# 2013 NAFCU REPORT ON CREDIT UNIONS

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# 2013 NAFCU REPORT ON CREDIT UNIONS

## December 2013

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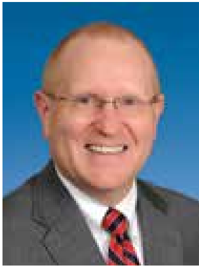
This material was prepared for a meeting on December 4, 2013 between the
NAFCU Board of Directors and the Board of Governors of the Federal Reserve System

# BOARD OF DIRECTORS AND PRESIDENT AND CEO OF THE NATIONAL ASSOCIATION OF FEDERAL CREDIT UNIONS

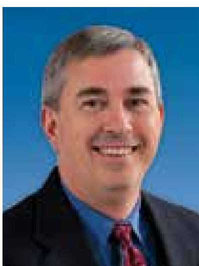


**Michael Parsons**
Chair
Region I Director
First Source FCU
New Hartford, NY
Asset Size: $372M
Members: 34,529
FOM: Community

**Ed Templeton**
Vice Chair
Director-at-Large
SRP FCU
North Augusta, SC
Asset Size: $669M
Members: 104,906
FOM: Community

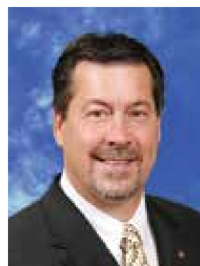
**Richard Harris**
Treasurer
Region V Director
Caltech Employees FCU
La Canada, CA
Asset Size: $1,229M
Members: 31,034
FOM: Multi-Occupational

**Jeanne Kucey**
Secretary
Region III Director
JetStream FCU
Miami Lakes, FL
Asset Size: $134M
Members: 16,897
FOM: Community



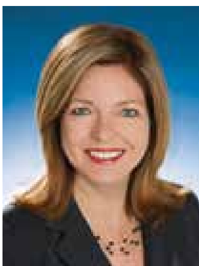
**Martin Breland**
Region II Director
Tower FCU
Laurel, MD
Asset Size: $2,636M
Members: 127,667
FOM: Multi-Occupational

**Cutler Dawson**
Director-at-Large
Navy FCU
Merrifield, VA
Asset Size: $54,412M
Members: 4,381,918
FOM: Defense



**Michael Lussier**
Director-at-Large
Webster First FCU
Webster, MA
Asset Size: $653M
Members: 63,891
FOM: Community

**Jan N. Roche**
Director-at-Large
State Department FCU
Alexandria, VA
Asset Size: $1,506M
Members: 66,673
FOM: Multi-Occupational



**Debra Schwartz**
Director-at-Large
Mission FCU
San Diego, CA
Asset Size: $2,408M
Members: 162,601
FOM: Community

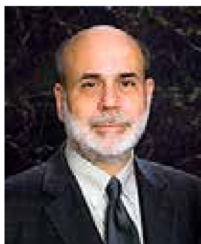
**Rod Taylor**
Region IV Director
Barksdale FCU
Barksdale AFB, LA
Asset Size: $1,143M
Members: 107,907
FOM: Multi-Occupational

**Daniel Weickenand**
Director-at-Large
Orion FCU
Memphis, TN
Asset Size: $534M
Members: 53,756
FOM: Multi-Occupational

**B. Dan Berger**
President and CEO

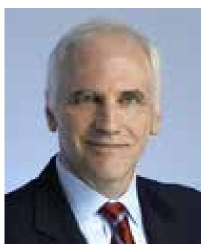
Asset size and members are from NCUA Call Report data as of June 2013.
FOM is Field of Membership.

## BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM



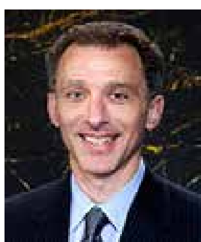
**Ben Bernanke**, chairman of the Board of Governors and the Federal Open Market Committee. He was sworn in on February 1, 2006. His four-year term as chairman ends January 31, 2014, and his term as a member of the Board ends January 31, 2020. Chairman Bernanke has served the Federal Reserve System in several roles. He was a member of the Board of Governors of the Federal Reserve System from 2002 to 2005; a visiting scholar at the Federal Reserve Banks of Philadelphia (1987-89), Boston (1989-90), and New York (1990-91, 1994-96); and a member of the Academic Advisory Panel at the Federal Reserve Bank of New York (1990-2002).

**Janet Yellen**, vice chair of the Board of Governors. Her four-year term as vice chair expires October 4, 2014, and her 14-year term as member ends January 31, 2024. She began her term on October 4, 2010. Prior to her appointment, Dr. Yellen was 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.

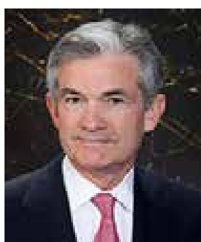


**Daniel Tarullo**, member of the Board of Governors. His term expires January 31, 2022. He took office on January 28, 2009. Before becoming a member of the Board, Mr. Tarullo was a professor at Georgetown University Law Center. He also worked in several senior staff positions during the Clinton Administration, 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.

**Sarah Bloom Raskin**, member of the Board of Governors. Her term expires January 31, 2016. She began her term on October 4, 2010. Prior to her appointment to the Board, Ms. Raskin was commissioner of financial regulation for the State of Maryland. Previously, she has served as managing director at Promontory Financial Group.  She also served as the banking counsel for the U.S. Senate Committee on Banking, Housing, and Urban Affairs and worked at the Federal Reserve Bank of New York and the Joint Economic Committee of Congress.



**Jeremy Stein**, member of the Board of Governors. His term expires January 31, 2018. He began his term on May 30, 2012. Prior to his appointment, Dr. Stein was a professor at Harvard University. He served the Obama administration as a senior adviser to the Secretary of the Treasury and on the Staff of the National Economic Council. Prior to that, he was a professor at the Massachusetts Institute of Technology's Sloan School of Management. In 2008, Dr. Stein was president of the American Finance Association.



**Jerome H. Powell**, member of the Board of Governors. His term expires January 31, 2014. He took office on May 25, 2012. 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 served as Assistant Secretary and as Undersecretary to the Treasury under President George H.W. Bush.

# ABBREVIATIONS

| | |
|---|---|
| ACH | Automated Clearing House |
| ANPR | Advance Notice of Proposed Rulemaking |
| APR | Annual Percentage Rate |
| APOR | Average Prime Offer Rate |
| ARM | Adjustable Rate Mortgage |
| ATM | Automated Teller Machine |
| CFPB | Consumer Financial Protection Bureau |
| CLF | Central Liquidity Facility |
| CUMAA | Credit Union Membership Access Act |
| CUSO | Credit Union Service Organization |
| DOR | Documents of Resolution |
| FCU | Federal Credit Union |
| FDIC | Federal Deposit Insurance Corporation |
| FFIEC | Federal Financial Institutions Examination Council |
| FHFA | Federal Housing Finance Agency |
| FHLB | Federal Home Loan Bank |
| FICU | Federally Insured Credit Union |
| FIRREA | Financial Institutions Reform, Recovery and Enforcement Act |
| FOM | Field of Membership |
| GDP | Gross Domestic Product |
| GSE | Government-Sponsored Enterprise |
| HOEPA | Home Ownership Equity Protection Act |
| HUD | Department of Housing and Urban Development |
| IRR | Interest Rate Risk |
| MBL | Member Business Loan |
| MBS | Mortgage-Backed Security |
| MLO | Mortgage Loan Originator |
| NAFCU | National Association of Federal Credit Unions |
| NCUA | National Credit Union Administration |
| NCUSIF | National Credit Union Share Insurance Fund |
| OCC | Office of the Comptroller of the Currency |
| QM | Qualified Mortgage |
| QRM | Qualified Residential Mortgage |
| RESPA | Real Estate Settlement Procedures Act |
| ROA | Return on Assets |
| TCCUSF | Temporary Corporate Credit Union Stabilization Fund |
| TCR | Transaction Coverage Rate |
| TILA | Truth in Lending Act |
| TIPS | Treasury Inflation Protected Securities |
| USPAP | Uniform Standards of Professional Appraisal Practice |

# PREFACE

The National Association of Federal Credit Unions (NAFCU), founded in 1967, is the only trade association that exclusively represents the interests of federal credit unions (FCUs) before the federal government and the public. 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 roughly 800 of the nation's most innovative and dynamic federal credit unions 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 2013, 86 of the 100 largest FCUs were NAFCU members. NAFCU represents 68 percent of total FCU assets and 63 percent of all FCU member-owners.

