



2018 NAFCU REPORT ON CREDIT UNIONS



Federal Advocacy,
Education & Compliance

NAFCU REPORT ON CREDIT UNIONS

November 2018

Table of Contents

- BACKGROUND..... 5
- KEY FINDINGS 7
- I. INDUSTRY TRENDS 8
- II. CREDIT UNION SERVICE OFFERINGS15
- III. THE CU INDUSTRY: OBSERVATIONS FROM THE SURVEY OF CONSUMER FINANCES17
- IV. POLICY PRIORITIES
 - A. A Regulatory Environment that Allows Credit Unions to Grow.....21
 - B. Appropriate, Tailored Regulation for Credit Unions and Relief from Growing Regulatory Burdens 25
 - C. A Fair Playing Field.....31
 - D. Government Transparency and Accountability32
 - E. A Strong, Independent NCUA as the Primary Regulator for Credit Unions34
- V. FINANCIAL TECHNOLOGY AND CREDIT UNIONS.....34
- APPENDIX: FED SERVICE RATINGS39

Abbreviations

ACET	Automated Cybersecurity Examination Tool	GSA	Glass-Steagall Act
ACH	Automated Clearing House	GSE	Government-Sponsored Enterprise
ADA	Americans with Disabilities Act	HELOC	Home Equity Line of Credit
API	Application Programming Interface	HMDA	Home Mortgage Disclosure Act
ATM	Automated Teller Machine	IRS	Internal Revenue Service
BUREAU	Bureau of Consumer Financial Protection	IT	Information Technology
CAMEL	Capital Adequacy, Asset Quality, Management, Earnings, and Liquidity/Asset-Liability Management	MBL	Member Business Lending
CLF	Central Liquidity Facility	MLA	Military Lending Act
CU	Credit Union	MSA	Metropolitan Statistical Area
CUMAA	Credit Union Membership Access Act	NAFCU	National Association of Federally-Insured Credit Unions
CUSO	Credit Union Service Organization	NCUA	National Credit Union Administration
DoD	Department of Defense	NCUSIF/SIF	National Credit Union Share Insurance Fund
DOJ	Department of Justice	OCC	Office of the Comptroller of the Currency
DTI	Debt-to-Income Ratio	ONES	Office of National Examinations and Supervision
FCC	Federal Communications Commission	P2P	Peer-to-peer
FCU	Federal Credit Union	PAL	Payday Alternative Loan
FHLB	Federal Home Loan Bank	PCA	Prompt Corrective Action
FI	Financial Institution	QM	Qualified Mortgage
FICU	Federally-Insured Credit Union	RBC	Risk-Based Capital
FINTECH	Financial Technology	RFI	Request for Information
FISCU	Federally-Insured State Chartered Credit Union	ROA	Return on Assets
FLEX	Flexible Examination Pilot Program	S. 2155	Economic Growth, Regulatory Relief and Consumer Protection Act
FOM	Field of Membership	SCF	Survey of Consumer Finances
FRB	Federal Reserve Board	TCPA	Telephone Consumer Protection Act
FTC	Federal Trade Commission	TIP	Trade, Industry, and Professional
FTE	Full-Time Equivalent	UDAAP	Unfair, Deceptive, or Abusive Acts and Practices
GAP	Guaranteed Acceptance Protection		

Board of Directors and President and CEO of NAFCU



Jeanne Kucey | Chair
Region III Director
President/CEO
JetStream Federal Credit Union
Miami Lakes, FL
Asset Size: \$199M
Members: 19,990
FOM: Community



Debra Schwartz | Vice Chair
Director-at-Large
President/CEO
Mission Federal Credit Union
San Diego, CA
Asset Size: \$3.5B
Members: 231,123
FOM: Community



Thomas W. DeWitt | Treasurer
Region IV Director
President/CEO
State Farm Federal Credit Union
Bloomington, IL
Asset Size: \$4.1B
Members: 127,411
FOM: Service



Gary Grinnell | Secretary
Region I Director
President/CEO
Corning Federal Credit Union
Corning, NY
Asset Size: \$1.4B
Members: 108,394
FOM: Multi-Occupational



Robert L. Fisher
Director-at-Large
President/CEO
Grow Financial
Federal Credit Union
Tampa, FL
Asset Size: \$2.5B
Members: 198,299
FOM: Multi-Occupational



Richard L. Harris
Region V Director
President/CEO
Caltech Employees
Federal Credit Union
La Canada, CA
Asset Size: \$1.6B
Members: 32,807
FOM: Multi-Occupational



James A. Kenyon
Director-at-Large
President/CEO
Whitefish Credit Union
Whitefish, MT
Asset Size: \$1.4B
Members: 55,541
FOM: Community



Jan N. Roche
Director-at-Large
President/CEO
State Department Federal
Credit Union
Alexandria, VA
Asset Size: \$1.9B
Members: 84,125
FOM: Multi-Occupational



Charles A. Rutan
Director-at-Large
President/CEO
Southwest Airlines
Federal Credit Union
Dallas, TX
Asset Size: \$542M
Members: 54,030
FOM: Multi-Occupational



Brian T. Schools
Region II Director
President/CEO
Chartway Federal Credit Union
Virginia Beach, VA
Asset Size: \$2.2B
Members: 181,676
FOM: Multi-Occupational



Daniel Weickenand
Director-at-Large
CEO
Orion Federal Credit Union
Memphis, TN
Asset Size: \$789M
Members: 76,023
FOM: Multi-Occupational



B. Dan Berger
President and CEO
NAFCU
Arlington, VA

FOM is Field of Membership

Board of Governors of the Federal Reserve System



Jerome H. Powell, Chairman of the Board of Governors. He was sworn in on February 5, 2018, for a four-year term. He also serves as Chairman of the Federal Open Market Committee. Mr. Powell has served as a member of the Board of Governors since taking office on May 25, 2012, to fill an unexpired term. He was reappointed to the Board and sworn in on June 16, 2014, for a term ending January 31, 2028. Prior to his appointment to the Board, Mr. Powell was a visiting scholar with the Bipartisan Policy Center, where he focused on federal and state fiscal issues. From 1997 through 2005, he was a partner at The Carlyle Group. Mr. Powell also served as Assistant Secretary and as Undersecretary to the Treasury under President George H.W. Bush.



Richard H. Clarida, Vice Chairman of the Board of Governors. He was sworn in on September 17, 2018, for a four-year term, and took office as Board member to fill an unexpired term ending January 31, 2022. Prior to his appointment to the Board, Dr. Clarida was the C. Lowell Harriss Professor of Economics and International Affairs at Columbia University, where he also served as chairman of the Department of Economics. Dr. Clarida is a former Assistant Secretary of the Treasury for Economic Policy, and served on the Council of Economic Advisers under President Reagan. He also served in multiple positions at PIMCO. Dr. Clarida is a member of the Council on Foreign Relations and a former member of the National Bureau of Economic Research.



Randal K. Quarles, Vice Chairman for Supervision. He was sworn in on October 13, 2017, for a four-year term. He took office as a member of the Board of Governors on Oct 13, 2017, to fill an unexpired term. He was reappointed to the Board on July 23, 2018, for a term ending January 31, 2032. Prior to his appointment to the Board, Mr. Quarles was founder and managing director of the Cynosure Group. Before founding the Cynosure Group, he was a partner at The Carlyle Group. Mr. Quarles served multiple positions in the Department of Treasury, most recently as the Under Secretary of the Treasury for Domestic Finance. He also served as the U.S. Executive Director of the International Monetary Fund, and was a partner at Davis, Polk & Wardwell.



Lael Brainard, member of the Board of Governors. She took office in June 16, 2014 to fill an unexpired term ending January 31, 2026. Prior to her appointment, Dr. Brainard served as Undersecretary of the U.S. Department of Treasury and Counselor to the Secretary of the Treasury. Dr. Brainard also was previously the Vice President and Founding Director of the Global Economy and Development Program, and held the Bernard L. Schwartz Chair at the Brookings Institution. She also served in several staff positions in the Clinton Administration and was a professor of Applied Economics at the Massachusetts Institute of Technology (MIT).

Background

The National Association of Federally-Insured Credit Unions (NAFCU), founded in 1967, is the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions (FICUs). NAFCU provides its members with advocacy, education and compliance assistance to meet the constant challenges that cooperative financial institutions face in today's economic environment. Membership in NAFCU is direct; there are no state or local leagues, chapters or affiliations standing between NAFCU members and NAFCU's Arlington, Virginia headquarters.

NAFCU Membership

NAFCU's membership consists of the nation's most innovative and dynamic FICUs, having various and diverse membership bases and operations. NAFCU proudly represents many smaller credit unions with relatively limited operations, as well as some of the largest and most sophisticated credit unions in the nation. NAFCU represents 71 percent of total federal credit union (FCU) assets and 47 percent of all FICU assets. NAFCU's membership includes more than 150 federally-insured state chartered credit unions (FISCUs).

The Credit Union Universe

Federally Chartered Credit Unions

Federally chartered credit unions obtain their charters from, and are regulated by, the National Credit Union Administration (NCUA). Their member shares (deposits) are insured by the National Credit Union Share Insurance Fund (NCUSIF), which is administered by the NCUA. As of June 2018, there were 3,444 FCUs, with assets of \$742 billion and a membership base of approximately 60 million.

Federally-Insured State Chartered Credit Unions

Federally-insured state chartered credit unions are chartered by their state, and their primary regulator is the state supervisory authority. Their member shares are insured by the NCUSIF. As of June 2018, there were 2,036 FISCUs, with assets of \$690 billion and a membership base of approximately 54 million.

Federally-Insured Credit Unions

All FCUs are required to be insured by the NCUSIF. State chartered credit unions in some states are required to be federally insured, while others may elect to be insured by the NCUSIF. The term "federally-insured credit unions" refers to both federal and state chartered credit unions whose accounts are insured by the NCUSIF. Thus, FCUs and FISCUs are subsets of FICUs. As of June 2018, there were 5,480 FICUs, with assets of \$1.4 trillion and a membership base of approximately 114 million.

Privately Insured Credit Unions

Private primary share insurance for FISCUs has been authorized in a number of states. Currently there are privately insured credit unions operating in ten states (Alabama, California, Idaho, Illinois, Indiana, Maryland, Montana, Nevada, Ohio and Texas). There is only one private insurance company (American Share Insurance of Dublin, Ohio) offering credit unions primary share insurance and excess deposit insurance. Another private insurer (Massachusetts Share Insurance Corporation) offers only excess deposit insurance coverage.

Corporate Credit Unions

Corporate credit unions are credit unions that serve other credit unions. Corporate credit unions provide services such as investment products, advisory services, item processing and loans to their members. As of June 2018, there were 11 corporate credit unions with assets of \$22 billion.

NAFCU Research

NAFCU devotes a great deal of institutional resources to keeping its finger on the pulse of its members' operations by surveying its membership regularly. In this report, we reference several research instruments:

Economic & CU Monitor

NAFCU's Economic & CU Monitor is a monthly report based in part on survey responses by NAFCU member credit unions on a special topic. The report includes a review of the survey responses, along with commentary on economic and industry trends.

CU Industry Trends Report

NAFCU's CU Industry Trends Report is a quarterly analysis of trends in the credit union industry, with key financial ratios aggregated by region and asset class.

NAFCU Report on Credit Unions

NAFCU's Federal Reserve Meeting Survey is an annual assessment of NAFCU members covering topics we discuss in the annual NAFCU Report on Credit Unions. Survey data for the current report was collected between July and August 2018.

Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy

NAFCU commissioned a special study to examine what would happen to the U.S. economy if the presence of credit unions was reduced significantly as a result of eliminating the credit union federal tax exemption. The 2017 study quantifies the benefits to all consumers - both credit union members and bank customers - of having a strong credit union presence in financial markets. The study shows that reducing the number of credit unions would weaken competition for consumer financial services and lead to higher interest rates on consumer loans and lower interest rates on retail deposits. The study also estimates the broader economic impact of these lost consumer benefits.

Economic & CU Monitor
National Association of Federally Insured Credit Unions

Industry & Economic Briefing
By Carl Long, Chief Economist / Director of Research

Industry Outlook As the year draws to a close, credit union performance remains solid. Strong loan growth has helped the industry capture market share, and according to estimates credit unions account for roughly 8 percent of new mortgages and one-quarter of auto loan originations. However, NAFCU's **Credit Union Sentiment Index** declined this month thanks to a sharp drop in respondents' growth outlook. These growth prospects could be challenged by a number of major regulatory changes in the coming years, with an expanded HMDA reporting requirements, risk-based capital, and CEC. In addition Fed tightening and the potential for narrowing interest rate spreads could stifle growth for many credit unions.

Economic Conditions Economic data is feeling the effects of the recent, disruptive weather events. Job growth went back up for the first time in seven years and home sales and housing starts data fell below even their downward expectations. On the other hand, soaring gas prices have boosted inflation, and auto sales suggest as many shoppers sought replacement vehicles. Since the data will continue to be heavily unreliable over the near term, the Fed is unlikely to waver from its stated intention to push through another quarter point rate hike in December.

Special Topic: Business Continuity and Disaster Recovery

We are in the midst of a historic year for natural disasters. Between Hurricanes Harvey, Irma, and Maria, as well as the destructive wildfires in the American west, large swaths of the United States and Puerto Rico have been ravaged by catastrophic events and disasters. More than most credit unions must be prepared with business continuity and disaster recovery plans to address real and potential disruptions to service.

The month's Economic & CU Monitor survey shows that credit unions are generally well prepared for unanticipated service disruptions, from small-scale interruptions caused by power outages or equipment weather to widespread disruptions due to catastrophic weather conditions or massive cyberattacks. Asked to rate their credit union's current preparedness for a disaster or catastrophic event, including cyber events, respondents were unanimously either "very" or "somewhat" prepared for disaster.

Economic & CU Monitor - October 2017 Page 7 [See the survey at: www.nafcucupublications.com](http://www.nafcucupublications.com)

CU INDUSTRY TRENDS
National Association of Federally Insured Credit Unions

Industry Performance Measures

- Member & share growth are on the rise, with net growth rising above 10 percent.
- Strong loan loss provision expenses and declining fee income are putting downward pressure on NIM.
- Stronger asset growth has resulted in a decline in the net worth ratio.
- Disincentives and charge-offs remain muted, but the ratio is on the rise.

Member & Share Growth (Line chart showing trends from 2010 to 2018)

Net Interest Margin (Line chart showing trends from 2010 to 2018)

Loan Performance (Line chart showing trends from 2010 to 2018)

Net Worth (Line chart showing trends from 2010 to 2018)

Asset Yields (Line chart showing trends from 2010 to 2018)

Member Balances (Line chart showing trends from 2010 to 2018)

NAFCU's Quarterly Report (NIMCA Call Report Area) www.nafcucupublications.com

Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy

January 2017

Robert M. Feinberg, Ph.D.
Professor of Economics
American University
Washington, DC

Douglas Meade, Ph.D.
Director of Research
Interindustry Economic Research Fund, Inc.
College Park, MD

Prepared on behalf of the National Association of Federally Insured Credit Unions
www.nafcucupublications.com

Key Findings

Industry Trends

- › The credit union industry occupies only a small share of the overall financial services landscape, but they provide a reliable source of credit to local communities in good times and bad.
- › Credit unions are healthy and well-capitalized, and the industry is continuing to grow and strengthen. However, compliance burdens have led to elevated merger rates among smaller credit unions.
- › It is vital that credit unions retain reliable access to the secondary mortgage market.

Credit Union Service Offerings

- › Investing in technology is a priority for credit unions, as evidenced by the growth in the number of institutions offering remote deposit capture, mobile payments, and other electronic services.
- › Services offered by credit unions are becoming increasingly accessible through a growing network of mobile banking, websites and ATMs.

The CU Industry: Observations from the Survey of Consumer Finances

- › Credit unions have enjoyed rapid membership growth in recent years and membership penetration is consistent across most age cohorts.
- › Credit union members have lower income than bank customers and tend to be more vulnerable financially.
- › There are strong indications that households view the credit union model with growing esteem.

Policy Priorities

- › Credit unions provide over \$16 billion annually in benefits to the economy, and preserving the credit union tax exemption remains NAFCU's top legislative priority.
- › A primary concern of credit unions and their members continues to be ensuring that our nation's retailers have data security standards to protect consumers' sensitive financial information.
- › NAFCU supports efforts to modernize the Glass-Steagall Act as a key step to producing a safer, more stable financial system.
- › Credit unions continue to labor under the immense cumulative regulatory burden in the post Dodd-Frank era. The number of employees devoted to regulatory compliance has more than doubled since 2010.
- › As the Federal Reserve works to update and improve the payments system, NAFCU's goal is to ensure that it will be cost-effective, operationally effective, and scalable for credit unions of all sizes.
- › Modernized field of membership (FOM) rules are crucial to the future welfare of the credit union industry. NAFCU will continue to support and defend the NCUA's FOM rule.

