# 2016 NAFCU REPORT *on* CREDIT UNIONS

NAFCU

Federal Advocacy, Education & Compliance

# NAFCU REPORT ON CREDIT UNIONS

## November 2016

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This material was prepared for a meeting on November 29, 2016 between the NAFCU Board of Directors and the Board of Governors of the Federal Reserve System.

# Board of Directors and President and CEO of NAFCU

**Richard Harris**
Chair
Region V Director
Caltech Employees
Federal Credit Union
La Canada, CA
Asset Size: $1.4B
Members: 31,676
FOM: Multi-Occupational

**Jeanne Kucey**
Vice Chair
Region III Director
JetStream
Federal Credit Union
Miami Lakes, FL
Asset Size: $183M
Members: 20,999
FOM: Community

**Debra Schwartz**
Treasurer
Director-at-Large
Mission
Federal Credit Union
San Diego, CA
Asset Size: $3B
Members: 196,620
FOM: Community

**Thomas W. DeWitt**
Secretary
Region IV Director
State Farm
Federal Credit Union
Bloomington, IL
Asset Size: $4B
Members: 132,316
FOM: Service

**Martin Breland**
Region II Director
Tower
Federal Credit Union
Laurel, MD
Asset Size: $2.9B
Members: 148,714
FOM: Multi-Occupational

**Robert L. Fisher**
Director-at-Large
Grow Financial
Federal Credit Union
Tampa, FL
Asset Size: $2.3B
Members: 192,657
FOM: Multi-Occupational

**Gary Grinnell**
Region I Director
Corning
Federal Credit Union
Corning, NY
Asset Size: $1.3B
Members: 100,434
FOM: Multi-Occupational

**Jan N. Roche**
Director-at-Large
State Department
Federal Credit Union
Alexandria, VA
Asset Size: $1.8B
Members: 73,220
FOM: Multi-Occupational

**Charles A. Rutan**
Director-at-Large
Southwest Airlines
Federal Credit Union
Dallas, TX
Asset Size: $416M
Members: 46,779
FOM: Multi-Occupational

**Rod Taylor**
Director-at-Large
Barksdale
Federal Credit Union
Barksdale AFB, LA
Asset Size: $1.2B
Members: 120,441
FOM: Multi-Occupational

**Daniel Weickenand**
Director-at-Large
Orion
Federal Credit Union
Memphis, TN
Asset Size: $621M
Members: 62,261
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

**Janet Yellen**, Chair of the Board of Governors. Her four-year term as Chair expires February 3, 2018, and her 14-year term as member ends January 31, 2024. She began her term on February 3, 2014. Prior to her appointment, Dr. Yellen was Vice Chair of the Board of Governors, previously a president of the Federal Reserve Bank of San Francisco and a member of the Federal Open Market Committee. She is professor emeritus at the University of California at Berkeley and has been a faculty member since 1980. She was also chair of the President's Council of Economic Advisers.

**Stanley Fischer**, Vice Chair of the Board of Governors. His term as Vice Chair expires on June 12, 2018, and his term as a member ends January 31, 2020. He began his term on May 28, 2014. Prior to his appointment, Dr. Fischer was governor of the Bank of Israel from 2005 through 2013. Dr. Fischer was a professor of economics at the Massachusetts Institute of Technology (MIT). Prior to joining the MIT faculty, Dr. Fischer was an assistant professor of economics and postdoctoral fellow at the University of Chicago. Dr. Fischer was also a Vice Chairman of Citigroup and served as the first deputy-managing director of the International Monetary Fund.

**Daniel Tarullo**, member of the Board of Governors. His term expires January 31, 2022. He took office on January 28, 2009. Before becoming a member of the Board, Mr. Tarullo was a professor at Georgetown University Law Center. He also worked in several senior staff positions during the Clinton Administration, including deputy assistant to the president for economic policy and assistant to the president for international economic policy. Prior to serving in the Clinton Administration, he was chief counsel for employment policy on the staff of Senator Edward Kennedy.

**Jerome H. Powell**, member of the Board of Governors. He took office on May 25, 2012, to fill an unexpired term ending January 31, 2014. He was reappointed and sworn in on June 16, 2014 for a term ending January 31, 2028. Prior to his appointment, 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.

**Lael Brainard**, member of the Board of Governors. She took office on 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).

## Abbreviations

| | |
|---|---|
| ACH | Automated Clearing House |
| ATM | Automated Teller Machine |
| CFPB | Consumer Financial Protection Bureau |
| CLF | Central Liquidity Facility |
| CUMAA | Credit Union Membership Access Act |
| CUSO | Credit Union Service Organization |
| DoD | Department of Defense |
| DTI | Debt-to-Income Ratio |
| FASB | Financial Accounting Standards Board |
| FCU | Federal Credit Union |
| FHLB | Federal Home Loan Bank |
| FICU | Federally-Insured Credit Union |
| FISCU | Federally-Insured State Chartered Credit Union |
| FOM | Field of Membership |
| FS-ISAC | Financial Services Information Sharing and Analysis Center |
| FSSCC | Financial Services Sector Coordinating Council |
| GLBA | Gramm-Leach-Bliley Act |
| GSE | Government-Sponsored Enterprise |
| HELOC | Home Equity Line of Credit |
| HMDA | Home Mortgage Disclosure Act |
| ICBA | The Independent Community Bankers of America |
| IRR | Interest Rate Risk |
| MBL | Member Business Loan |
| MLA | Military Lending Act |
| MSR | Mortgage Servicing Rights |
| NAFCU | National Association of Federal Credit Unions |
| NCUA | National Credit Union Administration |
| NCUSIF | National Credit Union Share Insurance Fund |
| OMB | Office of Management and Budget |
| PAL | Payday Alternative Loan |
| PCA | Prompt Corrective Action |
| QM | Qualified Mortgage |
| RBC | Risk-based Capital |
| RBNW | Risk-Based Net Worth |
| RESPA | Real Estate Settlement Procedures Act |
| ROA | Return on Assets |
| TILA | Truth in Lending Act |
| UDAAP | Unfair, Deceptive, or Abusive Acts and Practices |

## BACKGROUND

The National Association of Federal 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. 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 more than 800 of the nation's most innovative and dynamic federally-insured credit unions (FICUs) having various and diverse membership bases and operations. NAFCU takes pride in representing many smaller credit unions with relatively limited operations, as well as many of the largest and most sophisticated credit unions in the nation. In fact, as of June 2016, 87 of the 100 largest FCUs were NAFCU members. NAFCU represents 69 percent of total federal credit union (FCU) assets and 64 percent of all FCU member-owners. As of June 2016, NAFCU's membership also included over 100 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 2016, there were 3,679 FCUs, with assets of $650 billion and a membership base of approximately 55.4 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" (FICUs) 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 2016, there were 5,887 FICUs, with assets of $1.3 trillion and a membership base of over 105 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 nine states (Alabama, California, Idaho, Illinois, Indiana, Maryland, 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 2016, there were 12 corporate credit unions with assets of $19.9 billion.

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[1] The nine jurisdictions where state-chartered credit unions have obtained primary private insurance are Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio and Texas.

## 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 survey of NAFCU-member credit unions, which is compiled into a report with updates on our members' financial data, as well as their responses to questions on a special monthly topic.

### CU Industry Trends Report

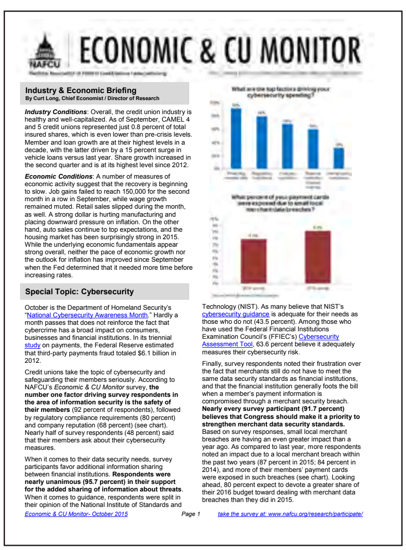
NAFCU's CU Industry Trends Report is a quarterly analysis of trends in the credit union industry, with key financial ratios summarized and aggregated by region and asset class.

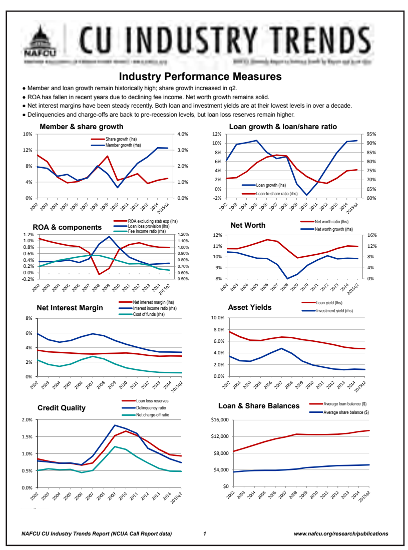
### NAFCU Report on Credit Unions

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 in September 2016.

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

NAFCU commissioned a special study in 2014 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 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 deposits for consumers. The study also estimates the broader economic impact of these lost consumer benefits.




# KEY FINDINGS

## CREDIT UNION TRENDS

- The credit union industry overall is very healthy and well capitalized. After dropping during the crisis, FICUs' net worth ratio has since recovered.
- Industry consolidation has increased, as the impact of growing compliance burden weighs heavily on the entire industry and particularly on small credit unions.
- The secondary mortgage market remains critical to credit unions, who utilize Fannie Mae and Freddie Mac more heavily than other lenders.

## CREDIT UNION SERVICE TO MEMBERS AND USE OF FEDERAL RESERVE SERVICES

- Electronic services continue to expand throughout the industry, both in terms of the range of services provided and the number of credit unions offering them to their members.
- A majority of credit unions offer internet banking and a growing number offer mobile banking. Credit unions also plan to invest heavily in mobile banking over the next three years.
- The Federal Reserve remains a critical source of transaction services for the industry.

## LEGISLATIVE ISSUES FACING CREDIT UNIONS

- Preserving the credit union tax exemption remains NAFCU's top legislative priority. Credit unions provide over $17 billion annually in benefits to the economy, and NAFCU remains vigilant in defending the industry against false attacks.
- The ever-increasing regulatory burden in the post Dodd-Frank era continues to challenge credit unions. Credit unions are unique and, as good actors within the financial services industry, they should not be subject to the expansive regulations aimed at the bad actors that caused the financial crisis.
- Credit unions face growing concerns over data security and cybersecurity, as they often are accountable for bearing significant costs to make their members "whole" when a merchant data breach occurs.

## REGULATORY ISSUES FACING CREDIT UNIONS

- Strengthening the ability for credit unions to serve more consumers and pursuing modernized field of membership reform is at the core of NAFCU's regulatory advocacy efforts.
- Credit unions are the most highly regulated of all financial institutions. Compliance challenges are exacerbated by the CFPB's seeming lack of understanding of the operational difficulties associated with implementing its complex rules.
- NAFCU continues to work to ensure that any new payments system will be cost-effective, operationally effective and scalable for credit unions of all sizes.

## STRATEGIC GOALS AND CHALLENGES

- While regulatory burden has proven to be a significant drag on credit union performance over the past six years, respondents expect that burden to grow in the future.
- Credit unions are under significant pressure to keep pace with a market undergoing rapid technological change by increasing expenditures in information technology.
- Strengthening the credit union dual chartering system is imperative to the future strength and well-being of the industry.

# CREDIT UNION TRENDS

## GENERAL FINANCIAL CONDITIONS

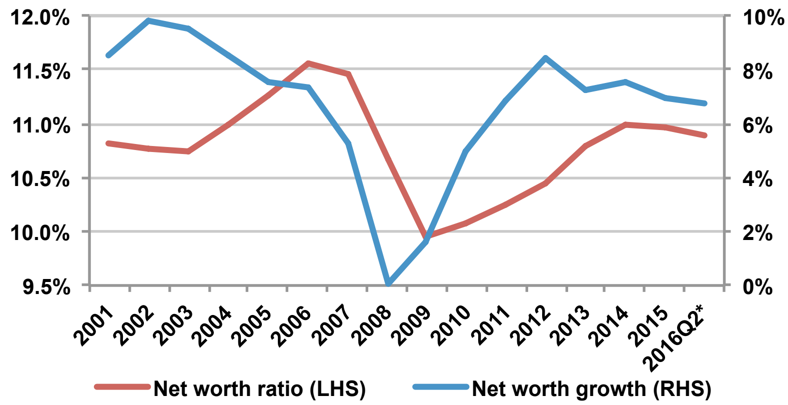
Credit unions are conservatively run, well-capitalized institutions, which helps to explain their relatively quick recovery from the financial crisis. After dropping during the crisis, FICUs' net worth ratio has since recovered (Chart 1). As of June 2016, year-over-year growth in net worth (6.7 percent) was slightly below asset growth (7.4 percent). Since the onset of the recession, credit unions have experienced a lower failure rate than banks. From 2008 through 2015, there were 515 bank failures compared to only 160 credit union failures.[1] As of June 2016, NCUA reported that there were 209 problem credit unions with a CAMEL rating of 4 or 5. These credit unions constitute 0.9 percent of industry shares, which is down from a peak of 5.7 percent in 2009 and on par with the pre-recession figure.