In addition, NAFCU's membership includes several state-chartered credit unions that were formerly federally chartered credit unions, which chose to retain their NAFCU membership.

# 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 2013, there were 4,189 FCUs, with assets of $574 billion and a membership base of approximately 52.4 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 are a subset of FICUs. As of June 2013, there were 6,681 FICUs, with assets of $1.06 trillion and a membership base of over 95 million.

## Privately Insured Credit Unions

Private primary share insurance for state-chartered credit unions has been authorized in a number of states. Currently there are privately insured credit unions operating in nine states.[1] 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 for credit unions. Corporate credit unions provide services such as investment products, advisory services, item processing and loans to their members. As of June 2013, there were 15 corporate credit unions with assets of $22.0 billion.

[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 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 2013.

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

NAFCU commissioned a special study in 2012 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.

# EXECUTIVE SUMMARY

## Regulatory issues facing credit unions

Credit unions face numerous regulatory obstacles. In the upcoming year, changes to all aspects of mortgage lending will prove to be extremely challenging. Also, changes to debit card interchange fees and rules has the potential to adversely impact all credit unions. Finally, the future of the secondary mortgage market is another critical issue for the industry, as the secondary market provides credit unions with an important source of liquidity.

## Credit union service to members and use of Federal Reserve services

The number of credit unions offering electronic services continues to increase, as does membership adoption of such services. Of all the Federal Reserve services offered, credit unions most commonly use Customer "Help" Services, Automated Clearing House (ACH) Receipts, FedLine Advantage, Currency Orders, and ACH Originations. The Federal Reserve's services were rated highly by survey participants, with a large majority rated above average or better.

## Credit union financial conditions

Credit union financial health continues to improve. Overall, they experienced strong share growth as a result of a "flight to safety" starting at the beginning of the recession in 2008. Recently, this growth has moderated. Despite ongoing financial turmoil and ever-increasing regulatory burdens, loan growth has also improved slightly during the past year and loan quality remains far higher than that of other financial institutions. Credit unions continue to provide their members with high-quality, low-cost products and services, while maintaining a small, but growing, market share.

## Consumer benefits of credit unions

To ensure ongoing consumer benefits, maintaining the credit union federal income tax exemption continues to be NAFCU's primary concern. The ongoing fiscal debate in Congress and discussions on tax reform have kept this issue in the spotlight.

While no one is singling out credit unions and many key federal legislators have offered their support, comprehensive tax reform eliminating many or all tax expenditures represents the greatest threat to the credit union federal income tax exemption at this time.

In September 2012, NAFCU released a study authored by Robert M. Feinberg, Ph.D., professor of economics at American University, and Douglas Meade, Ph.D., director of research at Interindustry Economic Research Fund, Inc., that looked at the economic benefits of the credit union federal income tax exemption to consumers, businesses and the economy.

The Feinberg-Meade study found that eliminating the credit union federal income tax exemption would reduce U.S. GDP by about $148 billion over the next decade. This would translate to a loss of 150,000 jobs per year, or 1.5 million job-years lost over the next decade.

Feinberg-Meade also found that the total benefit to U.S. consumers from the presence of the federal income tax exemption for credit unions is approximately $10 billion per year, and from 2005-2012, the direct consumer benefit totaled $78 billion.

# Important Legislative Issues Facing Credit Unions

## Regulatory Relief

Credit unions are facing an ever-increasing compliance burden in today's regulatory environment. This partially stems from the fact that many new and updated regulations continue to be promulgated, while old and outdated regulations are rarely revisited or removed. A May 2013 survey of NAFCU's credit union members found that 88 percent have seen an increase in the cost of compliance since the passage of the Dodd-Frank Act.

In February of 2013, NAFCU sent the new Congress a comprehensive 5-point plan to address the regulatory relief efforts that are essential to the credit union industry's ability to serve its members. Key provisions of this plan were incorporated into legislation introduced by House Financial Services Committee Vice Chairman Gary Miller (R-CA), the Regulatory Relief for Credit Unions Act of 2013 (H.R. 2572). This legislation, among other things, would direct the NCUA to establish a risk-based capital system for credit unions and allow federally chartered credit unions to comply with a state rule in lieu of a federal regulation in select instances approved by the NCUA.

## Housing Finance Reform

The development and reform of housing finance policy, in particular maintaining access to a viable secondary market with fair pricing, is vitally important to credit unions.

With the Obama Administration, the House Financial Services Committee, and the Senate Banking Committee all actively working on the future of the secondary mortgage market, NAFCU has remained engaged on all fronts. NAFCU member credit unions are especially sensitive to the level of government involvement in the market and believe that a government guarantee on mortgage-backed securities is essential to a robust secondary market.

NAFCU continues to promote a set of core principles that would help guarantee secondary market access for credit unions, give them fair pricing based on loan quality and maintain a government role in the market. We believe these key principles must be considered in order to ensure that credit unions are treated equitably in any housing finance reform process.

## Member Business Lending

When Congress passed the Credit Union Membership Access Act (CUMAA- P.L.105-219) in 1998, it put in place 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.

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.

NAFCU and its members are committed to pursuing all legislative avenues possible to lift the credit union member business lending cap in this Congress. Identical bipartisan legislation, the Credit Union Small Business Jobs Creation Act (H.R. 688) and the Small Business Lending Enhancement Act (S. 968) has been introduced in both chambers; in the House by Reps. Ed Royce (R-CA) and Carolyn McCarthy (D-NY), and in the Senate by Sens. Mark Udall (D-CO) and Rand Paul (R-KY). 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.

## Capital Issues

The economic crisis has further validated the need to reform the current system of capital standards for credit unions. Credit unions are the only insured depository institutions with a capital regulation system that: 1) relies primarily on a static net worth ratio rather than risk-based capital standards in setting required capital levels; and 2) excludes potential sources of reliable capital that would strengthen credit unions and allow them to better meet the credit needs of their members, contribute to the liquidity of the financial system, and support national economic growth and stability.

In addition to the aforementioned establishment of a risk-based capital system in H.R. 2572, legislation has also been introduced to open the door for supplemental capital for credit unions. Earlier this year, Reps. Pete King (R-N.Y.) and Brad Sherman (D-Calif.) introduced the Capital Access for Small Businesses and Jobs Act, H.R. 719. 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.

## Data Security

Data security breaches are a serious problem for both consumers and businesses. 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. The number and scope of data breaches are significant, and have caused extensive damage.

Despite the fact that they are rarely the source of data breaches, credit unions are still mandated to protect data consistent with the provisions set out in the Gramm-Leach-Bliley Act. However, there is no similar comprehensive regulatory structure to ensure that retailers and merchants are protecting a consumer's financial data. As the 113th Congress considers cyber security legislation, NAFCU is seeking inclusion of data security provisions as part of this effort. The issue of data security is also one of the provisions of NAFCU's 5-point plan on regulatory relief.

## Cyber Security

Cyber security is an important issue for credit unions, as some institutions have found themselves victims of denial of service attacks, in addition to other cyber crimes 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. Furthermore, 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 cyber security 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. As Congress addresses cyber security, data security measures should also be considered, as the two issues are intertwined.

## REGULATORY ISSUES FACING CREDIT UNIONS

- **Potential changes to interchange fees and rules will have a major impact on all credit unions.**
- **Regulation D limitations should reflect the reality of new technology and consumer habits.**
- **Complying with new rules related to mortgage lending is having a devastating effect on the ability to lend.**
- **Appropriate risk control is a key concern of the National Credit Union Administration.**
- **Guaranteed access to the secondary market is of paramount concern for credit unions.**

Credit unions keenly feel the addition of new regulatory burdens. A number of the provisions prescribed under the Dodd-Frank Act are effective in January 2014. As a consequence, the credit union industry is struggling to keep pace with the significant and far-reaching changes to the mortgage market. The CFPB's rules require a seemingly limitless supply of resources. Given the thin margins in today's mortgage lending market, NAFCU is concerned that the changes will, at best, constrain credit further and, at worst, drive small and mid-sized lenders from the market, at least in the short term. Of note, 71.9 percent of survey respondents will only offer loans that fit into the qualified mortgage standard.

The CFPB's mortgage rulemakings, however, are only part of a growing regulatory drain on credit union resources. While the CFPB's rules will make existing activities and authorities more difficult to carry out, NCUA continues to take actions that seek to restrict or encumber current credit union authorities.

