000	Loans

Administrative expenses related to the CDRLF are fully absorbed by NCUA. All appropriations, as well as any earnings generated from the CDRLF's assets, are provided to the intended low-income designated credit unions after any necessary adjustments to recognize potential losses in the loan portfolio.

Qualifying Applicants

In order to qualify for participation in CDRLF, credit union applicants must have a low-income designation and serve low-income members. The term predominantly is defined as a simple majority. NCUA regulations define low-income members as those persons either earning less than 80 percent of the average for all wage earners as established by the Bureau of Labor Statistics or those whose annual income falls at or below 80 percent of the median household income for the nation. The NCUA standard for 2003 income for a household was $35,913 and $21,360 for an individual.

Revolving Loan Component

The revolving loan component policy of the CDRLF is designed to assist as many qualifying credit unions as possible. Therefore, loans are limited to $300,000 and no credit union may have more than two separate loans at any one time. Loans must be repaid within five years, although a shorter repayment period may be considered.

Generally, loans are required to be paid in semiannual installments with no principal balance repayment due during the first year. To combat the potential misuse of funds, NCUA regulations require that credit unions must match the loan with funding from member share deposits or non-member deposits within the first year.

Interest rates are set annually by the NCUA Board and can be between one and three percent. Due to the current interest rate environment, NCUA currently charges a one percent interest rate.

NCUA has authorized an open application period for participation in the loan program. This unrestricted application period enables low-income credit unions – most of which have very few employees and limited resources – to develop and present a viable plan for better serving their fields of membership. The open application period also allows credit unions to implement timelier projects and services.

During 2002, NCUA revised the loan program in an effort to achieve greater flexibility in the program and mitigate risk to the CDRLF. Although loan repayments accelerated during this period of time, the revised program offset the anticipated loss of loans with increased interest and applications for the loan program, with 11 credit union loan applications received during 2003.

Credit unions most likely to utilize the loan program are small in size with the median asset size of participating credit unions since 1990 is $3.4 million.

To help ensure equality in loan approvals, a scoring system judges the purpose of the proposed use of funds, the financial condition of the credit union and management's capability of achieving the stated objective and operating the credit union in a safe and sound manner. As a regulator, NCUA has the added advantage of using credit union examinations to ensure the financial stability of loan grantees.

Technical Assistance Grants (TAGs)

TAGs are usually less than $5,000 and are made directly to low-income designated credit unions requiring assistance to further their outreach into the communities they serve. The grants assist these credit unions, generally less than $3 million in assets, in their efforts to improve service to their members by providing training opportunities to credit union staff, supply funds for operational upgrades in recordkeeping, offer stipends to credit unions for summer student intern programs, promote credit union services, develop training and consulting services for members and other worthwhile programs. With assistance provided through the TAG program, credit unions have realized improved service in the delivery of financial products and services through enhanced technology. In 2003, 114 credit unions received more than $259,000 specifically designated for technology improvements including upgraded hardware and software, debit card programs and automated response systems.

To ensure the funds are used solely for the purpose approved, grants are issued as reimbursements for goods or services previously approved by NCUA. Like the loan component of the CDRLF, the TAGs are available to low-income designated credit unions throughout the year.

Beginning in 2001, Congress specifically designated a portion of its annual appropriations for TAGs. Prior to 2001, the grant program was funded solely through earnings from outstanding CDRLF loans and never exceeded $250,000.

Grant requests continue to exceed all available resources. In 2003, NCUA received requests for more than $1.2 million. Due to limited resources, NCUA was forced to decline requests for more than $750,000 that could have been used to provide much needed services in low-incomes areas. Earlier this year, Congress, recognizing the high demand for technical assistance, approved $1 million for fiscal year 2004 specifically designated for the grant component of the CDRLF. The additional funding will assist in expanding two existing programs very important to the participating credit unions – the student intern program and the Volunteer Income Tax Assistance program, as well as establish a number of new community development initiatives.

From its inception in 1992, the CDRLF has provided 1,206 technical assistance grants totaling $2.8 million to low-income designated credit unions. In 2003, NCUA disbursed grants totaling $460,000.