Financial Technology and Credit Unions

- › Financial technology ("fintech") is an ill-defined term that encompasses a broad range of products and services. For traditional lenders, fintech firms represent both an opportunity and a threat.
- › Regulators have taken tentative steps toward increasing their oversight of fintech firms, but non-bank lenders still enjoy a tremendous advantage over the highly-regulated credit union industry.
- › Credit unions plan to increase their investment in technology, particularly as it relates to optimization of member development.

I. Industry Trends

Small Stature, Critical Role

Credit unions are member-owned, not-for-profit cooperative financial institutions. They are run democratically, led largely by volunteer directors, and exist to serve their field of membership. Strictly in terms of size, they occupy a small slice of the financial services industry, and yet they serve as a valuable partner for their members in good times and bad.

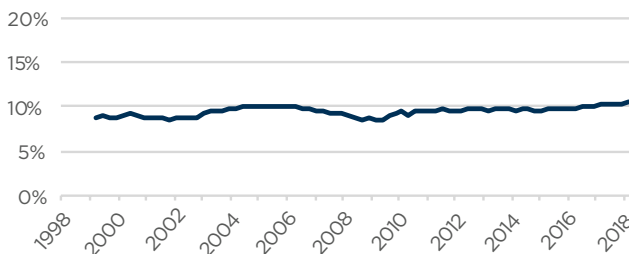
The vast majority of credit unions are small institutions struggling to find the resources to survive in the dynamic and highly-competitive field of financial services. The median credit union manages only \$33 million in assets and has just 8 full-time employees. By comparison, the median bank has over \$210 million in assets and 45 full-time equivalent employees. The largest bank is over 23 times the size of the largest credit union. Moreover, the credit union industry is less top-heavy than the banking industry. Where the top 100 banks represent 81 percent of total bank assets, the top 100 credit unions only account for 44 percent of industry assets. Each of the three largest banks controls more assets than all 5,480 credit unions combined.

While credit union competitors complain about their growth, the fact remains that the industry still occupies only a sliver of the overall market. Over the past 20 years, credit unions have consistently owned roughly 8 to 10 percent of household transaction

accounts (see Chart 1.1). As a share of total domestic financial assets, credit unions represent a scant 1.4 percent of the marketplace (see Chart 1.2). Where many of the larger holders of financial assets are part of the unregulated shadow banking system which drew scrutiny in the aftermath of the Great Recession, credit unions remain committed to serving Main Street, and acting as a source of credit for consumers and small businesses.

Nevertheless, credit unions are growing. As of June 30, 2018, their membership numbered 114 million, which represents a 4.3 percent increase over the prior year. This growth is a testament to their steadfast commitment to their members. Even during the near-zero interest rate environment, credit unions continued to offer financial products with superior rates to banks. And countless sources confirm that credit union members' satisfaction exceeds that of bank customers.¹ Where the banking industry has been plagued by scandals and fines, credit unions' commitment to their member-owners stands in stark contrast. Bank Transfer Day was a social media-driven movement in 2011 to switch financial institutions from large banks to credit unions, motivated by anger over excessive fees. While that event coincides with the increase in membership growth for credit unions, the trend has only strengthened in the years since. (For more on the growing appeal of credit unions, see *Household FI Preferences & the Appeal of Credit Unions*, pp. 18–20.)

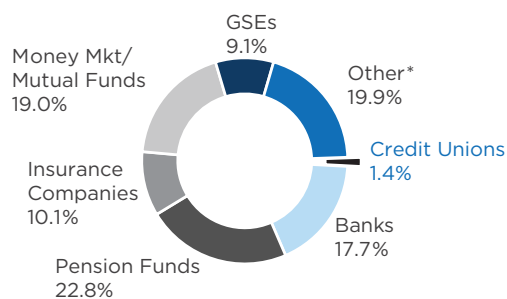
Chart 1.1: Credit Union Share of Household Transactions Accounts*



*Includes currency, checkable deposits, time & savings deposits, money market funds, and cash at broker/dealers

Source: *Financial Accounts of the United States*

Chart 1.2: Share of Domestic Financial Assets



*Includes finance companies, holding companies, private securitizers, securities brokers, REITs, closed-end and exchange-traded funds, funding companies and monetary authority

Source: *Financial Accounts of the United States*

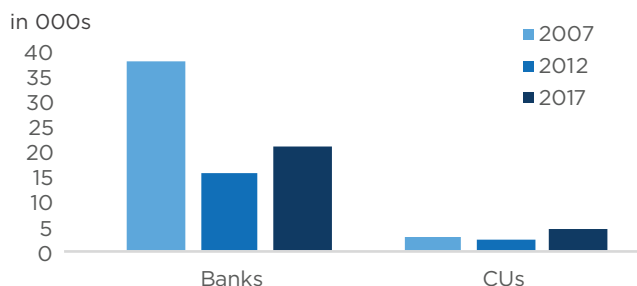
¹ See, for example, CFI Group's 2017 Credit Union Satisfaction Index

Despite the relentless outcry of well-heeled bankers to diminish the role of a smaller competitor, policymakers ought to view credit unions as part of the solution to creating a more vibrant, stable economy. Since the Great Recession, plenty of brainpower has been harnessed in the pursuit of achieving macroprudential goals of reducing the systemic risk in the financial system and supporting long-term growth. Many observers believe that the next economic downturn may be in sight, and anxiety is growing over how deep and long-lasting that event will be, whenever it does arrive. But while the financial crisis undoubtedly showed how weaknesses in the financial system can cascade across the entire nation and beyond, the crisis also proved that some communities were more resilient to an external shock than others. Several pieces of data suggest that the presence of credit unions in local communities serves to make them more resilient in times of crisis.

The Great Recession was associated with a nationwide collapse in housing prices. As communities struggled to dig out from under the rubble, their ability to do so was hampered by tight credit conditions in the mortgage market. A review of data collected under the Home Mortgage Disclosure Act (HMDA) shows that different types of institutions provided varying levels of credit to vulnerable communities during and following the crisis. Looking specifically at census tracts defined as “distressed” in 2007 by the Federal Financial Institutions Examinations Council (FFIEC), the number of mortgage loans made by credit unions in those communities held up better through the crisis than those made by banks (33 percent decline in loans made by credit unions from 2007 through 2012, versus 59 percent decline in bank mortgages; see Chart 1.3). Looking out to 2017, credit unions have expanded their mortgage loan originations by 70 percent in those census tracts as compared to 2007, while bank mortgage lending has contracted by 46 percent. The growth in credit union originations has served to provide a valuable offset to other lenders that have retreated from those markets.

Another element of the financial crisis was the collapse of funding for small businesses. A study undertaken by the Small Business Administration confirms that “the decline in bank lending was far more severe for small businesses than larger firms” during the recession.² Nevertheless, a review of credit extension by type of institution reveals a similar pattern of credit unions maintaining a flow of credit to a sector of the economy badly in need of it, even as larger lenders scale back (see Chart 1.4). As policymakers consider the troubling decline in business dynamism and its implications for the broader economy, they would do well to provide credit unions with more opportunities to partner with America’s engine of job creation – small businesses. Doing so would not only support growth over the long term, it would allow local communities to more ably weather a broad economic downturn.

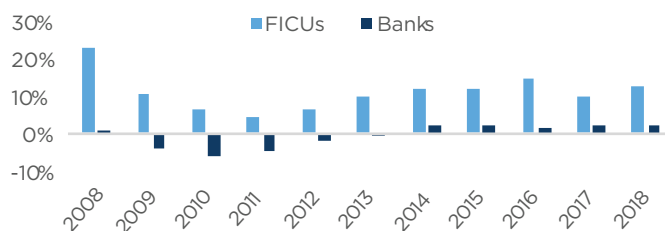
Chart 1.3: No. of Mortgage Originations in Distressed Areas



Note: Figures reflect 1- to 4-family, first-lien purchase loan originations in census tracts defined as “distressed” in 2007

Source: FFIEC

Chart 1.4: Small Business Loan Growth



Notes: (1) Beginning in 2017 Q3, NCUA reports commercial loans. FICU figures for 2017/18 show annualized growth rates in comm. loans; (2) All FICU comm. loans/MBLs are assumed to be small business loans; (3) Prior to 2011 FDIC data only collected in June. Growth rates for prior years are between-year averages of June-to-June growth.

Sources: NCUA, FDIC

² Cole, Rebel A., How Did the Financial Crisis Affect Business Lending in the U.S.? (January 22, 2018).

Taken together, credit unions' record of providing small business loans and mortgages in distressed areas during the financial crisis makes a compelling case that credit unions add to the sustainability of local economies. As member-owned institutions, they exist to serve their members, even in the depths of the largest economic calamity in 80 years. Given the value they bring to their communities, their growth should be encouraged, promoted, and celebrated.

Financial Conditions

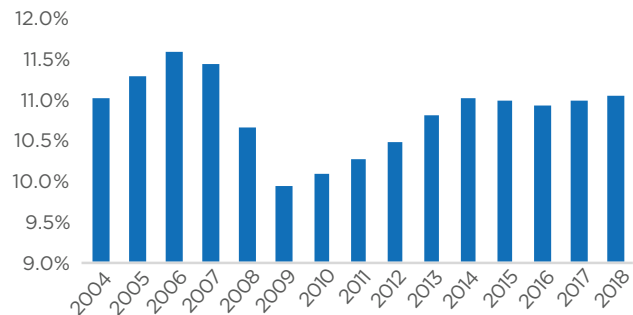
Credit unions are conservatively run, well-capitalized institutions, which helps to explain their quick recovery from the financial crisis. After dropping during the crisis, FICUs' net worth ratio once again exceeds 11 percent (see Chart 1.5). As of June 2018, year-over-year growth in net worth (7.9 percent) exceeded asset growth (5.8 percent). Since the onset of the Great Recession, credit unions have experienced a lower failure rate than banks. From 2008 through 2017, there were 528 bank failures compared to only 184 credit union failures.³ As of June 2018, NCUA reported that there were 210 problem credit unions with a CAMEL rating of 4 or 5. These credit unions constitute 1 percent of industry shares, which is down from a peak of 5.7 percent in 2009 and in line with the pre-recession figure.

Year-over-year growth in credit union membership was 4.3 percent in June 2018, which is its highest level in three decades. The increase in membership has not yet resulted in a surge in share growth. Historically, shares increase by roughly 6 percent annually. Recently, share growth peaked in 2016 at 7.5 percent, but has since moderated somewhat. Through June 2018, year-over-year share growth was 5.4 percent.

The extended period of low interest rates has resulted in a shift in liabilities as members have opted out of share certificates and into core deposits (share drafts, regular shares, and money market shares). From June 2007 to June 2018, the ratio of core deposits to total shares and deposits increased from 58 percent to 74 percent (see Chart 1.6). This shift has played a role in lowering credit union cost of funds, but that trend could be reversed as interest rates rise. From June 2017 through June 2018, the cost of funds ratio increased from 0.53 percent to 0.62 percent.

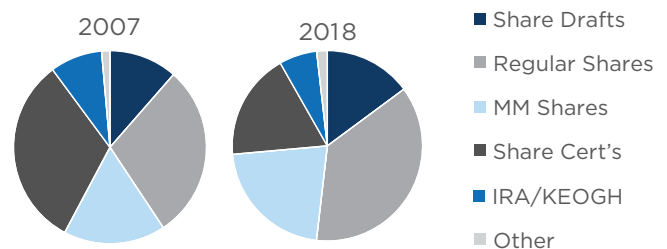
FICUs' June 2018 annualized return on average assets (ROA) of 0.9 percent was 15 basis points higher than a year prior. The bulk of that increase is explained by a \$736 million distribution to FICUs from the Share Insurance Fund (SIF). The distribution resulted from excess equity at the end of 2017 above the SIF's normal operating level. Without recognition of the distribution, June 2018 ROA would be an estimated 0.80 percent, which still represents a 5 basis point improvement over the prior year. A 14-basis point increase in net interest margin over that period provided a boost to ROA. Notable drags on ROA as compared to a year earlier include rising operating expenses (+4 basis points) and provision for loan and lease losses (+5 basis points). Fee income continues to decline, as well. At just 61 basis points in June, it is down 1 basis point from a year earlier and 13 basis points since 2011. Since that year credit unions' interchange fee income has been capped by the Durbin Amendment (for further discussion, see *Interchange Fees*, page 32).

Chart 1.5: FICU Net Worth Ratio



Source: NCUA

Chart 1.6: Percent of Total Share & Deposits



Source: NCUA

³ As of December 2007, there were 8,534 banks in existence and 8,101 credit unions.

Lending

Credit unions have maintained strong loan growth for several years. In the second quarter of 2018, total industry loans outstanding surpassed \$1 trillion. Over 70 percent of that total is comprised of first-lien residential mortgages and auto loans (35 percent each). The remaining loan portfolio consists of junior-lien residential loans (8 percent), commercial loans (7 percent), credit card loans (6 percent), and unsecured personal loans or lines of credit (4 percent).

Auto lending has been a key segment for the industry lately, fueling total loan growth in recent years. However, auto sales have slowed sharply from a year ago, as dealers are on pace to finish 2018 with the fewest units sold since 2014. While credit unions have still managed to boost year-over-year auto loan balances by over 10 percent, this represents a decline from previous years (see Chart 1.7). As a result, total year-over-year loan growth for credit unions through the second quarter of 2018 dropped below 10 percent for the first time in four years.

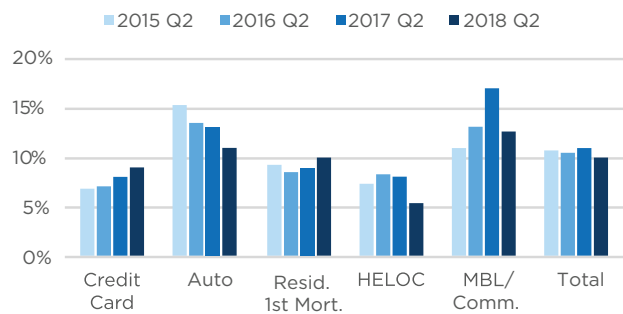
Other key loan segments are absorbing some of that slack. Credit card and commercial loan growth are each near or above 10 percent versus the previous year. (Note that in the third quarter of 2017 NCUA began reporting commercial loans rather than member business loans (MBLs). The figure for 2018 Q2 commercial loan growth represents annualized growth in the three quarters since the new reporting approach).

Growth in first-lien mortgages was 9.9 percent year-over-year as of June 30, 2018. That represents an increase of 100 basis points over the previous year. This segment is particularly critical for credit unions, given that it represents 35 percent of total credit union loans outstanding. However, while loan balances are increasing at a healthy rate, originations over the most recent 12 months declined by 3.6 percent versus the prior 12 months. The share of originations sold to the secondary market declined from 34 percent to 31 percent over that time, and with refinances on the decline, fewer existing loans are facing prepayment.

Credit union loan performance remains strong. As of June 31, 2018, only 0.67 percent of total loans were delinquent (see Chart 1.8). That represents a 14-basis point improvement over the end of 2017. By comparison, bank loan delinquencies totaled 1.06 percent of outstanding loans, and the community bank delinquency ratio was 0.82 percent. The net charge-off ratio was 0.60 percent through the first six months of 2018. That is unchanged from the previous year's figure.

Credit unions' coverage ratio (loan loss reserves-to-delinquent loans) was 137 percent at the end of the second quarter. That is up from 119 percent a year earlier. By comparison, the coverage ratio for banks is 118 percent.

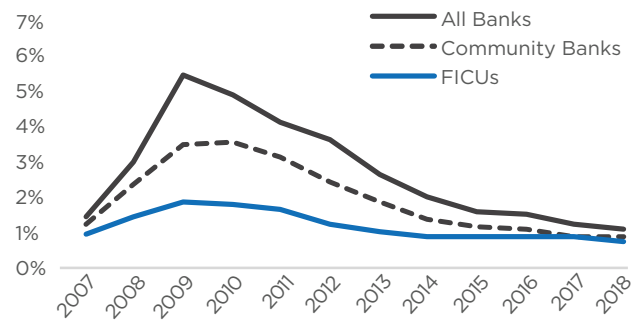
Chart 1.7: Loan Growth by Product Line



Note: Beginning in 2017 Q3, NCUA reports commercial loans rather than MBLs. FICU figure for 2018 shows annualized growth over three quarters.

