STATEMENT

OF

THE HONORABLE DENNIS DOLLAR

CHAIRMAN

NATIONAL CREDIT UNION ADMINISTRATION

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

U.S. HOUSE OF REPRESENTATIVES

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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 2004 funding of the Community Development Revolving Loan Fund and to request $1.5 billion in FY 2004 borrowing authority for our Central Liquidity Facility (CLF), and slightly increased CLF operational expenses for the year.

I will begin by discussing the Central Liquidity Facility.

NATIONAL CREDIT UNION ADMINISTRATION
CENTRAL LIQUIDITY FACILITY

INTRODUCTION

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 that 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 33 state and federally chartered corporate credit unions with approximately $67.1 billion in assets. The corporate credit union network provides operational and correspondent services, investment products and advice, and short-term loans to approximately 9,782 natural person credit unions members. 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 the 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. <u>The CLF is financially self-supporting and does not use government funds to support any of its administrative and operational expenses.</u>

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 confidence 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 Central Liquidity Facility 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 Central Liquidity Facility, loan demand has widely fluctuated in both volume and dollar amount.

The CLF is authorized by statute to borrow from any source up to twelve times its subscribed capital stock and surplus. Prior to fiscal year 2001, with the exception of the Y2K-transition period, Congress restricted the CLF's borrowing limit to $600 million through the annual appropriations process. For fiscal year 2001, the traditional $600 million cap was increased to $1.5 billion. The $1.5 billion borrowing limit was again approved for fiscal years 2002 and 2003. The continuation of the $1.5 cap for fiscal year 2004 will further assure that the CLF continues as a reliable, efficient backup liquidity source in times of need.

It is important to note that Central Liquidity Facility loans are not used to increase loan or investment volumes, because by statute, the proceeds from Central Liquidity Facility 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 2002 were $208,000, below the budget limitation of $309,000. Expenses were under budget in 2002 due to two factors; (1) a brief vacancy in the NCUA Board in the first quarter (2) travel expenses were not incurred as anticipated.

Total operating expenses for fiscal year 2003 are projected to be within our budget limitation of $309,000. In fiscal year 2003, pay and related benefits are higher than 2002 due to pay comparability and unknown contingencies.

For fiscal year 2004, the Central Liquidity Facility is requesting an administrative expense limitation of $310,000. This figure is slightly higher than the previous year due to a change in pay and benefits and unknown contingencies. Expenses for fiscal year 2003 are not formulated or approved by the NCUA Board until November 2003. Accordingly, fiscal year 2004 expenses are estimated with inflationary pressures, known pay adjustments, and unknown contingencies.

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.

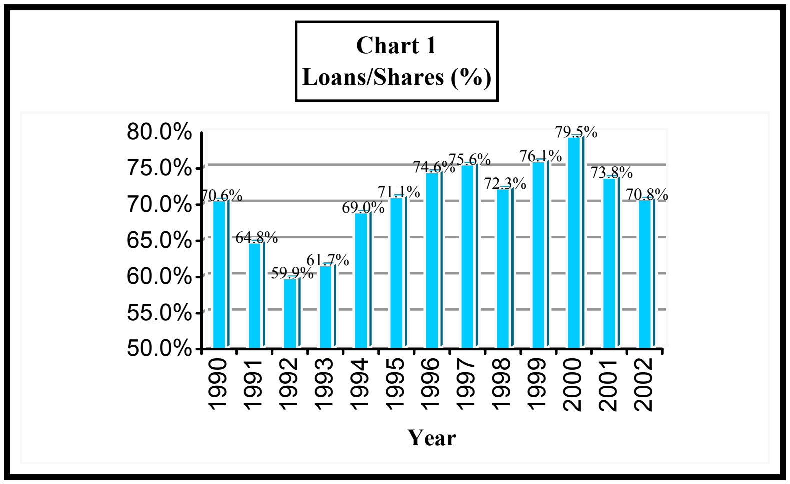

Chart 1 shows the ratio of loans to shares in all federally insured credit unions. As the ratio of loans to shares increases, the amount of funds maintained in short-term liquid investments declines. Liquidity risk has increased on average in the past decade as on-hand liquidity in federally insured credit unions gradually declined due to increased lending. A substantial inflow of shares during 2002 reduced the ratio from the Yearend 2001 high of 73.8% down to a Yearend 2002 level of 70.8%. Liquidity risk management remains a significant obligation for credit unions.

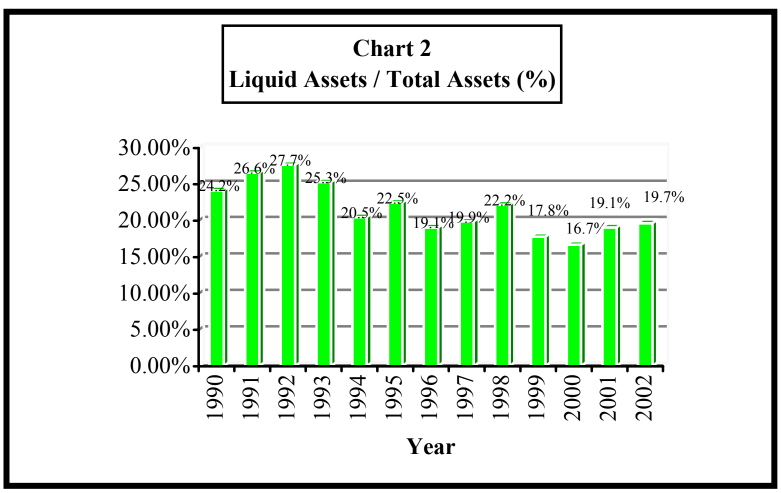

Chart 2 shows the ratio of liquid assets to total assets in all federally insured credit unions. As this ratio decreases, liquidity risk and the potential need for borrowed funds conversely increases. Credit unions utilize various market sources for funding needs including the repurchase market, correspondent 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.

