

**TESTIMONY
OF
TOM DORETY
PRESIDENT AND CHIEF EXECUTIVE OFFICER
SUNCOAST SCHOOLS FEDERAL CREDIT UNION
ON BEHALF OF THE
CREDIT UNION NATIONAL ASSOCIATION
ON
THE NEED FOR CREDIT UNION REGULATORY RELIEF AND IMPROVEMENTS
BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES**

MARCH 6, 2008

Chairman Frank, Ranking Member Bachus, and members of the committee, on behalf of the Credit Union National Association (CUNA), I appreciate the opportunity to appear before you and express the association's support for H.R. 1537, the Credit Union Regulatory Improvements Act (CURIA).

CUNA is the largest credit union advocacy organization, representing over 90% of our nation's approximately 8,400 state and federal credit unions and their 90 million members. I am Tom Dorety, President and CEO of Suncoast Schools Federal Credit Union in Tampa, Florida. I also serve as Chairman of the Board of Directors of the Credit Union National Association.

The nation is experiencing a credit crunch in many sectors of the economy. It is hard not to be struck by the irony of the fact that credit unions are ready, willing and able to help alleviate the problem and promote economic growth, and yet we are inhibited from doing so by outmoded laws that protect the narrow self interest of bankers

We hope this Committee can start the work of freeing us to do all we can do for our members, the American consumers.

Credit unions are member-owned financial cooperatives established to meet the financial services needs of their members. As Congress noted when it enacted the Credit Union Membership Access Act of 1998, large or small, credit unions have five features which make them unique in the financial world:

1. Credit unions are not-for-profit financial cooperatives, and therefore do not issue stock. Instead, earnings are returned to our members in the form of higher rates on deposits, lower rates on loans, and lower fees.
2. Credit unions are democratic. One member, one vote is the rule.
3. Credit unions are governed by volunteer boards of directors elected by their membership.

4. Under federal law, credit unions may not serve the general public. People qualify for membership in a credit union by virtue of their employment, organizational affiliation or community.
5. Credit unions have a social purpose. They exist to help people, not make a profit.

In order for credit unions to continue to meet the diverse financial needs of their membership, we ask Congress to enact H.R. 1537, the Credit Union Regulatory Improvements Act.

Mr. Chairman, the last major changes to the Federal Credit Union Act were made in 1998, through the enactment of the Credit Union Membership Access Act (CUMAA). Contrary to popular belief, these changes did not provide significant regulatory relief to credit unions – in fact, the opposite is the case.

CUMAA was enacted in response to a 1998 Supreme Court ruling that invalidated a 1982 National Credit Union Administration (NCUA) policy regarding multiple-group fields of membership. The bill provided a grandfather clause for then-current credit union members, and prescribed limitations that NCUA must consider prior to authorizing new multiple-group fields of membership. The law also contained “stricter regulatory, supervisory and commercial lending requirements for credit unions.”¹

As a result of CUMAA, credit unions for the first time were subjected to a statutory capital requirement, even though credit unions were, on average, far more heavily capitalized than banks. Banks operate with regulatory capital requirements, not with inflexible statutory capital requirements imposed on credit unions.

Credit unions were also subjected, for the first time, to a statutory member business lending cap. Some have mischaracterized CUMAA as giving credit unions authority to make member business loans. In fact, the law for the first time constrained business lending by credit unions. Business lending was done by many credit unions from their earliest days in the United States.

And CUMAA included language intended to clarify that all federal credit unions may apply to NCUA to add underserved areas to their field of membership. But the wording was challenged in court by banking trade groups, forcing NCUA to discontinue underserved area expansions for credit unions that would like to reach potential members who are not being served adequately.

Professor William Jackson, then of the University of North Carolina and now at the University of Alabama, noted in a 2003 study that “CUMAA imposed more limitations on credit union operations than it lifted.”² Further, he states that the wave of deregulation of depository institutions of the last two decades was not applied to credit unions.³ It is also noteworthy that

¹ Congressional Research Service. “Credit Union Membership Access Act: Background and Issues,” January 5, 2001. p. 1.

² William EE. Jackson, III. “The Future of Credit Unions: Public Policy Issues,” Filene Research Institute, 2003. p 67.

