STATEMENT

OF

THE HONORABLE JOANN JOHNSON
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

"CONSIDERATION OF REGULATORY REFORM PROPOSALS"

BEFORE THE

COMMITTEE
ON
BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

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Chairman Shelby, Senator Sarbanes, and Members of the Committee: thank you for inviting me to appear on this panel today. On behalf of the National Credit Union Administration (NCUA) I am pleased to provide our agency's views on regulatory efficiency recommendations. Many of the recommendations I will address today have been previously provided to you by NCUA in 2003 and 2004. I will also suggest other items for your consideration today, report to you what we are doing through our own annual review of regulations, and comment on progress NCUA is making under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).

Effective regulation, not excessive regulation is our guiding principle.

NCUA ANNUAL REVIEW OF REGULATIONS AND EGRPRA

NCUA is participating with the other four federal financial institution regulatory agencies in the review project mandated by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). We will soon be publishing our third request for public comment on ways in which we might improve or eliminate regulations that are burdensome or unnecessary. NCUA is carefully coordinating with the other agencies. However, because of the unique nature of credit unions and their differences from other financial institutions, NCUA is publishing separate notices.

We are also coordinating the EGRPRA effort with our own internal regulatory review process. Annually, we scrutinize one-third of our entire body of existing regulations to find ways to simplify or improve any regulation that is outdated or in need of revision. This internal process, which NCUA has had in place for a number of years, has brought about important regulatory reform for credit unions, including complete overhaul and modernization of NCUA's rules on lending, share accounts and incidental powers.

We expect that both EGRPRA and our internal review will continue to further a critical and strategic initiative of reducing or eliminating unduly burdensome regulation on the credit union system, and that the EGRPRA effort will result in additional recommendations for legislative reform as we work to complete the EGRPRA review by the 2006 statutory deadline.

LEGISLATIVE RECOMMENDATIONS

The legislative proposals I am presenting are consistent with the mission of credit unions and the principles of safety and soundness. One is time sensitive, some address regulatory efficiency and modernization, others are in the public interest and the technical corrections are clerical. All should benefit credit union members and have a positive effect for credit unions on the cost of doing business and complying with regulations and the Federal Credit Union Act.

I hope to gain your support for these recommendations and I would be pleased to assist your further deliberations on these in any way I can. I don't believe any of these should be considered controversial.

Accounting Treatment of Net Worth in Credit Union Mergers

A time-sensitive recommendation involves an expected Financial Accounting Standards Board (FASB) decision coming later this year with a January 2006 effective date. This is a recent development, therefore, it is not included in current legislation under consideration in Congress. The issue arises from the interface between the statutory definition of "net worth" in the Federal Credit Union Act and the accounting treatment of net worth in credit union mergers. This issue is important separate and apart from the question of converting to a system of risk-weighted net worth requirements addressed elsewhere in NCUA's testimony.

The Credit Union Membership Access Act of 1998 established a statutory system of capital standards and prompt corrective action (PCA) for federally insured institutions. Capital, or the term "net worth" for credit unions, is defined as being limited to their retained earnings as determined in accordance with generally accepted accounting principles (GAAP). In the context of credit union mergers, where the "pooling method" of accounting has traditionally been used, the retained earnings of the two credit unions are pooled and the sum of these retained earnings become the net worth of the combined credit union. This is a logical result that facilitates the ability of credit unions to merge when it is in the best interests of their members.

A proposed change to the accounting standards for credit union mergers that FASB expects to implement as early as January 1, 2006, will dramatically alter this treatment of retained earnings and net worth in a manner that will make it difficult or impossible for many credit unions to consider combining their strengths through merger. Specifically, FASB's proposed change to accounting rules will require, in a merger, that the retained earnings of one credit union be carried over as "acquired equity" rather than retained earnings. Thus, only the retained earnings of the remaining credit union will count as net worth after the merger. This seriously reduces the post-merger net worth ratio, because that ratio is the retained earnings stated as a percentage of the combined assets of the two institutions. A lower net worth ratio has strongly adverse implications under the statutory PCA scheme, and it is this result that will strongly discourage voluntary mergers and, on occasion, make NCUA assisted mergers more difficult and costly to the National Credit Union Share Insurance Fund (NCUSIF).

