3138 10th Street North
Arlington, VA 22201-2149
703.842.2215 | 800.336.4644
f: 703.522.2734
dberger@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

June 23, 2021

The Honorable Todd M. Harper, Chairman
The Honorable Kyle S. Hauptman, Vice Chairman
The Honorable Rodney E. Hood, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: **Federal Credit Union Loan Interest Rate Ceiling**

Dear Chairman Harper, Vice Chairman Hauptman, and Board Member Hood:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to you regarding the interest rate ceiling applicable to loans made by federal credit unions that is set to expire on September 10, 2021. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 125 million consumers with personal and small business financial service products. NAFCU encourages the National Credit Union Association (NCUA) Board to consider increasing the interest rate ceiling upon its expiration. However, absent an increase, the NCUA Board should reaffirm the current 18 percent interest rate ceiling and avoid lowering the rate given the current environment as our economy recovers from the COVID-19 pandemic. Also, NAFCU and its member credit unions encourage the NCUA Board to explore a floating interest rate ceiling that allows for adequate risk-based pricing models and mitigates interest rate risk (IRR).

General Comments

Although the Federal Credit Union Act (FCU Act) generally limits federal credit unions (FCUs) to a 15 percent interest rate ceiling on loans, it provides the NCUA flexibility to establish a higher rate for up to 18 months after considering statutory criteria.[1] Specifically, the NCUA Board may increase the rate—or, in the alternative, maintain the rate above 15 percent—if it determines interest rates have risen over the preceding six-month period and that the prevailing interest rate would threaten the safety and soundness of individual credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth.

NAFCU believes that the current market and financial conditions warrant an increase to the current interest rate ceiling. Although rates are lower than they were six months ago, recently they have begun to rise as the Federal Reserve signals that policy tightening may be closer than previously

[1] 12 U.S.C. § 1757(5)(A)(vi)(I).

expected. As the economy recovers from the COVID-19 pandemic, interest rates should reflect this environment as well. The median respondent to the Federal Reserve Bank of Philadelphia's Survey of Professional Forecasters anticipates that 3-month Treasury rates will rise gradually from their present level of 5 basis points to 10 basis points by the second quarter of 2022.[2] Raising the current interest rate ceiling aligns with the recent trend in rates and with the near-term rate outlook.

The following table shows increases in short-term interest rates during the past six months:

Table 1: Selected Interest Rates

figures in basis points	June 18, 2021	May 19, 2021	Dec 21, 2020	30-day change	180-day change
1-Month Treasury	5	0	8	+5	-3
3-Month Treasury	5	1	9	+4	-4
6-Month Treasury	6	3	9	+3	-3
1-Year Treasury	9	5	9	+4	0

Source: U.S. Treasury

Lowering the interest rate ceiling would be detrimental to the safety and soundness of credit unions. Federally-insured credit unions (FICUs) have experienced unprecedented share growth since the onset of the COVID-19 pandemic, which has diluted capital levels and severely dented net interest margins. While credit unions have weathered these stresses admirably, uncertainty remains. Loan growth remained steady during 2020 but was much lower than historical growth seen over the last few years. Lowering the interest rate ceiling would likely stall loan growth and could discourage credit unions from making loans or approving credit card applications for higher-risk members, ultimately leading them to pursue loans from other lenders at considerably higher rates. This would not only disadvantage credit unions, but also the communities they serve.

Loans with Rates Higher Than 15 Percent

As of March 31, 2021, 2,176 of the 3,167 FCUs in the U.S. reported making loans with interest rates above 15 percent. Among those FCUs, the average rate on such loans was 17 percent. Of these FCUs, 65 percent are designated as low-income credit unions. If the interest rate ceiling is not maintained at a level above 15 percent, then 68.7 percent of all FCUs would be required to change their rate policy, which might discourage many of them from making loans going forward. This not only would reduce available credit options for members, but also would reduce the

[2] https://www.philadelphiafed.org/-/media/frbp/assets/surveys-and-data/survey-of-professional-forecasters/2021/spfq221.pdf.

competitiveness of credit unions due to the reduced loan options they would be able to offer to their members.

