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B. Dan Berger
President & Chief Executive Officer

National Association of Federally-Insured Credit Unions

January 30, 2020

The Honorable Rodney E. Hood, Chairman
The Honorable Todd M. Harper, Board Member
The Honorable J. Mark McWatters, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Variable Interest Rate

Dear Chairman Hood and Board Members Harper and McWatters:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I write to you today to reiterate NAFCU's call for the National Credit Union Administration (NCUA) Board to establish a variable interest rate applicable to loans made by federal credit unions. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve nearly 120 million consumers with personal and small business financial service products. Last week, the NCUA Board voted to establish a fixed 18 percent interest rate ceiling, which has been the status quo since 1987. NAFCU continues to urge the Board to explore adoption of a variable interest rate and encourages the publication of an advanced notice of proposed rulemaking. The benefits of a variable interest rate allow for adequate risk-based pricing, expand lending access to underserved borrowers, and provide a timely and transparent mechanism for adjusting the interest rate ceiling. In addition, the implementation costs and administrative burdens are low.

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 19.75¹ percent and would *automatically adjust* with the Prime rate. According to NAFCU's March 2019 *Economic Monitor Survey*, 58 percent of respondents stated that a variable interest rate ceiling based on a fixed rate spread would be most appropriate. Moreover, a variable interest rate with a fixed spread over Prime would still be below the interest rates often charged by banks.

Benefits of a Variable Interest Rate

A variable interest rate allows credit unions to adequately utilize risk-based pricing, helping to mitigate interest rate risk (IRR) and credit risk. Chairman Hood noted during last week's Board meeting that efficient use of risk-based pricing allows for allocation of lending risks across fields of membership. However, without a variable interest rate, there is limited room for credit unions to allocate risk-based pricing options. Tailored risk-based pricing ensures availability of credit for higher risk members that may have otherwise been denied credit under a fixed rate model.

¹ See Wall Street Journal, *Money Rates*, <https://www.wsj.com/market-data/bonds/moneyrates> (last visited Jan. 30, 2020).

Currently, credit unions that lend to their members with lower FICO scores must tighten their lending standards, thereby effectively turning away some members who are then forced to take out “bad credit” such as 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). 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 considering the riskiness of the borrower.

Given the confines of the current interest rate ceiling, growth opportunities are stifled as credit unions are unable to take reasonable amounts of risk and lend to those members not suitable for an 18 percent rate. Setting a variable interest rate would position credit unions as more competitive in the financial services industry, expand access to lending, especially for underserved borrowers, including borrowers with lower credit scores or those deemed “thin file” or “credit invisible.” According to the Consumer Financial Protection Bureau’s (CFPB or Bureau) report on credit invisibles, an estimated 26 million Americans can be classified as credit invisible, another 19 million possess an insufficient credit history to produce a credit score.² A variable interest rate will enable credit unions’ to lend to these underserved borrowers.

Generally, interest rates following the Great Recession have remained low and stable; however, that may not be the trend going forward. If market conditions become more volatile, a fixed interest rate ceiling may not adjust in a timely manner. Historically, during periods of volatility, the Board has acted, but this action has lagged slightly due to Board-required procedures. The Board may act before the expiration of the fixed rate if circumstances warrant; however, this action is likely a longer process than a variable interest rate that adjusts automatically. Furthermore, given that shifts in the Board makeup are natural, the more reasonable and reliable approach is to have a mechanism in place that automatically adjusts as necessary. NAFCU urges the NCUA to put into place a process that will more effectively match the interest rate ceiling with market conditions. A variable rate ceiling would provide a more timely and transparent mechanism for adjusting the rate cap than a Board action once every 18 months.

Implementation Costs and Administrative Burdens Are Low

NAFCU reiterates that the costs of implementing a variable interest rate are minimal as credit unions already utilize variable interest rates for home loans and variable rate credit cards. Currently, rates are tied to Prime, 1-year LIBOR, or Federal Home Loan Bank (FHLB) rates. Operating systems are in place to track and monitor interest rate variables and credit union staff are capable of managing variable rate loans. Members who have implemented a variable interest rate expressed no concerns with implementation costs or associated administrative burdens. Moreover, NAFCU members who have not yet implemented variable interest rates expressed that there would be no administrative burden in doing so.

² See Patrice Ficklin and Paul Watkins. *An Update on Credit Access and the Bureau’s First No-Action Letter*, CFPB, (Aug. 6, 2019), <https://www.consumerfinance.gov/about-us/blog/update-credit-access-and-no-action-letter/>.

Conclusion

NAFCU appreciates the opportunity to share its members' views on this matter. NAFCU reiterates its call for the Board to establish a variable interest rate. A variable interest rate creates adequate risk-based pricing, increased access to lend to underserved borrowers, and serves as a timely and transparent mechanism for adjusting the interest rate ceiling. Should you have any questions or require additional information, please do not hesitate to contact me directly or Kaley Schafer, Regulatory Affairs Counsel, at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,



B. Dan Berger