³ Ibid., p 67.

the Treasury Department found in a 2001 study that “In general, federal credit unions have more limited powers than national banks and federal savings associations.”⁴

These new restrictions on credit unions have not been revisited by Congress since enactment, ten years ago. Given the time that has elapsed since the enactment of CUMAA, it is appropriate for Congress to reconsider the application of these statutory requirements.

CUNA asks Congress to provide regulatory relief in these areas. We also ask Congress to make amendments to some other sections of the Federal Credit Union Act to eliminate some regulatory burdens that were not addressed in 1998.

Member Business Lending

Credit unions support the provisions of H.R. 1537 which would increase the current limit on credit union member business loans (MBLs) from 12.25% to 20% of total assets, and permit the NCUA to increase the threshold for defining a MBL from \$50,000 to \$100,000. The bill would also allow, at the discretion of the NCUA Board, credit unions that fall below the net worth requirements for being “well capitalized” to make new business loans. This is especially important for adequately capitalized credit unions that have well-managed business lending programs.

Beyond what is currently in H.R. 1537, we hope that Congress also will consider eliminating the statutory business lending cap entirely, and provide NCUA with authority to permit a CU to engage in business lending above 20% of assets if safety and soundness considerations are met. If that broader approach is not approved, as an alternative, CUNA asks Congress to consider exempting MBLs made in underserved areas from the business lending cap, as proposed in H.R. 5519.

The current 12.25% member business lending cap is overly restrictive and undermines public policy to support America’s small businesses. It does not take into consideration the additional capital credit unions typically hold in excess of the statutory requirement. Credit unions on average hold nearly 12% of their capital in reserve, even though 7% is the level required to be considered well capitalized. In fact, if the 1.75 multiplier was applied against the average 11.6% net worth held by credit unions today, the figure would exceed the 20% of assets MBL cap in H.R. 1537.

Quite frankly, for many credit unions, the current 12.25% MBL limit effectively bars entry into the business lending arena. Startup costs and requirements, including the need to hire experienced lenders, exceed the ability many credit unions with small portfolios to cover these costs. Expanding the limit on credit union member business lending would allow more credit unions to generate the level of income needed to support compliance with NCUA’s regulatory requirements and would expand business lending access to many credit union members, thus helping local communities and the economy.

⁴ United States Department of the Treasury. “Comparing Credit Unions with Other Depository Institutions.” January, 2001. p. 19.

Banking trade groups have argued that Congress should not increase the credit union member business lending limits because this type of lending is not what credit unions have historically done. This is false. Credit unions have been offering their members business loans since their inception nearly 100 years ago.

Banking trade groups also argue that credit union member business lending is a competitive threat to the bank and thrift commercial lending. If this is true, their members certainly do not think so. A recent survey by the American Bankers Association (ABA) of its own members shows that only 2% of their member banks view credit unions as their chief lending competition.⁵

Moreover, the composition of the business lending market does not suggest that credit unions are currently in a position to threaten the banking industry's dominance in the commercial lending market. At mid-year 2007, 2,026 of the 8,247 credit unions (25%) in the United States had outstanding business loans. The average size of credit union MBLs granted in 2007 was \$181,000. Nationally, credit union member business loans totaled \$28 billion, compared to \$3.1 trillion at banking institutions. That's right: for every \$100 of business loans made by banks and credit unions, credit unions total less than a dollar, or a mere 89 cents of that \$100.

Over the years, credit unions' mission has been to meet the financial services needs of their members. Credit unions throughout the country have a good story to tell on how their member business lending programs have helped members who have been denied business loans from banks.

Let me provide you with several personal examples to show you how the business loans made by Suncoast Schools Federal Credit Union have helped business owners who otherwise would have had a very difficult time securing affordable commercial credit.

About a year ago, we helped a member who owns a small commercial trucking firm looking to update one of its trucks. The owner's Beacon score was significantly below our threshold of 660. Most financial institutions would have automatically declined the request due to the Beacon score, forcing the member to borrow from a finance company type organization at a significantly higher interest rate. We took the extra time to confirm that all of the negative trade lines on the member's credit report had been paid in full. Furthermore, we obtained copies of the trucking contracts that the member had to haul for Wal-mart which confirmed the stability of the borrower's cash flow. We priced the loan at 9% which was roughly 4% lower than the rates available from a finance company. The member has repaid the loan monthly according to all the contract terms.