The solution, which has been reviewed by FASB, is to redefine net worth for PCA purposes as equity, rather than just retained earnings. NCUA has suggested statutory language, as well as report language, clarifying the very limited purpose of this amendment, and they are attached for the Committee's consideration.

Prompt Corrective Action: Risk-Based Net Worth

The guiding principle behind PCA is to resolve problems in federally insured credit unions at the least long-term cost to the NCUSIF. This principle is consistent with our fiduciary responsibility to the insurance fund. However, the current statutory net worth structure establishes a system based largely on net worth to total assets. This creates inequities for credit unions with low-risk balance sheets and limits NCUA's ability to incorporate behavioral incentives related to higher risk activities.

The Committee heard the consensus among all the financial regulators at the April 20th hearing on the "Condition of the Banking and Credit Union Industries" about the value of an accurate risk-based capital system for different types of financial institutions. On April 21, 2004, NCUA sent a letter to Senator Crapo and all members of this Committee that included a recommendation for risk-basing PCA for federally insured institutions.

Legislation introduced in the House of Representatives in November 2003, H.R. 3579, the Credit Union Regulatory Improvements Act of 2003" (CURIA), has begun the deliberations over how such a risk-based system could be applied to federally insured credit unions.

Section 301 of CURIA would address these inequities by establishing a risk-based system for PCA. NCUA strongly supports such a risk-weighted system. A well-designed risk-based system would alleviate regulatory concerns by not penalizing low risk activities and by providing credit union management with the ability to manage their compliance through adjustments to their assets and activities. A PCA system that is risk-based would better achieve the objectives of PCA and is consistent with sound risk management principles.

Since first advocating the idea of an entirely risk-based PCA system, NCUA has envisioned a system similar to that currently employed in the banking system where assets are weighted by risk. However the Basel accords do not appropriately apply to credit unions as not-for-profit financial cooperatives that can only build net worth through retained earnings. In addition, unlike the current bank PCA system, which is intended only to address credit risk, we believe a risk-based credit union PCA system should be designed to address all relevant and material risks.

While NCUA supports a statutorily mandated PCA system, the system should contain a statutory definition of net worth with NCUA provided the ability through regulation to exclude certain accounts as necessary from what qualifies as net worth. The system should also establish a minimum core leverage requirement (net worth in relation to total assets) set by statute both for critically undercapitalized and adequately capitalized classifications, and statutory thresholds based on risk-assets defined by the NCUA Board for all of the net worth classifications. For the remaining elements of the risk-based PCA system, NCUA should be provided with the authority to set these by regulation to ensure the system remains relevant and up-to-date with emerging trends in credit unions and the marketplace.

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 to members (12 USC 1757(12)). To reach the "unbanked," federal credit unions should be authorized 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 in their field of membership. 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.

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. Federal credit unions should be able to make loans for second homes, recreational vehicles and other purposes in accordance with conventional maturities that are commonly accepted in the market today. It is our view that NCUA should retain the rulemaking authority to establish any maturity limits necessary for safety and soundness.

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. The one percent limit should be eliminated and the NCUA Board should be allowed to set a limit by regulation. NCUA is comfortable with increasing the CUSO investment limit from 1 percent to 3 percent.

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 Act should be amended to provide such additional investment authority as approved by regulation of the NCUA Board. This would enable the Board to approve additional safe and sound investments of a conservative nature which have a proven track record with state chartered credit unions or other financial institutions. Section 303 of H.R. 1375, as passed by the House of Representatives, appropriately addresses the issues NCUA has presented in our recommendation, limits additional investment to corporate debt securities (as opposed to equity) and further establishes specific percentage limitations and investment grade standards.

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 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.

Regulatory Relief from SEC Registration Requirements

NCUA is seeking a provision to provide regulatory 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.

Section 313 of HR 1375, and an identical provision in CURIA, 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 does 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 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.

Authority to Examine Credit Union Vendors

Unlike the other federal financial institution regulators, NCUA does not have direct authority to examine third party vendors that provide data processing and other related services to insured credit unions. Statutory authority did previously exist for NCUA, but under a sunset provision that expired in 2001. We are currently required to work through credit unions to obtain vendor information or seek voluntary cooperation from vendors. We do not have direct examination authority nor related powers to enforce full disclosure and cooperation in a case where that might become necessary.

