



**Prepared Testimony of George Reynolds  
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Georgia Department of Banking and Finance  
On behalf of the  
National Association of State Credit Union Supervisors  
Before the Subcommittee on Financial Institutions and Consumer Credit  
United States House of Representatives  
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**NASCUS History and Purpose**

Good afternoon, Chairman Gutierrez, Ranking Member Hensarling and distinguished members of the Subcommittee on Financial Institutions and Consumer Credit. I am George Reynolds, Senior Deputy Commissioner of Georgia Department of Banking and Finance and chairman of the National Association of State Credit Union Supervisors (NASCUS)<sup>1</sup>. I appear today on behalf of NASCUS, the professional association of state credit union regulators.

The mission of NASCUS is to enhance state credit union supervision and advocate for a safe and sound state credit union system. We achieve our mission by serving as an advocate for the dual chartering system, a system that recognizes the traditional and essential role of state governments in the national framework of depository financial institutions.

Thank you for holding this important hearing today on H.R. 2351, the Credit Union Share Insurance Stabilization Act. We appreciate the opportunity to discuss the stabilization of the corporate credit union system and ways to mitigate the impact on natural person credit unions. We also address ways to guard against the repeated convergence of issues that contributed to the current situation.

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<sup>1</sup> NASCUS is the professional association of the 47 state credit union regulatory agencies that charter and supervise the nation's 3,100 state-chartered credit unions.

NASCUS acknowledges the severity of the corporate credit union situation. State regulators continue to monitor the corporate credit union system and conduct ongoing dialogue with the National Credit Union Administration (NCUA). In addition, we are committed to finding ways to mitigate the impact on natural-person credit unions. State regulators are confident that by continuing to work closely with the NCUA, we will address the problems in the corporate credit union system and ensure a vibrant healthy, safe and sound credit union system in the future.

Today, the NASCUS testimony will focus on four key points:

- The State Credit Union System and Its Relationship to Corporate Credit Union Network
- Mitigating the Impact of Corporate Losses on Natural Person Credit Unions
- Preventing the Current Situation from Happening Again
- The Future of Corporate Credit Unions

### **State Credit Union System and Its Relationship to the Corporate Credit Union Network**

State regulators play an ongoing role in the safety and soundness of the corporate credit union system. Half of the 28 corporate credit unions<sup>2</sup> in this country are state-chartered, and forty percent of the natural person credit unions are state-chartered. Natural person credit unions can belong to any corporate credit union, regardless of their charter, and use their services. Additionally, retail corporate credit unions invest capital and obtain services from the wholesale corporate credit union, which is federally chartered.

State regulators partner with the federal regulator to ensure appropriate oversight of natural person credit unions and the 14 state-chartered retail corporate credit unions. Cooperation and transparency are crucial in the relationship between state and federal credit union regulators to ensure adequate oversight and examination of the entire credit union system, including corporate credit unions.

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<sup>2</sup> There are 27 retail corporate credit unions, which provide investment, liquidity and payment system services to credit unions and one federal wholesale corporate that acts as a liquidity and payment systems provider to the corporate system and indirectly to consumer credit unions.

The corporate credit union system is unique: while belonging to a Corporate Credit Union Network (Network), each corporate is an individual entity. The “pre-network” concept of a corporate credit union, sometimes referred to as a central credit union, dates back to the 1930s, with the modern Network taking form in the 1970s. The Network was developed by natural person credit unions to provide correspondent services for credit unions.

The Network has grown and today, corporate credit unions provide credit unions with payment and clearing services, access to money transfer services such as wire facilities and automated clearinghouse transactions, and investment services. In addition, the Network serves as an important source of liquidity for credit unions and as agents on behalf of NCUA’s Central Liquidity Facility (CLF) in connection with loans funded by the CLF. Corporate credit unions also provide operational and educational services to the credit union system.

### **Mitigating the Impact of Corporate Losses on Natural Person Credit Unions: Legislative Solutions**

The affect of the corporate stabilization plan has cascaded downward and is affecting otherwise healthy, natural person credit union balance sheets.

NCUA is using the NCUSIF to stabilize the corporate credit union system. The cost of using the NCUSIF is impacting natural personal credit unions in several ways. This action impairs their 1 percent capital deposit with the NCUSIF. Additionally, natural person credit unions will be assessed a premium to bring the NCUSIF to its statutory limit required by law.

State regulators want to mitigate the impact of losses on state-chartered, natural person credit unions, thereby protecting safety and soundness of the credit union system.

#### *Legislation*

H.R. 2351 and S. 896 would mitigate the impact of corporate credit union losses on natural person credit unions. NASCUS supports natural person credit unions having the ability to expense premium costs to the NCUSIF over an extended period of time. We believe this promotes safety and soundness for the entire credit union system and provides necessary flexibility for credit unions to best serve their members.

Both H.R. 2351 and S. 896 provide the establishment of an NCUSIF restoration plan period to recapitalize the NCUSIF’s equity ratio. This legislation contains provisions that the NCUA Board

shall establish and implement a restoration plan to rebuild the NCUSIF within eight years, and provides for a longer period if the NCUA Board determines there are extraordinary circumstances.

