NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

September 21, 2018

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

RE: Variable Interest Rate

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 provide additional commentary regarding the implementation of a variable interest rate applicable to loans made by federal credit unions. NAFCU would like to thank the Board for their consideration and noting the practicality of a variable interest rate during the August 2nd Board meeting. Fundamentally, credit unions protect small businesses and consumers by providing low interest rate loans. Setting a variable interest rate would poise credit unions as more competitive in the financial services industry, expand access to lending, and allow for more tailored risk-based pricing models while simultaneously preserving their core mission to protect small businesses and consumers and act as responsible lenders.

NAFCU members overwhelmingly support a variable interest rate. The fixed 18 percent interest rate has been in place since 1987. NAFCU suggests adopting a variable interest rate, specifically a 15 percent spread over Prime. Using today's rates, the ceiling would be set at 19.75 percent and would *automatically adjust* with the level of Prime. Although the current interest rate is suitable for certain amounts of risk, growth opportunities are stifled by credit unions' inability to take reasonable amounts of risk to lend to those members not suitable for an 18 percent rate. Increasing growth opportunities will eliminate the need for credit union members to pursue higher rate alternatives, such as high-cost, traditional payday loans, or high interest credit cards.

Benefits of a Variable Interest Rate

The Federal Open Market Committee (FOMC) raised interest rates at the end of June 2018, and are expected to raise rates again at the end of September and possibly in December. Given the current rising interest rate environment, a variable interest rate would position credit unions to be more competitive in the industry.

A variable interest rate allows credit unions the ability to utilize risk-based pricing. Tailored risk-based pricing ensures availability of credit for higher risk members that may have been denied credit under the preceding fixed rate. As interest rates continue to rise, loans may not be re-priced because they could potentially exceed the 18 percent ceiling – even though some are variable rate products, such as credit cards. This means, in the likely event of an interest rate increase, these loans are incorrectly priced given the default risk of the borrower. Presently, credit unions that lend to their members with lower FICO scores must make a choice to either tighten their lending standards, thereby effectively turning away some members who are then forced to take out "bad credit" which could include high-cost, traditional payday loans or a high interest credit card. Or, the credit union can issue credit at a rate that they do not feel comfortable with which in turn increases the risks to the credit union and ultimately to the National Credit Union Share Insurance (NCUSIF). Therefore, a fixed interest rate is riskier to the NCUSIF. Although credit unions have worked within the bounds of the current interest rate ceiling to lend to members who pose heightened credit risks, a variable interest rate would permit greater flexibility while still taking into account the riskiness of the borrower. Thus, a variable interest rate would lead to expanded access to credit and effectively mitigate interest rate and default risk by allowing tailored risk-based pricing.

While the benefits of a variable interest rate are applicable to all variable rate products, such an approach is particularly germane to credit cards. Currently, 2,011 of the 3,444 total federal credit unions hold credit card receivables on their balance sheets. As illustrated, this represents over 58 percent of the overall industry that stands to benefit from implementation of a variable interest rate. This majority includes credit unions from all different asset classes, not just the largest credit unions.

Implementation Costs and Administrative Burdens Are Low

Several NAFCU members have already implemented variable interest rates for home loans up to the maximum allowable rate under the *Federal Credit Union Act*. Those members who have implemented a variable interest rate expressed no concerns with implementation costs or associated administrative burdens. Existing systems are in place, and credit union staff are capable of managing variable rate loans even if monitoring is done manually to some extent. Currently, rates are tied to Prime, 1 year LIBOR, or Federal Home Loan Bank (FHLB) rates. Those NAFCU members who have not yet implemented variable interest rates expressed that there would be no administrative burden in doing so. Any costs incurred would be negligible.

NAFCU appreciates the opportunity to share its members' views on this matter. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,

Kaley Schafer
Regulatory Affairs Counsel