STATEMENT

OF

THE HONORABLE JOANN JOHNSON

CHAIRMAN

NATIONAL CREDIT UNION ADMINISTRATION

FISCAL YEAR 2006
BUDGET REQUEST

SUBMITTED TO THE HOUSE APPROPRIATIONS SUBCOMMITTEE ON TRANSPORTATION, TREASURY, and HOUSING and URBAN DEVELOPMENT, JUDICIARY, DISTRICT OF COLUMBIA

APRIL 29, 2005

Chairman Knollenberg, Ranking Member Olver, Members of the Subcommittee, I am pleased to submit this testimony that presents NCUA's request for FY 2006 funding of $950,000 for the Community Development Revolving Loan Fund (CDRLF) and to request $1.5 billion in FY 2006 borrowing authority for the Central Liquidity Facility (CLF), and an administrative limitation of $323,000 in CLF operational expenses for the year.

NATIONAL CREDIT UNION ADMINISTRATION COMMUNITY DEVELOPMENT REVOLVING LOAN FUND

NCUA remains committed in our efforts to promote and facilitate the extension of affordable financial services to individuals and communities throughout America. "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 and the community. 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 15 years. By yearend 2004, the CDRLF had provided 244 loans totaling $35 million to low-income designated credit unions. 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 disbursed 1,510 TAGs totaling $3.4 million.

NCUA views the CDRLF as a resource for 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, provide additional member services, increase capacity to service members and improve 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 member financial literacy programs and electronic delivery systems.

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. In 1990 the sole administration of the CDRLF was transferred to NCUA after having been administered by various Federal agencies.

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
FY 2005	$800,000	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 the CDRLF, credit union applicants must have a low-income designation and must serve predominantly low-income members. 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 2004 income for a household was $35,080 and $21,389 for an individual.

Revolving Loan Component

The revolving loan component 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 recipient 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 at a rate between one and three percent. Due to the current interest rate environment, the NCUA Board has set a one percent interest rate for 2005.

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 projects and services on a timelier basis.

During 2002, NCUA revised the loan program in an effort to achieve greater flexibility and mitigate risk. 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. During 2004, twenty-three credit union loan applications were received.

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 generally awarded in amounts 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 $18 million in assets, in their efforts to improve service to their members by providing training opportunities to credit union staff; supplying funds for operational upgrades in recordkeeping; offering stipends to credit unions for summer student intern programs; promoting credit union services; developing training and consulting services for members and other worthwhile programs. With assistance provided through the TAG program, credit unions have also realized improved service in the delivery of financial products and services through enhanced technology. In 2004, 106 credit unions received more than $448,000 specifically designated for technology improvements which includes upgrades in 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 and much like the loan component of the CDRLF, various TAG initiatives 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 2004, NCUA received requests for more than $3.4 million. Due to limited resources, NCUA was forced to decline requests for more than $2.2 million that could have been used to provide much needed services in low-income areas. Congress, recognizing the high demand for technical assistance, specifically designated $800,000 of the $1 million total appropriation for the grant component of the CDRLF for fiscal year 2005. From its inception in 1992, the CDRLF has disbursed 1,510 technical assistance grants totaling $3.4 million to low-income designated credit unions. In 2004, NCUA disbursed grants totaling over $600,000.

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. In 2004, the program approved grants totaling $63,000, with 26 low-income designated credit unions and their 26 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 2004, NCUA designated funds 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 12 credit unions a total of $56,322 dollars to offset some of the administrative burden associated with setting up these taxpayer clinics. Due to the success of last year's program, NCUA designated $60,000 for credit unions to set up VITA programs for 2005.

Financial Education Program

A new initiative offered last year was the Financial Education Program. Last year, NCUA granted 19 credit unions, a total of $80,683 to offset some of the costs associated with initiating and/or maintaining a financial education program. Grants provided under this initiative were granted to facilitate credit unions in providing members and potential members with practical money-management skills and an introduction to financial planning through course work that covers the fundamentals of money management.

Other TAG Programs

In addition to the above three programs and the Enhanced Technology Program, NCUA offered a Home Ownership Program, Individual Development Account Program, International Remittance Program, Officials and Staff Training Program, Mentoring Program, and Service to Underserved Areas Program in 2004.

2005 TAG Programs

In 2005, there will be five specific grant initiatives made available to low-income designated credit unions, entitled as follows: Urgent Needs Grant, Student Internship Initiative, Volunteer Income Tax Assistance (VITA) Initiative, Building Internal Capacity (Infrastructure) Initiative, and Enhancing Member Services (Outreach) Initiative.

NCUA plans to use both appropriated funds and funds derived from income from assets to cover the costs of these initiatives. These specialized TAG programs emphasize initiatives that help communities develop self-sufficiency.