We support providing an extension of the restoration period to the NCUSIF as provided in H.R. 2351 and S. 896. Allowing eight years would provide the flexibility credit unions need to recapitalize the NCUSIF as well as continue to serve their members. This provision also provides parity with the Federal Deposit Insurance Act's proposed eight-year restoration authority. NASCUS urges Congress to provide parity for the NCUA with the FDIC.

H.R. 2351 and S. 896 also provide for a Temporary Corporate Credit Union Stabilization Fund, which will further mitigate the impact of the corporate stabilization on credit unions. The Stabilization Fund is set up within the U.S. Treasury. It provides the NCUA with the same powers to administer the Stabilization Fund as it currently has over the Share Insurance Fund. The purpose and duration of the fund are limited, so it will provide relief specifically for corporate stabilization.

These bills also permanently increase the borrowing authority of the NCUA, as well as the Temporary Corporate Credit Union Stabilization Fund, to \$6 billion in aggregate. Additionally, the bill gives NCUA emergency borrowing authority of \$30 billion.

Both H.R. 2351 and S. 896 provide critical solutions for credit unions to mitigate the impact of the dislocated credit markets. The provisions will help credit unions protect their capital and liquidity in a safe and sound manner so that they can continue to serve their member needs, thereby helping to promote economic recovery for our nation.

### **Preventing the Current Situation from Happening Again: Regulatory Solutions**

Several things can be done from a regulatory perspective to guard against the repeated confluence of factors that contributed to the current situation. Several regulatory fixes might include the following:

- Identifying contributing factors and critically analyzing regulation.

- Revisiting past regulatory assumptions regarding concentration and systemic structure.
- Developing improved oversight and regulation.
- Reaffirming the consultation and cooperation between state and federal regulators.

As part of its corporate stabilization efforts, several months ago the NCUA issued an Advance Notice of Public Rulemaking (ANPR) on restructuring the corporate credit union system. NASCUS believes the ANPR was an important opportunity for stakeholders of the corporate system to provide comments about restructuring the corporate system, concentration and systemic risk, risk management oversight and other issues related to the corporate credit unions going forward.

NASCUS and state regulators believe we must look beyond the structure of corporate credit unions. We believe that it was not a structural issue that caused the conservatorships of U.S. Central and WesCorp federal corporate credit unions. Likewise, NASCUS is not persuaded that field of membership or general board makeup of these corporate credit unions led directly to the safety and soundness issues of the corporate credit union system. The problems at these institutions centered on risk management, risk mitigation and supervisory issues.

Regulators must identify the contributing factors that resulted in material losses that led to NCUA's recapitalizing U.S. Central (the federal wholesale corporate credit union) and then the conservatorship of U.S. Central and WesCorp (the federal retail corporate credit union).

Going forward, we should determine how much of a role rating agencies and their credit ratings should play in determining confidence that regulators and the industry place in mortgage-backed securities purchased by corporate credit unions. As regulators, we must determine if there is sufficient stress testing on investments. We must also monitor risk management policies to determine if proper policies are in place. In addition, if the risk management function is outsourced, regulators must determine if there is ample oversight of the function. Moreover, we must ensure the internal staff at a corporate credit union are well versed in risk management and mitigation and understand the assumptions being made.

Regulators should focus on ensuring any credit union, natural person or corporate, has robust risk management and mitigation policies in place to balance its investment portfolios. Such

policies should include adequate reserves, requisite expertise, meaningful shock testing and valuation mechanisms, and concentration limits.

NASCUS believes state agencies and the federal regulator need to discuss the regulatory oversight that allowed concentration risks to go unchallenged. From a regulatory perspective, we must identify contributing factors and critically analyze future regulation to ensure proper policies and procedures to prevent this from happening again.

NASCUS believes there is no question that after recent events corporate credit unions must retain higher capital reserves. NCUA should work with NASCUS and state regulators to develop more comprehensive capital requirements, including risk-based capital.<sup>3</sup>

The regulatory capital program for corporate credit unions should consider an institution's status as a wholesale or retail corporate, its mix of products and services (investment, payment systems, pass through, etc.) and establish parameters of actions for state and federal regulators if capital falls below defined thresholds.

Capital is important to both the corporate credit union system and the natural person credit unions that support the corporate credit unions. NASCUS has been urging Congress, the NCUA and the credit union system to enact supplemental capital for all natural person credit unions. During the corporate stabilization process, supplemental capital may have mitigated some of the unintended consequences to net worth categories at natural person credit unions. Additionally, access to a risk-based capital system would foster safety and soundness for the entire credit union system.

#### *Access to Supplemental Capital*

Allowing natural person credit unions access to supplemental capital would protect the safety and soundness of the credit union system and provide a tool for credit unions to use when they face declining net worth or liquidity needs.

Allowing natural person credit unions access to supplemental capital would require a simple fix to the Federal Credit Union Act authorizing state and federal regulators the discretion, when appropriate, to allow credit unions to use supplemental capital.