The industry experienced a spike in share growth during the financial crisis (Chart 2), but that moderated in subsequent years. Since 2013, however, there has been a steady rise in share growth as it has crept beyond its long-run average in non-recession years of roughly 6 percent. Not coincidentally, year-over-year growth in credit union membership was 3.8 percent in June 2016, which is its highest level in nearly 30 years.

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 December 2007 to June 2016, the percent of credit union shares in core deposits increased from 55.5 percent to 72.6 percent. This has resulted in a lower cost of funds for credit unions, but that trend is likely to be reversed if interest rates increase.

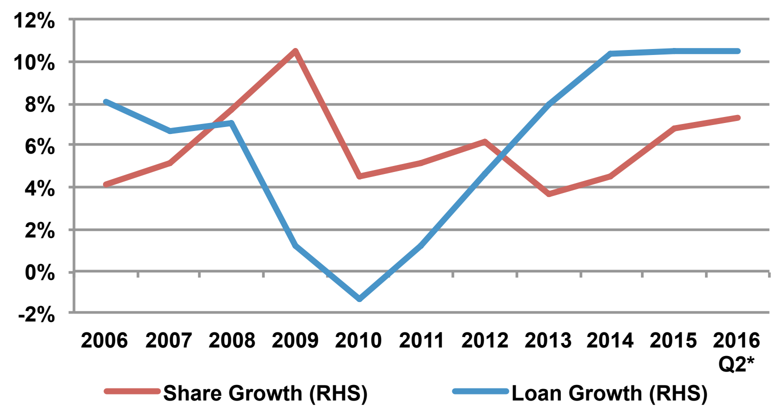
Credit unions are a critical source of credit for households, and their market share for first mortgage, vehicle and revolving loans has

**Chart 1 | FICU Net Worth Ratio**



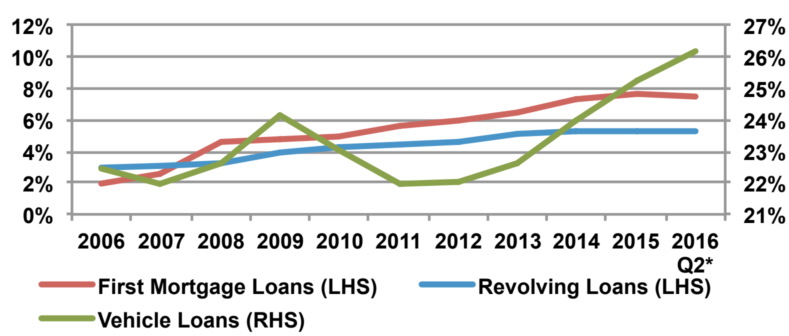

** Growth rates are year over year.*
*Source: NCUA*

**Chart 2 | FICU Loan and Share Growth**




** Growth rates are year over year.*
*Source: NCUA*

**Chart 3 | FICU Market Share**




** First mortgage loan figures reflect loan originations, revolving and vehicle loan figures show loans outstanding*

*Sources: NCUA, Mortgage Bankers Association, Federal Reserve*

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

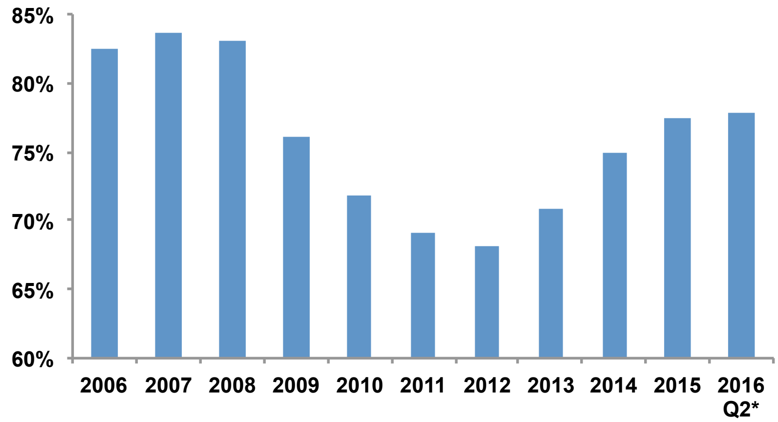
increased significantly since 2007 (Chart 3). Loan balances overall continue to surge, increasing 10.5 percent year over year as of June 2016. Vehicle loan balances grew by 14 percent year over year in June and accounted for 44 percent of overall loan growth during that time.

As a result of weak loan growth and the surge in share growth during the recession, the industry's loan-to-share ratio dropped by over 15 percentage points from 2007 to 2012 (Chart 4). Since declining to 68.1 percent in 2012, however, the ratio has climbed to 77.8 percent. Nevertheless, there remains a substantial amount of balance sheet liquidity within the industry when compared to pre-crisis levels.

FICUs' June 2016 annualized ROA (0.77 percent) represents a decline of four basis points from a year prior (Chart 5). In general, ROA has recovered since the recession as asset quality and provision for loan loss expense have returned to pre-crisis levels, but declining fee income in recent years presents a challenge for the industry as it seeks to maintain a viable operating margin. The cap on interchange fees has already affected credit union's non-interest earnings (see *Debit Card Interchange Fees*, page 22), and potential regulation on overdraft fees (see *Overdraft*, page 27) threatens to tighten margins for credit unions even further.

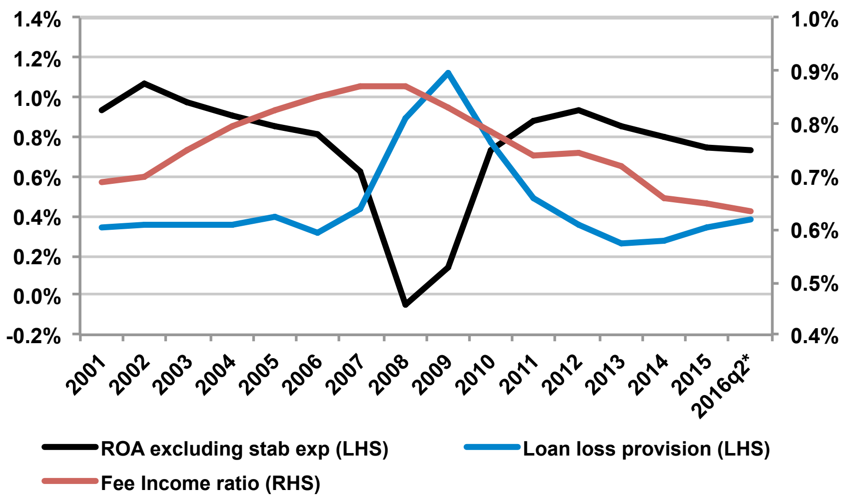
By and large, credit unions did not participate in the type of lending activities that precipitated the financial crisis, and yet, FICUs did experience some deterioration in their overall asset quality as a result of the recent financial turmoil. However, asset quality has improved since 2009 and returned to pre-crisis levels. The delinquency ratio for the credit union industry as of June 2016 was 0.75 percent, which is one basis point higher than a year earlier. This compares to a delinquency ratio of 1.49 percent for all banks and 1.05 percent for community banks (Chart 6). The net charge-off ratio for credit unions is 0.51 percent, which is five basis points higher than a year ago.

**Chart 4 | FICU Loan-to-Share Ratio**



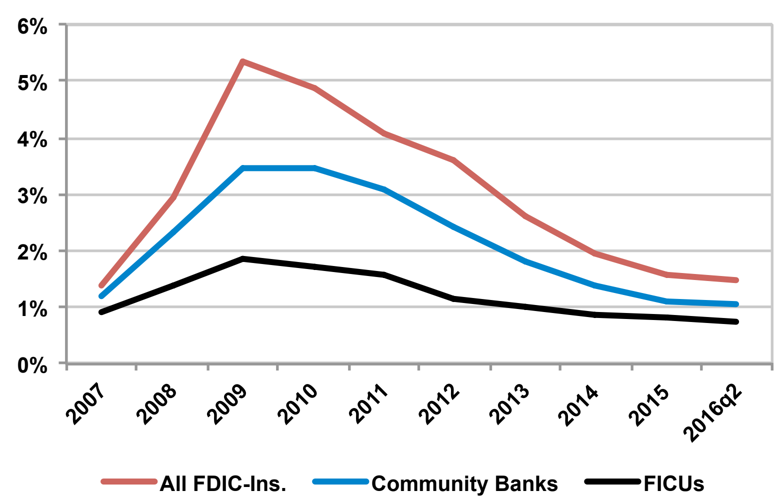

*Source: NCUA*

**Chart 5 | ROA**




** Growth rates are year over year.*
*Source: NCUA FPR*

**Chart 6 | Delinquency Ratios**




*Source: NCUA, FDIC*

## INDUSTRY CONSOLIDATION

While credit unions on the whole are performing well, small credit unions continue to struggle. Consolidation within the industry has been a long term-trend, but that trend has accelerated in recent years. The number of credit unions continues to decline, mostly due to mergers, at a pace of roughly one per day.

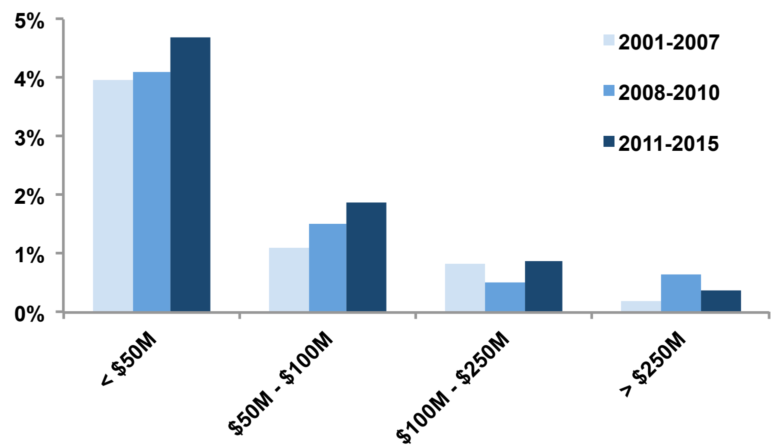
A review of merger trends since 2001 shows that small credit unions are far more likely to merge than larger credit unions (Chart 7). Since that time, an average of four to five percent of such credit unions merge out of existence each year. On the contrary, a merger of a credit union with over $250 million in assets is a relatively rare event.

The financial crisis affected the credit union industry most severely between the years 2008 and 2010. During those years, the combination of weak economic conditions, NCUA premium assessments related to the Share Insurance Fund and failures within the corporate credit union system depressed industry net worth and earnings. Three of the four asset classes showed an increased level of merger activity during those years.

However, small credit unions have seen even higher levels of merger activity in the years since, and that trend shows no signs of slowing down or reversing. In NAFCU's 2016 *Federal Reserve Meeting Survey*, small credit union respondents were more likely than larger respondents to indicate that they anticipated being merged into another credit union over the next three years (Chart 8).

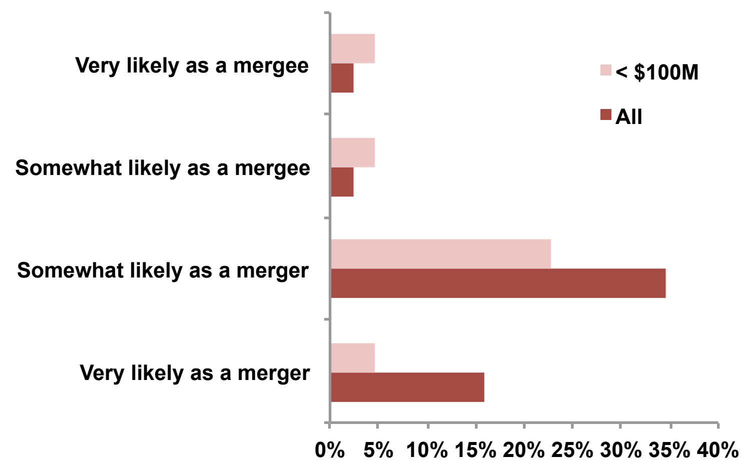
Two of the most significant challenges for small credit unions, according to NAFCU's survey, are regulatory burden and the low interest rate environment (Chart 9). While there may be some relief in the coming years if rates return to historical norms, the compliance burden continues to grow with no signs of abatement. As small credit unions often do not have the option to add compliance staff, they are left with few alternatives when the regulatory regime becomes too big to manage.