## Federal Reserve

### Debit Card Interchange Fees

NACS, et al., v. Board of Governors has the potential to change the face of interchange for credit unions and all other financial institutions alike. As such, NAFCU is appreciative of the Federal Reserve Board's decision to appeal the district court's ruling relating to the cap on interchange fees and network exclusivity provisions. In relation to interchange fees, NAFCU's last Economic & CU Monitor survey indicated that approximately 21.8 percent of our members' non-interest income came from debit card interchange fees. Although the district court's ruling does not directly influence fees charged by smaller issuers, NAFCU believes that market forces will drive down the fees financial institutions of all sizes can charge.

The impact of a fee cap will be substantially greater compared to other institutions because, unlike other financial institutions, credit unions cannot raise capital simply by going to the open market. The only capital they can raise comes from retained earnings.

The loss of fee income aside, the ruling also presents a substantial increase in compliance burden for credit unions. Credit unions of all sizes will be subject to the district court's interpretation of the network exclusivity rules, requiring at least two unaffiliated networks for each authentication method, if they are to go into effect. This interpretation of the network exclusivity provisions would require massive changes to the existing debit card system for issuers, according to 78 percent of Federal Reserve Survey (survey) respondents. NAFCU believes that serious safety and soundness issues will arise once credit unions factor the cost of complying with this requirement and, at the same time, realize reduced debit fee income. NAFCU appreciates that the Federal Reserve Board recognizes the importance of keeping the current electronic debit card payments system in place while these issues are considered in appeal.

### Regulation D

The restriction on "convenience transfers" under Regulation D presents an ongoing concern for NAFCU and its members. The current law is burdensome, confusing, and prevents depositors 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 outdated and, as a consequence, the transfer restrictions are incoherent. Consumers would benefit from a modification to the regulation that reflects their current needs and the present financial services environment.

Consumers expect to have the ability to transfer their funds with ease to and from particular accounts, and the regulation's six-transfer limitation from savings accounts creates an undue burden for both consumers and financial institutions. NAFCU believes that this six-transfer limitation should be updated and increased, while still making a distinction between savings and transaction accounts. NAFCU strongly recommends increasing the limit to at least nine convenience transfers per month.

### Regulation CC

In 2011, the Federal Reserve Board issued a proposed rule to amend Regulation CC. The Federal Reserve has joint rulemaking authority over Regulation CC with the CFPB. NAFCU believes that the regulation's time frame for making personal checks available should be increased from two business days to three business days. The current requirement places both the credit union and credit union member in undue risk, as a check could be counterfeit or there are insufficient funds. In addition, we are urging the Federal Reserve and the CPFB to allow a credit union to hold a cashier's check or money order, rather than requiring them to make funds available the day after it was received, to enable a credit union to mitigate against the risk of fraud upon the credit union or the credit union member. Fifty-nine percent of survey respondents reported seeing an increase in check fraud in recent years due to restrictions on hold times.

NAFCU also opposes the 2011 proposed elimination of Regulation CC's provisions regarding case-by-case holds and the ability of a credit union to issue a notice in lieu of return. The case-by-case hold still offers some minimal protection. While a notice in lieu of return is likely not needed in most instances in a highly digitized industry, it is still possible that it may be the best method available to an institution returning a check.

## Consumer Financial Protection Bureau

The CFPB has rule-making 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, as credit unions were not responsible for the financial crisis. Rather, NAFCU believes the NCUA is the agency best positioned to regulate and oversee federally chartered credit unions.

The CFPB is currently working on a number of issues of particular interest to the credit union industry. Since January, the CFPB has issued final rules on "qualified mortgages," mortgage servicing, Home Ownership Equity Protection Act, mortgage loan originator (MLO) compensation, and a comprehensive new interagency rule on appraisals. The CFPB is also set to finalize a rule to consolidate mortgage disclosures required by the Truth in Lending Act (TILA) and Real Estate Settlement Procedure Act (RESPA). In addition, the CFPB finalized two rules on remittance transfers this year. While NAFCU has a number of concerns with all of these rules, the following is a summary of the more important issues raised by the CFPB's proposals.

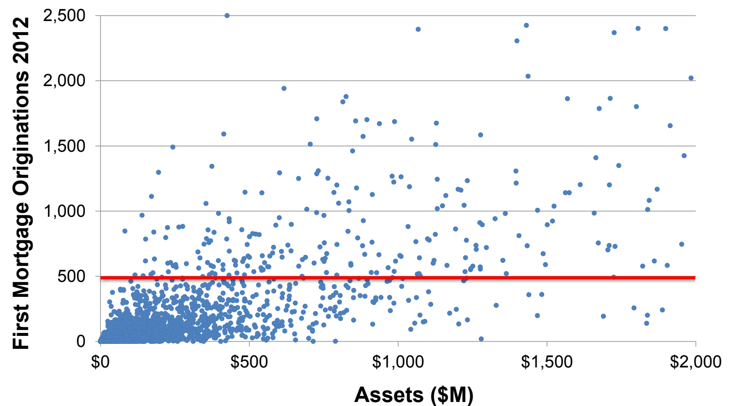
### Qualified Mortgages

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. A vast majority of NAFCU 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. Due to the hesitance of lenders to extend non-qualified mortgages, it is NAFCU's position that many otherwise qualified borrowers will not be able to obtain mortgages.

The rule exempts "small creditors" and defines them as lenders with $2 billion or less in assets that originate less than 500 first mortgages per year. As reflected in Chart 1, a large number of credit unions with assets under $2 billion originate more than 500 first mortgages. Accordingly, we recommended that the CFPB increase the threshold to 1,000 first mortgages per year.

**Chart 1 | FICU First Mortgage Originations by Asset Size**




*Source: NCUA 5300 call report data*

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.

## 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 statements, 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, the cost of servicing a mortgage will nonetheless greatly increase for all credit unions.

## Home Ownership Equity Protection Act (HOEPA)

The CFPB has also issued a final rule that makes sweeping changes to mortgage practices related to "high-cost mortgages" (for first liens, mortgages whose APR is more than 6.5 percentage points above the APOR). NAFCU is concerned about the cumulative effect of all the mortgage-related rules. This rule is not required by the Dodd-Frank Act, and complicates an already complex process. Given the host of regulatory changes required by the Dodd-Frank Act, it is NAFCU's position that the Bureau should not use its authority to require still more changes. Altering the calculation to determine whether a mortgage is a high cost mortgage is a significant measure and the cost of implementation is extraordinary. Those costs are particularly difficult for credit unions to bear as the industry struggles to comply with other aspects of the Dodd-Frank Act. At the same time, the benefits are modest given that the proposal will, at best, only marginally improve a disclosure that consumers do not use. Further, the proposal would disregard the statutory scheme, by including fees in the finance charge that are explicitly excluded from the definition by law. The changes are all the more problematic given the number of other State and Federal consumer protection laws that are tied to the finance charge.

## Mortgage Loan Originator (MLO) Compensation

The CFPB's MLO rule is difficult to comply with for credit unions. The Dodd-Frank Act prohibits inclusion of a mandatory arbitration clause for mortgage loans. Additionally, the Dodd-Frank Act and its implementing regulations restrict creditors' ability to pay compensation to a mortgage loan originator. Unfortunately, the definition of a loan originator is so broad and encompassing that many credit union employees that deal with borrowers could be included. In addition, the definition differs from the SAFE Act's definition of "mortgage loan originator," which further makes compliance difficult. In addition, the CFPB did decide to use its discretionary authority to allow creditors to charge up-front points and fees without a requirement that creditors offer an alternative loan without such fees; however, it is conducting consumer testing to determine how a requirement to offer an alternative loan will affect consumers. NAFCU continues to believe that a requirement to offer an alternative loan is both unnecessary and would lead to consumer confusion.

## Appraisals

The CFPB and the NCUA Board approved by notation an interagency (Federal Reserve Board, FDIC, FHFA, and OCC) final rule that, for higher-priced mortgages, requires a credit union to obtain an appraisal, provide applicants with a notification regarding the use of the appraisals, and give applicants a copy of written appraisals used. The interagency rule on appraisals is not particularly problematic for credit unions in terms of substantive changes, but is symptomatic of the larger issue of over-regulation. There is no shortage of existing rules and regulations concerning the appraisal process. The Uniform Standards of Professional Appraisal Practice (USPAP), the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), and existing NCUA rules already impose a number of requirements on credit unions' appraisal process. Nonetheless, this new interagency final rule creates another set of obligations with which credit unions must comply, despite the fact that the collective lending portfolio of the credit union industry survived the financial crisis relatively well. There needs to be flexibility for credit unions to meet their ever-increasing regulatory burden while continuing to be an important source of credit to their members and the communities they serve.