These credit unions would be impacted by any reduction in the interest rate ceiling as they are already offering loans on very tight margins. Additionally, a majority (61.2 percent) of these credit unions have assets below $100 million. Their growth potential as well as their liquidity, capital, and earnings levels would be negatively affected by a reduction in the interest rate ceiling.

Table 2: FCU Interest Rates on Unsecured Loans

Asset Peer Group	Number of FCUs charging >15%	Percent of total FCUs charging >15%*
Less than $25M	621	28.5%
$25M to less than $50M	344	15.8%
$50M to less than $100M	362	16.6%
$100M to less than $500M	558	25.6%
More than $500M	291	13.4%
Total	2,176	100.0%

* Asset peers may not add to 100 percent due to rounding
Source: NCUA's March 2021 5300 Call Report

Floating Interest Rate Ceiling

NAFCU has previously suggested that the NCUA Board adopt a "fixed spread over Prime" or "floating" interest rate ceiling. Specifically, NAFCU suggests adoption of a 15 percent spread over Prime. To illustrate, using the current Prime rate, the interest rate ceiling would be set at 18.25 percent and it would automatically adjust with the level of Prime.[3] According to NAFCU's January 2020 Economic & CU Monitor Survey, 83 percent of respondents support a variable interest rate ceiling with a fixed spread over Prime.

The benefits of a variable interest rate include allowing for adequate risk-based pricing, the mitigation of IRR, and the expansion of access to underserved borrowers. The NCUA's rulemaking agendas, including the current Spring 2021 agenda, provide for rulemaking activity regarding the interest rate ceiling. The Spring 2021 agenda lists an advance notice of proposed rulemaking (ANPR) regarding the impacts of the interest rate ceiling on FCUs and the

[3] See Wall Street Journal, *Money Rates*, https://www.wsj.com/market-data/bonds/moneyrates (last visited June 14, 2021).

methodologies used to set the ceiling, including a variable or floating rate. NAFCU encourages the NCUA to issue this ANPR as soon as possible.

Historically, the NCUA has expended resources to educate credit unions about IRR and provide them with multiple options to mitigate exposure to IRR. For example, the NCUA recently finalized the rule regarding the use of derivatives to hedge against IRR. However, as the NCUA noted in the final derivatives rule, this is an option for credit unions that possess the requisite knowledge and experience to adopt such a mitigation option. A floating or variable interest rate would be a viable option for all credit unions. Using a "fixed spread over Prime" approach to the interest rate ceiling would go a long way towards helping credit unions reduce IRR, while still serving the needs of members, and mitigating impairments to FCUs' earnings.

While the benefits of a floating interest rate ceiling would be applicable to all variable rate products, such an approach is particularly germane to credit cards which typically reflect the riskiness of the borrower. If interest rates rise, credit cards may not be re-priced because they could potentially exceed the 18 percent ceiling, despite the borrower's default risk. This can create adverse trends in credit unions' earnings and capital, which would present an increased risk to the National Credit Union Share Insurance Fund. A floating interest rate ceiling would effectively mitigate this issue and allow for proper risk-based pricing of variable rate products. Tailored risk-based pricing allows for the allocation of lending risks across fields of membership and ensures availability of credit for higher-risk members who may have otherwise been denied credit.

Conclusion

We thank you for the opportunity to share our views on this matter. NAFCU recommends the Board consider increasing the interest rate ceiling above the current 18 percent. In the absence of an increase, the Board should—at the very least—maintain the current 18 percent interest rate ceiling. NAFCU also asks that the Board explore the use of a floating interest rate ceiling – specifically a 15 percent spread over Prime. It is NAFCU's opinion that the Board has this authority so long as they continue to reauthorize such a structure every 18 months, as required by the FCU Act. Should you have any questions or require additional information, please contact me or Kaley Schafer, Senior Regulatory Affairs Counsel, at 703-842-2249 or kschafer@nafcu.org.

Sincerely,

B. Dan Berger
President & CEO

cc: Mr. Larry Fazio, Executive Director
Mr. Frank Kressman, General Counsel
Mr. Eugene Schied, Chief Financial Office