Nearly two years ago, we helped another member who owns a florist shop. She had financed the relocation and growth of her business on her personal credit cards. Even though her Beacon score exceeded our threshold, the debt service resulting from the balances on these personal credit cards adversely impacted the member's ability to qualify for a commercial loan elsewhere. We took the time to perform a site visit to the member's shop, evaluated the business potential due to the shop's proximity to the local hospital (which was in the process of expanding its

⁵ American Bankers Journal. "Community Bank Competitiveness Survey," March 2008.

cardiac care unit), and then carefully analyzed the company's projected cash flow once the debt consolidation took place. We were able to approve a \$170,000 commercial mortgage at 8.25%. The monthly cash flow savings to the member from this consolidating refinance equaled \$1,413. This member is also current on her all her payments.

But we are not just helping members who would have difficulty being served by local banks. We are also helping our members save considerable amounts of money.

Another member operates a small trucking company and needed a place to store their trucks. They located and purchased a small parcel of ground in a semi-industrial section of Tampa. Due to the size of the property and relatively small dollar amount of the loan (\$67,500), they were only able to obtain financing at 12.5%. The member approached Suncoast and we were able to provide mortgage financing at an interest rate of 8.25%. The savings in interest during the first five years of this loan term will amount to over \$14,000.

Consider two additional examples from North Carolina. In one case, owners of a pizzeria in Raleigh were forced into bankruptcy by their first franchise company, but they paid all of their debts anyway. They opened a new store in Henderson, North Carolina, but when they tried to expand, the banks in the area would not look past the bankruptcy. Coastal Federal Credit Union helped them – and they now have two locations and 30 employees.

The second case is that of a portrait studio owner who was turned away from every bank she approached when she sought a start-up loan. The banks told her that the loan she was seeking was too small. Coastal FCU made the loan, and she has now been in business for three years.

Unfortunately, Coastal FCU is one of those credit unions that have done so much to help its business-owning members that it is now approaching its member business lending cap. It makes quality business loans to their members. It has no delinquencies on their books. It has never had a business loan go bad. Yet, located in a state with a large banking presence, many of Coastal FCU borrowers have been turned away from banks. This is a travesty in light of our current economic situation and illustrates the void in business lending that can be filled by credit unions.

The Small Business Administration concurs: Credit unions that engage in member business lending often fulfill borrowing needs that not being met by other institutions. Addressing CUNA's Government Affairs Conference in February 2007, SBA Administrator Steven Preston said, "I encourage member business lending. Small businesses need a partner they can count on and credit unions often are reaching people that others have left behind."

According to a 2001 Department of Treasury study, credit union member business lending is generally less risky than commercial lending by banks or thrifts and presents little risk to the credit union share insurance fund.

“While commercial loans are generally riskier than consumer loans, credit union member business lending tends to be less risky than business lending by banks and thrifts. A simple stress test of the effect of credit union failures precipitated by member business lending on the National Credit Union Share Insurance Fund indicates that the insurance

fund would remain solvent if every member business loan defaulted at a loss of 100 percent, assuming no other losses at those credit unions.”⁶

FDIC and NCUA Call Report data support that claim. From 1998 to September 2007, the average net charge-off rate on business loans at credit unions was only 0.08% of loans outstanding compared to an average of 0.70% for commercial loans at banks.

The Small Business Administration’s Office of Economic Research notes that bank consolidation has led to a decrease in access to capital for the nation’s small businesses.⁷ And, a recent Wall Street Journal Article warns:

“A widening credit crunch doesn’t bode well for the economy. Start-ups and small businesses are generally the companies that create jobs in a downturn. But tighter credit could curb business investment and hiring as companies recalculate the cost of investing in new machines, marketing campaigns or ventures. This could magnify the current slowdown in growth.”⁸

Member-owned credit unions are a natural choice for business owners faced with bank consolidation- and credit crunch-related pressures. Credit unions are, by definition, locally owned and controlled with local decision-making and a strong service-oriented philosophy.

Credit union member business lending is targeted towards middle and lower income individuals. The Treasury Department study estimate that 45% of credit union member business loans went to households with incomes less than \$50,000.⁹ The Treasury report also confirms that credit unions that engage in business lending do so in a safe and sound manner, with extremely low loan loss rates.¹⁰ While credit union member business lending is a negligible share of the overall commercial lending market, in segments of our economy that need help the most, additional credit union member business lending will benefit the economy significantly.