Explanation of Obligations by Object Class

Personnel Compensation represents the estimated salary cost of 1.5 permanent full-time employees on duty during FY 2004.

Employees Benefits includes health benefits, government life insurance, miscellaneous cash awards, and change of station real estate differential.

Travel and Transportation represents travel expenses for CLF staff.

Communications, Utilities, and Other Rent represents estimated rent paid to the agency for office space, as well as telephone and postage expenses.

Printing and Reproduction represents costs primarily associated with the Annual Report. This expense category will also include minor costs associated with basic forms, statements, and notices sent to members.

Other Services represents payroll processing fees, training, and reimbursement to the agency for Board and staff payroll.

Supplies and Materials represents computer paper, visual aids, educational supplies, and miscellaneous supplies for the CLF, its Agents, and sponsors of training seminars.

Investments are purchases of new investments during the fiscal year.

Dividends are the cost of dividends paid to members of the Facility.

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.

We cannot foresee the exact circumstances that might necessitate a broad-based need for CLF lending but we are dedicated to the principle that we must be ready and able to fulfill that purpose; a purpose established by Congress when it created the Facility. 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 that is well adapted to meet the unique needs of its member credit unions.

NATIONAL CREDIT UNION ADMINISTRATION COMMUNITY DEVELOPMENT REVOLVING LOAN FUND

Turning to another subject, I would like to thank the Subcommittee for continuing its support of NCUA's Community Development Revolving Loan Fund (CDRLF).

Congress established the CDRLF in 1979, through an initial $6 million appropriation to assist officially designated "low-income" credit unions in their efforts to provide basic financial service and products to underserved communities. The credit unions participating in the CDRLF programs provide underserved communities with access to a variety of financial services and products which include basic savings and share draft accounts, home and car loans, and start-up entrepreneurial capital for small businesses.

Over the years, Congress has increased the number of dollars available for CDRLF loans to $13 million. For more than 13 years, NCUA has successfully administered the revolving loan program, providing more than 217 loans totaling $32.8 million. And, in 1992, the NCUA Board began funding technical assistance grants by using the interest generated from the CDRLF loans. In fiscal year 2001, Congress recognized the success of the grants by reserving certain funds specifically for this part of the CDRLF program. To date, the CDRLF technical assistance grant program has provided more than 1,000 grants totaling $2.4 million.

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.

In 2002, Access Across America proved to be a very successful initiative with over 23.5 million Americans living in CDFI designated underserved areas becoming eligible for credit union service. In many instances, residents of these underserved areas often find themselves at the mercy of higher-cost outlets such as pawnshops, check-cashing stores, and rent-to-own companies in the absence of an affordable financial alternative.

In 2002, NCUA received requests for loans in the amount of $7,007,000 and were able to approve $2,329,000. In addition, NCUA distributed $664,314 in technical assistance grants after receiving requests for $1,618,843. Unfortunately, due to limited resources, NCUA was forced to decline requests for more than $950,000 in technical assistance grants that could have been used to further the availability of much needed services and products through enhanced technology by these low-income designated credit unions, the overwhelming majority of which are smaller and challenged by the costs of advancing technology in the delivery of financial services.

As stated earlier, the technical assistance grant program had been funded primarily through its history by the earnings generated from the interest charged for the CDRLF loans. Because CDRLF loans are low interest – the current interest rate is 1 percent – the earnings generated are insufficient to meet all the technical assistance requests. NCUA accepts applications for loans and grants continuously through the year, and we expect a steady pace for requests for the remainder of 2003.

The NCUA Board constantly struggles with the need to keep loan interest rates low and the need to generate interest income in order to be able to provide additional technical assistance. The funds allocated specifically for technical assistance grants over the past two years have greatly enhanced our efforts to provide technical assistance to low-income credit unions. A survey completed in May 2001 found that low-income designated credit unions that receive CDRLF assistance demonstrated the following results:

- Used the program to make additional funds available to meet community loan demands and improve financial services to members,
- Experienced significant growth,
- Stimulated economic activities in their communities, and
- Increased funding for these institutions from other sources.

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 $1 million over last year's funding level could provide the CDRLF program even greater ability to further the growth and long-term viability of credit unions in low-income and underserved areas. Access to affordable financial services and products can provide these communities with a much needed and viable alternative to check cashers, pawn shops, and title loan companies which often charge exorbitant rates and fees for credit in many low-income areas. By providing an alternative to higher-cost lenders, credit unions play a significant and meaningful role in helping residents keep more of their money in their communities and households. The CDRLF program furthers this worthwhile public policy goal, and NCUA values the strong support this Subcommittee has provided to this program over the years. We look forward to working with you again this year to continue the CDRLF program and further enhance its effectiveness.

Finally, I would like to briefly summarize the current condition of credit unions and the National Credit Union Share Insurance Fund (NCUSIF). The U.S. credit union system continues to be in excellent health. Credit union share growth in 2002 was a significant 15.1 percent and assets increased 11.1 percent to $557 billion. Net-worth in federally insured credit unions at the end of 2002 stood at 10.7 percent and the number of problem credit unions remains at historical lows. These figures demonstrate the continued overall safety and soundness of the credit union system.

In summary, the credit union industry remains in excellent condition. NCUA greatly appreciates the Subcommittee's continued support of our 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 with verifiable needs.