## Remittances

In 2012, the CFPB issued a final rule on remittances. Subsequent modifications to the 2012 rule were issued in 2013. Financial Depository institutions had until October 28, 2013 to comply with the rule. The final rule exempts credit unions that execute less 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. Most credit unions will struggle to comply with this rule even with the 100 remittance exemption, and will cease to do remittance services absent a competitive business solution.

The regulatory burden that the final rule places on credit unions will lead to a significant reduction in consumers' access to remittance transfer services. The NAFCU Economic & CU Monitor survey indicated that over half of the respondents would exceed the 100-remittance transfer safe harbor for exemption from the rule's requirements. Further, almost 27 percent of the survey's respondents, including one credit union that averages 25,000 remittances per year, said they would drop their remittance program as a result of the final rule. Other NAFCU members have indicated that the very significant compliance costs associated with the final rule will have an impact on their ability to offer other services to their members.

### TILA/RESPA Integration

The CFPB has proposed to integrate mortgage disclosures currently required under TILA and RESPA. NAFCU's primary concern with the TILA/RESPA integration is that the proposal imposes complex and time-consuming requirements on lenders, while simultaneously providing lenders less time and less information to comply with those requirements. This problem is compounded significantly if one views all of the mortgage proposals as a whole. The TILA/RESPA proposal would modify the definition of an "application" to eliminate the current "catch-all" provision, which allows lenders to seek additional information that would be useful in underwriting the loan. This, in turn, will speed up the timing requirements for providing the proposed Loan Estimate. The CFPB stated that it wishes to speed up the process in order to enable comparison shopping. However, if lenders are forced to provide even more information in a shorter time frame, with less borrower information on which to rely, the likely consequences are errors or mistakes that complicate rather than simplify the process.

The proposal would also further restrict the tolerances that are permitted under RESPA for settlement costs. NAFCU opposes tightening the tolerances in general. Lenders are required to make the borrower whole if a fee exceeds the tolerance. Tightening the tolerances will likely result in less competition among service providers as lenders will be inclined only to work with well-established providers who can guarantee the fee or who will reimburse the lender if the fee exceeds the tolerance. Further, the Closing Disclosures must be provided three days before closing. Taken together, the proposal requires lenders to provide more disclosures, earlier in the process, with more costly penalties for any incorrect estimates.

### Fair Lending

NAFCU strongly advocates for fair lending. In April 2012, the CFPB issued Bulletin 2012-14 (Fair Lending) confirming that it plans to apply a disparate impact test in exercising its supervisory and enforcement authority under the Equal Credit Opportunity Act for all types of credit, including mortgage lending. In February 2013, the Department of Housing and Urban Development (HUD) issued a final rule providing that disparate impact can be used to establish liability under the Fair Housing Act. Use of disparate impact allows the CFPB, HUD, or a private plaintiff to prove unlawful discrimination even if there is no discriminatory intent.

Credit unions are unique financial institutions because based on the type of charter; they are only able to accept members from a specific field of membership. CFPB mortgage rules such as the ability-to-repay will tighten credit standards through facially neutral requirements that may lead to disparate outcomes for some categories of borrowers. The interaction between the use of disparate impact theory and the qualified mortgage rule is a serious concern for NAFCU and its members.

In March, the CFPB released a bulletin explaining that lenders that offer auto loans through dealerships are responsible for unlawful, discriminatory pricing by the dealers with which they work. The CFPB recommends that indirect auto lenders take steps to ensure that they are operating in compliance with fair lending laws as applied to dealer markup and compensation policies. Auto dealer compensation will still be allowed, but the practice of "dealer markup" and others that put consumers at risk for fair lending offenses will not be tolerated by the CFPB. NAFCU is very concerned with the CFPB's use of financial institutions to attempt to regulate auto dealers' practices, over which the CFPB does not have jurisdiction.

## National Credit Union Administration

Liquidity and risk control are key concerns of the National Credit Union Administration. During the last year, NCUA finalized rules involving loan participations, Treasury Inflation Protected Securities (TIPS), definition of rural districts, and is currently considering extending limited additional investment authority for credit unions. The agency has acknowledged that credit unions need to focus on interest rate risk (IRR).

## Capital

In July, NCUA announced that the agency is working to make changes to its regulatory capital rules. The NCUA is now working to build a new risk-based capital framework for credit unions in a way that would require credit unions over $50 million in assets to be subject to new risk-based capital requirements and those below $50 million to continue under the current regulatory capital system. A net worth ratio of 7 percent would remain the floor, as required by the Federal Credit Union Act. However, credit unions with assets over $50 million would be subject to risk-based capital requirements, to better correlate required capital levels to risk based on investments held in portfolio.

While NAFCU agrees the credit union regulatory capital system should be updated to better reflect risk, NAFCU firmly opposes a framework that splits the industry into two separate categories. Under the proposed framework, some credit unions could be required to shoulder a disproportionate amount of risk to the safety and soundness of the greater credit union system. Accordingly, NAFCU supports a legislative solution that will institute fundamental changes to the credit union regulatory capital requirements and strongly urges the NCUA to use its resources to work with Congress to construct a fair and sustainable regime.

## Emergency Liquidity

NCUA has issued a final rule to require federally insured credit unions (FICUs) with assets of $250 million or more to have access to backup sources of liquidity, using one of two methods: (1) becoming directly a member in good standing of the Central Liquidity Facility (CLF); or (2) obtaining and maintaining demonstrated access to the Federal Reserve Discount Window. The NCUA rejected NAFCU's call to include membership in the Federal Home Loan Banks (FHLBs) as satisfying the requirement to have a source of emergency liquidity. FICUs with assets of $250 million or more must submit either a completed application for access to the CLF or the necessary lending agreements and corporate resolutions to obtain credit from the Discount Window. The NCUA noted that memberships to the FHLBs, as well as access to liquidity via corporate credit unions and correspondent banks, are good ways to ensure access to marketplace, contingent liquidity.

A FICU with less than $50 million in assets must maintain a basic written policy that provides a credit union board-approved framework for managing liquidity along with a list of contingent liquidity sources that it can employ under adverse circumstances. Federally insured credit unions with assets of $50 million or more must have a contingency funding plan clearly setting out strategies for addressing liquidity shortfalls in emergency situations.

NAFCU supports effective liquidity programs in credit unions, but it believes NCUA's liquidity rule is unnecessary. NAFCU strongly believes that credit unions are well equipped to make their own determination regarding their liquidity needs, with respect to sources needed to meet their day-to-day liquidity needs, as well as emergency needs.

## Corporate Credit Unions

Strengthening the corporate credit union system remains an ongoing issue for the industry. In September 2010, NCUA issued a final rule amending its corporate regulations. Among other issues, the rule significantly altered capital requirements and matters related to concentration risk. Credit unions continue to pay the costs of losses relative to failed corporates. The projected cost of the corporate stabilization program has decreased somewhat over time. Initially, NCUA projected the total cost of stabilization to be between $8.3 billion and $10.5 billion, with total projected assessment made in 2012 of between $6.0 and $8.9 billion. NCUA's latest projected assessment is between $5.7 and $8.0 billion. The NCUA Board imposed a 2011 corporate stabilization fund assessment of 25 basis points of insured shares, 9.5 basis points in 2012 and 8 basis points in 2013. Stabilization Fund assessments to date total about $4.8 billion, including the 2013 assessment. The NCUA expects the 2014 assessments to be between 0 and 5 basis points for insured credit unions, with the net remaining assessment projected to be between $0.9 and $3.2 billion.

### Credit Ratings

Pursuant to the Dodd-Frank Act, the NCUA and other federal banking regulators have removed references to credit ratings in regulations, or replaced them with other appropriate standards of creditworthiness. The NCUA implemented the relevant provisions of the Dodd-Frank Act in three ways. First, for investments, the final rule replaces the minimum credit rating requirement with a requirement that credit unions conduct an internal credit analysis of the investment pursuant to one of two narrative standards: "investment grade" or "minimal amount of credit risk." Second, for counterparty transactions, the final rule replaces the minimum credit rating requirement with one that the credit union conduct an internal credit analysis of the counterparty pursuant to a standard set by the credit union's board. Finally, for regulations not concerning investments and counterparty suitability, the final rule removes the ratings requirement without requiring a substitute analysis.