Prompt Corrective Action

Credit unions seek modernization of the statutory capital requirements Congress enacted in 1998. The Federal Credit Union Act presently specifies the amount of capital credit unions must hold in order to protect their safety and soundness and the solvency of the National Credit Union Share Insurance Fund (“Insurance Fund”), administered by NCUA with insurance coverage comparable to that provided by the Federal Deposit Insurance Corporation to banks.

By law – not regulation, as for other insured depositories – credit unions must maintain a 7% net worth or leverage ratio in order to be considered “well capitalized.” In comparison, the current leverage ratio for banks to be well capitalized is only 5%. This capital requirement for credit

⁶ United States Department of Treasury, “Credit Union Member Business Lending.” January 2001. 35.

⁷ Small Business Administration. “Bank Consolidation and Small Business Lending: A Review of Recent Research,” Office of Economic Research. March 2005. 3.

⁸ “Credit Scare Spreads in U.S., Abroad,” *Wall Street Journal*. January 22, 2008. A1.

⁹ United States Department of Treasury. 27.

¹⁰ *Ibid.* 37.

unions is inefficient in that it unnecessarily retards member service and growth, and it does not appropriately account for risk of a credit union's assets.

Congress should consider the removal of all of the prompt corrective action (PCA) stipulations from the statute and leave it to regulatory determination, similar to the system under which the banking industry operates. In lieu of that approach, CUNA supports the capital reform provisions in H.R. 1537.

Title I of H.R. 1537 would modernize the credit union system of PCA by establishing a two-tier system for federally insured credit unions involving complementary leverage and risk-based minimum capital requirements. Under the proposed system, a well capitalized credit union would have to maintain a leverage ratio of 5.25% and a minimum risk-based ratio of 10%. Because the definition of net worth would be modified to exclude credit unions' 1% deposits in the share insurance fund, the GAAP leverage requirement would actually be in the neighborhood of 6%, still a full point higher than the comparable bank requirement. The risk-based requirement would adopt a Basel-type system that would account for risk much more accurately than the current credit union PCA structure.

Although the credit union capital requirements in H.R. 1537 would be more strenuous than those currently in effect for banks, there is substantial evidence that credit union capital needs are actually lower than they are at banks. Because of their cooperative structure, credit unions have less systematic incentives to take on risk to maximize profits. This strong structural bias to risk aversion helps to explain why credit unions currently hold capital in excess of the amount necessary to be well capitalized. As a result, the reform of PCA would lead to only modest decreases in credit union capital ratios.

In a 1996 article in the Journal of Banking and Finance entitled, *The Federal Deposit Insurance System that Didn't Put a Bite on U.S. Taxpayers*, Edward Kane and Robert Hendershott note: "differences in incentive structure constrain the attractiveness of interest-rate speculation and other risk taking opportunities to managers and regulators of credit unions." More recently, in the 2001 study *Differences in Bank and Credit Union Capital Needs*, David Smith of Pepperdine University and Stephen Woodbury of Michigan State University report that, "Because credit union loan portfolios are substantially less sensitive to macroeconomic fluctuations than bank loan portfolios, credit unions need less capital to protect themselves from loan losses."

Credit unions have been affected by the recent economic conditions (although not for the same reasons as banks). However, rather than being the causes of financial problems, credit unions have suffered collateral damage from elsewhere in the financial sector.

Credit unions have made virtually none of the toxic subprime loans that some other lenders have. Regrettably, some credit union members took out these loans from other lenders. And many credit unions operate in markets with falling home prices. As a result, credit unions have experienced some increases in delinquency and loan losses. We expect average loan losses in 2008 to rise to 0.75% of loans outstanding from 0.5% in 2007. These losses pale in comparison to the 15% to 20% losses expected on subprime loans. Considering just mortgage loans, the national average delinquency rate on mortgage loans from all lenders has risen from 2.1% at the

beginning of 2006 to 3.9% today. For credit unions, the comparable statistic has increased from 0.7% to about 1.5%. As a result of their conservative financial management, we expect that credit unions will come through the current economic slowdown in a very strong condition.

The capital reform proposed by H.R. 1537, supported by the National Credit Union Administration, will reinforce and strengthen the regulatory incentive for credit unions to remain very safe and sound.¹¹ It would also allow credit unions to do even more to serve their members.