Source: NCUA

Chart 1.8: Delinquency Rates



Note: FICU loans are delinquent at 60 days past due; bank loans at 90 days past due

Source: NCUA, FDIC

NAFCU's annual *Federal Reserve Meeting Survey* includes questions on lending standards, and a comparison between the results of the 2018 survey with each of the two prior years shows that standards are generally tighter than they have been in 2016 or 2017 (see Chart 1.9). In particular, a net majority of respondents indicated that they had tightened loan standards in 2018 as compared to the year prior for credit card loans, HELOCs, and commercial loans. A small net majority of respondents reported further easing of auto loan standards, but the share was much smaller than in past years. Credit unions have historically had excellent auto loan quality. A recent report from a large credit agency indicated that credit union auto loan delinquencies were less than half the industry average (1 percent versus 2.2 percent).⁴

For residential first mortgage loans, lending standards were little changed compared to a year prior. A slight easing was indicated for GSE-eligible, government-guaranteed, QM jumbo and non-QM non-jumbo loans. A slight majority tightened standards on non-QM jumbo loans.

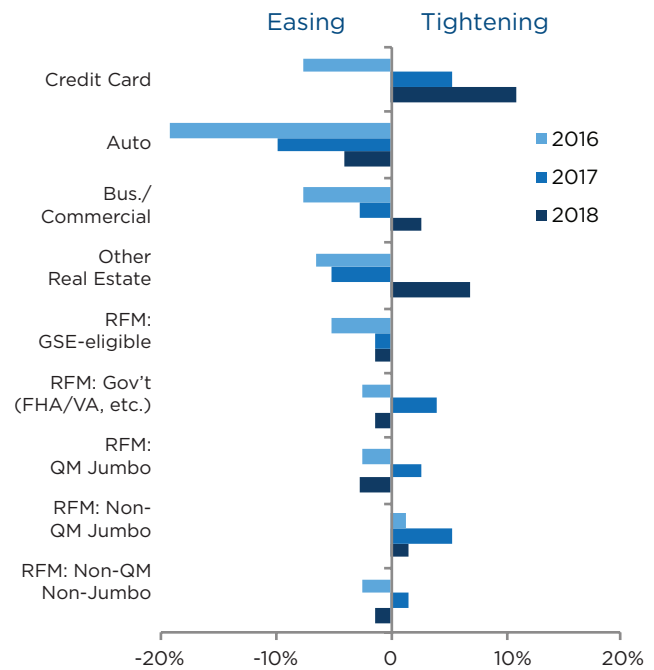
Consistent with strong loan growth, survey respondents reported solid loan demand again in 2018 (see Chart 1.10). In spite of the decline in auto sales in 2018, over half of credit unions reported that their loan demand has been stronger over the past 12 months than it was in the prior 12 months.

However, demand across all categories of residential first mortgages was little changed from a year earlier. This is a departure from previous years when a solid majority of respondents indicated stronger demand for mortgage loans.

Small Credit Unions & Industry Consolidation

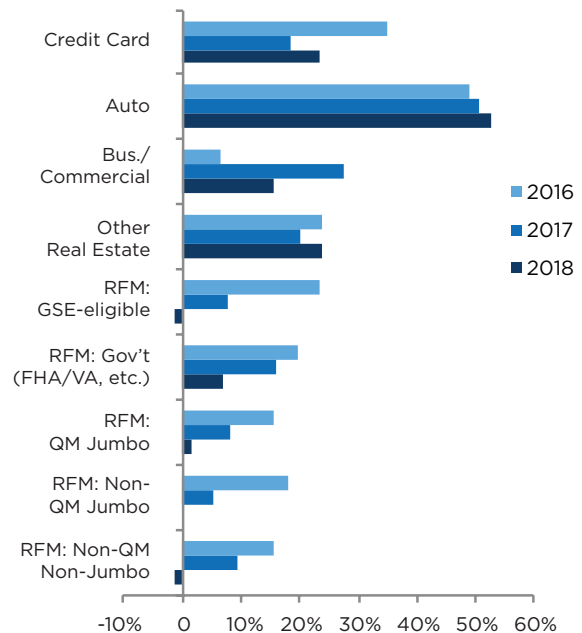
The post-recession environment has been an extraordinarily difficult one for small credit unions. The combination of increasing regulatory burden and low interest rates has been hard on all credit unions, but particularly smaller ones, who lack the scale to manage additional regulations and who tend to rely on wider spreads between their loan and deposit rates.

Chart 1.9: Net % of Respondents Tightening Loan Standards (Last 12 Months)



"RFM" = Residential First Mortgage
 Source: NAFCU 2018 Federal Reserve Meeting Survey

Chart 1.10: Net % of Respondents Indicating Stronger Loan Demand (Last 12 Months)



"RFM" = Residential First Mortgage
 Source: NAFCU 2018 Federal Reserve Meeting Survey

⁴ Experian PLC, *State of the Automotive Finance Market (2018 Q2)*

Respondents to NAFCU's 2018 *Federal Reserve Meeting Survey* were asked for the minimum asset level needed to survive in the current environment. As was the case in both 2016 and 2017, this year's median response was \$250 million. However, a larger portion of respondents than in years past (32 percent) indicated that it was even higher. As of June 30, 2018, 84 percent of credit unions managed less than \$250 million in assets.

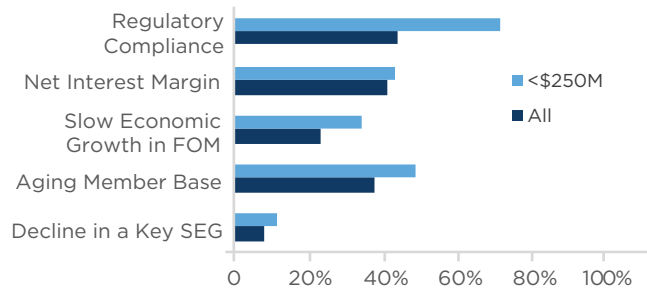
Survey respondents were also asked to anticipate the key strategic challenges that their credit unions will face over the next three years. A division of the responses at the \$250 million asset level results in some stark differences. While regulatory compliance was a key concern across all asset sizes, it was by far the top concern among smaller credit unions (see Chart 1.11). By comparison, there was little difference between smaller credit unions and larger ones in their concern over net interest margin. However, with the Treasury yield curve continuing to flatten, this could become more problematic for small credit unions in the future.

There were also a number of survey questions related to the health and viability of respondents' current field of membership. Small credit unions were more likely than large ones to identify the following as key concerns: slow economic growth within the field of membership; an aging membership base; and the potential decline in a key select employee group (SEG). These results suggest that enhanced abilities to expand one's field of membership would be a particular benefit to small credit unions as they seek the membership diversity and scale necessary to survive.

The stresses on small credit unions have led to a rise in merger activity within the industry. Since passage of the Dodd-Frank Act in 2010, the number of credit unions has declined by over 25 percent at a pace of roughly one per business day. The increased merger activity is confined to credit unions below \$250 million in assets (see Chart 1.12). Larger credit unions experienced a mild rise in mergers during the financial crisis, but since 2011 the merger rate has returned to the low, pre-crisis level.

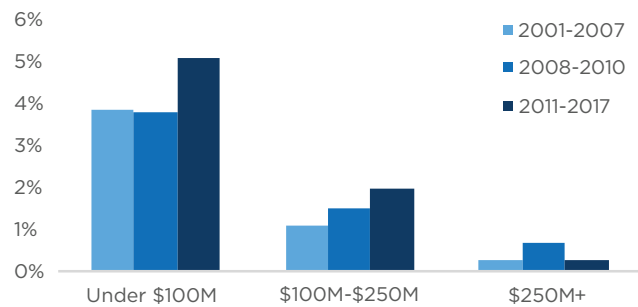
Another facet of industry consolidation has been the lack of de novo credit unions. From 2000 through 2009, NCUA chartered an average of 7.7 new credit unions annually. However, from 2010 through 2017, that number has shrunk to just 2.4 per year. Regulatory burden in the Dodd-Frank era is stifling the formation of credit unions. In the process, many households are forced to seek financial services from predatory lenders and other alternative providers.

Chart 1.11: Strategic Challenges Rated as "Significant", by Asset Class



Source: NAFCU 2018 Federal Reserve Meeting Survey, selected responses

Chart 1.12: Average Annual Merger Rate by Asset Class



Source: NCUA

Liquidity

Given the strong loan growth of recent years, industry liquidity conditions have tightened. The loan-to-assets ratio has steadily climbed from a low of 59 percent in 2012 to 70 percent as of June 30, 2018. This is in line with the pre-crisis ratio. However, the shift toward core deposits may provide some additional resiliency to credit union funding than was present prior to the crisis.

Corporate credit unions are a key source of liquidity for the industry. However, a number of corporate credit unions failed during the Great Recession, which led to a decline in their membership before a subsequent rebound. In 2008, over 90 percent of natural-person credit unions held capital in a corporate credit union (see Chart 1.13). That figure dipped below 60 percent in 2010 but has risen to over 80 percent today. Furthermore, a number of other credit unions that do not hold capital in a corporate credit union still maintain relationships with a corporate and utilize their services.

In the meantime, Federal Home Loan Banks (FHLBs) have come to play a more prominent role within the industry, and they now serve as a critical source of liquidity for many credit unions. The share of credit unions belonging to a FHLB increased from 12 percent in 2008 to over 25 percent in 2018. FHLB-member credit unions tend to be relatively large, with a median size of \$310 million.

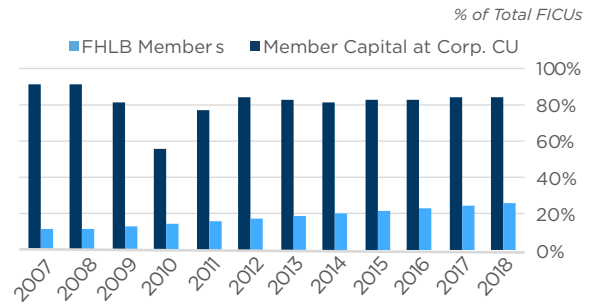
In October 2013, NCUA passed a rule requiring credit unions with over \$250 million in assets to establish a contingent liquidity funding source through either the Federal Reserve Discount Window or the Central Liquidity Facility (CLF). Based on responses to NAFCU's *2018 Federal Reserve Meeting Survey*, those credit unions have largely opted for the discount window.

Secondary Mortgage Market

The secondary mortgage market is vital to many small financial institutions with mortgage loan portfolios, both as a source of liquidity and as a tool to manage interest rate and concentration risks. Through June credit unions sold 31 percent of first mortgage loans originated in 2018. This is down from 2017 when 35 percent of first mortgage originations were sold. Credit unions that participated in NAFCU's *2018 Federal Reserve Meeting Survey* indicated that, on average, 59 percent of their outstanding first mortgage loans qualify to be sold on the secondary market (down from 72 percent in the prior year's survey). As compared to the previous 12 months, there were more respondents that said that they expect to sell a larger share of mortgage originations over the next 12 months (15 percent), than those who expect to sell a smaller share (6 percent).

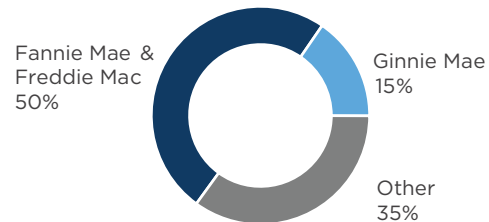
Based on data released under the Home Mortgage Disclosure Act (HMDA), credit unions tend to utilize Fannie Mae and Freddie Mac heavily for those loans that they do sell (see Chart 1.14). Among respondents to this year's survey, 23 percent sell mortgages to Fannie Mae, 10 percent sell to Freddie Mac, and another 23 percent sell to both. When asked which factor most influences their decision to utilize the GSEs, the most common response was ease of access relative to alternatives (26 percent), followed by pricing (23 percent). Among alternatives for placing mortgage loans, the most popular were FHLBs (23 percent), mortgage wholesalers (16 percent), and credit union service organizations, or CUSOs (14 percent).

Chart 1.13: Share of CUs with Membership in FHLBs vs. Corporate CUs



Source: NCUA

Chart 1.14: 2017 Credit Union Mortgage Sales by Purchaser



*Other includes banks, credit unions, life insurance companies, mortgage banks, finance companies, private securitization, affiliate institution, or other type of purchaser

Source: FFIEC

II. Credit Union Service Offerings

Credit unions carry on their commitment to offering superior products and services to their members. Investing in technology is a priority for credit unions. This is evident in the growth in the number of institutions offering remote deposit capture, mobile payments, and other financial products.

Electronic Financial Services

According to NCUA call report data, the percentage of federally-insured credit unions offering electronic financial services has increased for 19 of the 20 service categories during the 12-month period ending June 2018. Remote deposit capture, mobile payments and electronic signature services saw the largest increase in adoption rate. Account Balance Inquiry remains the most common online service offered by FICUs, with 79.8 percent reporting that they currently offer this service (see Table 2.1).

Electronic services offered by credit unions are also becoming more accessible through a variety of platforms. More FICUs are offering mobile banking to members (see Table 2.2). Nearly 58 million members now utilize their credit unions' transactional websites, an 8.4 percent increase from last June. The industry as a whole also expanded its reach through a growing network of ATMs.

NAFCU's 2018 *Federal Reserve Meeting Survey* found that 92.2 percent of the respondents expect to spend more on information technology over the next three years. Improving member experiences and services are top reasons behind such investments. When asked to identify specific IT-related projects, more than half of the respondents envisioned their credit unions investing in mobile banking and in ways to optimize customer development over the next three years (see Chart 2.1, next page).

As technologies supporting the payment process evolve, the share of respondents who expect to invest in this area picked up noticeably (49.4 percent, up from 35 percent last year). Over half of the participants are considering a faster payments settlement option for their members. In addition, over two-thirds noted that they would have greater interest in a faster payments settlement option if it was developed under the direction of the Federal Reserve, an initiative that NAFCU supports and has emphasized to agency staff (for further discussion, see *Payments*, page 29).

Table 2.1: Financial Services Offered Electronically by Federally-Insured Credit Unions

Online Service Offered	Provided in 2018	Provided in 2017
Account Balance Inquiry	79.8%	79.0%
View Account History	78.8%	78.0%
Share Account Transfers	77.8%	76.9%
Loan Payments	73.4%	72.4%
e-Statements	72.7%	70.9%
Download Account History	70.3%	69.2%
Bill Payment	65.7%	64.3%
Share Draft Orders	63.3%	62.6%
New Loans	53.7%	51.6%
Remote Deposit Capture	42.6%	37.3%
Member Application	39.5%	37.8%
Mobile Payments	28.9%	24.7%
New Share Account	28.5%	26.8%
External Account Transfers	26.9%	24.5%
Electronic Signature Services	25.8%	21.8%
Internet Access Services	18.6%	18.1%
Account Aggregation	14.2%	13.2%
Merchant Processing Svcs.	6.3%	5.9%
Merchandise Purchase	5.6%	5.7%
Electronic Cash	4.3%	4.2%

Source: NCUA June 2018 & 2017 Call Reports

Table 2.2: How Do Your Members Access/Perform Electronic Financial Services?

Electronic Service	Percentage of Institutions	
	2018	2017
Audio Response/Phone-Based	60.0%	59.5%
Automatic Teller Machine	75.5%	74.7%
Banking via Internet Website	78.1%	77.4%
Kiosk	6.8%	6.5%
Mobile Banking	60.7%	57.2%
Other	5.3%	5.0%

Source: NCUA June 2018 & 2017 Call Reports

Transaction Services

In NAFCU's 2018 *Federal Reserve Meeting Survey*, participants were asked to indicate their use of intermediaries for transaction services (see Table 2.3). Corporate credit unions fill a primary role in the credit union industry and saw an uptick in usage compared to last year. The Federal Reserve also plays an important part and is used by over three-fourths of the respondents.

Responses by asset class suggest that credit unions under \$500 million rely more heavily on corporate credit unions for their transaction services than larger credit unions do (see Chart 2.2). Credit unions over \$100 million in asset size are much more likely to utilize the Federal Reserve for at least some of their transaction services. Meanwhile, respondent usage of outside vendors was mostly uniform across asset classes.