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<sup>3</sup> It is significant that Congress specifically mandated NCUA consultation with state regulators when developing PCA for natural person credit unions. 12 U.S.C. 1790d [216] (l)(1). Public Law 105-219, Credit Union Membership Access Act (August 7, 1998) amended sections 102a(b), 109, 202(a)(6), 202(b), 202(c), 202(h), 205(b), 206(h), 206(k), and 207(a); repealed section 116; and added new sections 107A and 216.

NASCUS has studied this issue and follows several guiding principles in our quest for supplemental capital for natural person credit unions. First, a capital instrument must preserve the not-for-profit, mutual, member-owned and cooperative structure of credit unions. Next, it must preserve credit unions' tax-exempt status.<sup>4</sup> Finally, regulatory approval would be required before a credit union could access supplemental capital. We realize that supplemental capital will not be allowed for every credit union, nor would every credit union need access to supplemental capital.

Access to supplemental capital will enhance the safety and soundness of natural person credit unions and provide further stability, especially with efforts to stabilize the corporate credit union system. Further, supplemental capital will provide an additional layer of protection to the NCUSIF thereby maintaining credit unions' independence from the federal government and taxpayers.

### *Risk-Based Capital for Credit Unions*

Today, every insured depository institution, with the exception of credit unions, uses risk-based capital requirements to build and to monitor capital levels. Risk-based capital requirements enable financial institutions to better measure capital adequacy and to avoid excessive risk on their balance sheets. A risk-based capital system acknowledges the diversity and complexity between financial institutions. It requires increased capital levels for financial institutions that choose to maintain a more complex balance sheet, while reducing the burden of capital requirements for institutions holding assets with lower levels or risk. This system recognizes that a one-size-fits-all capital system does not work. It makes sense that credit unions should have access to risk-based capital; it is a practical and necessary step in addressing capital reform for credit unions.

Additionally, throughout our testimony, we have detailed the relationship between natural person credit unions and corporate credit unions. The complex relationship suggests the importance of transparency and cooperation between the NCUA and state regulators in the examination and supervision of corporate credit unions. State regulators need continued access to information to regulate corporate credit union activities because of their impact on all natural person credit unions. State regulators are essential elements of proper oversight and invaluable participants in working to ensure the credit union system is safe and sound.

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<sup>4</sup> State-chartered credit unions are exempt from federal income taxes under Section 501(c)(14) of the Internal Revenue Code, which requires that a) credit union cannot access capital stock; b) they are organized/operated for mutual purposes; and without profit. The NASCUS white paper "Alternative Capital for Credit Unions ... Why Not?" addresses Section 501(c)(14).

It is important that Congress continue to recognize and to affirm the distinct roles played by state regulatory agencies and the NCUA. The relationship between state and federal credit union regulators has been successful, in part, because the Federal Credit Union Act provides a system of “consultation and cooperation” between state and federal regulators.<sup>5</sup> This system creates the appropriate balance of power between state regulatory agencies and the NCUA. The intent of Congress was that credit union regulators share information and work together and in practice, we do work together.

## **Future of Corporate Credit Unions**

As changes to the corporate credit union network are considered, it is important to recognize that each corporate credit union has its own governance, risk profile and risk management practices. Any regulatory reshaping of the Network must be carefully determined to allow any well run corporate to adapt to changes in the marketplace on its own terms. NASCUS believes the marketplace has the ability to appropriately reshape the corporate system within the regulatory framework and to determine which corporate credit unions continue as ongoing concerns.

Corporate credit unions belong to credit unions: ultimately, it will be the credit unions who decide the future of the corporate system. Regulators will provide the regulatory parameters to ensure activities are safe and sound and concentration risk is managed appropriately.

## **Conclusion**

In closing, to ensure a strong corporate credit union system and to protect state-chartered credit unions, we encourage Congress to consider the following points:

- Pass legislation to mitigate the impact of corporate credit union losses on natural person credit unions.
- Improve regulatory oversight and require more prudent risk management expertise for corporate credit unions.
- Recognize state authority and encourage transparency between state and federal credit union regulators.
- Improve capital standards for the credit union system by allowing supplemental capital for all credit unions.

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<sup>5</sup> The Consultation and Cooperation With State Credit Union Supervisors provision contained in The Federal Credit Union Act, 12 U.S. Code §1757a(e) and 12 U.S. Code §1790d(l).



Further, an important ingredient of sound regulation for credit unions is consultation and cooperation between state and federal regulators. We recommend this strong working relationship continue in the future and encourage Congress to include the “consult and cooperate” language as found in the Federal Credit Union Act in appropriate legislation going forward.

NASCUS firmly believes that by working together, state and federal credit union regulators will address the problems in the corporate credit union system and ensure a vibrant, healthy, safe and sound credit union system in the future.

NASCUS appreciates the opportunity to testify today and discuss the stabilization of the corporate credit union system and H.R. 2351, the Credit Union Share Insurance Stabilization Act. NASCUS supports this legislation to mitigate the impact of corporate stabilization efforts on natural person credit unions and to guard against the repeated factors contributing to the current situation.

We welcome questions from Subcommittee members.

Thank you.