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 Financial Services Committee
United States House of Representatives
March 6, 2008

NASCUS History and Purpose

Good morning, Chairman Frank, and distinguished members of the House of Representatives Committee on Financial Services. 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)[1]. 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 government in the national system of depository financial institutions.

NASCUS believes H.R. 1537, the Credit Union Regulatory Improvements Act of 2007, commonly called CURIA, is important legislation. It provides regulatory modernization that enhances safety and soundness and offers additional ways for credit unions to meet the needs of consumer members. We are pleased to have this opportunity to share our state supervisory perspective regarding regulatory relief and to address the provisions in H.R. 1537 that apply to state-chartered credit unions. This testimony addresses those provisions that impact state-chartered credit unions. We appreciate your willingness to listen and understand the regulatory relief needs of the state credit union system.

As a professional state regulators association, NASCUS reviewed CURIA from a regulatory viewpoint. In determining our position on a particular provision, NASCUS considered the effect on credit union safety and soundness and state law.

[1] NASCUS is the professional association of the 48 state and territorial credit union regulatory agencies that charter and supervise the nation's 3,300 state-chartered credit unions.

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NASCUS Priorities for Regulatory Relief

NASCUS priorities for regulatory relief focus on reforms that strengthen the state system of credit union supervision and enhance the capabilities of state-chartered credit unions. The ultimate goal is to meet the financial needs of consumer members while assuring that the state system is operating in a safe and sound manner.

In this testimony, I address provisions in CURIA, as well as additional regulatory relief priorities that are vital to the future growth and safety and soundness of state-chartered credit unions. The CURIA provisions include the following:

- Proposed comprehensive capital reform for credit unions.
- Expanding the member business lending cap to 20 percent of total assets of a credit union increasing the availability of loans for consumer members.
- Amending the definition of business loans subject to the current cap of $50,000 to $100,000.
- Changes to the process for conversion of a state-chartered credit union.
- Providing an exemption from pre-merger notification requirements of the Clayton Act for credit unions.

Thinking beyond CURIA, there are several provisions from a state regulatory perspective that I believe should be considered; these provisions include:

- Advocating further capital modernization, including alternative capital.
- Allowing all state-chartered credit unions to join the Federal Home Loan Banks (FHLBs) system.
- Providing by statute that an individual with state credit union regulatory experience be included on the National Credit Union Administration (NCUA) Board.

Title I—Capital Modernization

The provisions in Title I amend the Federal Credit Union Act (FCUA) to reduce the minimum net worth ratio requirements for credit unions. The provisions also provide risk-based capital requirements for insured credit unions comparable to those imposed by the Federal Deposit Insurance Corporation (FDIC).

NASCUS supports comprehensive credit union capital reform. Credit unions need capital reform in distinct several areas. First, credit unions need to be assessed using risk-based capital standards; and second, credit unions should have access to alternative capital. From a state regulatory perspective, capital reform that addresses these areas makes logical sense for the safety and soundness of credit unions and the members they serve.

Risk-based capital

Section 102 in CURIA, Amendments Relating to Risk-Based Net Worth Categories Requirements, expands risk-based capital options to all federally insured credit unions, not just

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complex credit unions. NASCUS has long supported that risk based capital standards are appropriate; we believe it is a sound and logical approach to capital reform for credit unions.

The support for risk-based capital is widespread; the concept is supported by the federal credit union regulator, the NCUA, and by many within the credit union industry. A risk-based capital structure has proved successful for other financial institutions in this country for nearly 20 years.

The risk-based capital system of Basel I was introduced in the financial industry in 1988. The two fundamental objectives of Basel I were (1) to strengthen the soundness and stability of the international banking system; and (2) to be fair and have a high degree of consistency in its application.

Today, insured depository institutions, with the exception of credit unions, utilize risk-based capital to build and monitor capital levels. Risk-based capital enables financial institutions to measure capital adequacy and to avoid additional risk on their balance sheets. It is a system that acknowledges diversity and complexity in financial institutions. The structure provides for increased capital levels for financial institutions that choose to maintain a more complex balance sheet, while reducing the burden of capital requirements for institutions with less complex assets. This system recognizes that a one-size-fits-all capital system does not work.