Chart 2.1: Anticipated IT-Related Investments Over Next Three Years

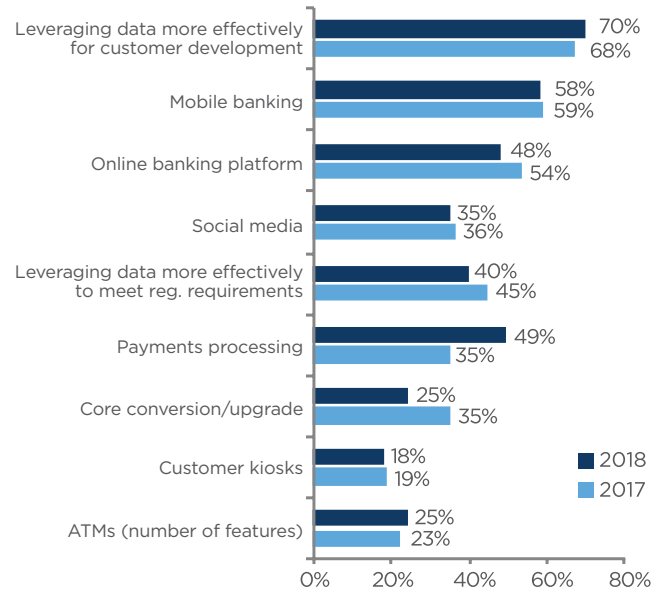
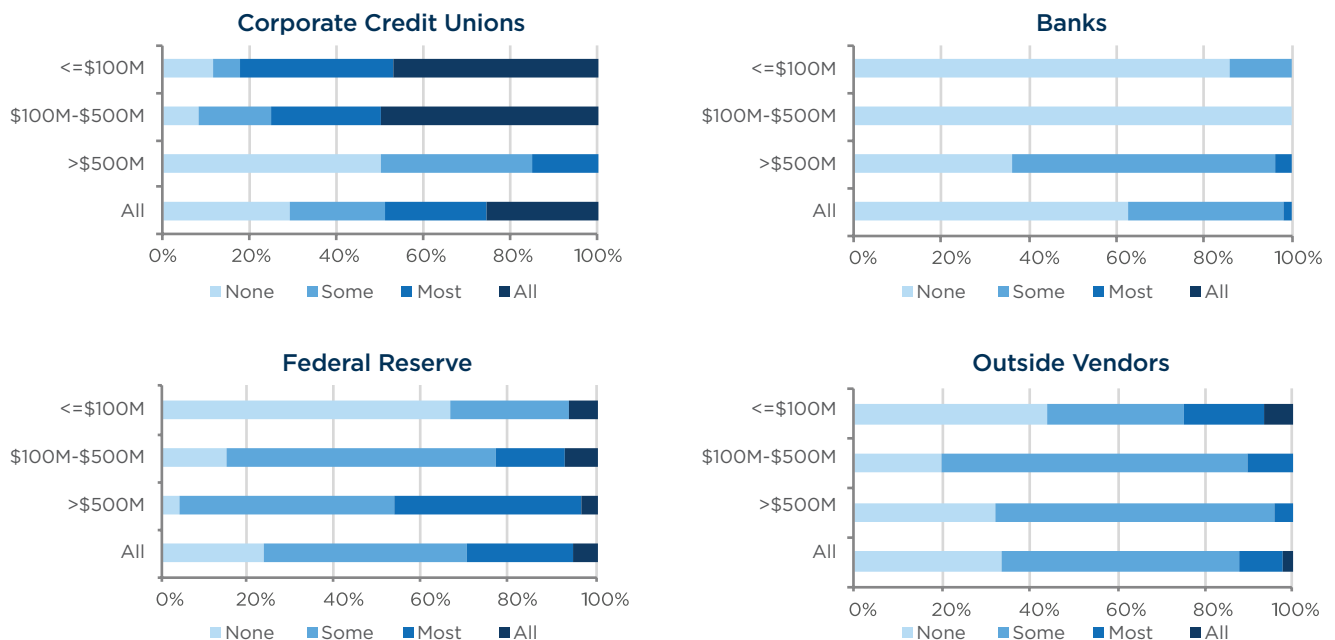


Table 2.3: Which Intermediaries Does Your Credit Union Use for Transaction Services?

	Corporate Credit Unions		Banks		Federal Reserve		Outside Vendors	
	2018	2017	2018	2017	2018	2017	2018	2017
None	29.1%	35.8%	62.5%	48.9%	24.1%	11.3%	33.3%	28.3%
Some	21.8%	30.2%	35.4%	40.4%	46.3%	47.2%	54.9%	65.2%
Most	23.6%	22.6%	2.1%	8.5%	24.1%	26.4%	9.8%	6.5%
All	25.5%	11.3%	0.0%	2.1%	5.6%	15.1%	2.0%	0.0%

Source: NAFCU 2018 & 2017 Federal Reserve Meeting Surveys

Chart 2.2: Use of Intermediaries by Asset Class



Source: NAFCU's 2018 Federal Reserve Meeting Survey

III. The CU Industry: Observations from the Survey Of Consumer Finances

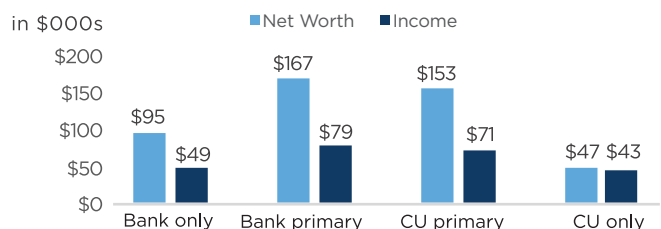
The Survey of Consumer Finances (SCF) is a triennial survey of a representative sample of U.S. households conducted by the Federal Reserve. The survey data include broad and detailed information on families' finances, as well as their use of financial institutions. The scope of the survey makes it useful for investigating various features of credit union members. In light of recent trends within the credit union industry, the SCF provides valuable insight into the type of members credit unions are serving, the evolving nature of credit unions' appeal to households, and the role credit unions play in providing credit to small business owners.

Membership Trends

Credit unions have enjoyed rapid membership growth in recent years. According to NCUA call report data, credit union membership is currently growing at a rate of 4.3 percent, where the growth rate over the past 20 years has been 2.3 percent. Data from the SCF confirms that a growing share of households are joining credit unions (see Table 3.1). In analyzing the survey data, households were divided into four groups: (1) bank only; (2) bank primary; (3) credit union primary; and (4) credit union only.⁵ The 2016 survey results are notable for having the highest share of households using credit unions as their exclusive financial institution (FI) type (7.9 percent), and the highest combined share of households as either the primary or exclusive FI type (18.9 percent) since at least 1995.

The SCF also provides evidence that credit union members tend to have both lower income and lower wealth than bank customers (see Chart 3.1). The median income for CU-only households was lower than that of bank-only households (\$43,000 vs. \$49,000), and the income of CU-primary households was lower than that of bank-primary households (\$71,000 vs. \$79,000). A similar story holds true for net worth, as CU-only household wealth is less than half that of bank-only households (\$47,000 vs. \$95,000), and CU-primary household wealth is less than that of bank-primary households (\$153,000 vs. \$167,000).

Chart 3.1: Median Income & Net Worth by FI Type



Source: FRB SCF

Table 3.1: Share of Households by Financial Institution (FI) Type

	1995	1998	2001	2004	2007	2010	2013	2016
Bank only	56.3%	58.6%	58.1%	59.6%	57.5%	60.1%	60.4%	58.3%
Bank primary	21.2%	19.5%	18.3%	17.6%	18.3%	17.4%	16.9%	18.3%
CU primary	8.6%	9.1%	9.8%	9.7%	10.5%	11.1%	10.6%	11.0%
CU only	6.1%	6.1%	7.8%	7.4%	7.7%	6.6%	7.4%	7.9%
None (unbanked)	7.7%	6.8%	6.0%	5.7%	5.9%	5.0%	4.6%	4.5%

⁵ Respondents are asked to identify up to 7 financial institutions that they do business with, and then rank those institutions according to how heavily they are used. For the “bank” or “credit union only” groups, the respective category is the only type of depository institution identified. For the “bank” or “credit union primary” groups, respondents use a mix of institution types, with the highest one listed determining how the household is categorized. This method is somewhat different but yields similar results to the one used by Dr. Jinkook Lee. See Jinkook Lee and William A. Kelly Jr., “Who Uses Credit Unions?” (Prepared for the Filene Research Institute and the Center for Credit Union Research, 1999, 2001).

In addition to earning lower incomes and owning less wealth than bank customers, credit union members tend to be more vulnerable financially than bank customers. Combining the CU-only households with CU-primary households, their median liquid savings totaled \$4,250, compared to \$5,000 for bank customers. Credit union members also have fewer family connections to call upon if a financial emergency arises. When asked whether they could get financial assistance of \$3,000 or more from friends or relatives, 37 percent of credit union households responded that they could not, compared to 34 percent of bank households.

Table 3.2: FI Affiliations by Age Group

Age	Bank only	Bank primary	CU Primary	CU Only
18 to 24	61.2%	17.0%	9.2%	12.6%
25 to 34	60.5%	19.5%	10.6%	9.5%
35 to 44	58.8%	21.6%	11.4%	8.3%
45 to 54	57.4%	20.7%	13.1%	8.9%
55 to 64	60.4%	19.3%	12.1%	8.2%
65+	66.0%	16.4%	11.3%	6.4%

One common perception of credit unions is that they serve an older demographic than other FIs. However, the SCF provides little evidence of this. The median age of CU-only heads of households is lower than that of bank-only households (50 years old vs. 53). The reverse is true, though, for households with mixed affiliations, as bank-primary households are younger than CU-primary households at the median (50 years old vs. 52).

Credit union membership penetration is fairly consistent across most age cohorts (see Table 3.2). As a share of banked households, those using credit unions as their primary or exclusive FI represent 20 to 22 percent of the total for all but the 65-year old and over category, where the figure drops to 18 percent. Younger members are more likely to use credit unions as their exclusive FI as opposed to a mix of credit unions and banks.

Household FI Preferences & the Appeal of Credit Unions

In addition to providing basic demographic data on households, the SCF asks some more probing questions about their decision-making processes for selecting their financial institution. Beginning with the 1998 survey, respondents were asked for the most important reason that they chose the institution with their primary checking account. The responses to this question reveal much about the evolution of customer choices over that span and the appeal of the credit union industry.

The responses are placed in one of over 30 possible options, which have been combined into the following categories: (1) location and convenience; (2) rates and fees; (3) products and services; (4) personal connections; (5) safety and absence of risk; and (6) reputation and institutional preference. In reviewing the top reasons identified by all households over time, some patterns emerge. Location and convenience are by far the most significant factor throughout the survey period (see Table 3.3). Despite their smaller size, credit unions attempt to expand their reach geographically through shared branching and ATM networks. Rates and fees were the second-most popular reason until 2007. Possibly as a result of increased competition and the lower interest rate environment, that category has declined in prominence, ranking fourth in the most recent survey. Finally, safety and absence of risk was mostly an afterthought for households until the financial crisis. Starting in

Table 3.3: Main Reason for Choosing FI for Primary Checking Account (All Banked Households)

	1998	2001	2004	2007	2010	2013	2016
Location & Convenience	39.9%	39.5%	42.2%	42.6%	43.3%	41.4%	41.7%
Rates & Fees	16.5%	15.2%	15.6%	12.9%	13.5%	14.5%	13.4%
Products & Services	14.8%	15.4%	14.3%	15.3%	16.1%	17.2%	15.4%
Personal Connections	11.5%	12.9%	13.6%	14.5%	12.4%	13.3%	14.9%
Safety & Absence of Risk	1.8%	2.0%	1.7%	2.6%	3.3%	3.2%	4.2%
Reputation & Institutional Preference	0.6%	0.9%	1.3%	0.7%	0.8%	0.9%	1.0%

2007, however, the share of households citing it as the primary reason for selecting their FI has risen steadily, reaching 4.2 percent in 2016.

Another angle on the data is to look at the likelihood that households would select credit unions given a particular selection criterion. Chart 3.2 compares the results from the 2007 survey to the one from 2016 in order to give a sense of how perceptions of credit unions have changed over the business cycle. For the 2016 survey, Millennial households are broken out separately, given the importance financial institutions attach to attracting younger generations. (Note: We follow Pew Research Center’s convention and define Millennials as those born between the years 1981 and 1996, corresponding to ages 20 to 35 in 2016.) The same age cohort is provided from the 2007 survey for comparison purposes.

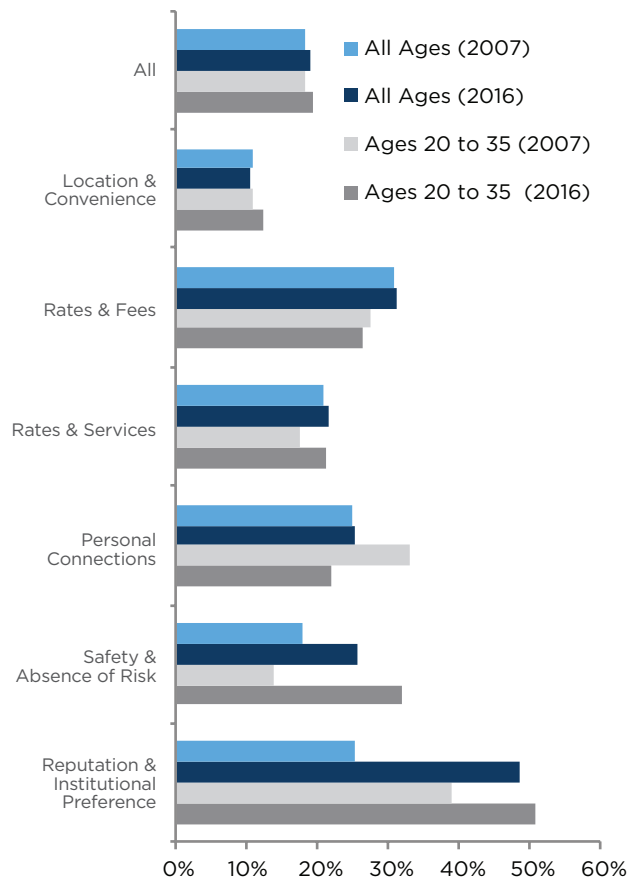
Among households selecting their FI based on the top four categories (location, rates and fees, products and services, personal connections), there was little change in the likelihood that they would select a credit union between 2007 and 2016. A combined 85 percent of households with a checking account select their FI on the basis of one of those categories, which helps to explain why the overall share of households selecting credit unions for their primary checking account changed little.

However, for households that based their selection on the final two categories – safety and absence of risk, and reputation and institutional preference – there was a pronounced rise in the likelihood that they selected credit unions. The survey instrument does not explain what is meant by “safety and absence of risk.” At a minimum, it is likely a response to the well-publicized scandals and account abuses at large banks in recent years. It also suggests that households may be seeking alternatives to the banks that they identify with the risky products and practices that led to the financial crisis (see also *Modern Glass-Steagall Act*, pp. 33-34). While the portion of households choosing their financial institution on the basis of its reputation or institutional type remains small at just 1 percent, nearly half of all respondents who do so opt for credit unions. Taken together, the sharp rise in the likelihood of selecting a credit union on the basis of less tangible qualities such as safety and reputation provide a strong indicator that households view the credit union model with growing esteem. Even among households where these categories are not the top reason for selecting their FI, they may still be an important consideration.

Reviewing the comparison between millennials and the same age cohort from the 2007 survey, many of the trends observed in the overall sample population remain intact. Millennials who select their FI based on rates and fees are somewhat less likely to opt for credit unions, but as was the case with the overall population, there was little change between 2007 and 2016. The large drop in the “personal connections” category appears to be an aberration. The likelihood of that group to select a credit union was noticeably higher in 2007 than in every other survey year.

Intriguingly, millennials who made their FI selection based on safety or reputation were even more likely than the overall population to opt for credit unions.

Chart 3.2: Share of Households Selecting CUs, Given Top FI Selection Criterion



That likelihood also increased strongly between 2007 and 2016. These trends suggest that the growing appeal of credit unions is at least as strong, if not more so, among younger households.

Credit Union Small Business Lending

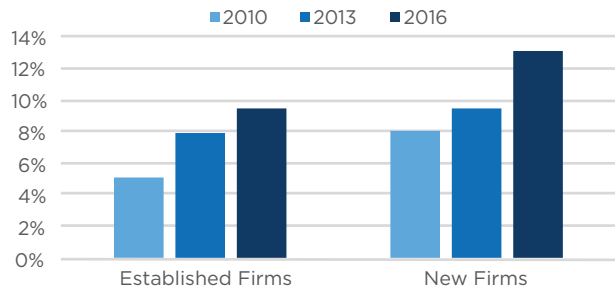
The design features of the SCF allow for the capture of a large number of privately-held business owners within the survey group. Beginning in 2010, an expanded set of questions asked business owners, among other things, about their primary financial institution. The data indicate that credit unions are serving an expanding share of small businesses, but ones that differ substantially from those that utilize banks.

In the analysis that follows, small business owners are defined as those who actively manage businesses with fewer than 500 employees. Many studies of small businesses categorize them into either established firms (defined here as those having been started or acquired by the respondent more than three years earlier) and new firms (started or acquired in the past three years). Credit unions tend to serve more new firms than established ones, but credit unions are rapidly gaining share in both categories (see Chart 3.3).