Student Intern Program

In 1996, NCUA established a student intern program funded entirely by the grant component of the CDRLF. The program is designed to provide low-income designated credit unions the opportunity for college students to contribute to the operations of the credit union while learning about the credit union community. The program makes grants totaling an average of $69,000 annually, with 28 low-income designated credit unions and their 28 credit union partners participating. Student interns participating in the program work at both the low-income designated credit unions and their partnering credit unions, affording them with the opportunity to share best practices between the institutions. Response from student and credit union participants has been extremely positive. The program is reevaluated annually to assess its ongoing impact and feasibility.

VITA Program

In 2003, NCUA designated $50,000 for low-income designated credit unions establishing VITA (Volunteer Income Tax Assistance) sites. The VITA program is administered by the Internal Revenue Service to assist low-income and elderly taxpayers with income tax preparation, and to encourage low-wage earners to file for the Earned Income Tax Credit (EITC). Last year, NCUA granted 13 credit unions a total of $50,000 dollars to offset some of the administrative burden associated with setting up these taxpayer clinics. With the increase in appropriated funds for fiscal year 2004 and expectations for increased participation, NCUA designated $75,000 for credit unions to set up VITA programs for 2005.

Other TAG Programs

With the increased funding for fiscal year 2004, NCUA has designated funds for new targeted initiatives. NCUA recently announced three new TAG programs. This year, $350,000 has been made available to low-income designated credit unions for developing financial education programs, homeownership initiatives and training assistance.

The specialized TAG programs emphasize initiatives that help communities develop self-sufficiency. The Financial Education Assistance Program is intended to provide members and potential members with practical money management skills, as well as an introduction to financial planning. Credit unions receiving funds through the Homeownership Assistance Program will utilize the funds to enhance their partnerships with affiliates of the Neighborhood Reinvestment Corporation, referred to as NeighborWorks® Organizations, in establishing and improving mortgage lending/homeownership programs. The training program TAGs will cover tuition and travel costs associated with attending recognized training courses for credit union staff and leaders. Educated and informed credit union staff and volunteers are essential to providing safe and sound services to credit union members.

NCUA is in the process of developing other TAG initiatives to assist credit unions in the enhancement of technology systems, expansion of financial services to underserved areas, the creation of individual development accounts (IDAs), the establishment of remittance programs and credit union mentoring opportunities. These programs will be announced in the second quarter.

The CDRLF continues to provide low-income designated credit unions – particularly those of smaller asset size – the opportunity to obtain loans and technical assistance grants to improve and enhance services to their members. Though a small program, it provides valuable aid and assistance for those credit unions benefiting from this support while striving for self-sufficiency. Credit unions, through their cooperative structure, are funded through the share deposits of their members. The CDRLF provides needed assistance to further growth and viability of participating credit unions serving low-income fields of membership. Access to affordable financial services can provide underserved communities with a much needed alternative to high-cost lenders, allowing the residents to keep more of their money in their communities. NCUA firmly believes that, based upon the amount of loan and technical assistance grant applications where the needs were unable to be met last year, an increase of an additional $800,000 over last year's funding level could provide the CDRLF program even greater ability to further growth and long-term viability of credit unions in low-income and underserved areas

NATIONAL CREDIT UNION ADMINISTRATION CENTRAL LIQUIDITY FACILITY

The National Credit Union Administration Central Liquidity Facility (CLF) was created by the National Credit Union Administration Central Liquidity Facility Act (Public Law 95-630, Title XVIII, 12 U.S.C. 1795, et seq.). The CLF is a mixed ownership government corporation managed by the National Credit Union Administration Board. It is owned by its member credit unions who contribute all of the capital by the purchase of stock. The CLF became operational on October 1, 1979.

The purpose of the CLF is to improve general financial stability by meeting the liquidity needs of credit unions and thereby encourage savings, support consumer and mortgage lending and provide basic financial resources to all segments of the economy. To accomplish this purpose, member credit unions invest in the CLF through the purchase of stock, which is used for investment purposes and the funding of some lending activity. The proceeds of borrowed funds from the Federal Financing Bank are used to match fund significant loan requests from member credit unions.