**Chart 7 | Average Annual Merger Rate by Asset Class**



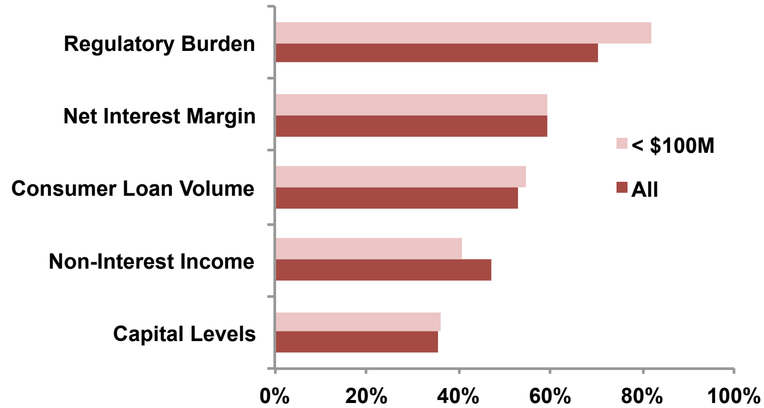

*Source: NCUA*

**Chart 8 | Likelihood of Involvement in a Merger in the Next Three Years**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

**Chart 9 | Strategic Challenges Rated as "Significant" Over the Next Three Years**




*Source: NAFCU 2016 Federal Reserve Meeting Survey, selected responses*

## LENDING STANDARDS & CONDITIONS

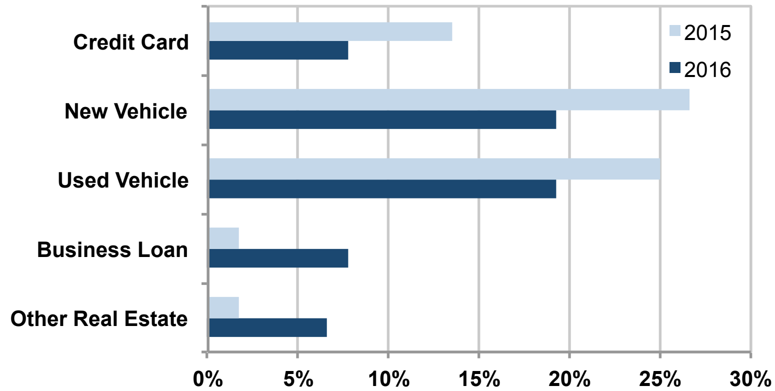
NAFCU's annual *Federal Reserve Meeting Survey* includes questions on lending standards, and a comparison between 2015 and 2016 shows that standards have been eased for most types of loans (Charts 10a and 10b). For credit card and vehicle loans, a smaller net majority of respondents indicated that they had eased loan standards in 2016 as compared to the year prior. For business and other real estate loans, the net majority increased versus 2015. Starting with the 2016 survey, NAFCU broke out types of residential mortgage loans based largely on their classification under the qualified mortgage (QM) standard. The category which saw the most widespread easing in lending standards was GSE-eligible. Non-QM jumbo was the only category where a net majority of respondents tightened loan standards over the past 12 months.

In those instances where respondents tightened lending standards, the most commonly cited reasons were rising delinquencies and charge-offs (86.8 percent "somewhat" or "very important") and less favorable or more uncertain economic outlook (59.5 percent). In 2016 the most commonly cited reasons were a reduced tolerance for risk and rising delinquencies and charge-offs.

Year-over-year loan growth has been strong by historical standards in recent years, and survey respondents indicated broad-based increases in loan demand over the past year. The strongest increases were seen in new and used vehicle loan demand (Chart 8). Other categories with significant increases in loan demand were credit card, GSE-eligible residential mortgage, and other real estate. Demand for credit card and business loans improved, as well.

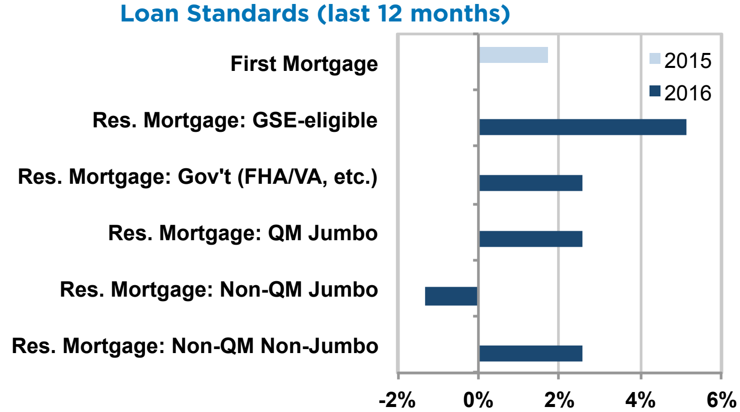
In terms of the change in the quality of loan applicants over the past year, respondents indicated disparities among the various loan categories (Chart 12). For business and real estate loans, a clear majority indicated that the creditworthiness of applicants had improved

**Chart 10a | Net Percentage of Respondents Easing Loan Standards (last 12 months)**



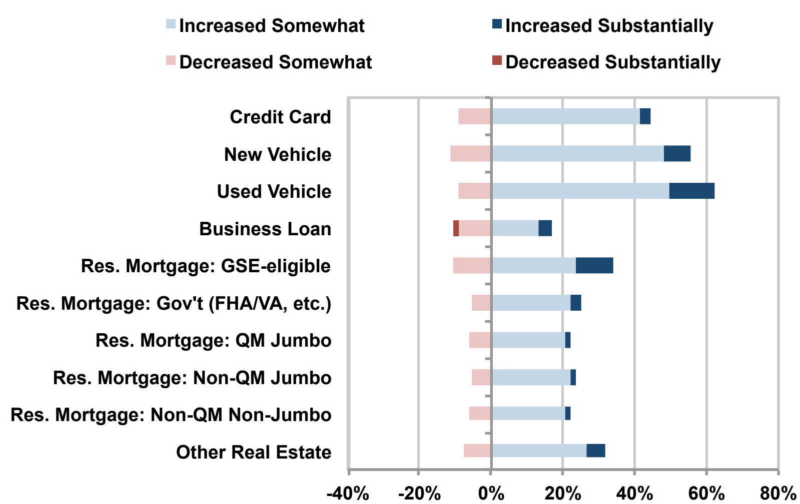

*Source: NAFCU 2016 Federal Reserve Meeting Survey*

**Chart 10b | Net Percentage of Respondents Easing Res. Mort. Loan Standards (last 12 months)**



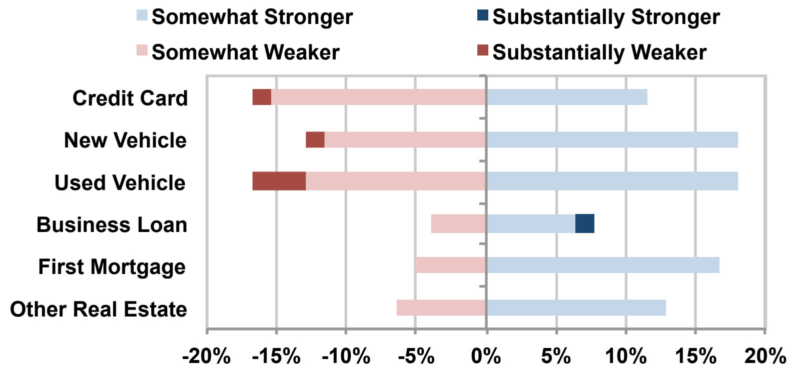

*Note: First mortgage loans replaced by residential mortgage categories in 2016*
*Source: NAFCU 2016 Federal Reserve Meeting Survey*

**Chart 11 | Change in Loan Demand (last 12 months)**




*Source: NAFCU 2016 Federal Reserve Meeting Survey* since a year ago. However, more than 10 percent of survey participants stated that applicant quality had weakened during that time for credit card and vehicle loans.

**Chart 12 | Change in Applicant Creditworthiness (last 12 months)**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

## LIQUIDITY

Prior to the recession, credit unions relied heavily on corporate credit unions for their short-term liquidity needs. However, a number of corporate credit unions failed in the wake of the financial crisis, which also impacted the NCUA's Central Liquidity Facility (CLF). When U.S. Central Bridge Corporate Credit Union shut its doors in October 2012, the CLF's borrowing authority was reduced by 96 percent, from $46 billion to just $2 billion. As of June 2016, the CLF's statutory borrowing authority was just over $6 billion.

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 CLF. Based on NAFCU's 2016 *Federal Reserve Meeting Survey* results, credit union respondents with over $250 million in assets have tended to utilize the Discount Window more heavily than smaller credit unions (Table 2). Federal Home Loan Banks (FHLBs), which NCUA did not include as an approved provider of contingency funding in their rule, are also an important source of liquidity for credit unions. This is especially true for those with over $250 million in assets, although a comparison to survey results from the previous year suggests growing use among smaller credit unions. Credit union respondents under the $250 million threshold continue to utilize corporate credit unions more heavily.

**Table 2 | Credit Union Liquidity Sources**

| | Increased available lines of credit in past 12 months | Accessed lines of credit in past 12 months | Tested access in backup liquidity plan in past 12 months | Intend to gain access to funds in next 12 months |
|---|---|---|---|---|
| **FRB Discount Window** | | | | |
| **<$250 million** | 3.2% | 3.2% | 16.1% | 0% |
| **>$250 million** | 11.9% | 4.8% | 90.5% | 2.4% |
| **Central Liquidity Facility** | | | | |
| **<$250 million** | 3.2% | 0% | 6.5% | 3.2% |
| **>$250 million** | 0% | 0% | 7.1% | 0% |
| **FHLBs** | | | | |
| **<$250 million** | 12.9% | 19.4% | 22.6% | 6.5% |
| **>$250 million** | 23.8% | 40.5% | 69.0% | 11.9% |
| **Corporate CUs** | | | | |
| **<$250 million** | 16.1% | 16.1% | 51.6% | 9.7% |
| **>$250 million** | 4.8% | 4.8% | 45.2% | 0% |
| **Banks** | | | | |
| **<$250 million** | 6.5% | 0% | 9.7% | 0% |
| **>$250 million** | 9.5% | 7.1% | 16.7% | 4.8% |

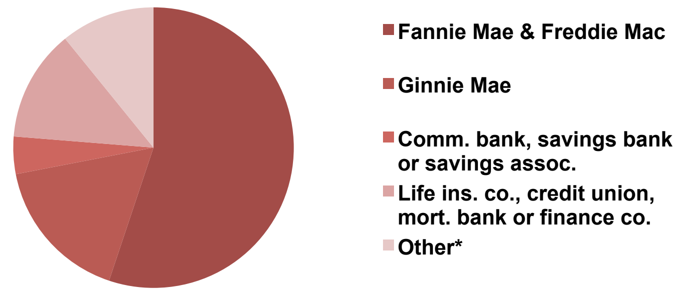
*Source: NAFCU 2016 Federal Reserve Meeting Survey*

## 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 38 percent of first mortgage loans originated in 2016. This is down slightly from 2015 when 39 percent of first mortgage originations were sold, and in line with historical averages. Credit unions that participated in NAFCU's 2016 *Federal Reserve Meeting Survey* indicated that, on average, 57 percent of their outstanding first mortgage loans qualify to be sold on the secondary market, down from 65 percent in the 2015 survey.

Based on data released under the Home Mortgage Disclosure Act (HMDA), credit unions tend to utilize Fannie Mae and Freddie Mac more heavily relative to banks and thrifts (Charts 13 and 14). Among respondents to this year's survey, 24.7 percent sell mortgage loans to Fannie Mae, 9.1 percent sell mortgages to Freddie Mac, and another 23.4 percent sell to both. Among other avenues for placing mortgage loans, the most popular was FHLBs (33.3 percent), followed by credit union service organizations, or CUSOs (23.5 percent), and mortgage wholesalers (27.5 percent).

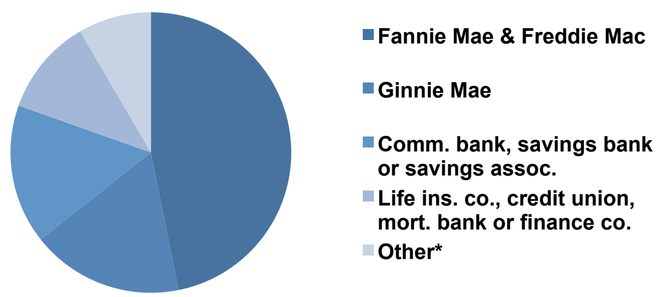
**Chart 13 | Credit Union Mortgage Sales by Purchaser Type**




** "Other" includes private securitization, affiliate institution or other type of purchaser*

*Source: 2015 HMDA data*

**Chart 14 | Bank & Thrift Mortgage Sales by Purchaser Type**




** "Other" includes private securitization, affiliate institution or other type of purchaser*

*Source: 2015 HMDA data*

# CREDIT UNION SERVICE TO MEMBERS AND USE OF FEDERAL RESERVE SERVICES

Credit unions continue 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 rising number of institutions offering remote deposit capture, mobile payments, and other financial products.

