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National Association of Federally-Insured Credit Unions

September 28, 2021

The Honorable Ed Perlmutter
Chairman
Subcommittee on Consumer Protection and
Financial Institutions
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Blaine Luetkemeyer
Ranking Member
Subcommittee on Consumer Protection and
Financial Institutions
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Tomorrow’s Hearing on “The Future of Banking: How Consolidation, Nonbank Competition, and Technology are Reshaping the Banking System”

Dear Chairman Perlmutter and Ranking Member Luetkemeyer:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts ahead of tomorrow’s hearing, “The Future of Banking: How Consolidation, Nonbank Competition, and Technology are Reshaping the Banking System.” NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 127 million consumers with personal and small business financial service products. NAFCU thanks the Subcommittee for holding this important hearing on the forces shaping the future of the financial services industry, and we appreciate the opportunity to share the perspective of our credit unions.

Consolidation of the Credit Union Industry

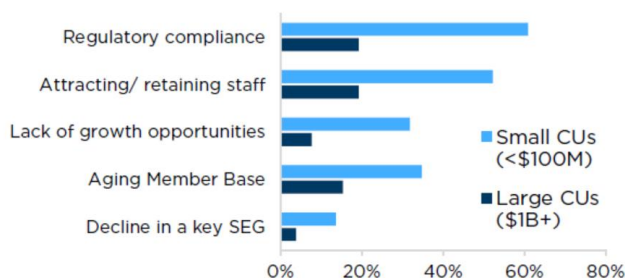
Since the Great Recession, the combination of heightened regulatory requirements and low interest rates has been particularly hard on small financial institutions. This is especially true for small credit unions, which are far smaller than for-profit banks. Compliance burden drains the few resources that small credit unions have, leaving them with precious little to devote to the business of actually growing. Last fall, NAFCU surveyed our members about their credit union’s growth rates prior to the pandemic. Among the smallest credit unions, those with under \$100 million in assets, 44 percent answered that their credit union needed to grow faster to remain viable. That number tapered down to 8 percent for credit unions with over \$1 billion in assets.

Chart 1.10 below shows where some of the specific pain points lie for small credit unions. As has been the case for a number of years, regulatory compliance was listed as the top concern among small credit unions. Other areas with a large discrepancy between credit unions based on size were staff retention, growth opportunities, and field of membership concerns such as an aging membership base and declining select employee groups (SEG). The National Credit Union Administration (NCUA) has made strides in advancing field of membership reform so that more credit unions can pursue growth opportunities. But the enormous day-to-day compliance burdens often prevent credit unions—especially small ones—from taking advantage.

The stresses on small credit unions have led to a rise in merger activity within the industry. Since passage of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) in 2010, the

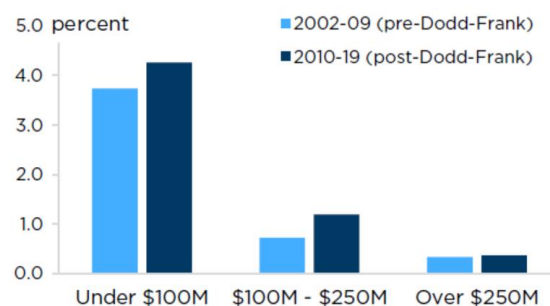
number of credit unions has declined by over 30 percent. The increase in merger activity is primarily among smaller credit unions with less than \$250 million in assets (see Chart 1.11 below). Larger credit unions experienced a mild rise in mergers during the Great Recession, but since 2011 the merger rate has returned to its low, pre-crisis level.

Chart 1.10: Strategic Challenges Rated as "Significant", by Asset Class



SEG = Select Employer Group
Source: NAFCU 2020 Federal Reserve Meeting Survey

Chart 1.11: Average Annual Merger Rate by Asset Class



Source: NAFCU analysis of NCUA data

The other side of industry consolidation has been a lack of de novo credit unions. From 2000 through 2009, the NCUA chartered eight new credit unions per year, on average. However, from 2010 through 2019, that number shrunk to just over two per year. Regulatory burden in the Dodd-Frank era is stifling the formation of credit unions, which already face a steep challenge in raising capital. This development comes at a time when bank branch networks are shrinking, and large banks in particular are fleeing from rural areas. Preventing the formation of new credit unions is another setback for underserved communities.