We believe that in these times, when privacy, money laundering and financing of terrorism are issues of such paramount national interest, as well as safety and soundness concerns, NCUA should have direct examination, but not regulatory, authority over those vendors providing services to federally insured credit unions. Direct examination authority would provide NCUA parity with other financial regulators with respect to examinations and would eliminate the need for us to approach the matter indirectly through credit unions, thus providing some measure of regulatory relief.

I should also note that the Government Accounting Office (GAO), in its October 2003 report on credit unions stated:

> To improve oversight of third-party vendors, Congress may wish to consider granting NCUA legislative authority to examine third-party vendors that provide services to credit unions and are not examined through FFIEC. (GAO-04-91)

Attached for the Committee's consideration are suggested legislative and report language to accomplish this recommendation.

Updating NCUA Authority to Address Qualified Financial Contracts

Qualified financial contracts, or "QFCs," are certain types of derivatives contracts. Since 1989, the Federal Deposit Insurance Act and the Federal Credit Union Act have had parallel provisions governing how the FDIC and NCUA should handle QFCs in the event of the failure of an insured bank or credit union that holds QFCs. These statutory QFC provisions help protect the stability of the derivatives market by ensuring that a receiver or liquidator does not "cherry-pick" among derivatives at a failed institution: that is, that the receiver or liquidator cannot damage a QFC counterparty by unfairly repudiating some QFCs while affirming others.

NCUA supports legislation to update the Federal Credit Union Act's 1989 QFC provisions and ensure that these federal credit union Act provisions mirror the parallel Federal Deposit Insurance Act provisions. Title IX of H.R. 975 the Bankruptcy Abuse and Consumer Protection Act of 2003, as passed by the U.S. House of Representatives, includes the needed changes as does H.R. 2120, now ready to proceed to the floor of the House.

Specifically, the amendments expand and clarify the types of derivatives that must be treated as QFCs, clarify a QFC counterparty's rights to net QFCs, and clarify NCUA's rights, as liquidator, to transfer QFCs to third parties.

These amendments are consistent with the recommendations of the other financial regulatory agencies for dealing with derivatives, as expressed by the President's Working Group on Financial Markets.

Additional Credit Union Provisions

I would also like to take this opportunity to comment on credit union provisions not originating from NCUA, but included in H.R. 1375 as passed by the House of Representatives, and referred to this committee.

NCUA has reviewed all of the additional credit union provisions included in H.R. 1375 and the agency has no safety and soundness concerns with these provisions. Among these are provisions which 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); and 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). Again, though we recognize these issues as statutory in nature and therefore a public policy decision only the Congress can make, we have carefully examined each and have determined that these provisions present no safety and soundness concerns for the credit unions we regulate and/or insure. Also, Section 312 of H.R. 1375 was added by the Committee on the Judiciary and provides for an exemption from pre-merger notification requirements of the Clayton Act. We have likewise reviewed this provision, and have no objections and actually see benefit from a safety and soundness perspective.

Privately Insured Credit Unions and Federal Home Loan Bank Membership

It is important to recognize that NCUA is neither the regulator nor the insurer of state-chartered credit unions whose deposits are not insured by the National Credit Union Share Insurance Fund.

NCUA has no official position on the public policy issue related to privately insured state-chartered credit unions being eligible to join the Federal Home Loan Bank System. However, we find ourselves uncomfortable with changes to Section 301 in HR 1375, as it passed the U.S. House of Representatives.