## ELECTRONIC FINANCIAL SERVICES

According to NCUA call report data, Account Balance Inquiry is the most common online service offered by FICUs, with 78.2 percent reporting that they currently offer this service (Table 1). This is up from last year's 77 percent. The electronic services that saw the largest increase in usage were Remote Deposit Capture (30.5 percent, up from 23.3 percent last year) and Mobile Payments (20.3 percent, up from 14.8 percent).

More credit unions are offering mobile banking to members (52.3 percent, up from 47.0 percent last year, Table 2). The shares of credit unions that offer ATM and internet banking services also increased from 73.1 percent to 74.1 percent and from 74.9 percent to 76.5 percent, respectively.

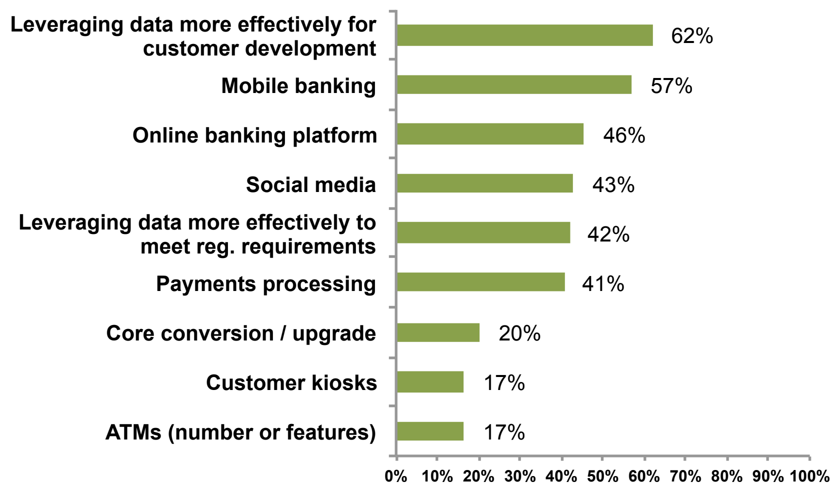
In NAFCU's 2016 *Federal Reserve Meeting Survey*, participants were asked to identify IT-related projects their credit unions could invest in over the next three years (Chart 1). More than half of the respondents envisioned their credit unions investing in ways to optimize customer development and in mobile banking.

**Table 1 | Financial Services Offered**

| Online Service Offered | Provided in 2015 | Provided in 2016 |
|---|---|---|
| Account Balance Inquiry | 77.0% | 78.2% |
| Bill Payment | 61.3% | 63.0% |
| Electronic Signature Services | 13.7% | 17.6% |
| e-Statements | 66.3% | 68.8% |
| Loan Payments | 69.5% | 71.2% |
| Mobile Payments | 14.8% | 20.3% |
| Remote Deposit Capture | 23.3% | 30.5% |
| View Account History | 75.4% | 77.0% |

*Source: NCUA June 2015 & 2016 Call Reports*

**Chart 1 | Anticipated IT-Related Investments Over Next Three Years**




*Source: NAFCU Federal Reserve Meeting Survey*

**Table 2 | How Do Your Members Access/Perform Electronic Financial Services?**

| Electronic Service | Percentage of # of Institutions | | Percentage of Assets | |
|---|---|---|---|---|
| | 2015 | 2016 | 2015 | 2016 |
| Audio Response/Phone-Based | 59.0% | 59.4% | 96.5% | 96.3% |
| Automatic Teller Machine (ATM) | 73.1% | 74.1% | 98.7% | 98.9% |
| Home Banking via Internet Website | 74.9% | 76.5% | 99.2% | 99.4% |
| Kiosk | 6.1% | 6.3% | 33.9% | 35.4% |
| Mobile Banking | 47.0% | 52.3% | 93.7% | 95.5% |
| Other | 4.7% | 4.9% | 5.7% | 5.9% |

*Source: NCUA June 2015 & 2016 Call Reports*

## FEDERAL RESERVE SERVICES

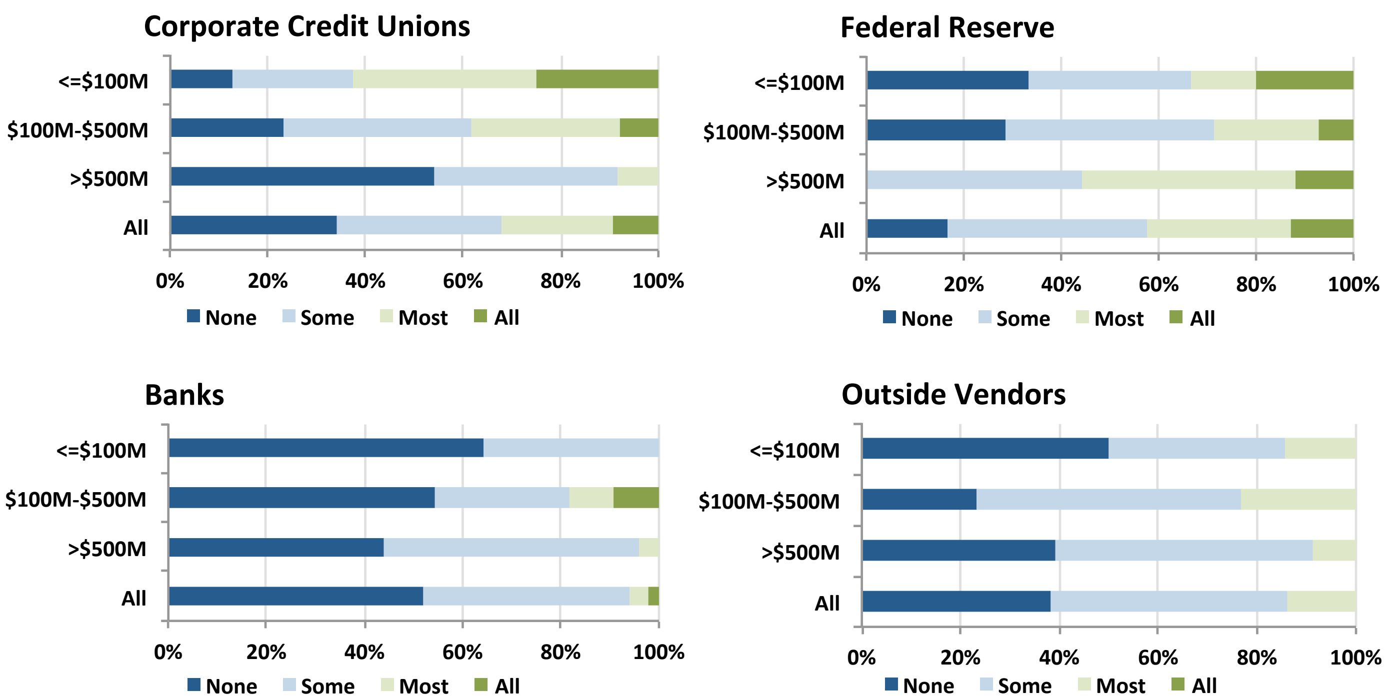
In NAFCU's 2016 *Federal Reserve Meeting Survey*, participants were asked to indicate their use of intermediaries for transaction services (Table 3). Usage of bank services fell sharply compared to last year as credit unions returned to corporate credit unions for their liquidity and processing needs. The share of respondents that use corporate credit unions for at least some of their transaction services increased from 53.8 percent to 66 percent. Meanwhile, the share of respondents that use the Federal Reserve decreased from 89.7 percent to 83.3 percent.

**Table 3 | Which Intermediaries Does Your Credit Union Use for Transaction Services?**

| | Corporate Credit Unions | | Banks | | Federal Reserve | | Outside Vendors | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 |
| **None** | 46.2% | 34.0% | 37.1% | 52.0% | 10.3% | 16.7% | 40.5% | 38.0% |
| **Some** | 25.6% | 34.0% | 60.0% | 42.0% | 33.3% | 40.7% | 51.4% | 48.0% |
| **Most** | 15.4% | 22.6% | 0% | 4.0% | 43.6% | 29.6% | 5.4% | 14.0% |
| **All** | 12.8% | 9.4% | 2.9% | 2.0% | 12.8% | 13.0% | 2.7% | 0% |

*Source: NAFCU 2015 & 2016 Federal Reserve Meeting Surveys*

**Chart 2 | Use of Intermediaries by Asset Class**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

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 (Chart 2). The over $500 million asset class is 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.

**Table 4 | Credit Union Usage and Rating of Federal Reserve Services**

| Federal Reserve Service | 2016 Respondent Usage | | | | Average Rating: 1 to 5 (5=excellent) | |
|---|---|---|---|---|---|---|
| | Total | Declining | Same | Increasing | 2015 | 2016 |
| ACH Receipts | 73.5% | 2.0% | 42.9% | 28.6% | 3.8 | 3.7 |
| Fedwire Funds Service | 70.2% | 2.1% | 51.1% | 17.0% | 3.8 | 3.7 |
| Customer Help Services | 63.8% | 2.1% | 57.4% | 4.3% | 4.0 | 3.7 |
| FedLine Advantage | 62.2% | 0% | 48.9% | 13.3% | 3.9 | 3.7 |
| Check 21 Enabled Service | 61.2% | 2.0% | 44.9% | 14.3% | 3.8 | 3.7 |
| Coin and Currency Orders | 60.8% | 3.9% | 39.2% | 17.6% | 3.9 | 3.7 |
| Account Services | 59.6% | 2.1% | 51.1% | 6.4% | 3.7 | 3.6 |
| Coin and Currency Deposit | 58.8% | 2.0% | 41.2% | 15.7% | 3.8 | 3.6 |
| Fed Discount Window | 58.0% | 0% | 54.0% | 4.0% | 3.6 | 3.6 |
| FedLine Web Services | 56.8% | 0% | 43.2% | 13.6% | 3.8 | 3.6 |
| ACH Originations | 56.3% | 2.1% | 29.2% | 25.0% | 3.8 | 3.6 |
| Educational Seminars | 54.2% | 2.1% | 45.8% | 6.3% | 3.8 | 3.5 |
| FedImage Services | 47.8% | 2.2% | 37.0% | 8.7% | 3.5 | 3.5 |
| Paper Check Clearing | 46.0% | 12.0% | 28.0% | 6.0% | 3.5 | 3.6 |
| FedLine Direct | 42.2% | 0% | 37.8% | 4.4% | 3.8 | 3.5 |
| FedMail | 41.3% | 4.3% | 32.6% | 4.3% | 3.4 | 3.4 |
| Presentment Point Services | 37.0% | 0% | 32.6% | 4.3% | 3.5 | 3.7 |
| FedPayments Reporter Service | 35.6% | 0% | 28.9% | 6.7% | 3.5 | 3.3 |
| ACH Risk Management Services | 33.3% | 0% | 28.9% | 4.4% | 3.4 | 3.5 |
| Foreign Check Services | 33.3% | 2.1% | 29.2% | 2.1% | 3.8 | 3.4 |
| Fedwire Securities Service | 30.4% | 2.2% | 23.9% | 4.3% | 3.8 | 3.2 |
| FedTransaction Analyzer Service | 28.9% | 0% | 26.7% | 2.2% | 3.4 | 3.4 |
| National Settlement Service | 27.7% | 0% | 27.7% | 0.0% | 3.6 | 3.3 |
| FedLine Command | 26.7% | 0% | 22.2% | 4.4% | 3.8 | 3.5 |
| FedGlobal ACH Payments | 25.0% | 2.1% | 16.7% | 6.3% | 3.3 | 3.3 |
| FedComplete Package | 25.0% | 0% | 20.5% | 4.5% | 3.6 | 3.5 |

*Source: NAFCU 2015 & 2016 Federal Reserve Meeting Surveys*

NAFCU's 2016 *Federal Reserve Meeting Survey* asked participants about their usage rates of Federal Reserve services with respect to last year and to rate the service provided (Table 4). The most widely-used Federal Reserve service was Automated Clearinghouse (ACH) Receipts (73.5 percent), followed by Fedwire Funds Services (70.2 percent), Customer Help Services (63.8 percent), Fedline Advantage (62.2 percent) and Check 21 Enabled Service (61.2 percent). The least-used services were FedComplete Package (25.0 percent), FedGlobal ACH Payments (25.0 percent) and FedLine Command (26.7 percent).