NAFCU understands that, generally, an overreliance on credit ratings is not appropriate, especially with respect to risky investments. However, NAFCU remains concerned that without appropriate guidance on how to implement these new standards, credit unions will be exposing both themselves and their members to unnecessary credit risk. Further, there is the chance that individual credit unions and other lenders will develop disparate credit standards, and both they and their prudential regulators will face difficulty comparing and analyzing their financial statements. Accordingly, NAFCU urges regulators to strive for improved and detailed guidance concerning internal credit analysis to give credit unions a more concrete scale against which to measure their investments.

## Federal Housing Finance Agency

### Government Sponsored Enterprises and Qualified Residential Mortgages

The Dodd-Frank Act also directed the Federal Housing Finance Agency (FHFA) to create parameters for "qualified residential mortgages" (QRM). The FHFA issued a proposed rule that would generally require securitizers to retain at least five percent of the risk for home mortgages. The proposed rule would eliminate this requirement for mortgages that meet certain underwriting standards and would thus qualify as QRMs. In an initial proposal, the QRM exception would have required a down payment of 20 percent as well as a loan-to-value ratio of 36 percent. However, the FHFA has now re-proposed the rule without these two requirements. Instead, QRM would be aligned with the CFPB's definition of "qualified mortgage." NAFCU strongly advocated for this change and is supporting the FHFA (and the other agencies working with the FHFA) on the re-proposal. While credit unions are technically exempt, the rule's impact will nevertheless be felt by any participant in the mortgage market.

The QRM proposal raises a broader question regarding the long-term health and viability of the secondary mortgage market. Credit unions rely heavily on the secondary market to make mortgage loans. Without a healthy secondary market, credit union mortgage lending would decrease significantly. The government should take steps to ensure there is a healthy and vibrant secondary market.

NAFCU strongly believes that housing finance reform must include guaranteed access for credit unions to the secondary market. In addition, NAFCU believes that fair pricing for credit union loans must be a part of any reform. To achieve guaranteed access and fair pricing, any reform must include the government guarantee of the principal and interest on mortgage-based securities. We also caution against reducing the government's role in the market too quickly by eliminating the guarantee on non-FHA loans, as doing so risks creating instability in the market, resulting in declining demand for mortgages and declining house prices.

Ensuring credit union access to the secondary market is one of NAFCU's top legislative and regulatory priorities. NAFCU is concerned that some current reform proposals would leave a secondary market dominated by a handful of large banking institutions. This could create undesirable consequences for credit unions and other small financial institutions, such as community banks.

# CREDIT UNION USE OF FEDERAL RESERVE SERVICES

- **Electronic services provided by credit unions continue on a slightly upward trend, as do the number of credit unions offering these services.**
- **A majority of credit unions offer Automated Teller Machines (ATMs), internet banking, and audio response systems.**
- **Use of Federal Reserve services by credit unions is increasing for the majority of services offered.**
- **NAFCU members hold a positive view of the quality of Federal Reserve services, rating most as "above average."**

## Electronic Financial Services

Even though many credit unions report that regulatory burden is stifling innovation, credit unions carry on their commitment to offering their members superior service though modern financial products.

Account Balance Inquiry is the most common online service offered by FICUs, with 74.2 percent reporting that they currently offer this service (Table 1). This is up from last year's 73.2 percent. The electronic services that saw the largest increase in usage were e-Statements (59.9 percent, up from 55.6 percent last year) and Remote Deposit Capture (9.2 percent, up from 6 percent).

More credit unions are offering members ATM and Internet banking services (70.8 percent and 71.6 percent, respectively). These figures are up from last year's 69.3 percent and 70 percent, respectively (Table 2).

Through shared branching and tens of thousands of free ATMs across the country, including those at key 7-Eleven locations, credit union members have access and convenience. The institutions that provide these services hold over 98 percent of the total assets held by all FICUs.

**Table 1 | Electronic Financial Services Offered**

| Online Service Offered | Provided in 2012 | Provided in 2013 |
|---|---|---|
| Account Aggregation | 8.0% | 9.4% |
| Account Balance Inquiry | 73.2% | 74.2% |
| Bill Payment | 55.3% | 57.6% |
| Download Account History | 60.7% | 62.6% |
| Electronic Cash | 3.4% | 3.7% |
| Electronic Signature Services | 4.2% | 6.6% |
| e-Statements | 55.6% | 59.9% |
| External Account Transfers | 12.1% | 14.6% |
| Internet Access Services | 13.2% | 14.2% |
| Loan Payments | 64.2% | 65.9% |
| Member Application | 28.4% | 30.4% |
| Merchandise Purchase | 5.3% | 5.5% |
| Merchant Processing Services | 3.6% | 4.3% |
| New Loans | 41.6% | 43.0% |
| New Share Account | 18.2% | 19.8% |
| Remote Deposit Capture | 6.0% | 9.2% |
| Share Account Transfers | 69.5% | 71.2% |
| Share Draft Orders | 56.6% | 58.0% |
| View Account History | 70.7% | 72.2% |

*Source: NCUA June 2012 & 2013 Call Reports*

**Table 2 | Methods of Access to Electronic Services**

| Electronic Service | Percentage of # of Institutions | | Percentage of Assets | |
|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 |
| Audio Response/Phone-Based | 57.4% | 58.0% | 96.3% | 96.3% |
| Automatic Teller Machine (ATM) | 69.3% | 70.8% | 98.2% | 98.4% |
| Home Banking via Internet Website | 70.0% | 71.6% | 98.6% | 98.8% |
| Kiosk | 5.2% | 5.6% | 24.5% | 31.0% |
| Other | 4.0% | 4.2% | 5.0% | 5.2% |

*Source: NCUA June 2012 & 2013 Call Reports*

## Federal Reserve Services

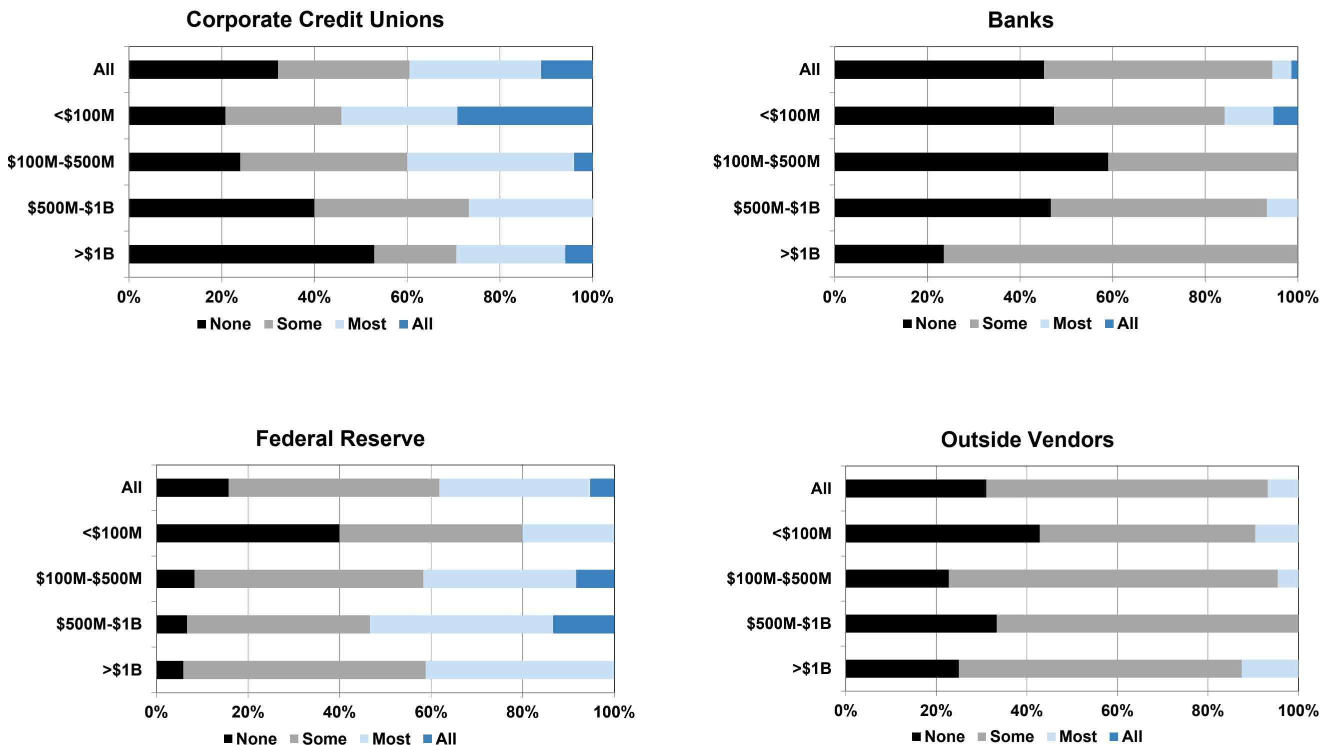
In NAFCU's 2013 Federal Reserve Survey, participants were asked to indicate their use of intermediaries for transaction services (Table 3). While corporate credit unions fill an important role in the credit union industry, usage is falling. Nearly one-third of respondents do not use corporate credit unions at all for transaction services. Because credit unions are increasingly looking outside of the corporate credit union system for their liquidity needs, Federal Reserve services are expected to grow in importance for credit unions.