Underserved Areas

The third major provision of H.R. 1537 clarifies the intent of Congress that all federally chartered credit unions should be allowed to apply to the NCUA to add underserved areas to their field of membership. CUNA supports this provision and believes that this provision would fulfill the Congressional intent of CUMAA.

This provision will enhance the ability of credit unions to assist underserved communities with their economic revitalization efforts by providing all federal credit unions with an equal opportunity to expand services to individuals and groups working or residing in areas that meet the income, unemployment and other distress criteria identified by the Treasury Department. The bill's definition of a qualified underserved area includes areas currently eligible as "investment areas" under the Treasury Department's Community Development Financial Institutions (CDFI) program, as well as census tracts qualifying as "low income areas" under the New Markets Tax Credit targeting formula adopted by Congress in 2000.

As Representative Kanjorski clarified during the consideration of the Senate amendments to H.R. 1151 in 1998:

Another important provision in this bill explicitly authorizes multiple group credit unions to include underserved areas in their field of membership. This is a provision which incorporates the principles of legislation originally introduced by the gentleman from Texas (Mr. Frost).

Providing service to underserved areas, which are defined in the bill and by NCUA regulations, helps all credit unions fulfill their mandate to serve persons of small means. It is integral to the spirit of the credit union movement.

By including explicit language authorizing multiple group credit unions to include underserved areas in their field of membership, we are not in any way restricting the ability of the National Credit Union Administration to allow community and single group credit unions to include underserved areas in their fields of membership.

Precluding community credit unions from serving underserved areas would be contrary to their reason for existence.

¹¹ http://www.ncua.gov/news/press_releases/2007/MA07-0621-2.htm

Similarly, precluding single group credit unions from serving underserved areas makes no sense and would only add paperwork and regulatory burden for both credit unions and the NCUA since virtually any single group credit union can apply to add an additional group to its field of membership, thus becoming a multiple group credit union. Single group credit unions are a subset of multiple group credit unions and it was never intended, and would make no sense, for multiple group credit unions to have this authority, and for single group credit unions not to have similar authority.¹²

The language in CUMAA related to underserved areas was included to codify and encourage use of an existing (1994) NCUA policy permitting federal credit unions “of any type” to include low-income groups within their field of membership as part of the credit unions’ broader mission “to ensure that adequate credit union services are provided to all persons in the community.”

Despite the clarification included in the Congressional deliberation, the ABA sued NCUA in 2005 for authorizing single sponsor and community chartered credit unions to add underserved areas to their field of membership. Within days of a November 2005 hearing before the House Ways and Means Committee during which the ABA complained that credit unions do not do enough to serve people of modest means, the same group took credit unions to court to prevent them from doing so.

In June 2006, as the result of the ABA lawsuit, the NCUA was forced to revise its field of membership regulations to limit the addition of financially underserved areas only to credit unions with multiple common-bond charters. The action effectively prohibits more than half of federal credit unions from extending credit union services to lower-income areas and groups that are not adequately served by other traditional financial institutions.

Mr. Chairman, as you know, these areas are called “underserved” with good reason. Banks make a business decision not to operate in or provide services to underserved areas. Credit unions seek to serve the underserved. It is not just part of our Congressionally-mandated mission. It is part of our core mission.

My credit union added, and opened a branch in, an underserved area in Immokalee, Florida in March 2002 -- nearly six years ago. The median income in this county is \$24,315. We currently have 6,652 members, \$24.6 million in deposits, \$62.8 million in loans from this area. This has been a successful branch for our members. We are providing quality financial services to an area that otherwise would not have it.

Those living in underserved areas lack access to mainstream financial services. For millions of lower income families, this means their only financial services alternative is to use the high cost financial products provided by check cashers, payday lenders, finance companies and pawn shops.

¹² United States House of Representatives. Consideration of H.R. 1151, the Credit Union Membership Access Act. 105th Congress. August 4, 1998. H7044.

In some areas, the dearth of mainstream financial service has led to violence against shop owners. When criminals know that small business owners cannot make deposits at a bank or credit union on a regular basis, they prey on those business owners.