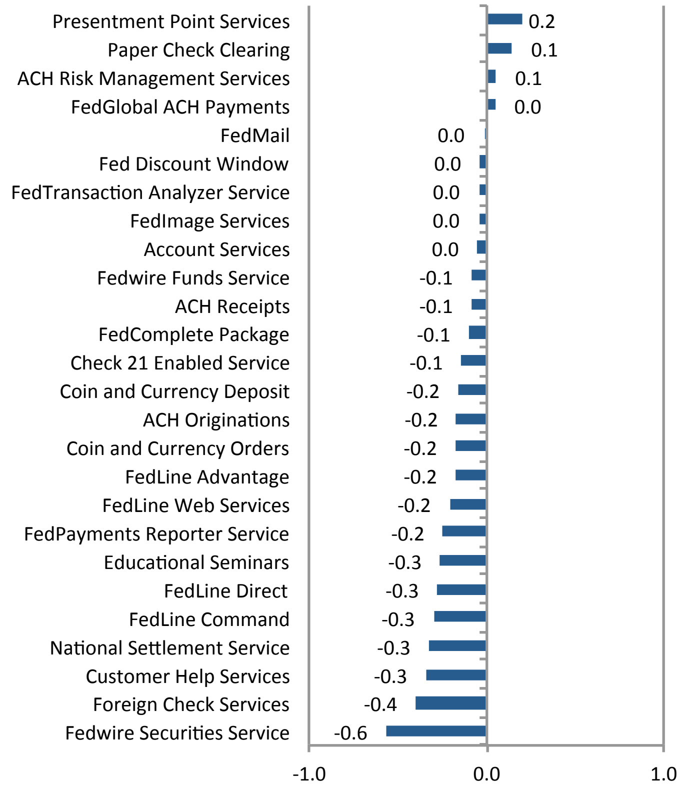
The services in which the greatest number of respondents noted a decline in usage were Paper Check Clearing (12.0 percent) and FedMail (4.3 percent). The services with the largest increases in usage were ACH Receipts (28.6 percent), ACH Originations (25.0 percent) and Coin and Currency Orders (17.6 percent). Of the 26 services in the survey, 22 showed a positive net usage change from a year ago. Three services showed no net change, while one (Paper Check Clearing) had a net decline in usage among respondents.

Participants were asked to rate the Federal Reserve services on a scale of one to five with five indicating an "excellent" rating (Table 4). Credit unions participating in the survey were generally pleased with the quality of Federal Reserve services, although ratings did decline on average from a year ago. All 26 of the services included in the survey received an average rating above three, or "average." The Federal Reserve services with the highest rating of 3.7 were Coin and Currency Orders, Customer Help Services, Check 21 Enabled Service, Presentment Point Services, FedLine Advantage, Fedwire Funds Service and ACH Receipts. Fedwire Securities Service received the lowest rating (3.2 rating).

Seventeen of the services received a lower average rating than in 2015, while only three received a higher rating (Chart 3). The services that saw the largest decline in their average ratings were Fedwire Securities Service (-0.6) and Foreign Check Services (-0.4). The services with improved ratings were Presentment Point Services (+0.2), Paper Check Clearing (+0.1) and ACH Risk Management Services (+0.1).

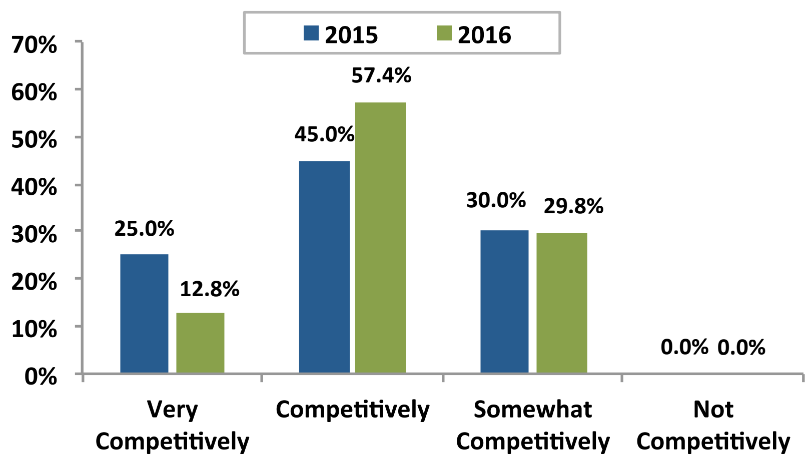
Survey participants were also asked to review the overall competitiveness of Federal Reserve services. A large majority (70.2 percent) felt that the Federal Reserve services were either "competitively" or "very competitively" priced (Chart 4). This is a slight increase from 2015, when 70.0 percent rated Federal Reserve service pricing as either "competitive" or "very competitive." None of the participants rated the Federal Reserve services as "not competitively" priced. The specific service identified as "most competitively-priced" was ACH Transaction, while the service viewed as "least-competitively priced" was Wire Processing.

**Chart 3 | Year-Over-Year Change in Rating of Fed Services**




*Source: NAFCU's 2015 & 2016 Federal Reserve Meeting Surveys*

**Chart 4 | Overall Competitiveness of Federal Reserve Service Pricing**




*Source: NAFCU's 2015 & 2016 Federal Reserve Meeting Surveys*

# LEGISLATIVE ISSUES FACING CREDIT UNIONS

## PRESERVING THE CREDIT UNION TAX EXEMPTION

Preservation of the credit union tax exemption continues to be NAFCU's top legislative priority. While no member of Congress has proposed eliminating the tax exemption, NAFCU remains vigilant. A NAFCU study on the benefit of the tax exemption, released in February of 2014, found that the presence of credit unions provided an average of $17 billion annually in benefits to consumers, businesses and the U.S. economy. 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.

*Rep. Jeb Hensarling (R-TX) with NAFCU President and CEO B. Dan Berger*

## REGULATORY RELIEF

Broad-based regulatory relief continues to be a top priority for NAFCU and its member credit unions. Credit unions continue to face an ever-increasing tidal wave of compliance burden in today's regulatory environment. Credit unions did not contribute to the financial crisis yet are still subject to increasing regulatory requirements in the post Dodd-Frank environment. Meanwhile, rarely are old and outdated regulations revisited or removed. Over 1,500 credit unions have disappeared since the passage of the Dodd-Frank Act in 2010, 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 and have had to merge out of business or be taken over.

Asked to rate the magnitude of the anticipated challenges facing credit unions over the next three years, approximately 71% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* indicated meeting regulatory compliance requirements represented a "significant" challenge to credit unions. Ballooning compliance costs are also a major challenge. The vast majority of respondents (75.6%) cited the current regulatory environment as an area they expect to drive spending increases the most over the next three years.

Regulatory relief for community focused financial institutions has been a topic of ongoing dialogue in the 114th Congress. Comprehensive relief is being considered in the Senate in the form of S. 1484, the *Financial Regulatory Improvement Act*. The House Financial Services Committee has also acted on comprehensive relief — The Financial Choice Act, H.R. 5983. In addition to NAFCU's Five-Point Plan for Regulatory Relief, updated in 2015, NAFCU has continued to call on Congressional leaders to embrace bipartisan regulatory relief for credit unions.

## DATA SECURITY

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. Asked to rate the magnitude of the anticipated challenges facing credit unions over the next three years, 72% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* indicated maintaining a secure electronic environment represented a "significant" challenge to credit unions. Data security breaches are a serious problem for both consumers and businesses, and stronger safeguards for consumers are necessary. Traditionally, consumers have trusted that entities collecting their financial information will take necessary steps to protect them from risk. Unfortunately, in the wake of several significant retailer breaches in recent years, consumers are losing that trust. While both merchants and credit unions are targets of cyberattacks and data thieves, only credit unions and other financial institutions have been subject to standards on data security since the passage of the Gramm-Leach-Bliley Act.

Retailers and many other entities that handle sensitive personal financial data are not subject to these same standards. Financial institutions such as credit unions bear a significant burden as they often incur steep losses to reestablish member safety after a data breach occurs. A February 2015 survey of NAFCU members found that the estimated costs associated with merchant data breaches in 2014 were $226,000 on average. Of their losses, respondents expected to recoup less than 0.5%. Credit unions, despite rarely being the source of data breaches, spent an average of $136,000 on data security measures and $226,000 in costs associated with merchant data breaches in 2014.

*Left to Right: NAFCU's Vice President of Legislative Affairs Brad Thaler; Director of Political Affairs Dan O'Brien; and Director of Regulatory Affairs Alexander Monterrubio*

NAFCU supports legislation introduced by Senators Tom Carper (D-DE) and Roy Blunt (R-MO), the *Data Security Act of 2015* (S. 961), and a similarly named House bill, H.R. 2205, introduced by Representatives Randy Neugebauer and John Carney that would create a national standard of data protection for those who handle sensitive financial information. The issue of data security is also one of the provisions of NAFCU's Five-Point Plan for Regulatory Relief. NAFCU has stayed at the forefront of this issue and continues to advance the call for national data security standards for all parties handling sensitive consumer financial information.

## CYBERSECURITY

Cybersecurity is an important issue for credit unions, as some institutions have found themselves victims of denial of service attacks, in addition to other cybercrimes that threaten to compromise the financial information of a member, especially with the growth of online commerce and banking. As an industry, credit unions and other financial institutions must increase their collaboration and work together to combat these crimes. NAFCU's October 2016 *Economic & CU Monitor* member survey found that the percentage of respondents' overall operating budget devoted to cybersecurity has nearly doubled over the past five years.

NAFCU is pleased to be an active participant in various industry and government cybersecurity initiatives. NAFCU is a member of the Payments Security Task Force, a diverse group of participants in the payments industry that is driving a discussion relative to systems security. NAFCU also supports many of the ongoing efforts at the Financial Services Sector Coordinating Council (FSSCC) and the Financial Services Information Sharing and Analysis Center (FS-ISAC). These organizations work closely with partners throughout the government creating unique information sharing relationships that allow threat information to be distributed in a timely manner. Last year NAFCU also participated in President Barack Obama's White House Summit on Cybersecurity and Consumer Protection at Stanford University, which featured leaders from across the country — industry, tech companies, law enforcement, consumer and privacy advocates, law professors who specialize in this field, and students — to collaborate and explore partnerships that will help develop the best ways to bolster cybersecurity.

The public sector should play a larger role in information sharing so that "known" threats are shared and can be protected against. NAFCU supports efforts to create a new cybersecurity framework which 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.

## MEMBER BUSINESS LENDING

When Congress passed the Credit Union Membership Access Act (CUMAA- P.L.105-219) in 1998, it put in place artificial restrictions on the ability of credit unions to offer business loans to their members. CUMAA codified the definition of a member business loan and limited a credit union's member business lending 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 standard for a member business loan at $50,000 and above.

In the current economic environment, many credit unions have capital available that could help small businesses create jobs. However, due to the outdated and arbitrary member business lending cap, their ability to help stimulate the economy by providing credit to small businesses is hampered. Removing or modifying the credit union member business lending cap would help stimulate the economy and create jobs without using taxpayer funds.

Legislation has, again, been introduced in the 114th Congress that would provide relief from the credit union member business lending cap. NAFCU and its members are committed to pursuing all legislative avenues possible to lift the arbitrary credit union member business lending cap. Identical bipartisan legislation, the Credit Union Small Business Jobs Creation Act (H.R.1188) and the *Small Business Lending Enhancement Act* (S. 2028) has been introduced in both chambers; in the House by Reps. Ed Royce (R-CA) and Greg Meeks (D-NY), and in the Senate by Sens. Rand Paul (R-KY) and Sheldon Whitehouse (D-RI). Under these pieces of legislation, credit unions would need to meet the following criteria to be deemed eligible for a member business lending increase to 27.5 percent of total assets:

- Must be considered well capitalized (currently seven percent net worth ratio).
- Must have at least five years of member business lending experience.
- Must be at or above 80 percent of the current 12.25 percent cap for at least one year prior to applying.
- Must be able to demonstrate sound underwriting and servicing practices (based on historical performance), and strong leadership and management.

Separate bills have also been introduced in the House and Senate to exempt certain residential real estate loans from counting against the business lending cap (H.R. 1422/S. 1440, the *Credit Union Residential Loan Parity Act*) and to exempt loans made to veterans from counting against the cap (H.R. 1133).

In February 2016, NCUA issued a final rule to amend its member business lending regulation. The new rule removes the prescriptive underwriting criteria and personal guarantee requirements of the current regulation, thereby eliminating the current burdensome waiver process. Instead, the rule allows credit unions to implement a principles-based risk management policy related to its commercial and business lending activities. Among other changes, the final rule:

- Gives credit union loan officers the ability, under certain circumstances, to not require a personal guarantee;
- Replaces explicit loan-to-value limits with the principle of appropriate collateral and eliminating the need for a waiver;
- Lifts limits on construction and development loans;
- Exempts credit unions with assets under $250 million and small commercial loan portfolios from certain requirements; and
- Affirms that non-member loan participations do not count against the statutory MBL cap.

This rule comprehensively overhauls the way that NCUA approaches commercial lending, from both a regulatory and supervisory perspective, but it does not alter the statutory member business lending cap.

In September 2016, the Independent Community Bankers of America (ICBA) filed a lawsuit against NCUA challenging the agency's final rule. ICBA's complaint alleges that NCUA violated the Administrative Procedure Act by carving out new commercial lending exemptions not expressly authorized by the Federal Credit Union Act. NAFCU will continue to advocate for implementation of the rule, the majority of which becomes effective January 1, 2017, which will ease regulatory burdens and allow credit unions to better serve the needs of their small-business members.