### Table 3 | Credit Union Transaction Services Intermediaries

| | Corporate Credit Unions | | Banks | | Federal Reserve | | Outside Vendors | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 | 2013 |
| **None** | 19.2% | 32.1% | 51.5% | 45.2% | 21.1% | 15.8% | 37.9% | 31.1% |
| **Some** | 32.9% | 28.4% | 47.0% | 49.3% | 45.1% | 46.1% | 60.6% | 62.2% |
| **Most** | 32.9% | 28.4% | 1.5% | 4.1% | 33.8% | 32.9% | 1.5% | 6.8% |
| **All** | 15.1% | 11.1% | 0% | 1.4% | 0% | 5.3% | 0% | 0% |

*Source: NAFCU 2013 Federal Reserve Survey*

### Chart 1 | Use of Intermediaries by Asset Class




*Source: NAFCU's 2012 & 2013 Federal Reserve Surveys*

Looking at the responses by asset class, it becomes clear that smaller credit unions rely more heavily on corporate credit unions for their transaction services than larger credit unions (Chart 1). The over $1 billion asset class is much more likely to utilize banks for some of their transaction services. The Federal Reserve is utilized by the three largest asset classes in similar fashion. Meanwhile, respondent usage of outside vendors was not heavily influenced by the size of the credit union.

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

| Federal Reserve Service | 2013 Respondent Usage | | | | Average Rating: 1 to 5 (5=excellent) | |
|---|---|---|---|---|---|---|
| | Total | Declining | Same | Increasing | 2012 | 2013 |
| **Customer "Help" Services** | 67.1% | 4.3% | 60.0% | 2.9% | 3.7 | 3.8 |
| **Coin and Currency Orders** | 66.7% | 2.8% | 58.3% | 5.6% | 3.8 | 3.8 |
| **FedLine Advantage** | 64.3% | 1.4% | 45.7% | 17.1% | 4.0 | 4.0 |
| **ACH Receipts** | 61.1% | 0% | 27.8% | 33.3% | 3.9 | 3.8 |
| **Coin and Currency Deposit** | 61.1% | 4.2% | 51.4% | 5.6% | 3.7 | 3.8 |
| **ACH Originations** | 58.3% | 0% | 29.2% | 29.2% | 3.8 | 3.8 |
| **Fedwire Funds Service** | 57.7% | 0% | 46.5% | 11.3% | 3.9 | 3.8 |
| **Account Services** | 56.7% | 1.5% | 52.2% | 3.0% | 3.7 | 3.8 |
| **Check 21 Enabled Service** | 52.9% | 2.9% | 40.0% | 10.0% | 4.1 | 3.9 |
| **FedLine Web Services** | 53.6% | 1.4% | 40.6% | 11.6% | 3.9 | 3.8 |
| **Fed Discount Window** | 52.1% | 1.4% | 42.3% | 8.5% | 3.7 | 3.7 |
| **Educational Seminars** | 45.6% | 0% | 39.7% | 5.9% | 3.8 | 3.6 |
| **Foreign Check Services** | 42.3% | 7.0% | 31.0% | 4.2% | 3.5 | 3.4 |
| **FedMail** | 41.2% | 2.9% | 36.8% | 1.5% | 3.4 | 3.5 |
| **Paper Check Clearing** | 36.2% | 13.0% | 20.3% | 2.9% | 3.6 | 3.6 |
| **ACH Risk Management Services** | 33.8% | 0% | 29.6% | 4.2% | 3.6 | 3.6 |
| **FedImage Services** | 33.3% | 1.4% | 29.0% | 2.9% | 3.8 | 3.9 |
| **Fedwire Securities Service** | 31.3% | 0% | 25.4% | 6.0% | 3.6 | 3.8 |
| **FedLine Direct** | 30.0% | 0% | 27.1% | 2.9% | 3.6 | 3.4 |
| **National Settlement Service** | 26.1% | 0% | 24.6% | 1.4% | 3.7 | 3.6 |
| **Truncation Services** | 21.7% | 0% | 21.7% | 0% | 3.6 | 3.6 |
| **FedPayments Reporter Service** | 20.9% | 0% | 19.4% | 1.5% | 3.3 | 3.7 |
| **FedGlobal ACH Payments** | 20.6% | 0% | 19.1% | 1.5% | 3.3 | 3.4 |
| **FedTransaction Analyzer Service** | 20.6% | 0% | 17.6% | 2.9% | 3.3 | 3.4 |
| **Presentment Point Services** | 18.2% | 0% | 18.2% | 0% | 3.6 | 3.6 |
| **FedLine Command** | 17.4% | 0% | 14.5% | 2.9% | 3.3 | 3.7 |
| **FedComplete Package** | 16.4% | 0% | 16.4% | 0% | 3.5 | 3.2 |

*Source: NAFCU 2012 & 2013 Federal Reserve Survey*

NAFCU's 2013 Federal Reserve 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 Customer "Help" Services (67.1 percent), followed by Coin and Currency Orders (66.7 percent), FedLine Advantage (64.3 percent), Coin and Currency Deposits (61.1 percent) and Automated Clearinghouse (ACH) Receipts (61.1 percent). The least-used service was FedComplete Package (16.4 percent).

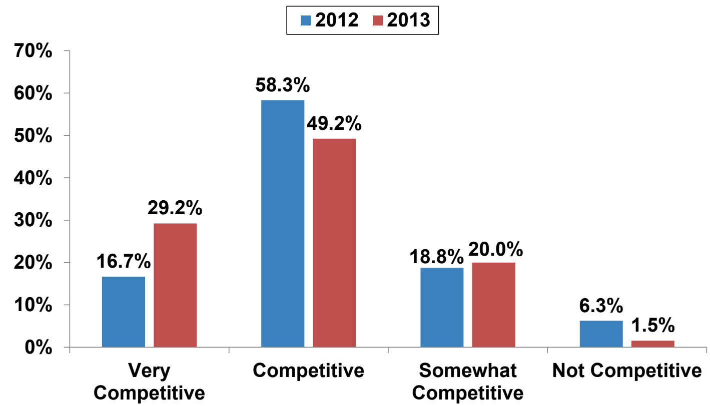
The services in which the greatest number of respondents noted a decline were Paper Check Clearing (13 percent) and Foreign Check Services (7 percent). The services with the largest increases in usage were ACH Receipts (33.3 percent), ACH Originations (29.2 percent) and FedLine Advantage (17.1 percent).

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. All 27 of the services included in the survey received an average rating above three, or "average." Ten of the services received a higher average rating than in 2012, while nine received a lower rating. The services that saw the largest increases in their average ratings were FedLine Command (+0.4), FedPayments Reporter Service (+0.4) and Fedwire Securities Service (+0.2). The services with the largest ratings declines were FedComplete Package (-0.3), FedLine Direct (-0.2), Check 21 Enabled Services (-0.2) and Educational Seminars (-0.2).

Survey participants were asked to review the overall competitiveness of Federal Reserve services. A large majority (78.5 percent) felt that the Federal Reserve services were either "competitively" or "very competitively" priced (Chart 1). This is an increase over 2012, when 75 percent rated Federal Reserve service pricing as either "competitive" or "very competitive." The specific services identified as "most competitively-priced" were ACH Originations and Receipts, Check 21 Services and Wire Processing Services. The service viewed as "least-competitively priced" was Foreign Check Services.