Credit unions have long been a critical provider of financial services to rural and underserved areas. As large and community banks have been shutting down branches and moving out of these areas, credit unions have been stepping up and expanding their presence to fill the void as they are able. In 2019, the Federal Reserve published a study detailing the dramatic decline in bank branches in rural areas. The study showed that 7 percent of rural bank branches were lost between the years 2012 and 2017, and that number has grown to 11 percent through 2019. Losses are not only concentrated among large banks, which lost 19 percent of their total rural branches, but also among community banks, which lost 5 percent. Credit unions, on the other hand, were the only financial institution type to add branches in both rural and urban areas, demonstrating credit unions' commitment to their members and serving underserved communities (see Table 2.1 below).

TABLE 2.1: BRANCH CHANGES BETWEEN 2012 AND 2019

Institution Type	County Type	Starting branches	Ending branches	Net change	Percent Change
Large Banks	Urban	48,707	42,298	-6,409	-13
	Rural	6,479	5,267	-1,212	-19
Community Banks	Urban	23,798	22,240	-1,558	-7
	Rural	13,890	13,137	-753	-5
Credit Unions	Urban	17,513	17,599	+86	+0
	Rural	3,458	3,537	+79	+2

Notes: Urban counties are those that were part of a metropolitan statistical area in 2017. Excludes U.S. territories as well as counties that have undergone code changes. Bank branches are assigned according to the institution it last reported under. Community banks are those with assets below \$10 billion in June 2019 or the last reported total. Bank branches include only those coded as types 11 or 12 in the FDIC data.

As Congress grapples with ways to ensure that underserved and unbanked populations have access to affordable financial services, credit unions want to be able to help. Unfortunately, many credit unions are limited by the restriction on adding underserved areas to their field of membership. In 1998, as part of the *Credit Union Membership Access Act*, Congress provided federal credit unions with the ability to add underserved areas to their field of membership. However, subsequent legal challenges by the banking industry over the reading of the statute led the NCUA to limit this authority to only multiple common-bond credit unions in 2006.

NAFCU supports expanding the ability of credit unions to add underserved areas to their field of membership, such has been proposed in [draft legislation](#) by the Committee, the “Expanding Financial Access for Underserved Communities Act.” While banking trades might say that credit unions already have the ability to add underserved areas to their fields of membership, they do not mention that not all have that ability, as only multiple common-bond credit unions can add underserved areas. Many credit unions want to do more to help underserved areas as banks retreat from these areas and passing legislation to help credit unions fill the void would be a commonsense first step.

Moreover, NAFCU supports efforts to promote new credit unions. We urge the Committee to consider and advance legislation to improve the chartering process for new credit unions as well as to consider ways to reduce the regulatory burden that discourages new credit union formation. We support legislative efforts such as the bipartisan H.R. 4590, the *Promoting New and Diverse Depository Institutions Act*, which would take important steps to help promote de novo institutions by studying the challenges facing these institutions and having regulators develop a strategic plan to meet those challenges.

NAFCU would also like to take this opportunity to comment on the issue of voluntary bank/credit union mergers, an issue which banking trades have long opposed. Contrary to what the banking trades might say, bank and credit union mergers are typically a win-win for a local community that may lose its community-focused financial services, or even local employees and branches, if a mega-bank buys the local community bank. Credit union-community bank mergers often mean employees retain jobs and branches remain open with a focus on the members in the community. These mergers also cannot occur without approval from both bank and credit union regulators. This is a power that NCUA takes seriously as evidenced by their work on rulemaking in this area last year. Furthermore, credit unions that merge with a bank retain their credit union characteristics and are still subject to strict statutory prohibitions and limits on powers as set out in the *Federal Credit Union Act*, including field of membership requirements for the newly acquired bank customers, limits on business lending, a usury ceiling, and the capital limitations of credit unions.

While the banking trades have also used these mergers to attack the tax status of credit unions, what they do not tell you is that these mergers are often purchase and assumption transactions (if the bank is a C-corporation, which is most common) and are subject to taxation at the bank level (unlike bank-to-bank transactions which are often stock transactions). We estimate that over \$100 million in taxes have been paid in the past several years due to these transactions. Additionally, the credit union actually pays many taxes, such as local property taxes and payroll taxes when the former bank remains open as a credit union. The truth is that while banking trade groups have called on Congress to change the tax status of credit unions, they fail to disclose that the banking industry received tens of billions of dollars in annual tax breaks from the *Tax Cuts and Jobs Act*. They also fail to point out that nearly one-third of all banks

are Subchapter S corporations and do not pay corporate income taxes themselves. These annual tax breaks for banks far outpace the annual tax expenditure of the credit union tax exemption.