*Rep. Ed Royce (R-CA) and NAFCU Chair Richard L. Harris, President and CEO, Caltech Employees FCU*

## CAPITAL ISSUES

In October 2015, the NCUA Board approved a final risk-based capital (RBC) rule, which will take effect January 1, 2019. NAFCU consistently opposed this rulemaking and urged its withdrawal. While significant concerns remain, the final rule is an improvement over the first RBC proposal issued in 2014. The final rule recalibrates many risk weights to better align with banks' requirements, removes interest-rate risk from the calculation of the risk-based capital ratio, and extends the implementation date.

However, to create a true and 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 in our Five-Point Plan for Regulatory Relief. The plan, as it relates to capital reform:

- Directs the NCUA to, along with industry representatives, conduct a study on prompt corrective action 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.

In addition to a legislative solution to risk-based capital, NAFCU is also seeking access to supplemental capital for credit unions. On February 13, 2015, Reps. Pete King (R-N.Y.) and Brad Sherman (D-Calif.) reintroduced, for the 114th Congress, the NAFCU-backed Capital Access for Small Businesses and Jobs Act, H.R. 989. This legislation would allow the NCUA to authorize forms of supplemental capital for credit unions provided certain criteria are met, most particularly that of maintaining a credit union's mutuality. NAFCU continues to advocate for capital reform for credit unions.

# REGULATORY ISSUES FACING CREDIT UNIONS

Credit unions are significantly hindered by regulatory burden and growing compliance costs. Indeed, 91.1% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* cited "total compliance activities" as an area in which significant expense increases are necessary for the near-term. While smaller credit unions continue to disappear due to the growing burden, all credit unions are finding the current regulatory environment challenging. Credit unions did not contribute to the financial crisis yet are still subject to increasing regulatory requirements mandated under the Dodd-Frank Act. For example, credit unions worked diligently for nearly two years to implement the almost 1,900-page Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) regulation, which went into effect on October 3, 2015, at a significant cost to their staffing and resources. The CFPB's mortgage rulemakings, however, are only part of a growing regulatory drain on credit union resources. Over the past year for example, in addition to the CFPB, the Department of Defense (DoD), and the Financial Accounting Standards Board (FASB) have each moved forward in promulgating rules that significantly impact credit unions. Unfortunately, many of these rules are redundant to other directives from NCUA. Meanwhile, NCUA continues to take actions that restrict or encumber credit union activities. While credit unions continue to look for ways to provide forward-thinking products and services to better serve their members, regulatory overreach continuously thwarts that innovation. Ultimately, regulators must work to strike a balance between industry safety and market growth.

## FEDERAL RESERVE

### Payments

NAFCU and its members continue to be engaged in the Federal Reserve's evolving payments initiative and Roadmap for the U.S. Payments System. Last year, NAFCU became a member of the Federal Reserve's two payments task forces: the Faster Payments Task Force and the Secure Payments Task Force. NAFCU appreciates the Federal Reserve's efforts thus far in gathering industry stakeholders and input on potential payment solutions that could benefit both financial services providers and their customers increase the speed and security of sending and receiving money. NAFCU and our members appreciate the Federal Reserve's recognition of the industry-wide movement toward the adoption of faster payment technologies with its approval of enhancements to its same-day automated clearing house (ACH) service. However, NAFCU continues to believe that it is best for the industry to lead the way to innovate and improve the U.S. payment systems rather than for the Federal Reserve to attempt its own reforms that risk resulting in unintended consequences.

Credit unions have a long established history of innovation and member-focused reform. However, because of their unique business model and sensitivity to each individual members' particular needs, a one-size-fits-all reform would likely not benefit the credit union industry as much as reform that occurred organically based on the industry's specific needs. The implementation of a new faster payment system must include a mechanism for adequate cost-recovery for even the smallest financial institutions. Additionally, since a faster payment system runs the risk of increased incidents of fraud going undetected, any new system must emphasize focus on payment security and the protection of sensitive personal and financial data, which are essential to combating dynamic and persistent cyber threats. Participants in NAFCU's 2016 *Federal Reserve Meeting Survey* expressed concern that a faster payment system would result in the potential for a higher incidence of fraud, with approximately 46% of respondents citing fraud as a "moderate" concern and approximately 54% saying fraud is a "major" concern. NAFCU looks forward to working with the Federal Reserve and other industry stakeholders in the future to create a payments model that is more efficient, secure, and cost sensitive for its members.

### Debit Card Interchange Fees

NAFCU continues to believe that the current cap on interchange fees remains too low. Although a low fee cap does not directly influence fees charged by smaller issuers, market forces have driven down the fees financial institutions of all sizes can charge. Further, the impact of this low fee cap is substantially greater for credit unions compared to other institutions because, unlike other financial institutions, credit unions cannot raise capital simply by going to the open market. The only capital credit unions can raise comes from their members.

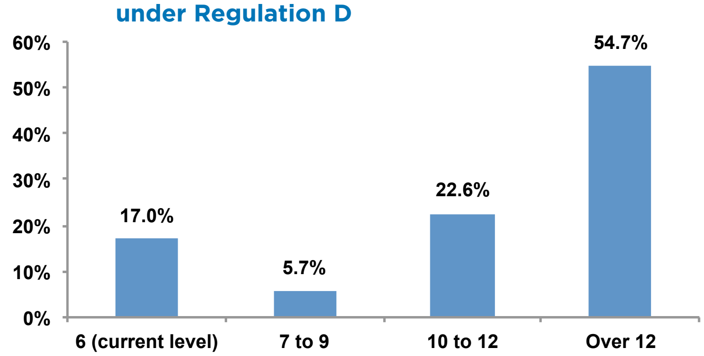
In an era of continuous data breaches and cybersecurity concerns, fraud monitoring costs are the highest yet. A large majority (71%) of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* indicated that their current data security budget, comparatively to pre-Durbin, represents a larger share of the credit union's overall budget. While the Federal Reserve's final rule implementing the debit interchange cap includes a one-cent adjustment for issuers who meet certain data security requirements, one cent is simply not enough. An overwhelming 97.1% of respondents to NAFCU's survey indicated the one cent per debit transaction is not sufficient to defray inflating data security costs. NAFCU believes that additional adjustments must be made to adequately capture all of the costs associated with fraud protection.

## 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 unable to understand and remember the arbitrary limits on the number and types of transfers the regulations permit them to make from their savings account. The regulation is antiquated given our technological society and, consequently, the transfer restrictions are incongruent with modern realities. Consumers would benefit from a modification to the regulation that reflects their contemporary needs and the current financial services environment.

Modern 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. Roughly three-quarters (73.2 percent) of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* did not believe it is necessary to limit the number of monthly transfers on accounts that fall under Regulation D. NAFCU believes that the Federal Reserve Board should update and increase this six-transfer limitation, while maintaining the distinction between savings and transaction accounts. NAFCU strongly recommends increasing the limit to, at a very minimum, nine convenience transfers per month. In fact, a large majority of the respondents to our survey suggested increasing the limit above nine transfers per month (Chart 1).

**Chart 1 | Reasonable Threshold for Monthly Transfers under Regulation D**



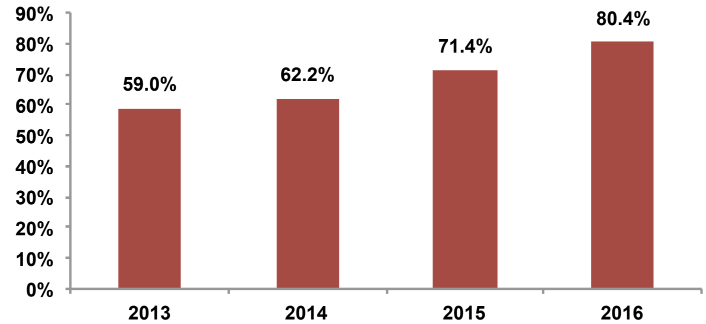

*Source: NAFCU 2016 Federal Reserve Meeting Survey*

## Regulation CC

In general, NAFCU believes that the Federal Reserve Board should closely evaluate and 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 both confusing and misleading for financial institutions and pose serious compliance and safety and soundness concerns.

In 2011, the Federal Reserve Board issued a proposed rule to amend Regulation CC. 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 credit union member because the rule does not allow sufficient time to determine if a check could be counterfeit or there are insufficient funds. Over 80% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* reported seeing an increase in check fraud in recent years due to restrictions on hold times (up from 59% in 2013) (Chart 2).

**Chart 2 | Credit Unions Experiencing an Increase in Check Fraud in Recent Years due to Regulation CC**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

Additionally, NAFCU does not support eliminating provisions regarding case-by-case holds. Many credit unions employ such holds to protect against bounced checks and, although the absence of non-local checks makes the extended hold period less useful, it is still a worthwhile instrument compared to a complete lack of protection for many credit unions. Further, NAFCU does not support eliminating entirely the notice in lieu of return. Although there are fewer instances where such notice is necessary as processing systems become more digitized, there remain situations where the notice serves as the best method available to a credit union returning a check and the additional flexibility thus provides an important and continuing benefit.

## CONSUMER FINANCIAL PROTECTION BUREAU

The CFPB has rulemaking authority for all credit unions, regardless of size, and has examination and enforcement authority over credit unions with more than $10 billion in assets. NAFCU remains opposed to the CFPB's authority over credit unions, given that credit unions were not responsible for the financial crisis and, despite that, credit unions are more highly regulated than any other financial depository institution. Not only are credit unions subject to strict field of membership and capital restrictions, they are also subject to the numerous consumer protection provisions in the Federal Credit Union Act, including the usury ceiling, the prohibition on prepayment penalties, and the member business lending cap. The CFPB 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.

The CFPB is currently working on a number of regulatory issues of particular interest to the credit union industry. The CFPB continues to make adjustments to the January 2013 mortgage rules and remittance rule; assist financial institutions and other industry stakeholders in Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) integration efforts; and actively engage in monitoring fair lending issues. The CFPB has also made changes to the Home Mortgage Disclosure Act requirements, the regulations governing financial institution privacy under Regulation P, and most recently, a rule on short-term, small-dollar (payday) loans. While NAFCU has a number of concerns with all of these rules, one particular concern is CFPB's apparent lack of understanding of the tremendous burden and operational challenges associated with implementing its extensive and complex rules, such as systems upgrades that typically require a heavy reliance on third-party vendors.

The following is a summary of the more important issues raised by the CFPB's rules.

### Unfair, Deceptive, or Abusive Acts and Practices

Since the enactment of the Dodd-Frank Act, and particularly throughout the past year, NAFCU has worked to seek clear, transparent guidance from CFPB 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 CFPB nor NCUA has provided any specific guidance. Meanwhile, CFPB continues to regulate through enforcement action in this area. 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 CFPB 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 CFPB 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.

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. Asked about their credit union's approach to non-qualified mortgages, approximately 30% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* indicated they ceased to originate non-qualified mortgages. Another 17.4% of respondents stated they have reduced originations of non-qualified mortgages. Due to the hesitance of lenders to extend non-qualified mortgages, NAFCU is concerned that many otherwise qualified borrowers will not be able to obtain mortgages.

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. Our primary concerns include 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 CFPB proposed a cure for unintentional points and fees overages. While NAFCU supported such a cure, it still believes a legislative change is necessary to clarify points and fees calculations.

## Mortgage Servicing

The CFPB's mortgage servicing rule has unnecessarily complicated mortgage servicing, greatly increased costs of servicing 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.

## Reputation Risk

The CFPB continues to encourage consumers to utilize its Consumer Complaint Database. The CFPB created the publicly available database in early 2012 to disclose credit card complaints that the Bureau received from consumers. The database has since been expanded to include complaints that the CFPB receives on most financial products, such as mortgages, bank accounts and services, private student loans, other consumer loans, credit reporting, money transfers and debt collection. The database is public and available on the CFPB's website. The disclosures are made for institutions under the CFPB's supervisory authority. By September 2016, there were reportedly 100,000 complaints in the public Consumer Complaint Database.

In March 2015, the CFPB issued its Final Policy Statement announcing that consumers would have the ability to include narratives when filing a complaint on the CFPB's database. Only those narratives from consumers who opt-in and give their consent to use their narratives are published. The CFPB assures that all narratives are scrubbed of information that would make the consumer identifiable. Financial institutions, including credit unions, are then able to submit a narrative response for inclusion in the consumer complaint database. In June

2015, the CFPB published over 7,700 consumer complaint narratives.

NAFCU believes that the CFPB 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 CFPB 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, but the reputation risk brought on by unverified complaints is significant.