Providing credit to young firms is of vital importance given the trends in business dynamism. During the Great Recession, the pace of business formation plummeted and has only seen a mild recovery since (see Chart 3.4). This decline has myriad implications for the broader economy. Small businesses have traditionally been engines for job growth, key sources of innovation, and providers of competition in the marketplace. Moreover, many of those who started a small business during the financial crisis did so following a job loss. Ensuring a steady source of credit to small businesses throughout the business cycle would make communities more economically resilient.

Given the strategic importance of small businesses, and the fact that credit unions are well-positioned to serve them, policymakers should make every effort to provide credit unions with regulatory relief for their small business lending efforts (for further discussion, see *Member Business Lending*, page 26). Bankers often attack any efforts to loosen restrictions on credit union business lending, arguing that doing so merely diverts small business loans to a different institution. But credit union loans in this area are categorically different from bank loans. The average revenues of a small business bank customer are 24 times larger than that of a credit union member (see Table 3.4). Similarly, average income is nine times greater, and the average value of the firm is 10 times greater. Simply put, credit unions are lending to different firms than banks are. They should be allowed greater freedom to serve an important segment of the economy that other lenders often ignore.

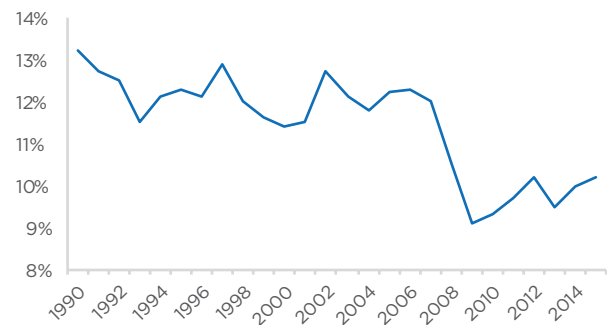
Chart 3.3: Share of Small Businesses Using CUs as Primary Financial Institution



Notes: (1) Actively-managed firms only; (2) small businesses defined as those with fewer than 500 employees; (3) established firms were started or acquired more than 3 years before the survey year

Source: FRB SCF

Chart 3.4: Startups as a Share of Total Firms



Source: U.S. Census Bureau

Table 3.4: Small Business Averages by Primary Financial Institution

in \$000s	Banks	CUs
Gross Sales	\$2,835	\$120
Net Income	\$350	\$39
Firm Value	\$2,740	\$246

Source: FRB SCF (2016)

IV. Policy Priorities

A. A Regulatory Environment that Allows Credit Unions to Grow

Credit unions are laboring under significant regulatory burdens and growing compliance costs. Regulatory burdens are the top challenge facing credit unions today. Reducing burdensome and unnecessary regulatory compliance costs is the only way for credit unions to thrive. Indeed, 81 percent of respondents to NAFCU's 2018 *Federal Reserve Meeting Survey* indicated that "a healthy, appropriate regulatory environment" is critical to their credit union's continued growth and success.

Compliance costs have skyrocketed in the aftermath of the economic crisis. NAFCU's 2018 *Federal Reserve Meeting Survey* found that the number of full-time equivalent (FTE) staff members devoted to "total compliance activities" has increased 127 percent since 2010, a 13 percent increase from 2017 (see Chart 4.1), and 91 percent of respondents expect it will be necessary to increase the number of compliance FTEs even more. Consolidation in the industry has accelerated since the passage of the Dodd-Frank Act (see *Small Credit Unions and Industry Consolidation*, pp. 12-13).

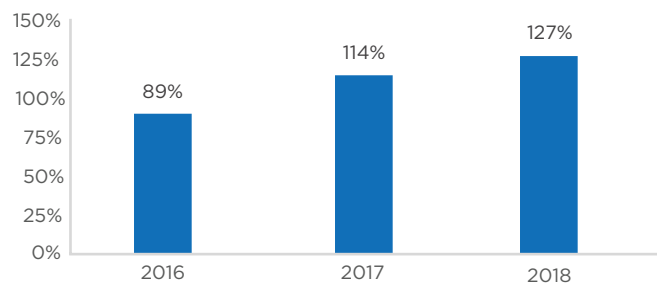
While credit unions continue to look for ways to provide forward-thinking products and services to better serve their members, regulatory overreach thwarts that innovation. Ultimately, regulators must work to strike a balance between industry safety and market growth.

Preserving the Credit Union Tax Exemption

The *Federal Credit Union Act* grants credit unions a tax exemption because they operate on a not-for-profit basis, are organized without capital stock, and for mutual purposes. These defining characteristics, no matter the size, persist today just as they did when the *Federal Credit Union Act* was first enacted in 1934. In December 2017, President Trump signed the *Tax Cuts and Jobs Act* into law, keeping the credit union tax exemption fully intact. This historic legislation is a testament to the value and strength of credit unions. Credit unions still pay many taxes and fees, including payroll and property taxes. Moreover, share dividends paid to credit union members are taxed at the membership level.

Preservation of the credit union tax exemption continues to be a top legislative priority. While there has been no proposed legislation on the subject, NAFCU remains vigilant as Congress eyes tax reform in the wake of the *Tax Cuts and Jobs Act*. Following its passage, the Senate Finance Committee conducted a review of all tax-exempt industries, including the credit union industry. Chairman Hatch wrote both the National Credit Union Administration (NCUA) and the IRS positing that "larger" credit unions should have to file Form 990 information returns to the IRS. NAFCU believes that such an action would be a new regulatory burden with very little benefit, as credit unions already provide financial data to their federal regulator (NCUA) and make information available to their member-owners.

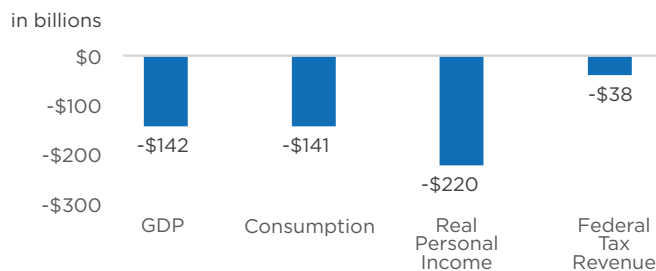
Chart 4.1: Percent Increase in Compliance FTEs Since 2010



Source: NAFCU Federal Reserve Meeting Surveys

A 2017 NAFCU study on the benefit of the tax exemption found that the presence of credit unions provided an average of \$16 billion annually in benefits to consumers, businesses and the U.S. economy. Removing the credit union tax exemption would result in the loss of an estimated 900,000 jobs and cost the federal government \$38 billion in lost income tax revenue over the next 10 years (see Chart 4.2). NAFCU remains vigilant in educating lawmakers about the value of the credit union tax exemption and ensuring larger tax reform efforts do not alter credit unions' tax-exempt status.

Chart 4.2: Economic Impact from Loss of CU Tax Exemption (2017-26)



Source: *Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy (2017)*

Housing Finance Reform

Effective housing finance reform that preserves a government guarantee, maintains unfettered access to the secondary market and ensures fair pricing for credit unions based on loan quality, not volume, remains a top legislative issue for NAFCU as lawmakers continue deliberations on the disposition of the Government-Sponsored Enterprises (GSEs), including Fannie Mae and Freddie Mac. The securitization processes of the GSEs remains a key component of the safety and soundness of credit unions nationwide.

The GSEs enable credit unions to obtain the necessary liquidity to provide new mortgages for their member-owners by utilizing the secondary market. In addition, the Federal Home Loan Banks (FHLBs) allow credit unions to meet their liquidity needs through timely loans. The availability of these stable and reliable sources of funding has facilitated credit unions' ability to offer new mortgage loans and related credit to their members, many of whom have been denied access to homeownership by other lenders. The GSEs and FHLBs have long served as valuable partners in credit unions' efforts to meet their members' mortgage needs. This continues to be true in the current economic environment.

In the ten years since the federal government took Fannie Mae and Freddie Mac under conservatorship, the GSEs and the secondary mortgage market have continued to be a key topic of congressional debate. More recently, several lawmakers and agency heads have indicated that housing finance reform will be a major agenda item under their leadership. NAFCU is committed to educating Congress and the Administration about the positive impact the secondary market has had for the credit union community and the role credit unions play in ensuring the safety and soundness of America's housing market. In any housing finance reform efforts, NAFCU will push for equal access to the secondary market for credit unions and fair pricing based on loan quality as opposed to volume.

The Federal Housing Finance Agency (FHFA) issued a proposed rule to create a risk-based capital framework for the GSEs. The Administration was involved in the development of this rule and believes such a capital structure is necessary before any meaningful housing finance reform can occur.

Field of Membership

Strengthening the credit union dual chartering system is imperative to the future strength and well-being of the industry. The dual chartering system functions best when the state and federal credit union charters keep pace with one another. In recent years, however, several states have been much more progressive in modernizing their field of membership (FOM) rules and as a result, the industry has seen multiple credit unions convert to state charters because of their inability to grow under the federal charter.

NAFCU continues to hear from our members that NCUA's FOM rules and regulations have unreasonably inhibited their ability to grow and serve their communities. According to NAFCU's *2018 Federal Meeting Survey* over

53 percent of our respondents consider FOM critical to their continued growth and success. Moving forward, the federal charter must keep pace with changes in state laws, technology, and the financial services industry. While legislation is necessary to relax aspects of the *Federal Credit Union Act's* limitations on chartering, the credit union industry as a whole will benefit from the continued modernization of NCUA's chartering and FOM procedures, as well as removing all non-statutory constraints on FOM chartering and expansion. Greater outreach to underserved areas is of particular importance.

In October 2016, the NCUA finalized the FOM rule and issued additional changes in a second proposal. On December 7, 2016, the American Bankers Association (ABA) filed a lawsuit challenging the NCUA's final rule. In March 2018, a United States District Court for the District of Columbia upheld two challenged portions of the NCUA's FOM rule and struck down contested provisions. Those provisions struck down by the court included one that automatically qualified a combined statistical area with fewer than 2.5 million people to be deemed a community, and another which increased the definition of rural districts to one million. The NCUA appealed the decision to the United States Court of Appeals for the District of Columbia.

In June 2018, the NCUA Board voted unanimously to approve a final rule that allows credit unions to provide a narrative approach application to establish a well-defined local community. This approach was allowed prior to 2010, and now credit unions may explain the well-defined local community in the application versus limiting the FOM to a statistical community. Any community applicant that exceeds a population of 2.5 million people, the NCUA will hold a public hearing to address the narrative application. The narrative approach aligns with the District Court of the District of Columbia's opinion.

NAFCU supported the NCUA's FOM rule and strongly believes the FOM amendments are well within the agency's legal authority and allowed by the *Federal Credit Union Act*. FOM reform will help federal credit unions reach potential members who want and need affordable financial services as well as provide much needed regulatory relief by streamlining the FOM process for community, multiple common bond and TIP charters alike. This important relief measure is crucial to the future welfare of the credit union industry and NAFCU will continue to support and defend the rule.

Capital Reform

NAFCU continues to push for a fair capital system for all federally-insured credit unions that both provides an appropriately tailored risk-based capital (RBC) requirement and provides access to supplemental capital. In October 2015, the NCUA Board approved a final RBC rule, with an effective date of January 1, 2019. NAFCU consistently opposed this rulemaking and urged its withdrawal. The final rule recalibrates many risk weights to better align with bank requirements, removes interest-rate risk from the calculation of the risk-based capital ratio, and extends the implementation date.

However, to create a fair risk-based capital system for credit unions, NAFCU fundamentally believes that legislative reforms are necessary. NAFCU has outlined a legislative solution that will institute fundamental changes to the credit union regulatory capital requirements. The plan, as it relates to capital reform:

- › Directs the NCUA to, along with industry representatives, conduct a study on prompt corrective action (PCA) and recommend changes;
- › Modernizes capital standards to allow supplemental capital, and directs the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks; and
- › Establishes special capital requirements for newly chartered federal credit unions that recognize the unique nature and challenges of starting a new credit union.

On August 2, 2018, the NCUA Board issued a proposed rule that would delay the effective date of the RBC rule by one year, to January 1, 2020. This proposal also would raise the threshold of what the NCUA considers to be a "complex" credit union subject to the rule from \$100 million to \$500 million in assets. NAFCU is generally supportive

of these regulatory efforts to allow credit unions alternative forms of capital, so long as they do not conflict with the mutual, cooperative structure of credit unions. NAFCU believes a two-year legislative delay is still desirable to ensure that the NCUA has additional time to review the RBC rule before it takes effect and credit unions have sufficient time to prepare. According to NAFCU's *2018 Federal Meeting Survey* 41 percent of respondents indicated that they already have or anticipate making business changes related to risk-based capital requirements including changes to the types of products offered, the makeup of their balance sheet, or the amount of capital held.

In addition to a legislative solution to risk-based capital, NAFCU is also seeking access to supplemental capital for credit unions. Currently, a credit union's net worth ratio is determined solely on the basis of retained earnings as a percentage of total assets. Because retained earnings often cannot keep pace with asset growth, otherwise healthy growth (such as share growth) can dilute a credit union's regulatory capital ratio and trigger non-discretionary supervisory actions under PCA rules.

Allowing all credit unions access to supplemental capital, in addition to retained earning sources, will help ensure healthy credit unions can achieve manageable asset growth and continue to serve their member-owners efficiently.

Congress sought to delay RBC three different times through various legislation. NAFCU continues to advocate for capital reform for credit unions. Ultimately, NAFCU believes legislative action is necessary to bring about comprehensive capital reform for credit unions such as allowing credit unions to have access to supplemental capital sources, and making the statutory changes necessary to design a true risk-based capital system for credit unions.

Telephone Consumer Protection Act

In July 2015, the Federal Communications Commission (FCC) issued a Declaratory Ruling and Order clarifying its interpretations of the *Telephone Consumer Protection Act* (TCPA). The order provided an expansive treatment of the term "automatic telephone dialing system" (auto-dialers), to broadly include any equipment even if it lacks the "present ability" to dial randomly or sequentially but can be modified to provide those capabilities.

This interpretation was challenged in *ACA International v. FCC*. On March 16, 2018, the U.S. Court of Appeals for the District of Columbia held: (1) the FCC's interpretation of the definition of "autodialer" is invalid, bringing the FCC back to the limited definition in the TCPA; (2) the FCC's one-call safe harbor for reassigned numbers is arbitrary and invalid, but a "called party" is the consumer currently assigned to the number, not the intended recipient; and (3) the FCC's standard for revoking consent by "any reasonable means" is a permissible interpretation of the TCPA. There is a split among the Second and Third Circuit's adoption of an autodialer definition and the Ninth Circuit.

This provides some relief for credit unions, but NAFCU supports a definition of "called party" as the intended recipient of a communication and believes that consumers should not be allowed to revoke consent by "any reasonable means." Credit unions should be able to dictate clear opt-out methods for consumers to provide consistency and limit their potential TCPA liability. NAFCU has urged the FCC to create a single, FCC-designated reassigned numbers database that allows credit unions to access reassigned numbers data at little or no cost.

The TCPA authorizes the FCC to create exemptions for calls "that are not made for a commercial purpose" or "do not include the transmission of any unsolicited advertisement" to residential lines. The TCPA also provides the FCC with exemption authority on autodialed or prerecorded calls to wireless numbers so long as the calls are free to the consumer and may be subject to conditions prescribed by the FCC to protect consumers' privacy rights. NAFCU has urged the FCC to expand its existing exemption (from the 2015 Order) for financial institutions to contact consumers regarding fraud or data breaches. Sometimes consumers are difficult to reach and more than three communications (both calls and text messages) over a three-day period immediately following the fraud or data breach event may be necessary.

B. Appropriate, Tailored Regulation for Credit Unions and Relief from Growing Regulatory Burdens

Lawmakers across the political spectrum recognize that credit unions did not engage in the risky behaviors that led to the financial crisis, yet credit unions continue to face a litany of new regulations aimed at those institutions that did. The compliance burden is not attributable to any single regulation or agency, but rather, the cumulative layers of duplicative, conflicting and onerous regulations that overall create an overwhelming burden for credit unions. This onslaught of regulation is becoming more than many credit unions can bear, resulting in further consolidation among credit unions. Over 1,700 credit unions have disappeared since the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in 2010—at a rate of approximately one credit union loss per day—and over 95% of those were small institutions with under \$100 million in assets. Many smaller institutions simply cannot keep up with the new regulatory tide. Meanwhile, surviving credit unions must divert resources in order to meet all of the compliance requirements.

In its 2018 *Federal Reserve Meeting Survey*, NAFCU asked members for the minimum asset level needed to survive in the current environment, and the median response was \$250 million. Currently, 84 percent of credit unions manage less than \$250 million in assets, and the median credit union has only eight full-time employees. As a result, the consolidation rate among small credit unions has grown in recent years.

An appropriate and tailored regulatory environment is crucial for credit unions to thrive, and continues to be a top priority for NAFCU and its members. History can attest that a robust and thriving credit union industry benefits our nation's economy, as credit unions often fill a need for consumers and small businesses in the financial services marketplace not otherwise met by other institutions.

