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National Association of Federally-Insured Credit Unions

May 31, 2018

The Honorable J. Mark McWatters, Chairman
The Honorable Rick Metsger, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Federal Credit Union Loan Interest Rate Ceiling

Dear Chairman McWatters and Board Member Metsger:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the interest rate ceiling applicable to loans made by federal credit unions. As the agency is aware, the current 18 percent interest rate ceiling expires on September 10, 2018, and I would encourage the National Credit Union Administration (NCUA) Board to consider the potential benefits of increasing the interest rate ceiling when it considers the issue in advance of its expiration. However, absent an increase, the NCUA Board should at minimum maintain the current 18 percent interest rate ceiling, and avoid lowering the rate given the rising interest rate environment. Also, I would encourage the NCUA Board to explore a floating interest rate ceiling.

General Comments

NAFCU believes that lowering the interest rate will be detrimental to the safety and soundness of credit unions as it could potentially result in a loss of capital. Further, it could discourage federal credit unions (FCUs) from making loans or approving credit card applications for higher risk members. This in turn would likely lead members to pursue loans from other lenders at considerably higher rates.

While the *Federal Credit Union Act* (FCU Act) generally limits 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. Given that the prevailing interest rates have increased over the last six months, and will continue to increase as forecasted by the Federal Open Market Committee (FOMC), NAFCU believes the NCUA should increase the current interest rate ceiling, as it will increase lending and competition in the marketplace.

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[1] 12 U.S.C. § 1757(5)(A)(vi)(I).

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

Table 1: Selected Monthly Interest Rates

figures in basis points, monthly average	Apr 2018	Nov 2017	Change
1-Month Treasury	163	107	+56
3-Month Treasury	176	123	+53
6-Month Treasury	193	136	+57
1-Year Treasury	208	151	+57

Source: Federal Reserve

"Most Common" Interest Rates – All Unsecured Loans

Loans with Rates Higher Than 15 Percent

As of December 31, 2017, 2,361 of the 3,499 FCUs in the U.S. reported making loans with interest rates above 15 percent. Among those FCUs, the average rate on such loans was 17.1 percent. Of these FCUs, 59 percent are designated as low-income credit unions. If the interest rate ceiling was not maintained at a level above 15 percent, 67.6 percent of all federal credit unions would be required to change their rate policy, which might discourage many of them from making these kinds of loans going forward. This would not only reduce available credit options for members, but would also reduce the competitiveness of credit unions due to the reduced loan portfolio they would be able to offer to their members.

These credit unions would be impacted by any reduction in the interest rate ceiling. A majority (52.3 percent) of these credit unions have assets below $50 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 $10M	427	18.1%
$10M to less than $50M	807	34.2%
$50M to less than $100M	363	15.4%
$100M to less than $500M	532	22.5%
More than $500M	232	9.8%
Total	2,361	100.0%

Source: NCUA's December 2017 5300 Call Report

Floating Interest Rate Ceiling

The interest rate ceiling has been set at an 18 percent fixed rate since 1987, and the NCUA should explore options to modify the interest rate ceiling from a fixed rate to a "fixed spread over Prime" or "floating" interest rate ceiling. Specifically, the NCUA should consider amending the interest rate ceiling to a "15 percent spread over Prime."

Mitigation of Interest Rate Risk (IRR)

Using today's rates, the ceiling would be set at 19.75 percent and it would *automatically adjust* with the level of Prime. Historically, the NCUA has expended a number of resources in an effort to educate and examine credit unions' exposure to IRR, as evidenced by the topic consistently listed as a supervisory focus for the agency. IRR is a primary concern for all FCUs, and as a result, credit unions have been vigilant in identifying and managing such risk. 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. Credit card interest rates typically reflect the riskiness of the borrower. As such, borrowers with higher-risk FICO scores may receive credit cards at, or near, the maximum rate of 18 percent; a rate that still fulfills credit unions' mission as the rate is lower than rates offered by banks for similar credit cards. As interest rates continue to rise, as anticipated by the Federal Reserve, credit cards may not be re-priced because they could potentially exceed the 18 percent ceiling – even though they are a variable rate product. This means, in the likely event of an interest rate increase, these credit cards are incorrectly priced given the default risk of the borrower. 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 (NCUSIF). A floating interest rate ceiling would effectively mitigate this issue.