In August 2016, the CFPB proposed the addition of a Company Response Survey to its Consumer Complaint Database. The survey will solicit feedback about the complaint resolution process and replace the consumer dispute function sometime in early 2017. NAFCU does not believe that the insights gained from the proposed survey would be particularly useful for credit unions, yet they would correspond with substantial and costly increases in reputational risk. NAFCU and its members do not think it would be productive for credit unions to redirect their resources toward defusing potentially disingenuous survey criticism in addition to managing ratings across myriad social media platforms. Dealing with online criticism is costly, particularly when the criticism is difficult to verify. There are alternative means of improving customer service that do not necessitate public disclosure of survey results. For example, CFPB could invite companies to provide their own, private surveys to customers, which would likely yield more specific and helpful insights. Making the survey results public might compromise the usefulness of the data and forestall what would ideally be an open dialogue between the company and the consumer.

## Remittances

In July 2014, the CFPB finalized amendments to its Remittance Rule. Prior to these amendments, the Bureau, released a series of final rules concerning remittances, all of which became effective on October 28, 2013. The Remittance Rule exempts credit unions that execute fewer than 100 remittances per year. If a credit union is not already complying with the rule's requirements, it has six months to do so from the day it executes its 100th remittance. The rule also simplifies the disclosure requirements for recurring or preauthorized transfers. Under the final rule, remittance transfer providers are permitted to provide an estimate at the time the consumer requests the transfer and a final receipt within one business day after the remittance is executed.

The regulatory burden that the Remittance Rule places on credit unions has led to a significant reduction in consumers' access to remittance transfer services. NAFCU has heard from a number of its members that, because of the rule's compliance burden, they have been forced to discontinue, or will be forced to discontinue, their remittance programs. A 2013 NAFCU survey of our members found that over one-quarter of those that offered remittance services before the CFPB's Remittance Rule have now stopped offering that service to members and even more were considering dropping. Those continuing to offer remittances have been forced to significantly increase their members' fees. This demonstrates that the 100-remittance transfers allowance threshold is too low. Further, 26.9 percent of survey respondents, including one credit union that averages 25,000 remittances per year, said they dropped their remittance program as a result of the rule. NAFCU members have also indicated that the compliance costs associated with the rule have had an impact on their ability to offer other services to their members. Accordingly, NAFCU continues to encourage the CFPB to expand the threshold for the safe harbor from the definition of "remittance transfer provider" in order to ensure that a meaningful safe harbor is established.

## Home Mortgage Disclosure Act Requirements

The CFPB finalized amendments to Regulation C in October 2015 that made several substantive changes to the reporting requirements under the Home Mortgage Disclosure Act (HMDA). The final rule, among other things, expanded the data financial institutions are required to collect and report under Regulation C. Some of the expanded data collection and reporting is driven by Dodd-Frank, which amended HMDA to require collection of certain new data points. However, the CFPB also appears to have taken this opportunity to collect significantly more data than Dodd-Frank expressly requires. In addition to expanded data collection, the final rule changed the scope of Regulation C's coverage to include most closed-end loans, open-end lines of credit and reverse mortgages secured by dwellings. Under this expansion, reporting is required on all HELOCs.

NAFCU believes that the Bureau should limit the changes to the HMDA dataset to those mandated by Dodd-Frank. While credit unions support HMDA requirements that further the goal of ensuring fair lending and anti-discriminatory practices, NAFCU is concerned that some of the additional reporting requirements do not achieve these goals and only serve to impose significant additional compliance and reporting burdens.

## Privacy

The Gramm-Leach-Bliley Act (GLBA) and its implementing regulation, Regulation P, require credit unions to provide members with annual privacy notices throughout the course of the member relationship. In October 2014, the CFPB's final rule amended Regulation P to permit credit unions to post their annual privacy notices on their website if they met certain conditions. Regardless of the delivery method, credit unions were still required to provide members with an annual privacy notice. Late last year, President Obama signed the Fixing America's Surface Transportation Act (FAST Act) into law, which included the "*Eliminate Privacy Notice Confusion Act*" in Section 750001. This Section amended the GLBA to require that consumers receive privacy notices after opening a new account and after their providers' privacy policies change. NAFCU supported this regulatory relief because it allowed credit unions to avoid unnecessary expenses and resources in the dissemination of redundant annual notices. Such a change was likely to reduce consumer confusion and provide a more efficient means of informing consumers about the privacy of their personal information.

NAFCU continues to support efficient and cost-effective means of putting consumers first and keeping them informed of how their personal financial information is being shared with third parties. In July 2016, the CFPB issued a proposed rule to implement the new statutory amendment. NAFCU and its members support the CFPB's efforts to implement the changes to the GLBA, but remain concerned about the CFPB's proposal to eliminate the alternative delivery method for providing annual notices, and the requirement for a 60-day notification period.

## Overdraft

For the past several years, the CFPB has consistently placed overdraft on its rulemaking agenda. However, the timeframe for the release of a proposal continues to be delayed due to the Bureau's tenuous statutory authority in this area coupled with consumers' continued support of overdraft programs. In the meantime, the CFPB has released two studies of overdraft markets and conducted several high profile information collections. Most notably, the CFPB issued an order in November 2014 to several financial services core processors that required they provide the Bureau with anonymized data related to overdraft services. In September 2015, the Bureau requested approval from the Office of Management and Budget (OMB) to conduct "a national web survey of 8,000 individuals as part of its study of ATM/debit card overdraft disclosure forms." All of these efforts indicate the Bureau is continuing to progress toward a rulemaking on overdraft.

NAFCU believes the CFPB's continued pursuit of data on overdraft programs constitutes extraordinary regulatory overreach. Credit unions are focused on providing value to their members by offering responsible overdraft protection. In fact, NAFCU's June 2015 *Economic & CU Monitor* survey found that every respondent offered an alternative to overdraft or courtesy pay programs, with overdraft lines of credit and linked savings or money market accounts being the most popular (84.4% each). Additionally, 97% of respondents reverse overdraft charges on a case-by-case basis. NAFCU will work to ensure that the substance of any rule does not curtail credit unions' overdraft programs.

### Payday Lending

In July 2016, the CFPB issued a proposed rule to impose sweeping and complex new requirements on payday, vehicle title, and similar loans. The proposal would serve as a comprehensive overhaul of the short-term, small-dollar lending space, potentially reaching a number of other products not traditionally associated with "payday lending." For covered loans, the proposal would require the lender to undertake enhanced ability-to-repay requirements and limit the number of allowable subsequent loans. In addition, the CFPB proposal would impose additional limitations on a federal credit union's ability to offer Payday Alternative Loans (PAL loans) under NCUA's rule, such as restricting the use of the statutory lien authorized by the Federal Credit Union Act. Several provisions in the proposed rule would encroach upon NCUA's authority and could impair prudential regulations related to safety and soundness. NAFCU is advocating for an exemption for credit unions from the entirety of the rule.

For many small credit unions, the proposed rule would necessitate an end for most, if not all, covered loan products. For larger credit unions, the restrictions would impose substantial barriers to access to credit, which might drive members to predatory lenders in times of financial emergency. NAFCU believes the Bureau should exercise its exemption authority granted by Congress to preserve the ability of credit unions to accommodate members with consumer friendly, short-term, small dollar loans. A complete exemption for credit unions is the only way to avoid the overwhelming burden imposed by the proposal's novel and complex compliance regime, and to allow credit unions to continue to serve the needs of their financially distressed members. NCUA has also reached out to CFPB to recommend a blanket exemption for credit unions for loans made under, and consistent with, NCUA's PAL loan regulation.

## NATIONAL CREDIT UNION ADMINISTRATION

Capital and risk control are key concerns of the National Credit Union Administration (NCUA). Over the past several years, NCUA has finalized rules on stress testing, derivatives, and Credit Union Service Organizations (CUSOs). In addition, the agency finalized risk-based capital rule that fundamentally changes its Prompt Corrective Action (PCA) system by replacing NCUA's current risk-based net worth (RBNW) requirements with new requirements for federally-insured credit unions over $100 million in assets. Further, the agency's supervisory focus for the past several years has prioritized a credit union's management of interest rate risk (IRR).

### Risk-Based Capital

In October 2015, the NCUA Board finalized a rule regarding risk-based capital (RBC) for credit unions. The rule makes a number of revisions to NCUA's capital adequacy rules. Most notably the final rule establishes a new method for computing NCUA's risk-based requirement that would include a risk-based capital (RBC) ratio measure for federally-insured "natural person" credit unions with over $100 million in assets. The rule sets forth ten categories of risk-weights for various types of assets based on the risk associated with particular investments. For example, cash would be assigned a zero percent risk weight while riskier assets such as mortgage servicing and CUSO activities would have substantially higher risk-weights.

NAFCU supports an RBC system for credit unions that would reflect lower capital requirements for lower-risk credit unions and higher capital requirements for higher-risk credit unions. However, we continue to believe that Congress needs to make statutory changes to the Federal Credit Union Act in order to achieve a fair system. Such a system should move away from the static net-worth ratio to a system where NCUA joins the other banking regulators in having greater flexibility in establishing capital standards for institutions. NAFCU also believes that capital reform must include access to supplemental capital for all credit unions.

NCUA, however, proceeded with a rulemaking that fails to achieve an appropriate risk-based system for credit unions. Further, NCUA failed to consider the true impact this rulemaking would have on the entire credit union industry. Although NCUA estimates that only 19 credit unions will be downgraded if the final were in place today, NAFCU believes that this rule will impose astronomical costs and burdens on all credit unions. NAFCU believes that NCUA cannot look at the impact of the rule in a vacuum and merely consider how many credit unions would be downgraded or forced to hold more capital. Instead, NAFCU believes the true impact of the rule can only be measured by examining how it will impact the long term growth and strategic planning of all credit unions.

NAFCU has outlined a legislative solution that will institute fundamental changes to the credit union regulatory capital requirements in our Five-Point Plan for Regulatory Relief. The plan, as it relates to capital reform:

- Directs the NCUA to, along with industry representatives, conduct a study on PCA and recommend changes;
- Modernizes capital standards to allow supplemental capital, and direct 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.

### Investment Authority

Last year, NCUA approved revisions to part 703 of NCUA's Rules and Regulations that expanded FCU investment authorities by granting qualified credit unions authority to engage in derivatives transactions. The rule allows certain credit unions to engage in a limited set of derivatives transactions solely for the purpose of reducing interest rate risk and managing balance sheets. The NCUA also proposed an asset securitization rule that is not yet finalized.

NAFCU has urged NCUA to continue its focus on evaluating new products and services that would serve as beneficial investment opportunities for FICUs. In particular, NAFCU and our members have asked that the agency allow credit unions to purchase Mortgage Servicing Rights (MSRs). The credit union industry, like each credit union, is a cooperative system. Many credit unions, especially small credit unions, have neither the capacity nor the resources to perform certain functions. As a result, they often choose to rely on third parties to perform such functions. NAFCU and our members believe it is in the best interest of these credit unions and the industry as a whole if as many of these functions as possible may be performed by other credit unions. Increased investment authority is essential to mitigating against interest rate risk and balancing the ever increasing regulatory burden and compliance requirements credit unions face.

## DEPARTMENT OF DEFENSE

### Military Lending Act

In July 2015, the Department of Defense (DoD) released a final rule amending regulations under the Military Lending Act (MLA). The new rule vastly expanded the number and types of products that are subject to the MLA. Credit unions that were not previously covered have been working vigorously in 2016 to develop rigorous MLA compliance policies and procedures before the majority of the changes were implemented beginning October 3, 2016. Protecting members of the military and their families from predatory actors by fulfilling the purpose of the MBL is of the utmost importance to NAFCU's member credit unions. However, the complexities of the MLA rule are staggering and significantly impact credit unions. Credit unions are different than most other types of financial institutions. As member-owned, not-for-profit cooperatives, credit unions have a duty to provide members with financial products and services that are designed to help members reach their individual financial goals. The relationship between a credit union and its member is based on disclosure, fairness, and responsible practices and, in particular, credit unions have a strong track record of working with active duty members of the armed forces and their families to escape predatory practices that prompted Congress' passage of the MLA.

NAFCU and its members have repeatedly voiced concerns regarding unclear regulatory language in the MLA rule and urged DoD to remedy the numerous ambiguities and uncertainties in the rule. In August 2016, the DoD issued guidance interpreting its MLA rule. However, while NAFCU continues to support the objectives of the

MLA, the DoD's interpretive guidance fell far short of addressing the extensive list of ambiguities within the language of the rule. In fact, the interpretive guidance raised some additional questions and concerns among NAFCU's members.

As the October 3, 2017 compliance deadline for the credit card components of the MLA rule draws near, NAFCU continues to advocate for additional clarification from DoD. Further, NAFCU continues to urge DoD to exercise its authority to exempt credit cards from the MLA Rule for at least an additional year. Delaying compliance is necessary to allow credit unions the opportunity to complete the process of updating core systems and to develop policies and procedures necessary to meet the compliance requirements relative to the 36 percent MAPR cap set forth in the MLA rule.