The real issue is that it is difficult to be a community financial institution today. Regulatory burdens and competition from big banks and unregulated actors entering the financial services space make it hard to survive. Many institutions, whether banks or credit unions, need to grow to survive. One avenue for growth is mergers—whether bank-bank, credit union-credit union, or credit union-bank. The fact is that credit union-bank mergers remain a small percentage of overall mergers among financial institutions. There have also been cases where the bank acquires a credit union and is the surviving institution. A top priority of NAFCU is to ensure that there is an environment where credit unions can grow, thrive, and continue to serve the over 127 million Americans that are credit union members today. We look forward to continuing to work with you to achieve that goal.

Nonbank Competition and Fintech Partnerships

As NAFCU testified before the Subcommittee in April 2021, the growth of fintech in recent years offers new opportunities for the delivery of financial services.¹ The use of financial technology can have a positive effect on credit union members. Credit unions have worked with fintech companies to improve efficiency in traditional banking, and many of the technologies that are commonplace today, such as credit cards and e-sign, would have once qualified as “fintech” when they were first introduced. Consumers today come to expect technological developments from their financial institution—from online banking to mobile bill pay. Many credit unions embrace innovations in technology to improve relationships with members and offer more convenient and faster access to financial products and services.

However, the growth of fintech can also present new threats and challenges as novel entities emerge in an underregulated environment. As such, NAFCU believes that Congress and regulators must ensure that when technology firms and fintechs compete with regulated financial institutions, they do so on a level playing field where smart regulations and consumer protections apply to all participants. NAFCU has outlined some of the challenges and opportunities in this area in a [white paper](#) that proposes regulatory recommendations for oversight of fintech companies.²

For example, fintech companies that specialize in lending, payments, or data aggregation present unique consumer protection concerns. A fintech company that permits consumers to consolidate control over multiple accounts on a single platform elevates the risk of fraud and may not be subject to regular cybersecurity examination and data privacy and protection requirements in the same way that credit unions are under the *Gramm-Leach-Bliley Act* (GLBA). Although non-bank lenders are subject to consumer protection rules, the connectivity and segregation of discrete services within the fintech marketplace can create supervisory challenges.

Additionally, consumers may not be aware that funds deposited with certain fintech companies are not insured the same way deposits at a credit union or bank are and could be subject to loss. This could cause

¹ House Committee on Financial Services Subcommittee on Consumer Protection and Financial Institutions, “Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters,” April 15, 2021, <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407533>.

² NAFCU, Regulatory Approaches to Financial Technology, available at <https://www.nafcu.org/fintech-whitepaper>.

consumer confusion, or even harm confidence in the financial system should one of these companies have issues that cause a loss of consumer funds. An example of a step Congress could take to help ensure a level playing field would be to require a clear, concise, and prominent disclosure to consumers when funds are uninsured.

Recently, fintech companies are enjoying unprecedented liberalization of bank chartering rules to either acquire or become banks. Recent developments with both the Office of the Comptroller of the Currency's (OCC) new chartering options and the Federal Deposit Insurance Corporation's (FDIC) approval of deposit insurance for Industrial Loan Company (ILC) applicants also present problems. In each case, a nonbank company can potentially evade regulation under the *Bank Holding Company Act* (BHCA), either because of a statutory loophole unique to ILCs, or because the entity does not accept deposits. Lack of BHCA coverage raises serious concerns regarding the quality and extent of supervision for these specialized or limited purpose banking entities. Chartering additional ILCs or granting new licenses to payments companies could also weaken the safety and soundness of the wider financial system.

In certain cases, specialized, limited purpose bank charters may allow a fintech to operate with national bank privileges but without the same prudential safeguards that apply to traditional banks and credit unions. While some may characterize these chartering schemes as innovative, they are ultimately loopholes that invite unnecessary risk into the financial system and create an uneven playing field.

NAFCU believes that there are a number of steps that should be taken to address our concerns. First, it is important that existing charters, such as the credit union charter, keep pace with advances in technology and consumer preferences to ensure that credit unions have the tools to serve their members' needs, especially post-pandemic. Additionally, we support a moratorium on new ILC charters and closing the BHCA ILC loophole, which we are pleased to see addressed in draft legislation before the Subcommittee, the "Close the ILC Loophole Act." Congress should also ensure that the data security and privacy requirements for financial institutions in the GLBA, including supervision for compliance, apply to all that are handling consumer financial information and that programs for implementing these requirements conform to the guidance developed by Federal Financial Institutions Examination Council (FFIEC) member agencies.