Our concerns stem from language added to the basic provision which makes it appear that oversight responsibility for non-federally insured credit unions and certain state regulated private share insurance companies rests with NCUA. NCUA has no legal authority and no regulatory or supervisory jurisdiction over these non-federally insured credit unions or commercial insurance companies (nor do we seek it). In our view, the language requiring private insurance providers to submit copies of their annual audit reports to NCUA should be removed to avoid potential consumer confusion and misunderstanding. Likewise, we believe that the consultation language which seeks to bring the federal regulatory authority into a role that appropriately rests with state credit union and insurance regulators should also be removed. In its passage of the Federal Deposit Insurance Corporation Improvement Act in 1991 (FDICIA), Congress designated the Federal Trade Commission as the agency responsible for oversight of private deposit insurance companies and the protection of consumers through appropriate disclosure provisions. As the matter remains one of consumer awareness, disclosure and notification -- and not of federal credit union regulation -- NCUA feels strongly that the Federal Trade Commission should retain this oversight responsibility. The additional language which could be interpreted to infer an NCUA role that is neither appropriate nor statutorily authorized to provide oversight to either state-chartered privately insured credit unions or a private insurance company regulated by an agency designated by state statute should be removed from Section 301.

Technical Corrections to the Federal Credit Union Act

NCUA has also submitted a list of technical corrections that we hope can be included in legislation in the near future.

Conclusion

As we implement regulatory reforms through our own annual review of regulations, through the EGRPRA process or through any legislative improvements the Congress ultimately chooses to enact, effective regulation, not excessive regulation, should be the basis of fulfilling our mission and ensuring the safety and soundness of our nation’s credit unions.

Thank you.

ADDENDUM TO CHAIRMAN JOHNSON’S TESTIMONY

Proposed Language to the Federal Credit Union Act Regarding Mergers and Net Worth

Proposed technical correction to Section 216 of the Federal Credit Union Act (12 USC 1790d(o)(2)(A)):

(2) **Net Worth**.---The term ‘net worth’--

(A) with respect to any insured credit union, means equity as determined under generally accepted accounting principles and as authorized by the Board; and

(B) with respect to a low income credit union, includes secondary capital accounts that are---

(i) uninsured; and
(ii) subordinate to all other claims against the credit union, including claims of creditors, shareholders, and the Fund.

Draft Report Language

This amendment to Section 216 of the Federal Credit Union Act (FCU Act) (12 USC 1790d(o)(2)(A)) redefines the term "net worth" for PCA purposes by replacing the phrase "retained earnings balance" with the phrase "equity" and by inserting the phrase "and as authorized by the Board" (i.e., NCUA Board) where indicated. The amendment is necessary to cure the unintended consequence of business combination accounting rules the Financial Accounting Standards Board (FASB) is intending to apply to the combinations of mutual enterprises (e.g., credit unions).[1]

[1] In June 2001, the FASB adopted 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).

When FASB lifts the paragraph 60 deferral of the acquisition method that credit unions have enjoyed, this will eliminate the practice of accounting for mergers as a pooling of interests. The acquisition method would require the valuation of the target credit union at fair value; the recognition of identifiable intangibles (e.g., core deposit intangibles and/or goodwill), when relevant; and the application of a market-based acquisition model to a non-bargained transaction. The FASB intends to expose a statement for public comment in the 2nd quarter of 2004 and to finalize the standard in the 2005 with an effective date in early 2006.

Currently, under the FCU Act, a credit union's capital is measured based on the retained earnings balance as determined under GAAP. The FASB is preparing to revise GAAP in relation to the combination of mutual enterprises (i.e., credit unions) with the effective result that the interplay between the capital definition in the FCU Act and FASB's new rules will create a disincentive to otherwise desirable credit union mergers. Additionally, the change will make it more difficult for the NCUA to carry out its responsibilities to protect the public interest in managing and minimizing losses to the National Credit Union Share Insurance Fund (NCUSIF) through the merger option. The FASB has expressed support for a legislative solution and has indicated that a legislative redefinition of capital (net worth) will not affect their standards-setting activities. The remedy needed is an expanded definition of capital in the FCU Act in advance of the FASB rule effective date (expected January 2006) to mitigate this unintended result. Banks and their insurers do not have the same concerns because their existing capital definition under relevant law is broader.

This amendment is intended to address a narrow and technical accounting issue and in the process remove the unintended disincentive to credit union mergers that FASB's imminent action will create.

The "as authorized by the Board language" has the limited effect of allowing the Board comparable authority as federal banking regulators to exclude items within the capital structure that do not have value to the insurance fund in a liquidation scenario, e.g., core deposit intangibles, goodwill, etc., thus not "overvaluing" resulting post-merger capital. The "as authorized" language does not provide the Board any other authority to either limit the definition of net worth or alter the PCA net worth categories. The authority would be exercised only after due deliberation and public comment through a federal register notice and rulemaking process.