## FEDERAL COMMUNICATIONS COMMISSION

### Telephone Consumer Protection Act

In July 2015, the Federal Communications Commission (FCC) issued a Declaratory Ruling and Order to clarify its interpretations of the Telephone Consumer Protection Act (TCPA). Among other things, the order provides limited robocall exemptions under the TCPA for financial institutions making free autodialed calls to consumers. Unfortunately, the FCC's Order will make it more difficult for credit unions and other financial institutions to contact their members about identity theft or data breaches. NAFCU is concerned that the order could lead credit unions to cease important communications with members about their accounts over fear of inadvertently violating the rule. NAFCU believes that the FCC should provide more flexibility to the prescriptive requirements for financial institutions using this exemption, especially because this exemption meant to apply in exigent circumstances to protect consumers.

In addition, NAFCU is concerned about the FCC's expansive treatment of the term "automatic telephone dialing system" (auto-dialers). The FCC's order defines auto-dialers to include broadly any equipment even if it lacks the "present ability" to dial randomly or sequentially but can be modified to provide those capabilities. This interpretation is troublesome since it remains unclear what type of technology is actually covered. NAFCU believes the vague standard for what qualifies as an auto-dialer will further inhibit credit union communications to members. Furthermore, NAFCU has significant concerns about the FCC's antiquated regulations that create distinctions between mobile and residential phones. As cell phones replace traditional home phone landlines for an increasing number of consumers, the regulations may have the unintended consequence of reducing consumers' access to vital information about their financial accounts. NAFCU believes that the FCC must remove the distinction between residential and mobile phone lines as it applies to making automated informational calls to consumers about their existing accounts.

The FCC's order also creates an overly vague standard for revoking previous consent and prohibits a financial institution from controlling how the consumer may revoke consent in a reasonable manner. Thus, the order creates a system where the question of whether a consumer's revocation is reasonable becomes a subjective issue, opening up financial institutions to insurmountable liability.

Finally, the order does not provide enough flexibility with regard to the portability of wireless numbers from one consumer to another. Instead, it places a strict burden on credit unions when a consumer's phone number is reassigned. Credit unions could make one call to a reassigned number and have no reason to believe that consent is no longer valid, yet incur substantial liability even when acting in good faith.

In October 2015, NAFCU joined a lawsuit filed by the U.S. Chamber of Commerce seeking a review of the FCC order. NAFCU will continue to urge the FCC to reconsider its order relative to credit unions.

# LOOKING AHEAD: STRATEGIC GOALS AND CHALLENGES

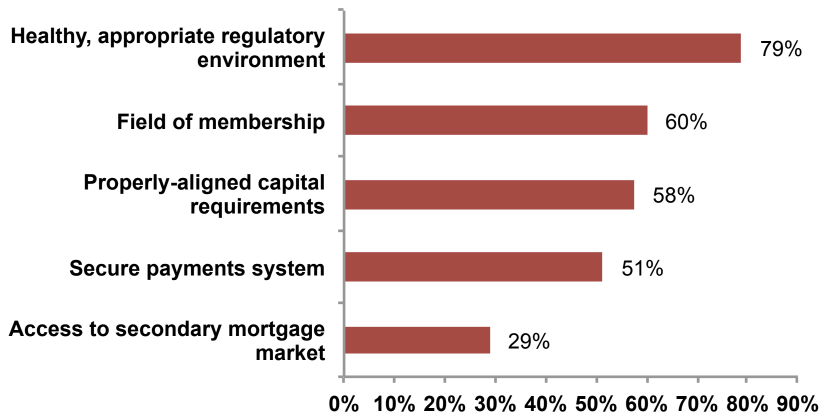
Today's credit unions continue to remain true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." As member-owned not-for-profit cooperatives, credit unions consistently strive to ensure their members' financial health and well-being by offering responsible products and services. Overall, whether from the perspective of capital levels, CAMEL ratings, or asset quality, the credit union industry is generally healthy and well-capitalized. Lawmakers and regulators readily agree that credit unions did not participate in the reckless activities that caused the financial crisis and should not be placed in the crosshairs of regulations aimed at those entities that did. Yet, credit unions have faced a crippling wave of new regulatory burdens in the years since the enactment of the Dodd-Frank Act.

Burdensome and unnecessary compliance costs are a key challenge facing credit unions as they forge ahead into tomorrow. Additional obstacles risk jeopardizing the future progress of the credit union industry: growing pressure to innovate and to incorporate more sophisticated and highly digitized services, coupled with continued threats to data security, is a troubling issue that all credit unions are facing. In addition, as the credit union industry continues to suffer growing consolidation, it is increasingly important that chartering and field of membership rules provide the necessary tools to enable credit unions to grow and thrive into the 21st century.

## GROWING REGULATORY BURDEN

Credit unions have always been some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital. Additionally, there are many consumer protections built into the Federal Credit Union Act, such as the only federal usury ceiling on financial institutions, the statutory prohibition on prepayment penalties, and the arbitrary cap on credit union member business lending. Despite the fact that credit unions are already heavily regulated, did not cause the financial crisis, and actually helped blunt the crisis by continuing to lend to credit worthy consumers during difficult times, they are still laboring under the weighty regulatory burden in the post-Dodd-Frank environment.

**Chart 1 | Factors Considered Critical to Continued Growth & Success**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

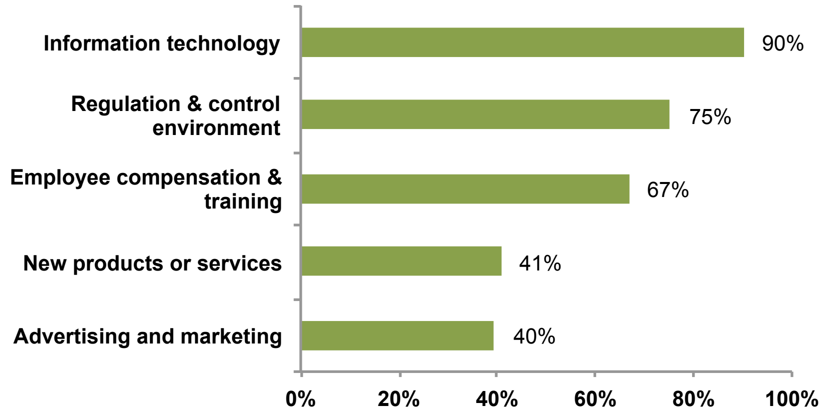
On average, respondents to our survey saw the approximate number of full-time equivalent (FTE) staff members devoted to total compliance activities essentially double from 2010 (pre- Dodd-Frank Act) to today. Respondents also estimated, on average, that the approximate amount of expenses attributed to compliance activities has increased by over 50 percent from 2010 to 2016. Meanwhile, small credit unions that cannot afford those costly expenses have disappeared due to merger at an alarming rate (see *Industry Consolidation*, page 10). To the question of what asset level is required to survive in the present environment, the majority of respondents replied that it was $250 million or more. That is a sobering response given that the median size of a credit union as of June 2016 was under $30 million.

While regulatory burden has proven to be a significant drag on credit union performance over the past six years, respondents are expecting it to grow even worse in the future. Approximately 88% of respondents surveyed identified total compliance activities as an area in which further increases in the number of FTE staff members will be needed in the next three years. As a result, 79% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* said a healthy, appropriate regulatory environment is crucial to their credit union's continued growth and success (Chart 1). There is a pressing need for meaningful and comprehensive regulatory relief and better tailoring of regulations to help credit unions continue to serve the nation's 104 million members.

## RAPID INNOVATION AND SAFEGUARDING DATA

In order to continue to meet their members' needs, credit unions must keep pace with a rapidly evolving financial marketplace. Modern consumers — particular millennials — are accustomed to a highly digitized environment and demand an increasingly sophisticated mobile banking experience. Today's consumers expect instant and convenient access to financial services on their smartphones, tablets, and desktops. Meanwhile, innovators in the financial technology (Fintech) space are entering the financial services market at a growing pace. According to a recent report, global venture capital investment in Fintech companies rose to $13.2 billion in the first half of 2016, up 148%.[2] A recent wave of startups and newer non-depository actors offering advanced technologies in payments, virtual currency, crowdfunding, neobanking, roboadvisors, marketplace lending, personal finance and more are threatening to disrupt the traditional financial services market.

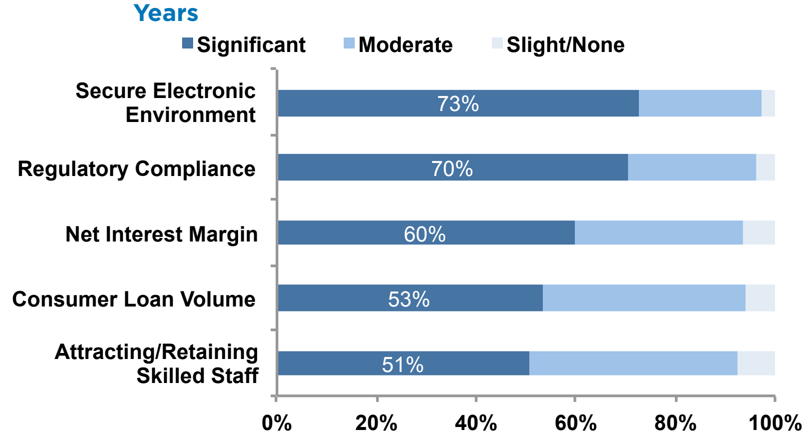
**Chart 2 | Expected Drivers of Spending Increases Over Next Three Years**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

Faced with growing competition from non-traditional financial services providers that are more streamlined and unencumbered by existing financial regulations,[3] credit unions are under significant pressure to keep pace with a market undergoing rapid technological change by increasing expenditures in information technology. In recent years, credit unions have succeeded in extending their offerings of electronic services (see *Electronic Financial Services*, page 14). Approximately 90% of respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* cited information technology as the area they expect to drive spending increases the most over the next three years, reflecting credit unions' commitment to offering their members cutting-edge financial products (Chart 2). Nevertheless, given their budget limitations as well as the strains of compliance costs, credit unions may be challenged to keep pace with competitors who have more resources or fewer regulatory constraints.

**Chart 3 | Challenges Facing Credit Unions Over Next Three Years**




*Source: NAFCU 2016 Federal Reserve Meeting Survey*

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[2] Law360, "Global VC Fintech Investment Soars 148%, Report Says."
[3] Office of the Comptroller of the Currency, "Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective," (March 2016) ("Many . . . innovations are taking place outside the banking industry, often in unregulated or lightly regulated fintech companies.").

Along with the mounting pressure to continually innovate and evolve, credit unions continue to face serious and costly threats to data security. A February 2015 NAFCU *Economic & CU Monitor* survey reported credit unions, on average, spent $136,000 on data security measures and $226,000 in costs associated with merchant data breaches in 2014. Despite the fact that many credit unions have implemented sophisticated, effective, and costly data security (including cybersecurity) safeguards, attackers adapt to constantly evolving technology and find new ways to penetrate systems. Looking toward the future, NAFCU survey respondents considered maintaining a secure electronic environment to be the most significant challenge they face over the next three years (Chart 3). In addition, it is vital that all entities handling sensitive consumer financial information — not just federally-regulated financial institutions — be accountable to comprehensive federal data protection standards.

## MODERNIZING FIELD OF MEMBERSHIP

While consolidation within the credit union industry has been an ongoing trend, the number of credit unions continues to decline at a pace of roughly one per day. Smaller credit unions are far more likely to merge than larger credit unions. Merger trends since 2001 indicate that, since that time, an average of four to five percent of small credit unions merge out of existence each year. Unfortunately, this trend shows no signs of abating. Small credit union respondents to NAFCU's 2016 *Federal Reserve Meeting Survey* were far more likely than larger respondents to anticipate being involved in a merger over the next three years (see Industry Consolidation, page 10).

Strengthening the credit union dual chartering system is imperative to the future strength and well-being of the industry. The credit union 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 rules to recognize today's dynamic and ubiquitous marketplace. As a result, the industry has seen multiple credit unions convert to state charters over the past year because of their inability to grow under the federal charter.

NAFCU continues to hear from our members that NCUA's current field of membership (FOM) rules and regulations have unnecessarily inhibited their ability to grow and serve their communities. 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 constructive reform of NCUA's chartering and FOM procedures, as well as removing all non-statutory constraints on FOM chartering and expansion.

NCUA's recent FOM amendments 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.

## FUTURE OUTLOOK

Since the Great Depression, the credit union industry has defined itself as "not for profit, not for charity, but for service." That shared philosophy has endured to this day. Credit unions have largely recovered from the financial crisis and, today, the industry overall is healthy and strong. As the credit union industry looks toward the future, maintaining a competitive business model in a highly regulated, rapidly evolving, and increasingly complex financial marketplace is key to securing credit unions' continued growth and success. NAFCU and its members stand ready to face any challenges that lie ahead and will continue to serve the millions of consumers who benefit from safe and sound credit union services.

NAFCU is a direct membership association committed to representing, assisting, educating and informing its member credit unions and their key audiences.

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