In addition to serving its direct members, the CLF complements the organizational structure of the U.S. credit union financial system by working with its agent members, which are corporate credit unions acting as agents of the CLF on behalf of their natural person credit union membership. This agent framework consists of a private financial network of 29 state and federally chartered corporate credit unions with approximately $74.5 billion in assets. The corporate credit union network provides operational and correspondent services, investment products and advice and short-term loans to its approximately 9,751 natural person credit unions. The CLF provides this network with assurance that if temporary liquidity shortages or public confidence issues arise due to external events or internal problems, funds are available to meet abnormal savings outflow. By being a specialized lender housed within NCUA, the CLF has the ability to draw upon the supervisory and insurance resources of the agency. However, CLF assistance is generally a secondary source of funds after the corporate system or other sources of credit have been utilized. Often the CLF is used when other credit sources have been unable to provide the appropriate terms and conditions required in a specific situation.

The borrowings of the CLF have the "full faith and credit" of the United States government. The Federal Financing Bank of the U.S. Treasury is available as a source for the CLF to fund its lending programs. The CLF is financially self-supporting and does not use government funds to support any of its administrative and operational expenses.

Lending Activities

Loans are available to credit unions directly from the CLF or through its agent credit members. Credit unions rely on market sources to meet their demands for funds. The CLF normally is not an active participant in the on-going daily operations of this system. Rather, its role is to be available when unexpected, unusual or extreme events cause temporary shortages of funds. If not handled immediately, these shortages could lead to a larger crisis in individual credit unions or even the system as a whole. Because of its knowledge of credit unions and its immediate access to the supervisory information of NCUA, the CLF exercises a vital role in maintaining member and public confidence in the health of the U.S. credit union financial system.

Factors Influencing Credit Union Borrowing Demand

Under the Federal Credit Union Act, the CLF is intended to address unusual or unpredictable events that may impact the liquidity needs of credit unions. Since these events are not generally foreseen, it is extremely difficult to forecast potential loan demand. Throughout the history of the CLF, loan demand has widely fluctuated in both volume and dollar amount.

The CLF is authorized by statute to borrow from any source up to 12 times its subscribed capital stock and surplus. Since fiscal year 2001, a borrowing limit of $1.5 billion has been approved by Congress. The continuation of the $1.5 billion cap for fiscal year 2005 will further assure that the CLF continues as a reliable, efficient backup liquidity source in times of need.

It is important to note that CLF loans are not used to increase loan or investment volumes because by statute the proceeds from CLF loans cannot be used to expand credit union portfolios. Rather, the funds are advanced strictly to support the purpose stated in the Federal Credit Union Act – credit union liquidity needs – and in response to circumstances dictated by market events.

Administrative Expenses

Total operating expenses for fiscal year 2003 were $208,000, below the budget limitation of $309,000. Expenses were under budget due to lower travel expenses than anticipated due to a reorganization of CLF officers and low group agent fee expense.

Total operating expenses for fiscal year 2004 are projected to be within our budget limitation of $310,000. In fiscal year 2004, pay and related benefits are higher than 2003 due to salary increases and higher agent fee expenses.

For fiscal year 2005, the CLF is requesting an administrative expense limitation of $309,000. This figure is slightly lower than the previous year, a result of reduced expenses associated with projected operations for 2005.

Additional Background

Credit unions manage liquidity through a dynamic asset and liability management process. When on-hand liquidity is low, credit unions must increasingly utilize borrowed funds from third-party providers to maintain an appropriate balance between liquidity and sound asset/liability positions. The CLF provides a measure of stability in times of limited liquidity by ensuring a back-up source of funds for institutions that experience a sudden or unexpected shortage that cannot adequately be met by advances from primary funding sources. Two ratios that provide information about relative liquidity are the loan-to-share ratio and the liquid asset ratio. Liquid assets are defined as all investments less than one year plus all cash on hand. Managing liquidity risk is a major priority for credit unions and has become an increasingly important risk issue in the past decade as the charts below indicate.