The financial community continues to refine risk-based capital and acknowledges that it is a logical and important part of monitoring capital. Credit unions are the only insured depository institution currently not subject to risk-based capital standards as it was presented in the Basel Accord of 1988. A risk-based capital structure would help credit unions monitor risks in their balance sheets. It makes logical 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.

Alternative capital

While risk-based capital is part of the solution for credit unions, more is needed to ensure comprehensive capital reform. NASCUS believes that CURIA's capital reform provisions would be enhanced by allowing a provision for the inclusion of alternative capital for all credit unions. Simply put, credit unions would benefit from alternatives that allow them to raise capital other than through retained earnings.

NASCUS supports complete capital reform and regulatory modernization. NASCUS regulators believe it makes sound economic sense for credit unions to access other forms of capital in addition to retained earnings to improve their safety and soundness. In fact, low-income and corporate credit unions already have access to alternative capital.

NASCUS is not the only voice advocating that credit unions should have access to alternative capital. There are others who support capital reform and alternative capital for credit unions. The Filene Research Institute released a study in November 2007, *Alternative Capital for U.S. Credit Unions? A Review and Extension of Evidence Regarding Public Policy Reform* authored by Robert F. Hoel, PhD, Professor Emeritus of Business, Colorado State University, and Filene Fellow in Residence. The report makes the case for expanded sources of credit union capital and concludes that it is in the public interest to permit credit unions greater access to alternative capital sources.

The Filene report unequivocally supports alternative capital for credit unions. It is one more voice in favor of allowing alternative capital for credit unions. Please find following a copy of the Filene Research Institute's study.

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While the majority of credit unions are not involved in the problems of the subprime real estate market, currently all financial institutions are affected by its negative impact in the residential mortgage market. During the next several years, more subprime mortgages are expected to reprice than we have experienced thus far in this uncertain market. There could be further dislocations in the home equity lending market, increased credit risk exposure, changes in appraisal values and a further decline in home values in some markets. As regulators, we are concerned about diminished asset quality, increased default rates, the impact on the secondary market and a borrower's ability to secure future loans.

Alternative capital would allow credit unions, as it does other financial institutions, to meet these challenges and potentially thrive in an uncertain market. It would provide a cushion for credit unions to recover from financial setbacks and it would add an extra layer of protection for the National Credit Union Share Insurance Fund (NCUSIF).

As regulators, we realize that alternative capital requires solid regulation and rigorous regulatory review to ensure that these products are properly structured, meet proper disclosure requirements and do not create any systemic risk. Before a credit union would be given access to alternative capital, it must demonstrate that it has the resources to properly manage alternative capital. We understand that additional dialogue with policy makers, the credit union industry and the NCUA will be necessary in order to reach consensus on alternative capital. But, NASCUS believes that the time for such dialogue is now, before capital requirements are acute and time sensitive.

Strong cooperation between state and federal regulators

NASCUS supports strong cooperation and consultation between state and federal credit union regulators as provided for in the Credit Union Membership Access Act (CUMAA). NASCUS believes that coordination between state and federal regulators is imperative to ensure effective capital reform.

Economic Growth—Title II

NASCUS supports revisions to member business lending (MBL). MBL changes can provide an opportunity for credit unions to better serve their members and they are not believed to be a risk to safety and soundness, provided that sound and proper underwriting and controls are maintained in the credit union.

Specifically, Section 201 of CURIA amends the section of the FCUA that addresses member business lending. NASCUS supports the proposed statutory increase on credit union member business lending to 20 percent of the total assets of a credit union.

In addition, Section 202 of the bill amends the current definition of a member business loan to allow NCUA to exempt loans of $100,000 or less. This amends the definition of business loans subject to the current cap of $50,000 to $100,000.

NASCUS further supports Section 204 of H.R. 1537, which revises member business lending restrictions in the FCUA, thus lifting the restrictions on member business lending to nonprofit religious organizations for federally insured, state-chartered credit unions.

While NASCUS supports these provisions, we recognize that they require proper regulatory oversight through the examination and supervision process. Further, credit unions must have a thorough understanding of member business lending and be diligent in their written policies, underwriting and controls for these provisions to be implemented in a safe and sound manner.

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Again, as I stated with alternative capital, I believe these provisions can be regulated without presenting undue safety and soundness concerns.