Unlike FDIC-insured financial institutions, credit unions are permitted by law to count as capital only their "retained earnings" as determined under GAAP. The law excludes all other equity components. Federally-insured credit unions are required to comply with a Congressionally-mandated system of minimum regulatory capital standards known as "prompt corrective action." 12 U.S.C.§1790d. A credit union's "net worth ratio" determines its classification among five statutory net worth categories. The lower the category, the more supervisory actions the credit union must comply with and implement. The denominator of the net ratio is the balance of a credit union's total assets. The numerator of the ratio is narrowly limited by law to the "retained earnings" component of equity. 12 U.S.C.§1790d(o)(2)(A). In contrast, the numerator of an FDIC-insured financial institution's equivalent "leverage ratio" may include virtually all GAAP equity components.

Under FASB's expected approach, however, a combination between credit unions would cause the acquiring credit union's capital ratio to *decline* in most cases. Potential acquiring credit unions would naturally find the prospect of being demoted to a lower net worth category, and potentially subject to more supervisory actions, too high a price to pay to merge with another credit union. In contrast, the expected approach would not inflict this problem on acquiring banks and thrifts because they are allowed to include virtually all components of equity in their capital.

The adverse impact on an acquirer's post-merger capital level will be a disincentive to otherwise desirable credit union mergers. In turn, it will be much more difficult for NCUA to carry out its responsibility to protect the public interest. Fewer potential merger partners will come forward to rescue a troubled credit union when they realize that the reward for doing so is a reduction in post-merger capital. This also will undermine the purpose of "prompt corrective action" which is to resolve the problems of credit unions while minimizing losses to the NCUSIF. Fewer willing merger partners mean fewer opportunities to avert losses to the NCUSIF by merging a troubled credit union. Credit union mergers have traditionally been effective in accomplishing both objectives while preserving the continuity of credit union service to the target credit union's members. We have no doubt that Congress neither intended nor expected to discourage mergers when it adopted GAAP retained earnings as the definition of credit union capital.

Proposed Amendment to the Federal Credit Union Act Regarding Vendor Examinations.

The Federal Credit Union Act, (12 U.S.C. §1752 et seq.) is amended by deleting existing Section 206A, 12 U.S.C. §1786a, and adding the following new section:

§1786a

Examination of credit union service providers -

(a) If an insured credit union causes to be performed for itself, by contract or otherwise, any service that provides information systems support, technology services, data processing services, loan services or other services related to the credit union's operations (as those terms are defined by the Board, by regulation) such service shall be subject to examination by the Board to the same extent as if such services were being performed by the insured credit union itself on its own premises.

(b) Administration by the Board – The Board may issue such regulations and orders as may be necessary to enable it to carry out examinations under this Section.

Draft Report Language on Authority to Examine Credit Union Vendors

Unlike the other federal financial institution regulators, NCUA does not have direct authority to examine third party vendors that provide data processing and other services to federally insured credit unions. This statutory authority did previously exist for NCUA, but under a sunset provision that expired in 2001. Indeed, the authority that expired in 2001 allowed NCUA to examine and regulate all third-party service providers, and was thus broader than the authority now being provided to NCUA.

As of December 2003 approximately 25% of all federally insured credit unions contract with outside vendors to perform many of their automated back room accounting processes. Another 70% use vendor supplied software and data processing programs that rely upon vendor servicing and maintenance to function effectively. These services may include such things as electronic money transfers, check clearance, transactional internet services, and varying levels of internal controls to assist credit unions in identifying and reporting suspicious activity. Other third-party vendors provide processing and support services in areas such as loan processing and overdraft protection.

This heavy and increasing reliance on vendors by credit unions for many critical functions makes it essential for NCUA to have the authority to examine and evaluate vendor operations. The General Accounting Office in October 2003 recommended that Congress consider giving NCUA the authority to examine third-party vendors. NCUA's ability to timely identify weaknesses and require their correction is critical to our ability to assure credit unions operate in a safe and sound manner.