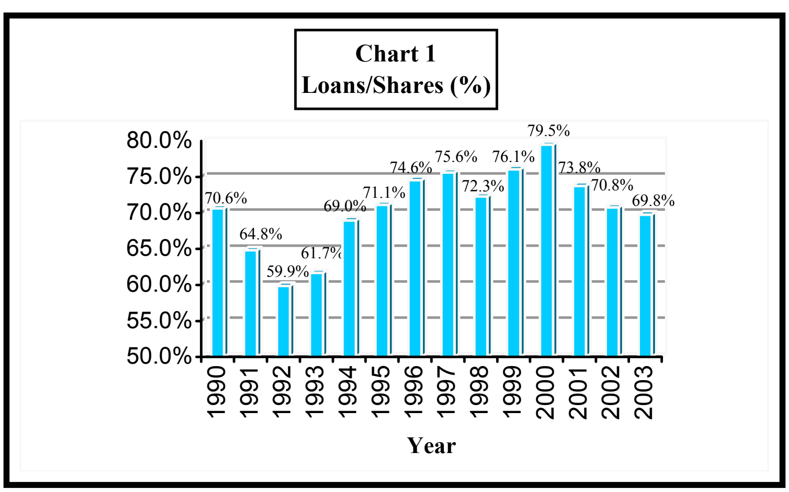

Chart 1 shows the ratio of loans to shares in all federally insured credit unions. As the ratio of loans to shares increases, the amount of funds maintained in short-term liquid investments declines. Liquidity risk has increased on average in the past decade as on-hand liquidity in federally insured credit unions gradually declined due to increased lending. A substantial inflow of shares during 2003 reduced the ratio from the yearend 2002 high of 70.8 percent down to a yearend 2003 level of 69.8 percent. Liquidity risk management remains a significant obligation for credit unions.

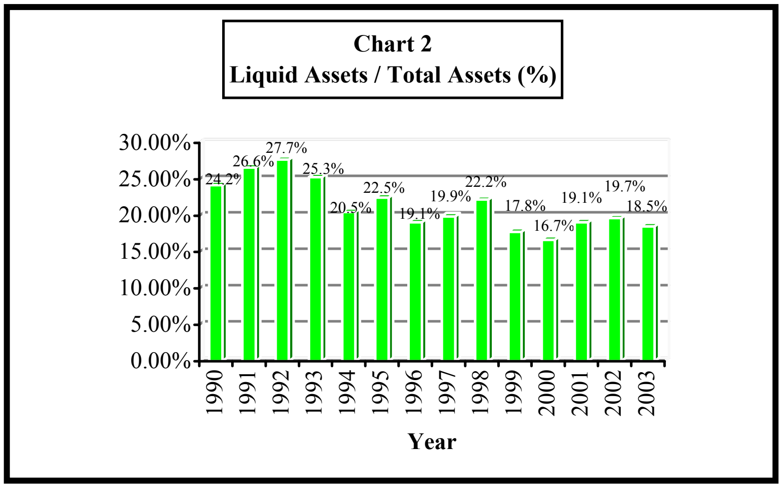

Chart 2 shows the ratio of liquid assets to total assets in all federally insured credit unions. As this ratio decreases, liquidity risk and the potential need for borrowed funds conversely increases. Credit unions utilize various market sources for funding needs including the repurchase market, correspondent relationships with corporate credit unions and other financial institutions, and, to a growing extent, membership in the Federal Home Loan Bank system. CLF serves as a back-up source of liquidity when an unexpected need for funds arises and primary sources are not available.

The CLF continues to experience infrequent demand for liquidity loans from its member credit unions. This is due in no small part to the strong financial position of credit unions and the ample levels of on-hand liquidity maintained during the 1990s. This is not to say, however, that credit unions are not in need of a special purpose liquidity lender. The CLF is a very important resource for credit unions that experience an unexpected need for liquidity, especially when primary funding sources are inadequate or unavailable.

NCUA cannot foresee the exact circumstances that might necessitate a broad-based need for CLF lending but is dedicated to the principle that it must be ready and able to fulfill that purpose; a purpose established by Congress when it created the CLF. Liquidity remains an important priority. Like all depository institutions, credit unions are forced to borrow if their on-hand supply of liquidity is depleted beyond the level of current funding obligations. Credit unions do plan for such borrowing but there are times when contingency funding arrangements are potentially inadequate. Such times call for a responsive CLF.

Whether it lends on an isolated basis or whether it is called upon to address a more widespread or even systemic demand for loans, the CLF is an efficient, effective and low-cost facility well adapted to meet the unique needs of its member credit unions.

Summary

During 2003, credit union assets and shares grew to $610 billion and $528 billion respectively, with net worth remaining a strong 10.72 percent. The number of federally insured credit union members grew to over 82 million. These numbers demonstrate the continued safety and soundness of the credit union system.

NCUA greatly appreciates the Subcommittee's continued support of its efforts to keep credit unions safe and sound, enhance credit union liquidity and provide needed assistance through loans and grants to low-income credit unions.