Regulatory Modifications—Title III

On conversions, CURIA outlines several new procedures on voting requirements. NASCUS supports full transparency and disclosure in the conversion process. Further, NASCUS believes that any legislation concerning conversion requirements of a state-chartered credit union should recognize state law. It is the role of state authority as established by state law to determine the proper procedure and disclosure for state-chartered credit union conversions.

The chartering of a state credit union is an issue determined by state law. Approval authority for a conversion is decided, likewise, by state law, which generally authorizes the state chartering authority to determine if a credit union may convert and the processes for a conversion. A conversion is a function of a credit union's original charter, separate from insurance oversight. Federal legislation should clearly recognize the rightful authority of states to determine chartering and conversion decisions for state-chartered credit unions.

In addition, NASCUS supports Section 309 of H.R. 1537 giving all federally insured credit unions the same exemptions as banks and thrift institutions from pre-merger notification requirements and fees of the Federal Trade Commission. In fact, we believe it should be expanded to include all state-chartered credit unions, regardless of their insurance.

Additional Regulatory Relief Priorities

NASCUS supports regulatory relief priorities beyond those found in H.R. 1537 and encourages this committee to add the appropriate provisions that allow for the needed changes.

Membership in FHLBs for all state-chartered credit unions

Currently, not all state-chartered credit unions have access to the same benefits. For example, not all state-chartered credit unions have access to the Federal Home Loan Bank (FHLB) System. We ask this committee to add a provision to CURIA allowing for membership by all state-chartered credit unions in the FHLB System.

We believe that all state-chartered credit unions should have access to the FHLB System, regardless of insurance type. All state-chartered credit unions are regulated and examined by state regulatory agencies to ensure they are operating in a safe and sound manner. Regulatory functions are a primary determinant of the safety and soundness of the credit union system.

State Regulatory Representation on the NCUA Board

A legislative provision providing for state-chartered financial institution regulatory experience on a federal financial agency regulatory board is not a new idea. A similar provision requiring state bank supervisory experience is included in the Federal Deposit Insurance Act. 12 U.S.C 1812(a). The Federal Deposit Insurance Act requires that a position be reserved on the FDIC Board of Directors for an individual with state bank supervisory experience.

We would appreciate your support for adding a provision to CURIA requiring that one NCUA Board member shall always have state credit union regulatory experience. NASCUS believes that requiring state regulatory experience for one of the NCUA Board members would provide value to the entire credit union system.

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About forty percent of credit unions are state-chartered. The majority of them have federal insurance provided by the NCUSIF. We believe that comprehensive experience in regulating state-chartered credit unions would provide a balanced perspective when overseeing the NCUSIF. In addition, as the NCUA promulgates regulations to further enhance safety and soundness, an individual with state-chartered credit union supervisory experience will better understand how proposed regulations will impact state-chartered, federally insured credit unions, thereby providing additional expertise to the agency.

Conclusion

NASCUS state credit union regulators believe relieving regulatory burden for credit unions is critical. Regulatory relief implemented with foresight ensures a safe and sound credit union system for the future. It also provides enhanced products and services for consumer members.

The following points review NASCUS' position on CURIA provisions and on other regulatory relief priorities for credit unions.

- NASCUS supports a risk-based capital structure for credit unions.
- NASCUS believes credit unions should be permitted to issue alternative capital.
- NASCUS supports strong cooperation and consultation between state and federal credit union regulators as provided for in the Credit Union Membership Access Act (CUMAA).
- NASCUS supports expanding member business lending provisions to 20 percent of total assets of a credit union increasing the availability of loans to consumer members.
- NASCUS supports amending the definition of business loans subject to the current cap of $50,000 to $100,000.
- NASCUS believes that the process for converting a state-chartered credit union to another financial institution charter is a matter that should be determined by state law and regulation, not dictated by federal legislation.
- NASCUS supports Section 309 that provides all federally insured credit unions the same exemption that banks and thrift institutions already have from pre-merger notification requirements and fees of the Federal Trade Commission. Additionally, we support expanding this provision to include all state-chartered credit unions.
- NASCUS believes all state-chartered credit unions should be eligible to join the FHLB system.
- NASCUS supports a statute that requires an individual with state credit union regulatory experience be included on the National Credit Union Administration (NCUA) Board.

NASCUS appreciates the opportunity to testify today and share our priorities for CURIA and for credit union regulatory relief.

We urge this Committee to be watchful of federal preemption and to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have presented in our testimony. We welcome questions from Committee members.

Thank you.

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