On May 24, 2018, the *Economic Growth, Regulatory Relief and Consumer Protection Act* (S. 2155) was passed and signed into law, providing regulatory relief to credit unions. The NAFCU-backed S. 2155 contained several provisions rolling back Dodd-Frank implications, including a provision reforming the definition of a member business loan under the *Federal Credit Union Act*, an exemption from certain escrow requirements of the *Truth in Lending Act*, among other provisions. This is an important piece of legislation which provides meaningful relief to credit unions, but more needs to be done to ensure that they are able to thrive in a hypercompetitive marketplace.

Examination Modernization

In August 2018, the NCUA released a Letter to Credit Unions regarding its efforts to improve and modernize its examinations and supervision of credit unions. With the goals of replacing outdated, end-of-life examination systems in order to achieve cost savings, minimize burdens on credit unions and improve adaptability to changes in the marketplace and credit union business models the agency outlined five initiatives to modernize its process:

- › Flexible Examination Pilot Program (FLEX);
- › Office of National Examinations and Supervision (ONES) Data Driven Supervision;
- › Shared NCUA-State Regulator Federally Insured, State-Chartered Credit Union (FISCU) Program;
- › Enterprise Solution Modernization Program (ESM); and
- › Virtual Examination Program.

NAFCU has long advocated for more streamlined and efficient examination processes and is encouraged by the NCUA's pilot program for remote examinations under the Exam FLEX initiative, particularly from a cost savings perspective. NAFCU continues to monitor development of continuous supervision processes under ONES to ensure that credit unions can make management decisions with the necessary speed and efficiency to ensure long-term financial health.

NAFCU has also advocated for several reforms to the examination process, including a return to an 18-month exam cycle for all healthy credit unions, not just those \$1 billion and below. NAFCU is also supportive of

bipartisan legislation to set standards for examination fairness for federal financial institution regulators (including the NCUA), including clear guidance from regulators, consistency from exam to exam, timeliness of reported exam results and an independent appeals process free of examiner retaliation.

Member Business Lending

NAFCU has long advocated for member business lending (MBL) reform, both through legislation and regulatory relief from the NCUA. When Congress passed the *Credit Union Membership Access Act* (CUMAA) in 1998, it put in place unnecessary restrictions on the ability of credit unions to offer business loans to their members. CUMAA codified the definition of a MBL and limited a credit union's MBLs to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets and set the threshold for a member business loan at \$50,000 and above.

S. 2155 included a provision amending the *Federal Credit Union Act* to provide that a one-to-four family dwelling that is not the primary residence of a member will not be considered a MBL for purposes of the cap. On June 1, 2018, the NCUA approved a final rule amending its definition of a MBL to conform with S. 2155.

NAFCU remains supportive of increased flexibility for MBLs made by credit unions. As the country continues to recover from the financial crisis, credit unions have the capital to help America's small businesses thrive. Despite the regulatory relief provided by S. 2155, further modifications or removal of the cap would help provide economic stimulus without costing taxpayers (see *Credit Union Small Business Lending*, page 20).

Unfair, Deceptive, or Abusive Acts and Practices

Since the enactment of Dodd-Frank, and particularly in recent years, NAFCU has worked to seek clear, transparent guidance from the Bureau on its expectations for credit unions under the law. Of special concern are those areas of the law, such as a call for a focus on unfair, deceptive, or abusive acts and practices (UDAAP), that provide few or no specific directives for implementation and for which neither the Bureau nor the NCUA has provided any specific guidance. Meanwhile, the Bureau continues to regulate through enforcement action in this area.

According to NAFCU's January 2018 *Economic & CU Monitor*, UDAAP was the second issue that respondents identified as the ripest for reform. Two-thirds of respondents believe that additional guidance to articulate the Bureau's supervisory expectation is necessary. Nearly 20 percent of respondents indicated that the Bureau's exercise of its UDAAP authority in recent years has had a chilling effect on their product and service offerings. Significant resources are necessary to monitor and track the Bureau's consent orders in order to determine how best to design or modify internal practices and procedures to avoid a UDAAP violation. NAFCU believes that additional Dodd-Frank guidance—articulating clear supervisory expectations—is necessary to ensure credit unions have the information they need to ensure their operations are safe, sound, and reflective of the spirit and letter of the law governing them.

Qualified Mortgages

The Bureau has issued a final rule that imposes requirements on credit unions to assess and verify a borrower's ability to repay a mortgage loan before extending the loan. In that same rule, the Bureau defined "qualified mortgage" and extended legal protections to mortgages that meet the definition. The rule extends a "safe harbor" legal protection to prime loans that meet the qualified mortgage definition, while a rebuttable presumption of compliance would apply to non-prime loans.



NAFCU witness Sonya McDonald, executive vice president and chief lending officer at Randolph-Brooks Federal Credit Union, testified on the SBA's 7(a) lending program in January.

Section 101 of S. 2155 codifies a version of the small creditor portfolio qualified mortgage category to allow credit unions expanded flexibility with respect to making qualified mortgage loans. NAFCU recommends additional clarity on the type of documentation of “debt, income, and financial resources” a credit union must consider when making a residential mortgage loan to a member.

Many of NAFCU's members have decided to extend only mortgages that meet the definition of safe harbor “qualified mortgage” as they are concerned that they will not be able to sell non-qualified mortgages and are worried about the legal and regulatory risks associated with extending non-qualified mortgages. According to NAFCU's January 2018 *Economic & CU Monitor Report* nearly half of respondents indicated that they have reduced originations of non-qualified mortgages due to the rule, while another 10 percent of respondents indicated that they have ceased to originate non-qualified mortgages entirely.

NAFCU believes the definition of qualified mortgage must be revised in a number of ways to reduce the enormous negative impact the rule will undoubtedly have on credit unions and their members. Of primary concern is the debt-to-income (DTI) threshold (43% of the total loan) and the inclusion of affiliate fees in the calculation of points and fees. The DTI threshold excludes many otherwise creditworthy borrowers from the market, while the inclusion of affiliate fees hinders the ability of credit unions to find cost savings for their members. The Bureau proposed a cure for unintentional points and fees overages. While NAFCU supported such a cure, a legislative change is still necessary to clarify points and fees calculations. NAFCU remains concerned about the increasing costs of mortgage lending due to this rule, as well as adverse effects on origination volume, profitability, and member satisfaction.

Mortgage Servicing

The Bureau's mortgage servicing rule has unnecessarily complicated servicing, greatly increased costs and jeopardized credit unions' established practices that center on relationships with members. NAFCU's concerns with the rule include the cost and burden related to the host of new or greatly revised periodic statement, policies, procedures and notices it requires, as well as the timing and inflexible procedural requirements related to how a credit union must deal with delinquent borrowers and take loss mitigation actions. Although the rule does exempt credit unions that service 5,000 or fewer mortgages, along with affiliates, from some of the requirements, mortgage servicing costs have nevertheless greatly increased for all credit unions as small servicers must still adhere to the rules for successors in interest and force-placed insurance.

Consumer Complaint Database

The Bureau continues to encourage consumers to utilize its publicly available Consumer Complaint Database. Since its inception, the Bureau has received over one million consumer complaints through the public Consumer Complaint Database.

NAFCU has strongly advocated for the removal of the database entirely from public view given the associated reputational risks. Alternatively, additional safeguards could be implemented to mitigate unverified complaint narratives that are inappropriate or based on subjective grievances without reporting a specific issue.

The Consumer Complaint Database presents a very specific reputational risk concern for financial institutions. These complaints follow a pattern of unverified information that is given credibility by the mere fact that the Bureau is posting it on their website. There is no mechanism to ensure the complaints are fully vetted. Consequently, narrative data accompanying unverified complaints filed against each institution could be misleading and could create reputational risks that cannot be easily mitigated. Credit unions have unique relationships with their members and NAFCU supports resolution and investigation of valid and verified member complaints by the credit unions.

Remittances

The Bureau's final rule governing remittance transfers became effective in October, 2013. The Bureau anticipates completing its required assessment of the rule later this year. NAFCU is hopeful that its comments along with recommendations from the Treasury will prompt the Bureau to reconsider the rule's unwieldy disclosure requirements and raise the current remittance transfer threshold.

NAFCU members consistently voice concerns regarding the effects of the remittance rule. The rule has resulted in increased confusion and costs to consumers. NAFCU's May 2018 *Economic & CU Monitor* member survey found that more than 18 percent of those that offered remittance services before the rule was promulgated have now stopped offering that service to members and over 58 percent have seen remittances decline since the rule went into effect. Additionally, over 55 percent of respondents reported higher costs associated with the rule. Between the countless disclosure requirements and additional fees, many credit unions have come to realize they cannot justify continuing to offer remittance services. With fewer credit unions now providing these services, consumers' options are severely limited.

Overall, the remittance rule has not promoted access to the market, has created inefficiencies, and has caused significant market disruption. NAFCU believes the Bureau should more closely evaluate the real-world impact of the rule and consider excluding credit unions from its onerous requirements.

Home Mortgage Disclosure Act

Section 104(a) of S. 2155 granted a partial exemption from reporting certain data points under HMDA for those insured depository institutions that originate less than 500 closed-end mortgage loans or less than 500 open-end lines of credit in each of the two preceding calendar years.

On September 7, 2018, the Bureau published an interpretive and procedural rule implementing and clarifying the requirements of section 104(a) of S. 2155 which amended HMDA. The rule clarifies that insured credit unions covered by a partial exemption under section 104(a) have the option of reporting exempt data fields as long as they report all data fields within any exempt data point for which they report data. Only loans and lines of credit that are otherwise HMDA reportable count toward the thresholds for the partial exemptions. Further, the rule clarifies which of the data points in Regulation C are covered by the partial exemptions, and the rule designates a non-universal loan identifier for partially exempt transactions for institutions that choose not to report a universal loan identifier.

NAFCU believes that the Bureau should limit expansion of the HMDA dataset to items specifically mandated by the Dodd-Frank Act. While credit unions support the role HMDA plays in ensuring fair lending and detecting anti-discriminatory practices, NAFCU is concerned that additional reporting requirements do not achieve these goals and only serve to impose significant additional compliance and reporting burdens. According to NAFCU's January 2018 *Economic & CU Monitor* survey about the top three areas ripe for reform, HMDA was the top priority identified by our members as the top issue for reform, followed by UDAAP enforcement and qualified mortgages.

Overdrafts

For the past several years, the Bureau has consistently placed overdraft reform on its rulemaking agenda. However, the timeframe for the release of a proposal continues to be delayed due to the Bureau's tenuous



United Nations Federal Credit Union's John Lewis testified in June before a House Financial Services subcommittee on the challenges credit unions face in providing services such as international remittances to their members given the regulatory hurdles they face.

statutory authority in this area coupled with consumers' continued support of overdraft programs. In addition, the Dodd-Frank Act requires the Bureau to convene a Small Business Review Panel to solicit input from small entities before introducing any formal proposed rule. In the meantime, the Bureau has released two studies of overdraft markets and conducted several high profile information collections. All of these efforts indicate the Bureau is continuing to progress toward a rulemaking on overdraft.

Small Business Data Collection

Section 1071 of the Dodd-Frank Act assigns responsibility to issue implementing regulations for collection of small business loan data to the Bureau. The goal is to facilitate enforcement of fair lending laws and enable communities, businesses, and other entities to better identify the needs of women-owned, minority owned, and small businesses. Section 1071 requires financial institutions to collect and report information to the Bureau using similar systems and procedures to those currently used with HMDA reporting. Section 1071 gives the Bureau broad discretion to establish the requirements, define the scope, provide exemptions, and protect the privacy of individuals.

Given credit unions' legislative constraints with providing loans to small businesses that fall squarely within their field of membership, NAFCU believes that the information collected from credit unions will be misleading and unhelpful in achieving the statutory purpose. The data will be skewed in relation to other lenders. Although the statutory purpose is well intentioned, the impacts not only burden credit unions with additional compliance, but could also have adverse effects on credit union small business lending.

NAFCU will continue to urge the Bureau to exempt credit unions from any future rulemaking under section 1071 of the Dodd-Frank Act in order to reduce regulatory burdens and preserve lending growth. Further, NAFCU advocates for a definition of "small business" as a business having \$1 million or less in gross annual revenue.

Payments

NAFCU and its members continue to be engaged in the Federal Reserve's evolving Strategies for Improving the U.S. Payment System initiative. From 2015 to 2017, NAFCU served as a member of the Federal Reserve's two payments task forces: the Faster Payments Task Force and the Secure Payments Task Force. In addition, NAFCU is a current member of the Federal Reserve's FedPayments Improvement Community, and has met with Federal Reserve staff throughout 2018 to discuss ongoing strategies and industry work efforts to improve payment security.

NAFCU's goal is to ensure that any future payment system will be cost-effective, operationally effective, and scalable for credit unions of all sizes. To achieve these objectives, NAFCU has been an active contributor to the Federal Reserve's efforts in gathering industry stakeholders' input on potential payment solutions that could benefit both financial services providers and their customers. NAFCU and our members have worked to educate and inform members about the Federal Reserve's adoption of faster payment technologies, the output of industry work groups, and enhancements to existing payment systems such same-day automated clearing house (ACH) services.

While NAFCU believes that the financial services industry should lead efforts toward developing a faster, more secure payment system, the Federal Reserve is well positioned to help achieve the strategic goal of achieving ubiquitous, faster payments capability by 2020. In that regard, NAFCU is encouraged by the Federal Reserve's October 2018 proposal announcing its plans to consider approaches for developing a real-time gross settlement system to support faster payments services.

Over 56 percent of respondents to NAFCU's 2018 *Federal Meeting Survey* reported that they are currently considering faster payments (real-time or near real-time) settlement options for their members. Also, 69 percent of respondents would have a greater interest in a faster payments settlement option if developed under the direction of the Federal Reserve. Over 49 percent of respondents anticipate investing in an IT-related project for payment processing over the next three years.

As the Federal Reserve has acknowledged, today's systems clearing and settlement systems are not designed to work in a 24/7, real-time world. While there are many technological challenges to overcome in terms of achieving security, reliability, and interoperability, NAFCU stands ready to work with the Federal Reserve and industry partners to develop a faster payments system that is accessible to credit unions and their members while urging the Federal Reserve to stay away from a "one size fits all" approach to the payment system's future.

Regulation D

The outdated restriction on "convenience transfers" under Regulation D presents an ongoing concern for NAFCU and its members. The current law is burdensome, confusing, and prevents credit union members from enjoying unfettered access to their funds. Consumers are often unaware or do not understand and remember the arbitrary limits on the number and types of transfers the regulations permit them to make from their savings account. Over 70 percent of respondents to NAFCU's 2018 *Federal Reserve Meeting Survey* indicated that Regulation D transaction limits generate confusion and questions among their members. The regulation is antiquated given our technological society and modern realities. Consumers would benefit from a modification to the regulation that reflects the current financial services environment.

Today's consumers expect to have the ability to transfer their funds with ease to and from particular accounts, and the regulation's six-transfer limitation from savings accounts creates an undue burden for both consumers and financial institutions. NAFCU believes that the Federal Reserve should update and increase this six-transfer limitation, while maintaining the distinction between savings and transaction accounts.

Regulation CC

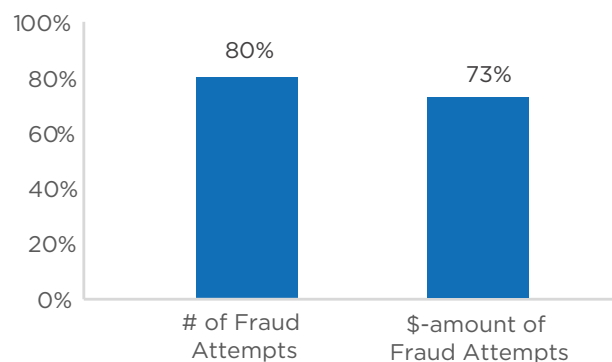
In general, NAFCU encourages the Federal Reserve Board to modernize the language of Regulation CC in order to bring it in line with the rest of the Board's current regulatory framework and applicable requirements under the Dodd-Frank Act and other legislation. The outdated terminology and requirements still found in Regulation CC are confusing and misleading for financial institutions and pose serious compliance and safety and soundness concerns.

NAFCU believes that the regulation's timeframe for making personal checks available should be increased from two business days to three business days. In addition, NAFCU urges the Federal Reserve to allow a credit union greater ability to hold a cashier's check or money order, rather than requiring next day availability. The current requirement creates undue risk for both the credit union and the member because the rule does not allow sufficient time to determine if a check could be counterfeit or there are insufficient funds. Among respondents to NAFCU's 2018 *Federal Reserve Meeting Survey*, 80 percent reported seeing an increase in check fraud in recent years due to restrictions on hold times (see Chart 4.3), and nearly as many reported seeing an increase in the dollar amount of check fraud attempts in recent years.