**Chart 2 | Overall Rating of Federal Reserve**




*Source: NAFCU's 2012 & 2013 Federal Reserve Surveys*

# CREDIT UNION FINANCIAL CONDITIONS

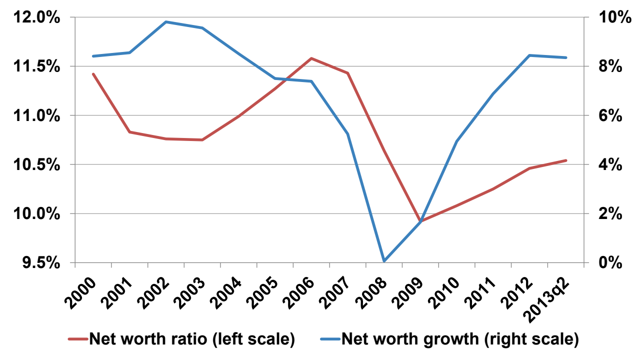
- **Federally Insured Credit Unions' (FICUs) net worth ratio increased from 10.2 percent in June 2012 to 10.54 percent as of June 2013.**
- **Over 96 percent of all FICUs remained above the "well capitalized" level of 7 percent.**
- **According to NCUA, credit unions with a CAMEL rating of 4 or 5 constitute only 1.4 percent of total credit union assets, which is down from 5.5 percent in 2009.**
- **As of June 2013, FICUs' year-over-year loan growth (5.5 percent) outpaced year-over-year share growth (4.7 percent) for the first time since 2008.**
- **FICUs' loan-to-share ratio of 67.5 percent is still well below it pre-recession level.**
- **FICUs' return on average assets (ROA), excluding corporate stabilization assessments, declined slightly from the December 2012 level of 0.93 percent to an annualized 0.88 percent through the first half of 2013.**
- **FICUs' total loan delinquency ratio declined from 1.16 to 1.04 percent during the first six months of 2013, while the total net charge-off ratio decreased from 0.73 to 0.64 percent.**
- **According to NAFCU's annual Federal Reserve Survey, more credit unions are loosening lending standards for vehicle loans and tightening standards for real estate and member business loans.**

## General Financial Conditions

Credit unions are conservatively run, well-capitalized institutions. This has enabled credit unions to weather the financial downturn. Their net worth ratio[2] has risen steadily since 2009 (Chart 1). Compared to June 2012, the net worth ratio climbed 34 basis points, from 10.2 percent to 10.54 percent in June 2013. As of June 2013, NCUA reported that there were 330 problem credit unions (4.9 percent of all FICUs) with a CAMEL rating of 4 or 5. These credit unions constitute 1.4 percent of total credit union assets, which is down from 5.5 percent in 2009.

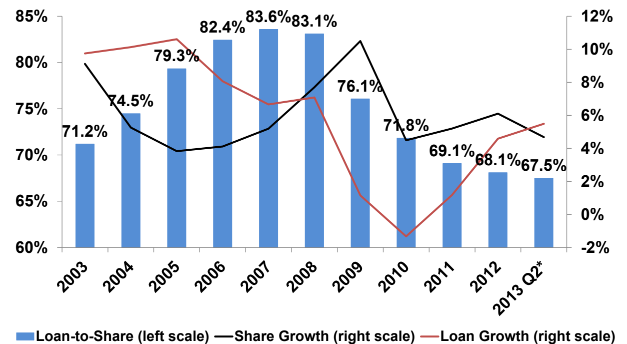
The recession resulted in a spike in share growth for FICUs due to a flight to safety (Chart 2). However, share growth has moderated lately, and in the second quarter, year-over-year loan growth outpaced share growth for the first time since 2008. As of June 30, 2013, total loans at FICUs increased 5.5 percent year over year, while shares were up 4.7 percent. The loan-to-share ratio increased from 67 percent in June 2012 to 67.5 percent in June 2013. Nevertheless, the loan-to-share ratio is well below its pre-recession level.

### Chart 1 | FICU Net Worth Ratio




*Source: NCUA Financial Performance Report (FPR)*

### Chart 2 | Trends in FICU Loan and Share Growth




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

[2]See 12 USC §1790d (o) for more information

As of June 30, 2013, the largest category of total loan dollars outstanding came from first mortgage real estate loans (41.4 percent (Chart 3)). Regular shares made up the largest part of total shares and deposits (32.5 percent (Chart 4)).

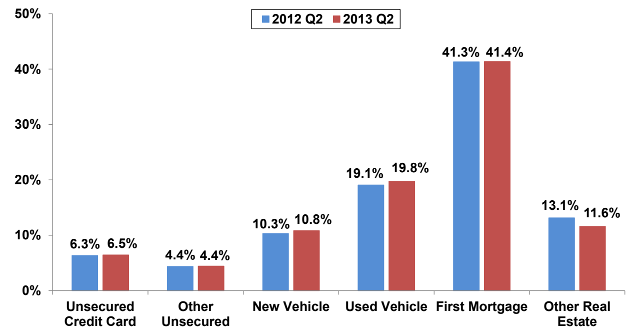
FICUs' June 2013 annualized ROA, including corporate stabilization assessments, remained at its December 2012 level of 0.85 percent. Excluding corporate stabilization assessments[3], ROA declined slightly from 0.93 percent in 2012 to an annualized 0.88 percent in June 2013 (Chart 5).

ROA has returned to pre-crisis levels despite declining net interest margins. Credit unions have cut operating expenses during the crisis, as the net operating expense-to-average assets ratio has declined from 2.7 percent in 2009 to 1.7 percent in June 2013. Moreover, credit unions' high-quality loan portfolio has allowed for reductions in provision for loan loss expense.

The delinquency ratio for the credit union industry as a whole currently stands at 1 percent, much lower than the delinquency ratio of 3.1 percent reported by FDIC-insured financial institutions (Chart 6). Most credit unions did not participate in the type of lending activities that precipitated the financial crisis. Although some FICUs experienced deterioration in their overall asset quality as a result of the recent financial turmoil, asset quality measures have improved since 2009 and have nearly returned to pre-crisis levels.

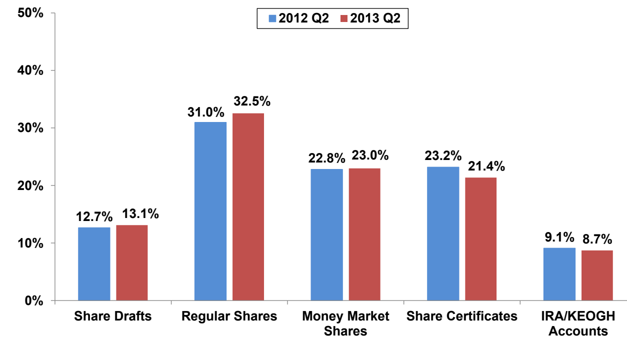
The FICU delinquency ratio declined by 12 basis points in the first half of 2013 (Chart 6), from 1.16 percent in December to 1.04 percent in June 2013. This is approaching the 2007 level of 0.9 percent. The net charge-off ratio declined from 0.73 percent in December 2012 to an annualized 0.58 percent in June 2013. This is also nearing the 2007 ratio of 0.51 percent.

## Chart 3 | Share of Total Loans



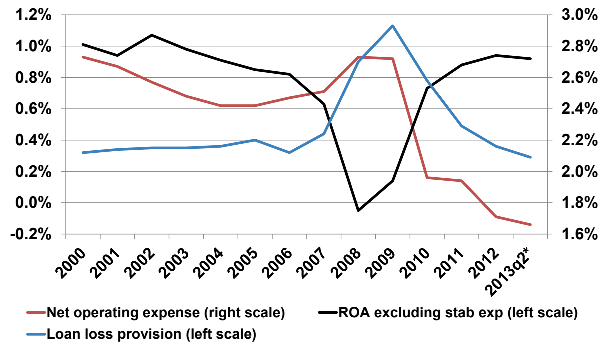

*Source: NCUA FPR*

## Chart 4 | Share of Total Shares and Deposits



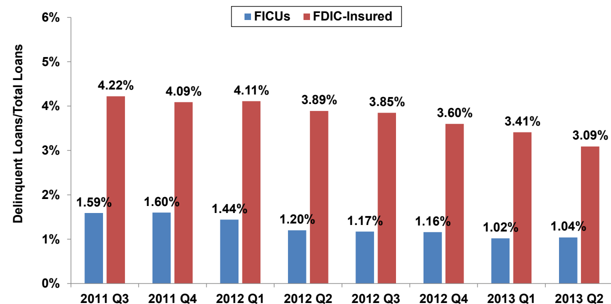

*Source: NCUA FPR*

## Chart 5 | ROA




*Source: NCUA FPR*

## Chart 6 | Delinquency Ratios




*Source: FDIC Quarterly Banking Profile, NCUA FPR*

[3] In July, NCUA announced that the current year's corporate stabilization assessment would be 8 basis points of insured shares. Last year's assessment was 9.5 basis points of insured shares.