The mountain community of Idaho City, Idaho, has been seeking a financial institution for several years after the only bank closed its branch because it was not profitable. The Idaho Credit Union League met with community leaders in Idaho City and identified a credit union – Les Bois Federal Credit Union -- willing to locate a branch there. The credit union put together a business plan and was ready to open there. The only thing that stood in their way was approval by NCUA. Les Bois FCU is a community chartered credit union. Because of the ABA lawsuit against NCUA, and the subsequent forced moratorium on underserved area expansions for community chartered credit unions, Les Bois FCU was not permitted to open a branch and serve these unbanked people.

Store owners in Idaho City have no place to deposit their daily receipts. The owner of Trudy's Restaurant must keep hers in a safe at her home. The law enforcement in this part of Idaho consists of a small county sheriff's department that covers a very large county. Trudy has been robbed five times since the bank closed. She is in the unenviable situation of having to risk her life to simply operate a small business in a mountain community. Because of the bankers' unwillingness to operate in her community, and their trade group's litigation to prevent credit unions from operating in areas like this, she risks her life and her business every time she closes her shop. Congress can and should fix this.

When NCUA was approving underserved area expansions, credit unions responded to the need for service. Between 2001 and 2006, 220 single-group and community charter credit unions received approval from NCUA to serve individuals and businesses in more than 800 areas. A survey of these credit unions conducted by CUNA in March 2006 estimated that 1.6 million members had been served in these underserved areas at a total investment to the credit unions of \$1.3 billion. There are an estimated 315 credit union branch offices within underserved areas, and additional 153 branches located near these areas. Additionally, 142 shared service centers reside within or near underserved areas. As of year-end 2005, credit union members residing in underserved areas had an estimated \$4 billion in outstanding loans and \$3.4 billion in savings deposits with their credit unions.

Mr. Chairman, it is unfortunate that credit unions must come to Congress to ask for this clarification because we believe that we are asking Congress to enact provisions which were thought by the Congressional architects of H.R. 1151 to have been enacted ten years ago. We believe Congress authorized all federally chartered credit unions to serve underserved areas in 1998. This is what many credit unions would like to do. This is what many Americans need in order to have mainstream financial services.

Other Legislative Changes

Mr. Chairman, H.R. 1537 also contains several additional changes to the Federal Credit Union Act, many of which have been passed by the House of Representatives on at least one occasion. These provisions were also subject of hearings before the House Financial Services Committee

on March 27, 2003, July 20, 2004, May 19, 2005, June 9, 2005, September 22, 2005, and October 18, 2005. In lieu of additional discussion today, I have included a summary of all the CURIA provisions at the end of this written testimony.

Credit unions also support language included in H.R. 5519 that would permit federally chartered credit unions to offer payday lending alternative services to persons within their field of membership. This provision is modeled after a similar provision permitting federal credit unions to offer remittance and check cashing services to person within their field of membership, enacted into law as part of the Financial Services Regulatory Relief Act of 2006 (PL 109-351).

Conclusion

Mr. Chairman, thank you very much for the opportunity to discuss these critically needed regulatory improvements for credit unions. I am happy to answer any questions you or the Members of the Committee may have.

**Section-by-Section Summary of H.R. 1537
The Credit Union Regulatory Improvements Act**

Title I: Capital Reform

Section 101. Amendments to Net Worth Categories

The Federal Credit Union Act presently specifies the amount of capital credit unions must hold in order to protect their safety and soundness and the solvency of the National Credit Union Share Insurance Fund (“Insurance Fund”). Many experts, however, have noted that this capital allocation system is inefficient and does not appropriately account for risk. Section 101 incorporates recent recommendations of the National Credit Union Administration (NCUA) to provide a two-tier capital and Prompt Corrective Action (PCA) system for federally insured credit unions involving complementary leverage and risk-based minimum capital requirements. Under the proposed system, a well capitalized credit union must maintain a leverage net worth ratio of 5.25% and a minimum risk-based ratio of 10%. This exceeds the 5% capital requirement for FDIC-insured banks, even more so when a credit unions capital deposit in the insurance fund is added.

Section 102. Amendments Relating to Risk-Based Net Worth Categories

Currently, only federally insured credit unions that are considered “complex” must meet a risk-based net worth requirement under the Federal Credit Union Act. Section 102 would instead require all credit unions to meet a risk-based net worth requirement, and it directs the Board to take into account comparable risk standards for FDIC-insured institutions when designing the risk-based requirements appropriate to credit unions.