NAFCU also believes financial regulators have a role to play in the supervision and regulation of fintechs under their existing authorities. Congress should also be willing to step in and clarify the role of regulators when necessary. For example, NAFCU believes that the Consumer Financial Protection Bureau (CFPB) can play a role under its "larger participants" authority under the Dodd-Frank Act to regulate and supervise technology firms and fintech companies that enter into the financial services marketplace. If the CFPB does not believe it has this authority currently, Congress should examine granting the Bureau explicit authority in this area.

Congress should also consider creating an FFIEC subcommittee on emerging technology to monitor the risks posed by fintech companies and develop a joint approach for facilitating innovation. We would envision the subcommittee having the following under its charge:

- a. To report its findings to Congress annually;
- b. To define the parameters of responsible innovation to ensure consistent examination of emerging technologies;
- c. To identify best practices for responsible innovation; and,

- d. To recommend regulatory improvements to allow FFIEC-regulated institutions to adopt new technologies with greater legal certainty.

We would also like to take the opportunity to comment on another piece of draft legislation before the Subcommittee, the “NCUA Oversight of Third Party Vendors Act.” NAFCU and our member credit unions believe that cybersecurity, including the security of vendors that credit unions do business with, is an important issue. However, we are opposed to granting additional authority to the NCUA to examine third parties at this time. NAFCU believes in a strong NCUA, but we also believe that the NCUA should stay focused on where their expertise lies—regulating credit unions. Credit unions fund the NCUA budget. Implementing such new authority for the NCUA would require significant expenditures by the agency. The history of the NCUA’s budget growth has shown that these costs would ultimately be borne by credit unions and their members.

There are other tools already in place for the agency to get access to information about vendors. We believe the agency’s time and resources are better focused on reducing regulatory burden by coordinating efforts among the financial regulators. The NCUA sits on the FFIEC with the FDIC, OCC, and the Federal Reserve. The FFIEC was created to coordinate examination findings and approaches in the name of consistency and to avoid duplication. This means that as a member of the FFIEC, the NCUA should be able to request the results of an examination of a core processor from the other regulators and not have to send another exam team from the NCUA into their business and duplicate an examination. This would seem to be an unnecessary burden on these small businesses. Additionally, if the NCUA did its own examination, the likelihood of finding anything the other regulators did not would seem to be close to nil.

Instead of granting the NCUA vendor examination authority, Congress should encourage the agency to use the FFIEC and gain access to the information on exam findings on companies that have already been examined by other regulators. This would address the NCUA’s concerns without creating additional costs to credit unions and increasing regulatory burdens on credit unions and small businesses.

Other Legislation Before the Subcommittee

NAFCU supports H.R. 2311, the *Credit Union Governance Modernization Act of 2021*, which would help protect credit unions and their members from abusive, fraudulent, or criminal activity. Currently, federal credit unions can only expel a member of their community by a two-thirds vote of all members at a special meeting and only if the behavior that member is engaged in is illegal. With notice requirements, the time it takes to hold a special meeting is significant. This legislation would allow credit unions to adopt an expulsion policy to expel members who engage in abusive or illegal behavior, while allowing for an appeal process that would provide due process for the accused member. It would also provide parity with several state-chartered credit unions’ model or standard bylaws, which often have a “for cause” provision or a board-adopted policy for expulsion. Credit unions have an obligation to ensure their cooperatives act in the best interests of their members and local communities. This common-sense legislation would put safety first, while still protecting the rights of credit union members.

Other Issues to Consider on the Future of Financial Services

As we have previously communicated, NAFCU believes that the lack of appropriate separation between commercial and investment banking activities presents risks that are worth legislative consideration. A significant aspect of this risk involves reliance by nonbank financial firms on deposit accepting banks to secure liquidity in times of financial stress or crisis. NAFCU believes that such dependency undermines financial stability in the long term, which puts both credit unions and their members at risk. Consequently, NAFCU continues to recommend that Congress consider the creation of a modern *Glass-Steagall Act* to address bipartisan concerns related to the increasingly interconnected and interdependent shadow banking system. Such a new law should be designed to protect consumers against future financial crises caused by big banks pushing the limits of what constitutes the “business of banking.”

We appreciate the opportunity to share our input and look forward to continuing to work with the Subcommittee on these issues. Should you have any questions or require any additional information, please contact me or Sarah Jacobs, NAFCU’s Associate Director of Legislative Affairs, at sjacobs@nafcu.org.

Sincerely,



Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Subcommittee on Consumer Protection and Financial Institutions