Credit unions receiving funds through the Student Internship Initiative are provided an opportunity to introduce college students to credit unions and credit union operations. The purpose of the VITA Initiative is to provide financial assistance to credit unions wishing to help existing and potential members prepare their tax returns, especially those eligible for the Earned Income Tax Credit. The Building Internal Capacity Initiative grants will cover the costs of projects which improve the overall operations or financial condition of the credit union and ultimately enable the credit union to better deliver services to its members. Grant awarded under this initiative may include enhancing and improving technologies; preparing emergency and business resumption strategies or training and developing management. Credit unions receiving funds through the Enhancing Member Services Initiative are provided an opportunity to provide new or better services to existing members and those projects which will extend services to potential members and the community. Grant awarded under this initiative may include financial education, homeownership opportunities and developing marketing and outreach programs.

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.

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 CLF 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 works through agents to serve substantially all natural person credit unions. CLF agents are a private financial network of 29 state and federally chartered corporate credit unions with approximately $69.6 billion in assets. The corporate credit union network provides operational and correspondent services, investment products and advice and short-term loans to its approximately 9,324 natural person credit unions. The CLF provides this network with funds to meet abnormal savings outflows if temporary liquidity shortages or public confidence issues arise. As 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.

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 corporate credit union 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. With its knowledge of credit unions and its immediate access to the supervisory information of NCUA, the CLF plays a vital role in maintaining member and public confidence in the health of the U.S. credit union financial system.

During 2004, the CLF did not receive any requests for loans. Credit union liquidity remained strong in 2004. Although credit union member loan demand moderately exceeded share growth in 2004, share growth exceeded loan growth in the three prior years. However, the CLF remains ready and able to meet the liquidity needs of the credit union system when unusual, unexpected or extreme events occur.

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 2006 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 2004 were $214,000, below the budget limitation of $310,000. Expenses were under budget in 2004 due to a vacancy in the NCUA/CLF Board in the third and fourth quarters and travel expenses were not incurred as anticipated.

Total operating expenses for fiscal year 2005 are projected to be within our budget limitation of $309,000. In fiscal year 2005, pay and related benefits are higher than 2004 due to salary increases.

For fiscal year 2006, the CLF is requesting an administrative expense limitation of $323,000 and borrowing authority not to exceed $1,500,000,000.

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
Loans/Shares (%)

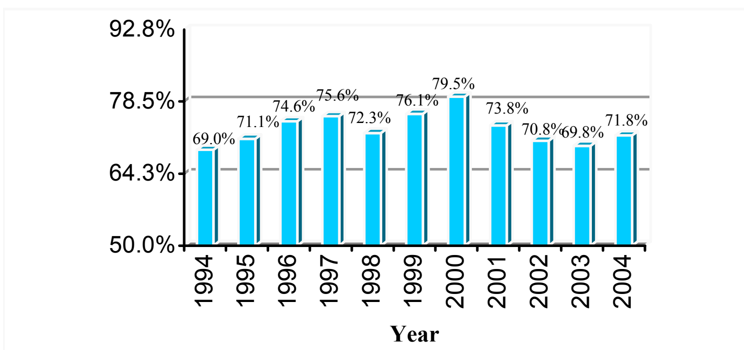

Chart 1 shows the ratio of loans to shares in all federally insured credit unions. As the ratio of loans to shares increases, the amount of funds maintained in short-term liquid investments declines. Liquidity risk has increased on average in the past decade as on-hand liquidity in federally insured credit unions gradually declined due to increased lending. Weak share growth during 2004 increased the ratio from the year-end 2003 low of 69.8% to a mid-year 2004 level of 71.8%. Liquidity risk management remains a significant obligation for credit unions.

Chart 2
Liquid Assets / Total Assets (%)

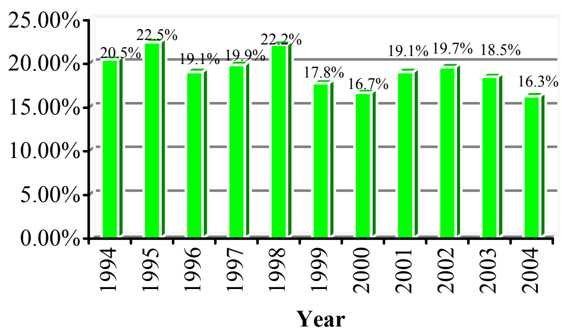

Chart 2 shows the ratio of liquid assets to total assets in all federally insured credit unions (using mid-year data for 2004). As this ratio decreases, liquidity risk and the potential need for borrowed funds conversely increases. Credit unions utilize various market sources for funding needs including 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

Summary

NCUA greatly appreciates the Subcommittee's continued support of NCUA's 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.