Increase in Overall Lending

Maintaining the current fixed rate interest rate ceiling may force FCUs to simply stop lending to individuals who have few alternatives for credit as interest rates rise, placing these FCUs in a position inconsistent with their mission. Conversely, a floating interest rate ceiling would likely lead to an overall increase in lending and expand access to credit. NAFCU has observed an increasing trend in overall credit lending, and we anticipate that this growth will continue.

Year over year figures show that at the end of March 2018, revolving credit increased by 4.8 percent from March 2017.[2] Although revolving credit has increased year over year, we would likely see additional growth with a floating interest rate ceiling due to consumer demand for

[2] *See* Federal Reserve's G.19-Consumer Credit release

credit cards, and the ability to offer credit card products to a larger portion of the membership by adjusting the rate ceiling on par with the level of risk associated with the member. Also, looking at the transformation to digital payments, more payments are now made by debit and credit cards, necessitating lending by FCUs to members across all consumer borrowing segments as credit cards are an essential financial tool. JP Morgan estimates that by 2021, credit card payments will make up 68% of all transactions.[3] Due to their small size and regulatory limitations, FCUs have less opportunity to diversify lending through offering multiple credit products, or by offering credit products to different types of borrowers, due to limitations on field of membership, and credit risks associated with the borrowing member. A floating interest rate ceiling would permit more diversified lending and increase credit availability for FCU members.

Delinquency Rates & Subprime Lending

A floating interest rate will allow FCUs to lend to those members who need access to credit the most but fall within the "subprime" or "near-prime" consumer segments at a higher rate (i.e. the ceiling cap). Breaking down revolving credit card growth for the past quarter into credit risk profiles, growth in the "super prime" consumer segment increased by 4.9 percent, "prime plus" increased by 3.2 percent, and "subprime" or "near-prime" fell by 2.7 percent.[4] Despite subprime credit card lending falling in Q1 2018, there was an increase year over year from Q1 2017 to Q1 2018 by 3.3 percent.[5]

A recent quarterly report by TransUnion found that delinquency rates on credit cards remain low at 1.78 percent at the end of Q1 2018 for borrowers past due by 90 days.[6] Lenders are mitigating risks by slowing originations for those individuals who pose a higher risk and extending lower amounts of credit.[7] Delinquency rates on all loans are still below those immediate post-recession delinquency rates.[8] Our members have reported that their delinquency rates have remained relatively unchanged since 2014, and also significantly lower than the delinquency rates they saw post-recession.[9] FCUs are cognizant of delinquency rates and continue to mitigate risk. Delinquency rates on all loans by credit unions continue to be lower than banks.[10]

Although FCUs have worked within the bounds of the current interest rate ceiling to lend to members who pose heightened credit risks, a floating cap would permit greater flexibility while

[3] David Marino-Nachison, PAYMENTS: THE NEXT STEP TOWARD THE EXTINCTION OF CHECKS AND CASH, BARRON'S (2018), https://www.barrons.com/articles/payments-the-next-step-toward-the-extinction-of-checks-and-cash-1526048738 (last visited May 15, 2018).
[4] Credit Card Usage at All-Time Highs, But Delinquency Rates Still Remain in Check, TransUnion (2018), https://newsroom.transunion.com/credit-card-usage-at-all-time-highs-but-delinquency-rates-still-remain-in-check/ (last visited May 15, 2018).
[5] *Id.*
[6] *Id.*
[7] NAFCU, *supra,* note 2
[8] TransUnion, *supra,* note 4
[9] *See* NAFCUs Quarterly CU Industry Trends Report
[10] *Id.*

still taking into account the riskiness of the borrower. Furthermore, a floating interest rate would in no way impair FCUs' ability to safely offer rates below those of traditional banks.

Recommendation

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. We suggest the Board add this topic to the docket for a potential Board briefing, as rising interest rates are a reality and this issue is of importance to the industry as a whole.

Conclusion

I hope this information is helpful, and we thank you for this opportunity to share our views on this matter. Should you have any questions or require additional information, please contact me or Kaley Schafer, Regulatory Affairs Counsel, at 703-842-2249 or kschafer@nafcu.org.

Sincerely,

B. Dan Berger
President and CEO

cc: Mr. Mark Treichel, Executive Director
Mr. Michael McKenna, General Counsel
Mr. Rendell Jones, Chief Financial Officer