Additionally, NAFCU does not support eliminating provisions regarding case-by-case holds, or eliminating the notice in lieu of return as this service is the best method available in certain situations.

In September, 2018, the Board published a final rule that establishes a rebuttable presumption of alteration under Regulation CC when there is a dispute about whether a check has been altered or forged, and the original paper check is not available for inspection. NAFCU is generally supportive of the presumption, and will continue to work with the Federal Reserve.

Chart 4.3: Share of Respondents Seeing Increased Check Fraud



Source: NAFCU 2018 *Federal Reserve Meeting Survey*

Military Lending Act

Credit unions have always protected servicemembers and their families from predatory lending practices which precipitated Congress's enactment of the Military Lending Act (MLA). NAFCU has urged the Department of Defense (DoD) to provide clear rules, that do not unduly restrict access to financial products or services. However, uncertainties in the MLA rule remain and threaten access to credit for servicemembers.

Many credit unions are concerned about the DoD's amended Question and Answer #2 (Question 2) which virtually prohibits access to GAP insurance when the MLA-covered borrower tries to finance the GAP insurance with the loan used to purchase the vehicle. Limiting the availability of GAP insurance has the potential to cause significant financial hardship, as GAP insurance is a protection against situations where a borrower's vehicle is destroyed or stolen and the value of the car is less than the remaining loan balance. Due to uncertainties in the rule many credit unions and their vendors no longer offer this product to servicemembers and their families.

NAFCU has recommended that the DoD rescind Question #2 from the MLA Interpretive Rule to alleviate regulatory confusion, and will continue to advocate for the DoD to address ambiguities regarding secured vehicle loans and GAP insurance.

C. A Fair Playing Field

NAFCU believes that credit unions should have as many opportunities as other financial institutions and non-regulated entities to provide provident credit to our members. We also want to ensure that all similarly situated depositories and lenders follow the same rules of the road and do not escape oversight.

Data and Cybersecurity

Data security and cybersecurity are important issues for credit unions, especially with the continued growth of online commerce and banking. Some institutions have found themselves victims of denial of service attacks and data breaches, in addition to other cybercrimes that threaten to compromise the financial information of a member. Respondents to NAFCU's 2018 *Federal Reserve Meeting Survey* were asked to rate the magnitude of the anticipated challenges facing credit unions over the next three years. Maintaining a secure electronic environment was identified as a "significant" challenge by over 71 percent of respondents, more than any other in the survey.

A primary concern of credit unions and their members continues to be ensuring that our nation's retailers have data security standards to protect consumers' sensitive financial information. Unfortunately, in the wake of numerous significant retailer breaches in recent years, consumers are losing trust that entities collecting their financial information will take necessary steps to protect them from risk. While both merchants and credit unions are targets of cyberattacks and data theft, credit unions and other financial institutions have been subject to data security standards since the passage of the *Gramm-Leach-Bliley Act*. As a result of this regulatory imbalance, credit unions bear a significant burden as they must absorb fraud-related losses, and often incur additional costs in re-establishing member safety after a breach occurs.

In July 2018, the Department of the Treasury formally recommended that Congress enact a federal data security and breach notification law to protect consumer financial data and notify consumers of a breach in a public and timely manner. In addition to the Treasury recommendations, NAFCU would like to see any comprehensive data security bill include: the payment of associated costs by breached entities; national standards for safekeeping of information; data security policy disclosures; timely and public disclosure of breached entities; enforcement of prohibition on data retention; notification of the account servicer; and the burden of proof shifted to the breached entity.

House Financial Services Committee Subcommittee on Financial Institutions and Consumer Credit Chairman Blaine Luetkemeyer (R-MO) and Representative Carolyn Maloney (D-NY) have circulated draft legislation that would establish data protection standards, outline a process for notifications, and recognize financial institutions' compliance with the Gramm-Leach-Bliley Act. While that legislation has yet to be officially introduced, it is

similar to two NAFCU-backed bipartisan bills that were introduced in the 114th Congress: H.R. 2205, the Data Security Act of 2015 and S. 961, the Data Security Act of 2015.

Lastly, the public sector should play a larger role in information sharing so that “known” threats are shared and can be guarded against. NAFCU supports efforts to create a new cybersecurity framework that encourages or even mandates a greater level of collaboration, not only between financial institutions, but also between the public-private sectors, in addition to protecting our nation’s cyber infrastructure.

Payday Lending

In October 2017, the Bureau issued a final rule on payday, vehicle title, and similar loans which becomes effective in August 2019. The final rule requires the lender to undertake enhanced ability-to-repay requirements and limits the number of allowable subsequent loans for certain covered loans. However, the final rule grants a safe harbor for NCUA Payday Alternative Loans (PAL). Under the leadership of Acting Director Mulvaney, the Bureau has publicly stated that it intends to substantively revisit its payday lending rule, but has not offered any specific timeframe.

In June 2018, the NCUA issued a proposed rulemaking creating a second PALs option – PALs II – which would not replace the existing PALs I but would expand access to safe and affordable short-term, small-dollar lending, and provide an alternative to the kinds of predatory lending that can entrap borrowers. The PALs II option would set the maximum loan amount at \$2,000 with no minimum; the maximum maturity term of the loan is 12 months; no minimum length of credit union membership required; and no time restriction on the number of loans to a borrower in a six-month period so long as only one loan is outstanding at a time. According to NAFCU’s 2018 *Federal Reserve Meeting Survey*, the top feature of the PALs II proposal which respondents believe needs to be changed or will be most limiting to their members is the 28-percent interest rate ceiling, followed by the limitation of one PAL loan to a member-borrower at a time.

In 2018, NAFCU met with Bureau staff on multiple occasions to ensure that the agency’s payday lending rule does not impair the NCUA’s ability to promote access to small dollar credit through new PAL options. NAFCU has advised the Bureau to exempt new iterations of the PAL program from the payday lending rule.

Interchange Fees

NAFCU continues to push for repeal of the Dodd-Frank Act’s amendment on interchange fees (Durbin amendment). NAFCU is also opposed to any efforts to expand interchange price caps to credit products.

The Electronic Payments Coalition, of which NAFCU is a member, released results of a recent study proving that retailers paid much less in interchange fees while passing no savings on to consumers. More than half of voters surveyed felt they had not received a discount from retailers since the Durbin amendment went into effect seven years ago.

The loss of interchange revenue has contributed to a decline in fee income for credit unions in recent years, and, unlike other institutions, credit unions cannot raise capital simply by going to the open market. NAFCU will continue to work on behalf of our members to preserve a reasonable return for credit unions from interchange fee income.

D. Government Transparency and Accountability

NAFCU believes regulators need to be transparent in their actions, with the opportunity for public input, and should respect different viewpoints. Also, a bipartisan commission structure is the best form of regulatory governance for independent agencies, and all stakeholders should be able to provide feedback in the regulatory process.

Americans with Disabilities Act Reform

Credit unions across the country have been faced with an overwhelming number of demand letters regarding website inaccessibility under the Americans with Disabilities Act (ADA). A regulatory void exists due to ambiguities in the law regarding website accessibility requirements, and well-intentioned credit unions are being exploited by opportunistic plaintiffs’ attorneys.

Title III of the ADA stipulates that places of “public accommodation” such as credit unions, banks and other “service establishments” are generally prohibited from discriminating on the basis of a disability in the activities of that place of public accommodation.

Both the ADA and Department of Justice (DOJ) regulations are silent on required standards for website accessibility. The DOJ has not provided specific technical requirements through a formal rulemaking process. The ADA was enacted in 1990, and reforms have not evolved on pace with technological advances. The DOJ began gathering information on setting website accessibility standards, but has not adopted any technical requirements. This issue was removed from the DOJ’s rulemaking agenda, and two advanced notices of proposed rulemaking on the issue were withdrawn as the DOJ wanted to evaluate whether regulations were necessary and appropriate.

NAFCU believes that legislative action is necessary to reform and modernize the ADA to provide clear guidance and standards for website compliance to combat meritless lawsuits. During the 115th Congress, the House of Representatives passed NAFCU-backed H.R. 620, the *ADA Education and Reform Act of 2017*. Members of Congress from both parties have also written to the DOJ to express concern over the ambiguity surrounding the issue and to ask the DOJ to help address it.

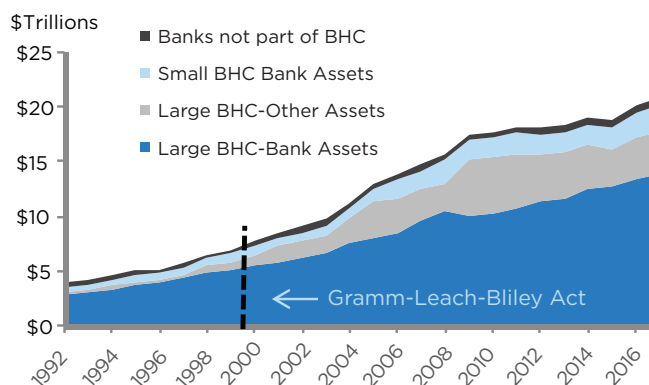
Modern Glass-Steagall Act

Since the financial crisis, the credit union industry has experienced significant consolidation while the largest banks have reaped record profits and grown in both size and scope (see Chart 4.4). The Glass-Steagall Act (GSA) was established in response to the depression and imposed rules on Federal Reserve member banks to require the separation of commercial and investment banking activities. However, in 1999 the *Gramm-Leach-Bliley Act* (GLBA) effectively repealed several key sections of the GSA, resulting in an under-regulated environment that benefited large institutions by incentivizing megamergers. This resulted in the creation of institutions that are able to engage in virtually unlimited activities, sometimes outside the reach of federal and state regulators. The consolidation of the commercial and investment banks into large financial conglomerates gave rise to the “too big to fail” institutions whose losses accounted for three-fifths of the total losses recorded from mid-2007 to 2010.

Congress has acknowledged that a degree of separation between commercial and investment banks should exist to promote financial stability. More recently, Senators Warren and McCain introduced S. 881, the “*21st Century Glass-Steagall Act of 2017*,” which modernizes the GSA and provides protections from “too big to fail” financial institutions. The bill was previously introduced in both the 113th and 114th congresses.

Competition, confidence, liquidity, and stability are the hallmarks of a strong future financial system. NAFCU is confident that the proper division of investment and commercial activity through implementation of a modern GSA would help foster these principles. Big banks must be encouraged to discover more innovative, yet honest, ways of accessing liquidity that do not put the American taxpayer at risk. Shifting the focus of our banking system from acquiring profits to helping local communities is the first step. In September 2018

Chart 4.4: U.S. Banking Assets



Notes: A large bank holding company (BHC) is a top-tier BHC that files a Y-9C report. Bank assets of large BHCs are measured as the sum of consolidated assets reported by each banking subsidiary in its Call Report filing. Other assets of large BHCs represent the difference between total assets as reported in the Y-9C and bank assets as defined above. Assets of small BHCs reflect only those of their commercial bank subsidiaries. S&L holding companies are excluded from the set of large BHCs.

Sources: National Information Center; FR Y-9C; FFIEC 031; FFIEC 041 See also Avraham, D., P. Selvaggi, and J. Vickery. 2012. “A Structural View of U.S. Bank Holding Companies.” *Federal Reserve Bank of New York Economic Policy Review*.

NAFCU released a white paper calling on members of Congress to discuss creating a modernized GSA, which is available at www.stilltoobigtotofail.org.

E. A Strong, Independent NCUA as the Primary Regulator for Credit Unions

NAFCU believes that the NCUA is best situated with the knowledge and expertise to regulate credit unions due to their unique nature.

Bureau Reform

The Bureau has rulemaking authority over all credit unions, regardless of asset size, and examination and enforcement authority over credit unions with more than \$10 billion in assets. In the wake of the Dodd-Frank Act, NAFCU was the only credit union trade association to oppose the creation of the Bureau. NAFCU remains opposed to the Bureau's authority over credit unions, given that credit unions were not responsible for the financial crisis and that credit unions are more highly regulated than any other financial depository institution. NAFCU has consistently taken the position that the Bureau should exercise its exemption authority under Section 1022 of Dodd-Frank.

The Bureau should be cognizant of NCUA's role as primary regulator for credit unions and recognize the positive role that credit unions serve in the financial services industry. In doing so, they should be aware of not only the detrimental impact their rules can have, but also focus on the unique benefits that credit unions consistently provide to consumers.

Bureau reform has always been a top priority for NAFCU advocacy. Litigation calling into question the constitutionality of a single Bureau director could open the door to legislative reforms to the Bureau, including improvements to its leadership structure and subjecting it to the appropriations process.

V. Financial Technology and Credit Unions

Financial technology (alternatively, "fintech") encompasses a broad range of products and services that are not easily confined within a single, all-encompassing definition. Financial regulators have struggled to supply a concrete definition of fintech, even as they grapple with the task of overseeing rapid advances in financial innovation. Over the long term, fintech products may eventually become as commonplace as credit cards, and treating the use of certain technologies as distinct from the business of a credit union may no longer make sense. In the broadest sense, fintech is technology that supports or enables the offering of a financial product or service.

For the past several years, credit unions have faced growing competitive pressure to adopt new technologies in order to attract and retain members. Credit unions are now offering digital services such as peer-to-peer (P2P) payments, personal financial management suites, and digital wallets. While some credit unions are partnering with fintech companies such as Zelle and Apple Pay to expand services, other are seeking to develop their own platforms.

Deploying services powered by fintech can also be strategically important for diversifying a credit union's membership demographic. For example, the habits of Millennial consumers have contributed significantly to the success of fintech applications such as P2P payments. The Federal Reserve has estimated that two-thirds of consumers between the ages of 18 and 29 who have a mobile phone and a bank account use mobile banking. Millennial consumers expect that they will be able to purchase things like groceries online and make payments that are nearly instantaneous. The demand for both speed and convenience opens up new

opportunities for financial sector growth but also introduces new risks.

Credit unions also understand that financial technology does not always need to be member-facing, and investments in data analytics can help improve member satisfaction. For example, 70 percent of credit union respondents to NAFCU's 2018 Federal Reserve Meeting Survey plan to make IT-related investments to leverage data for optimizing member development, an 8-percentage point increase since 2016 (see Chart 5.1). In addition, credit unions also see value in making improvements to legacy technology. In each of the last two surveys, a greater share of respondents indicated that they plan to invest in ATMs, such as by expanding deployment or adding features. By contrast, the percentage of respondents planning to make IT-related investments in mobile banking systems increased only slightly over the past two years, from 57 percent in 2016 to 58 percent in 2018.

Competition and Cost Recovery

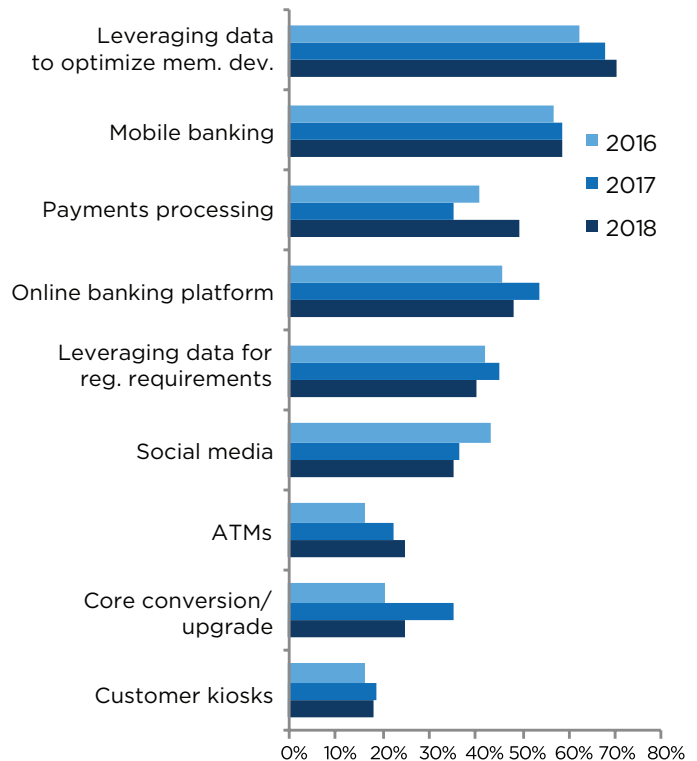
Investments in financial technology have helped credit unions adapt to an evolving financial services landscape, but the cost of developing new capabilities or partnering with fintech companies has introduced unique challenges, such as managing cybersecurity risk, ensuring cost recovery, and navigating new competitive pressures. With fintech companies such as Square pursuing industrial loan company (ILC) charters, and large retailers such as Amazon considering entering the retail banking space, credit unions should prepare for the possibility that competition with non-banks may pose the greatest threat to future growth.