Section 103. Treatment Based on Other Criteria

Section 103 would permit the NCUA Board to delegate to regional directors the authority to lower by one level a credit union’s net worth category for reasons related to interest-rate risk not captured in the risk-based ratios, with any regional action subject to Board review.

Section 104. Definitions Related to Net Worth

Net worth, for purposes of prompt corrective action, is currently defined as a credit union’s retained earnings balance under generally accepted accounting principles. Section 104 would make three important revisions to this definition. First, it clarifies that credit union net worth ratios must be calculated without a credit union’s capital deposit with the Insurance Fund. Second, it provides a new definition for “risk-based net worth ratio” as the ratio of the net worth of the credit union to the risk assets of the credit union. Third, it would permit the NCUA to impose additional limitations on the secondary capital accounts used to determine net worth for low-income credit unions where necessary to address safety and soundness concerns.

Section 105. Amendments Relating to Net Worth Restoration Plans

Section 105 would provide the NCUA Board with authority to waive temporarily the requirement to implement a net worth restoration plan for a credit union that becomes undercapitalized due to disruption of its operations by a natural disaster or a terrorist act. It would further permit the Board to require any credit union that is no longer well capitalized to

implement a net worth restoration plan if it determines the loss of capital is due to safety and soundness concerns and those concerns remain unresolved by the credit union.

This section would also modify the required actions of the Board in the case of critically undercapitalized credit unions in several ways. First, it would authorize the Board to issue an order to a critically undercapitalized credit union. Second, the timing of the period before appointment of a liquidating agent could be shortened. Third, the section would clarify the coordination requirement with state officials in the case of state-chartered credit unions.

Title II: Economic Growth

Section 201. Limits on Member Business Loans

Section 201 would increase the current arbitrary asset limit on credit union member business loans from the lesser of 1.75 times actual net worth or 1.75 percent times net worth for a well-capitalized credit union (12.25% of total assets) to a flat limit of 20% of the total assets of a credit union. This update would facilitate added member business lending without jeopardizing safety and soundness at participating credit unions, as the 20% cap would still be equal to or stricter than business lending caps imposed on other depository institutions.

Section 202. Definition of Member Business Loans

Section 202 would give NCUA the authority to exclude loans of \$100,000 or less as *de minimus*, rather than the current \$50,000 exclusion, from calculation of the 20% cap on member business loans. This change would thus facilitate the ability of credit unions to make additional loans and encourage them to make very small business loans. It also builds upon the findings in a 2001 study by the Treasury Department that found that "...credit union member business loans share many characteristics of consumer loans" and that "...these loans are generally smaller and fully collateralized, and borrower risk profiles are more easily determined."¹³

Section 203. Restrictions on Member Business Loans

Section 203 would modify language in the Federal Credit Union Act that currently prohibits a credit union from making any new member business loans if its net worth falls below 6 percent. This change would permit the NCUA to determine if such a policy is appropriate and to oversee all member business loans granted by an undercapitalized institution.

Section 204. Member business loan exclusion for loans to non-profit religious organizations

To facilitate the ability of credit unions to support the community development activities of non-profit religious institutions, Section 204 would exclude loans or loan participations by federal credit unions to non-profit religious organizations from the member business loan limits contained in the Federal Credit Union Act.

Section 205. Credit unions authorized to lease space in buildings in underserved areas

In order to enhance the ability of credit unions to assist underserved communities with their economic revitalization efforts, Section 205 would allow a federal credit union to lease space in a building or on property on which it maintains a physical presence in an underserved area to other parties on a more permanent basis. It would also permit a federal credit union to

¹³ United States Department of Treasury. 36.

acquire, construct, or refurbish a building in an underserved community, then lease out excess space in that building.

Section 206. Amendments relating to credit union service to underserved areas

Section 206 would revise a provision of the 1998 Credit Union Membership Access Act that has been incorrectly interpreted as permitting only federal credit unions with multiple common bond charters to expand services to individuals and groups living or working in areas of high unemployment and below median incomes that typically are underserved by other depository institutions. The change would reestablish prior NCUA policy of permitting all federal credit unions, regardless of charter type, to expand services to eligible communities that the Treasury Department determines meet income, unemployment and other distress criteria.