In addition, fintech companies now have an avenue to pursue a special purpose national bank charter through the Office of the Comptroller of the Currency (OCC), which began accepting applications in August 2018. While the OCC has not yet approved any fintech charter applications, and recipients of the charter would be restricted from taking deposits, the possibility remains that fintech companies might benefit from regulatory arbitrage and federal preemption to outmaneuver traditional financial institutions. On the other hand, the OCC charter may represent the first step towards bringing fintech companies within a coherent supervisory framework that includes regular examinations, capital adequacy and liquidity requirements, and compliance with consumer protection laws.

Given these dynamics, it is not surprising that credit union respondents are just as concerned about competition from fintechs as community banks. When asked how competition has evolved in recent years, 35 percent of respondents to NAFCU's 2018 *Federal Reserve Survey* reported a "significant" increase from fintech firms.

The NCUA's Strategic Plan for 2018-2022 notes that credit unions may confront cost recovery problems if automated underwriting by fintech companies reduces the cost of loan origination to levels that are unsustainable for traditional financial institutions. In addition, the potential for fintech companies to exploit supervisory gaps to obtain a competitive advantage in the marketplace raises concerns that they may not be competing on a level playing field. Although non-bank lenders are subject to the enforcement and rulemaking authority of the Bureau, they are not always supervised the same way as credit unions or banks.

Chart 5.1: Share of Respondents Anticipating Investment in IT-Related Projects in next 3 Years



Source: NAFCU 2018 Federal Reserve Meeting Survey

The NCUA's 2019-2020 budget justification also devotes attention to the topic of fintech, and the agency has allocated additional staffing resources to develop expertise with financial technology and cryptocurrencies.

While NAFCU believes that fintech can produce real benefits to consumers, including increased speed, convenience and new product offerings, innovation should not be prioritized in a way that undermines financial sector stability and competitive equality.

To ensure that credit unions and fintech companies compete on a level playing field, NAFCU has presented testimony before Congress on several occasions this year to explain the need for an appropriate regulatory framework that addresses supervisory gaps. Specifically, NAFCU has provided testimony to both the Senate Banking Committee and Democratic members of the House Financial Services Subcommittee urging Congress to ensure that fintech companies are held to the same consumer protection standards as banks and credit unions. NAFCU has also actively engaged with the Bureau to ensure that future regulations aimed at facilitating innovation are appropriately tailored and present meaningful opportunities for credit unions.

Third-Party Access to Consumer Financial Data

Multiple financial regulators have expressed support for improving data portability and access to consumer financial information to promote innovation in financial services. Today, almost all fintech services rely on consumer information to support critical features, such as account aggregation or development of automated underwriting models, and reliable access to such data has become an issue of paramount concern within the fintech community.

Traditionally, individual contracts have governed the terms and conditions for sharing transaction information between financial institutions and third parties; however, international developments in the UK and European Union have inspired consideration of open models that rely on data transmission through application programming interfaces (APIs). U.S. financial regulators appear to be interested in developing international partnerships to facilitate financial innovation, and the Bureau announced in August 2018 its participation in a global regulatory consortium called the Global Financial Innovation Network. While these developments may be of no immediate concern to credit unions, an emphasis on global cooperation, interoperability, and standardized data sharing could have an impact on domestic regulations, particularly future implementation of Section 1033 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

On November 17, 2016, the Bureau issued a Request for Information (RFI) to solicit feedback on challenges consumers may face in accessing and securely sharing their financial records. The RFI was closely aligned with the substantive provision of Section 1033 of the Dodd-Frank Act, which provides a framework for standardized sharing of consumer financial records, but requires implementing regulations to become effective. In the RFI, the Bureau sought to learn “how much choice consumers are being given about the use of their records, how secure it is for them to share their records, and to what extent consumers have control over their records.”

NAFCU is supportive of the Bureau's efforts to promote consumer access to new technologies and financial services through the cultivation of an innovative and competitive marketplace. Many credit unions provide these services through partnerships with individual vendors. However, NAFCU does not think that financial aggregators or other fintech companies should be able to obtain “open” access to member information absent clearly defined standards for liability and data security. In surveys conducted this year, NAFCU found that the majority of credit union respondents do not use APIs for the purpose of sharing data on member transactions. In addition, only 20% of respondents in previous surveys indicated that they share data on member transactions with third parties. Only 6% of respondents indicated that they had developed their own API for data-sharing purposes.

NAFCU has advised the Bureau that it should construe the scope of sharable data narrowly in order to protect consumers from inadvertent disclosure of sensitive information. NAFCU has also recommended that the Bureau hold prospective aggregators to heightened cybersecurity standards to mitigate potential data security risks.

In October 2017, the Bureau published a set of non-binding, voluntary data sharing principles that acknowledged many of NAFCU's concerns regarding data security and privacy of member information. The Bureau has not indicated that it intends to proceed with a rulemaking to implement Section 1033 of the Dodd-Frank Act in the near term, but recent recommendations from the Department of the Treasury (Treasury) may put pressure on the Bureau to initiate a rulemaking soon.

In its July 2018 report titled “Non-Bank Financials, Fintech, and Innovation” (Fintech Report), Treasury acknowledged that bilateral agreements to obtain data through APIs can be difficult to scale given the large number of U.S. financial services companies. While Treasury does not endorse any particular set of standards for data aggregation and sharing of consumer financial data, the Fintech Report offers an expansive view on how consumers may authorize third-party access to their data. NAFCU believes that while data sharing through open APIs may be beneficial in some contexts, credit unions’ ability to conduct data sharing via bilateral contracts should not be impaired.

Managing Cybersecurity Risks

Maintaining a secure electronic environment was ranked as the top strategic challenge by credit union respondents this year (see Chart 5.2).

While cybersecurity encompasses a range of activities, such as preventing fraud and thwarting unauthorized access to credit union networks, it also entails careful review of third party supply chain risks. Addressing such risks may become increasingly important as credit unions begin to consider partnerships with fintech companies and other technology service providers that are pushing traditional banking services onto digital platforms.

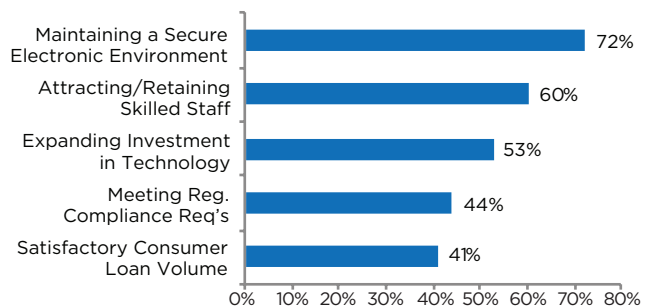
Introducing new financial technology through a vendor requires credit unions to comply with the NCUA's due diligence requirements. For example, credit unions typically request audits and penetration testing reports to determine if a vendor has adequate controls and policies in place to safeguard member information. Credit unions may also need to conduct in-depth assessments to determine the extent to which third parties should be able to directly access and process member data.

The adoption of new financial technologies could impact a credit union's cybersecurity posture and the scope of future cybersecurity examinations. For example, the NCUA's Automated Cybersecurity Examination Tool (ACET) may necessitate enhanced scrutiny of third-party relationships as a credit union develops its inherent risk profile. Although the NCUA conducted limited examinations with the ACET in 2018 (impacting credit unions with \$1 billion or more in assets), the agency plans on expanding the range of credit unions that will be subject to ACET reviews in 2019.

ACET examinations, much like previous cybersecurity examinations, will require credit unions to evaluate the complexity and scope of third-party network connections; however, the tool will also require credit unions to document adoption of “emerging payments technologies”—such as mobile wallets or P2P applications. Accordingly, credit unions may face heightened cybersecurity examination scrutiny if they choose to partner with fintech companies, which could substantially raise the cost of adopting new technologies.

Given the NCUA's cautious approach towards fintech partnerships, lengthier and more in-depth examination procedures could place strains on credit unions' already limited staffing resources. Currently, IT compliance accounts for the single largest compliance-related expense for credit unions, and it is likely that the cost of such

Chart 5.2: Share of Respondents Rating Challenge as a “Significant” One



Top 5 responses shown

Source: NAFCU 2018 Federal Reserve Meeting Survey

compliance will grow. Credit union respondents reported, on average, a 90% increase in full-time equivalent staff devoted to IT compliance functions since 2010. In addition, 47% of respondents expect to increase the number of staff devoted to IT compliance in the next three years, and 92% expect IT-related expenditures to drive overall spending increases during that same period.

Credit unions may also need to devote greater resources to monitoring fraud as consumer use of data aggregation services increases. Furthermore, breaches involving consumer data at non-bank financial companies has highlighted the extent to which the entire financial sector is vulnerable to the data collection practices at fintech firms.

Non-bank financial companies are not universally examined for compliance with cybersecurity requirements promulgated by the functional banking regulators. Under the FTC's rules, fintech companies that qualify that are not traditional, depository institutions, are generally subject to the FTC's Safeguards Rule. The requirements under the Safeguards Rule, which were finalized in 2002, are more generalized than those that apply to credit unions or banks and offer fewer specific protections such as vendor due diligence requirements and incident response programs. Furthermore, the FTC has no examination authority over non-bank financial companies and must bring enforcement actions to address non-compliance with the Safeguards Rule. To address these risks, NAFCU has urged regulators and Congress to consider adoption of heightened cybersecurity standards for fintech companies that handle private member information.

No-Action Letters and Trial Disclosure Programs

Since 2013, the Bureau has actively sought to encourage financial innovation through its no-action letter (NAL) and trial disclosure program policies, which are designed to provide limited safe harbors to companies that wish to test new products or disclosures through Bureau-supervised pilot programs. Initially, both policies generated minimal interest from industry stakeholders, who perceived the Bureau's rules for NALs and trial disclosure programs as overly restrictive and ill-suited for cultivating experimental deployment of new products or services. However, in 2018, the Bureau rebooted its innovation-focused efforts by creating the Office of Innovation, which released a substantially revised policy for its trial disclosure program in September 2018 and intends to revisit guidance related to NALs.

In September 2018, the Bureau also convened a series of meetings with the Credit Union Advisory Council (CUAC), Community Bank Advisory Council, and Consumer Advisory Board (collectively, the "Advisory Councils"), to discuss the revised trial disclosure program and financial technology in general. NAFCU member credit unions who attended the Advisory Council meetings shared their thoughts on the challenges of developing trial disclosures, which will typically require substantial investments in compliance resources to perform necessary legal due diligence. NAFCU also submitted formal comments in response to the Bureau's revised trial disclosure program policy notice, which expressed support for making the program more flexible, but urged the Bureau to reduce barriers to entry for smaller financial institutions. Given the demands of the current regulatory environment, many credit unions cannot afford to test novel disclosures in addition to guaranteeing compliance with existing disclosure rules.

Alternative Data

In September 2018, the Bureau convened the Advisory Councils to discuss the use of financial technology to support innovation in financial services. Since 2017, the Bureau has sought feedback on the use of alternative data and modeling techniques in the credit decision process. To date, the Bureau has conducted preliminary research on specific types of data used in the credit process to determine how credit unions and other financial institutions might responsibly use alternative data methods to promote financial inclusion and access to credit. The Bureau believes that alternative data and modeling techniques—potentially supplied by fintech companies—could increase access to credit for consumers who lack a credit score. According to the Bureau, 45 million Americans are credit invisible.

Some credit unions already collect rent or utility bill payment information from credit reporting agencies; however, smaller landlords usually do not share this type of data with credit reporting agencies. Fintech companies may be able to facilitate access to alternate data to enable novel credit scoring techniques in the future, but for now, uncertainty regarding regulatory compliance risks likely renders the use of such data impractical.

NAFCU has long advocated for the use of alternative models that more accurately capture creditworthy borrowers and allow them to access affordable credit. NAFCU supports flexibility in the use of credit scores and the opportunity for a credit union to decide, based on its unique membership, which credit score works best.

More specifically, NAFCU does not think the Bureau should create new rules to compel usage of alternative data. Credit unions are in the best position to identify the sources of information that are most useful in determining the creditworthiness of members. Instead, the Bureau should give financial institutions safe harbor when using existing credit models that incorporate alternative data. Additionally, in furtherance of developing and employing alternative data and modeling techniques, a feasible strategy is for the Bureau to establish pilot programs that give financial institutions a presumptive safe harbor on activities pursued under the pilot program parameters. This would provide a degree of certainty for financial institutions as they discover and utilize new ways of underwriting consumers with little or no credit history.

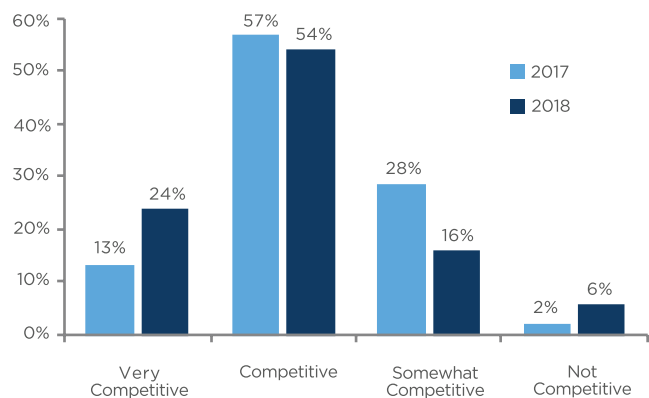
Appendix: Credit Union Ratings of Federal Reserve Services

NAFCU's 2018 *Federal Reserve Meeting Survey* asked participants to rate the services provided by the Federal Reserve on a scale of one to five, with five indicating an "excellent" rating (see Table 1, next page). Credit unions participating in the survey were generally pleased with the quality of Federal Reserve services. All 29 of the services included in the survey received a rating above three, or "average." Top rated services this year include ACH originations and receipts, coin and currency orders, the Fedwire Securities Service and several Fedline Solutions services. FedGlobal ACH Payments received the lowest rating of 3.2.

Of the 29 services in the survey, 12 received higher average ratings compared to 2017, while 9 received lower user scores than last year. Fedline Direct and National Settlement Service saw the largest improvement and decline in rating, respectively.

Survey participants were also asked to review the overall competitiveness of Federal Reserve services. Similar to last year, a large majority (78 percent) felt that the Federal Reserve services were either "competitively" or "very competitively" priced (see Chart 1). Only 6 percent of the participants rated the Federal Reserve services as "not competitively" priced. ACH transaction was identified as the "most competitively-priced" service. Coin and currency services were viewed as the "least-competitively priced" by a minority of the participants.

Chart 1: Overall Competitiveness of Federal Reserve Service Pricing



Source: NAFCU 2018 & 2017 Federal Reserve Meeting Surveys

Table 1: Credit Union Rating of Federal Reserve Services

Federal Reserve Service	Average Rating: 1 to 5 (5=excellent)		Change in Rating
	2018	2017	
ACH Receipts	3.7	3.6	0.1
FedLine Advantage	3.7	3.8	-0.1
FedLine Command	3.7	3.5	0.2
Coin & Currency Orders	3.7	3.5	0.2
ACH Originations	3.7	3.6	0.1
FedLine Direct	3.7	3.4	0.3
Fedwire Securities Service	3.7	3.5	0.2
Check 21 Enabled Service	3.6	3.6	0
Fedwire Funds Service	3.6	3.7	-0.1
Accounting Services	3.6	3.6	0
Check Adjustments Services	3.6	n.a.	
Coin and Currency Deposit	3.6	3.5	0.1
FedACH SameDay Service	3.6	n.a.	
FedComplete Packages	3.6	3.5	0.1
Paper Check Clearing	3.5	3.6	-0.1
National Settlement Service	3.5	3.7	-0.2
FedACH Information File Svcs.	3.5	n.a.	
FedMail	3.5	3.5	0
FedLine Web Services	3.5	3.6	-0.1
Customer Help Services	3.5	3.6	-0.1
FedImage Services	3.5	3.5	0
FedPayments Reporter Service	3.5	3.4	0.1
FedACH Risk Management Svcs.	3.5	3.3	0.2
Presentment Point Services	3.5	3.3	0.2
Educational Seminars	3.5	3.5	0
Fed Discount Window	3.4	3.5	-0.1
FedTransaction Analyzer Service	3.3	3.2	0.1
Foreign and Canadian Check Svcs.	3.3	3.4	-0.1
FedGlobal ACH Payments	3.2	3.3	-0.1

The National Association of Federally-Insured Credit Unions is a strong, independent, direct membership association committed to advancing the credit union community through its relentless focus on membership value in representing, assisting, educating, and informing its member credit unions and their key audiences.



3138 10th Street North
Arlington, VA 22201
nafcu.org