Section 207. Underserved areas defined

Section 207 would expand the criteria for determining whether a community or rural area qualifies as an underserved area. The definition of a qualified underserved area includes not only areas currently eligible as "investment areas" under the Treasury Department's Community Development Financial Institutions (CDFI) program, but also census tracts qualifying as "low income areas" under the New Markets Tax Credit targeting formula adopted by Congress in 2000.

Title III: Regulatory Modernization

Section 301. Investments in securities by federal credit unions

The Federal Credit Union Act presently limits the investment authority of federal credit unions to loans, government securities, deposits in other financial institutions, and certain other limited investments. Section 301 would provide additional investment authority to allow credit unions to purchase for the federal credit union's own account certain investment grade securities such as highly rated commercial paper, and asset-backed securities. The total amount of the investment securities of any one obligor or maker could not exceed 10% of the credit union's net worth and total investments could not exceed 10% of total assets.

Section 302. Authority of NCUA to establish longer maturities for certain credit union loans

The Federal Credit Union Act was amended in 2006 to allow the NCUA Board to increase the 12-year maturity limit on non-real estate secured loans to 15 years. Section 302 would further provide the Board with additional flexibility to issue regulations providing for loan terms exceeding 15 years for specific types of loans as NCUA considers appropriate (such as for educational loans).

Section 303. Increase in 1 percent investment limit in credit union service organizations

The Federal Credit Union Act authorizes federal credit unions to invest in organizations providing services to credit unions and credit union members. Currently, an individual federal credit union may invest in aggregate no more than 1% of its unimpaired capital and surplus in these organizations, commonly known as credit union service organizations (CUSOs). A federal credit union is also limited in the amount it may loan to all CUSOs to 1% of unimpaired capital and surplus. Section 303 would increase to 2% the amount a federal credit union may invest in all CUSOs and to 2% that it may lend to CUSOs. NCUA would have authority to reduce these limits for any individual federal credit union because of safety and soundness concerns.

Section 304. Voluntary mergers involving multiple common-bond credit unions

NCUA has identified ambiguous language in the 1998 Credit Union Membership Access Act as creating uncertainty for certain voluntary credit union mergers by suggesting that groups of more than 3,000 members be required to start a new credit union rather than be incorporated as a new group within a multiple common-bond credit union. Section 304 would clarify that this numerical limitation would not apply to bar groups of more than 3,000 members that are transferred between two existing credit unions as part of a voluntary merger.

Section 305. Conversions involving certain credit unions to a community charter

In cases when a single or multiple common-bond federal credit union converts to a community credit union charter, there may be groups within the credit union's existing membership that are located outside the new community charter's geographic boundaries, but which desire to remain part of the credit union and can be adequately served by the credit union. Section 305 would require NCUA to establish the criteria whereby it may determine that a member group or other portion of a credit union's existing membership, located outside of the community, can be satisfactorily served and remain within the credit union's field of membership with the new members of group added.

Section 306. Credit union governance

Section 306 would provide federal credit union boards the flexibility to expel a member, based on just cause, who is disruptive to the operations of the credit union, including harassing personnel and creating safety concerns, without the need for a two-thirds vote of the membership present at a special meeting as required by current law. The section would also permit a federal credit union board to limit the length of service of their directors to ensure broader representation from the membership.

Section 307. Providing the National Credit Union Administration with greater flexibility in responding to market conditions

Currently, the NCUA Board may raise the usury interest rate ceiling on loans by federal credit unions above 15% whenever it determines that money market rates have increased over the preceding six-month period and prevailing interest rates threaten the safety and soundness of individual credit unions. Section 307 would give the Board greater flexibility to make such determinations based either on sustained increases in money market interest rates or prevailing market interest rate levels. The change would allow NCUA to address an on-going high interest rate environment.

Section 308. Credit union conversion voting requirements

Section 308 includes several changes to current law pertaining to credit union conversions to mutual thrift institutions. It would increase the minimum member participation requirement in any vote to approve a conversion to 30% of the credit union's membership. It would require the board of directors of a credit union considering conversion to hold a general membership meeting one month prior to sending out any notices about a conversion vote that contain a voting ballot. It would also prohibit use of raffles, contest, or any other promotions to encourage member voting in a conversion vote.

Section 309. Exemption from pre-merger notification requirement of the Clayton Act

Section 309 would give federally insured credit unions the same exemption that banks and thrift institutions already have from pre-merger notification requirements and fees for purposes of antitrust review by the Federal Trade Commission under the Clayton Act.