## Lending Standards

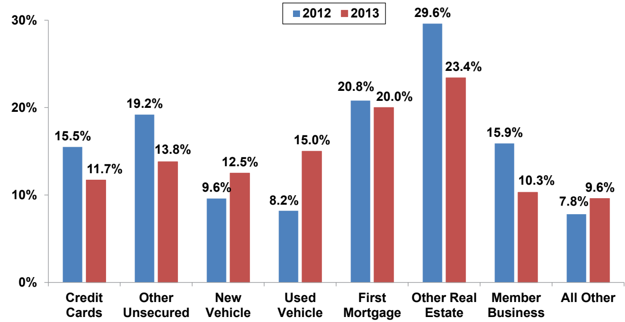
NAFCU's annual Federal Reserve Survey includes questions on lending standards, and a comparison between 2012 and 2013 shows mixed results. In general, more respondents are loosening lending standards for vehicle loans and tightening standards for real estate and business loans (Charts 7a and 7b). Compared to last year, however, both of these trends are slowing. Lending standards for credit cards and other unsecured loans changed, but not dramatically.

Of the respondents who tightened lending standards, the most commonly cited reason was a reduced tolerance for risk (53.3 percent), followed closely by rising delinquencies and charge-offs at 50 percent. As compared to last year, economic uncertainty was cited less often (46.9 percent in 2012 versus 33.3 percent in 2013), as was increased concern about legislative changes, supervisory actions or changes in accounting standards (46.9 percent in 2012 versus 36.7 percent in 2013).

Credit unions continue to make loans to members who have been turned down by other lenders. According to NAFCU's 2013 Federal Reserve Survey, the most common category for such loans was used vehicles, where 90.4 percent of respondents extended loans to members who were unable to borrow from other lenders (Chart 8). More credit unions saw an improvement in the quality of loan applicants (20.8 percent) than a decline (13 percent).

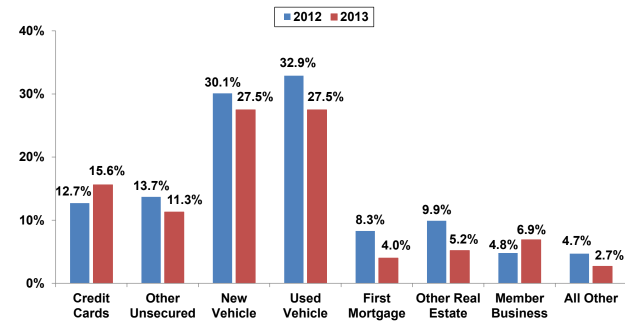
According to NAFCU's 2013 Federal Reserve Survey, 26.8 percent of the responding credit unions indicated that they have seen an increase in real estate foreclosure notices among members during the past 12 months, versus 19.7 percent who have seen a decrease (Chart 9). However, 26.8 percent of respondents have seen a decrease in actual foreclosures, as compared to 23.9 percent who have seen an increase. A substantial majority of responding credit unions (94.5 percent) also stated that they have a loan modification program in place to help members prevent foreclosures, and 78.1 percent have helped a member(s) forestall a foreclosure during the last 12 months. Among respondents, the average debt-to-income ratio for members applying for mortgage workouts and loan modifications during the past 12 months was 58.8 percent. For those who were approved, the average debt-to-income ratio was 53.1 percent. The

### Chart 7a | Tighter Loan Standards



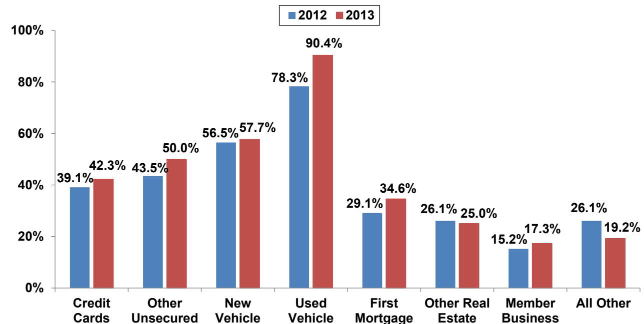

*Source: NAFCU's 2013 Federal Reserve Survey*

### Chart 7b | Looser Loan Standards



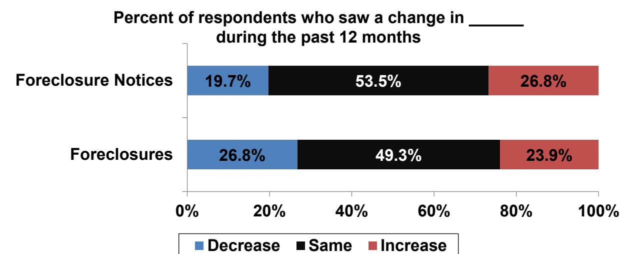

*Source: NAFCU's 2013 Federal Reserve Survey*

### Chart 8 | Loans to Members Who Were Turned Down by Other Lenders




*Source: NAFCU's 2013 Federal Reserve Survey*

### Chart 9 | Foreclosures




*Source: NAFCU's 2013 Federal Reserve Survey*

most commonly-cited obstacle to modifying mortgage loans was the member's financial situation (32.7 percent), followed by NCUA regulations (29.1 percent) and the costliness of modifications (27.3 percent).

## 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. When U.S. Central Bridge Corporate Credit Union shut its doors in October 2012, the NCUA's Central Liquidity Facility's (CLF's) borrowing authority was reduced by 96 percent, from $46 billion to just $2 billion.

As credit unions seek new avenues for liquidity sources, more are looking to Federal Home Loan Banks (FHLBs) and the Federal Reserve Discount Window. One-in-four respondents to NAFCU's 2013 Federal Reserve Survey increased their lines of credit at FHLBs during the past 12 months, while approximately 20 percent did so at corporate credit unions and the discount window, respectively (Table 1). Only 2.8 percent of respondents increased lines of credit at banks, down from 10.8 percent in the 2012 survey. When asked which sources of backup liquidity they intend to access in the next 12 months, respondents favored the discount window (18.1 percent), followed by FHLBs (13.9 percent) and corporate credit unions (11.1 percent).

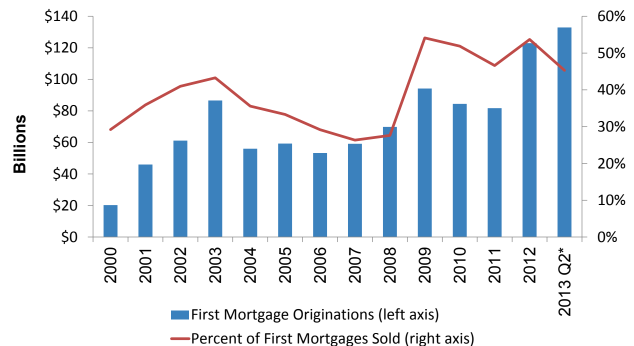
**Table 1 | Credit Union Liquidity Sources**

| | 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 |
|---|---|---|---|---|
| **Banks** | 2.8% | 2.8% | 6.9% | 2.8% |
| **FRB Discount Window** | 19.4% | 2.8% | 26.4% | 18.1% |
| **FHLBs** | 25.0% | 22.2% | 30.6% | 13.9% |
| **Corporate CUs** | 20.8% | 22.2% | 19.4% | 11.1% |
| **Central Liquidity Facility** | 4.2% | 0% | 1.4% | 4.2% |

## Secondary Mortgage Market

The secondary mortgage market is vital to many small financial institutions with mortgage loan portfolios, as a source of liquidity and as a tool to manage interest rate and concentration risks. Credit unions that participated in NAFCU's 2013 Federal Reserve Survey indicated that, on average, 63.8 percent of their outstanding first mortgage loans qualify to be sold on the secondary market (down from 64.5 percent in last year's survey). More respondents securitized or sold mortgage loans over the conforming limit to Fannie Mae or Freddie Mac in this year's survey versus last year's (13.2 percent of respondents in 2013 vs. 7.6 percent in 2012), and more respondents are planning to ramp up sales of conforming jumbo loans in the next 12 months (18.4 percent of respondents in 2013 to 14.1 percent in 2012). Meanwhile, 19.2 percent of respondents noted a decline in the availability of services offered by Fannie Mae and Freddie Mac (up from 14 percent in 2012), and 26.4 percent have shifted investments away from agency/GSE mortgage-backed securities (down from 32.3 percent in 2012).

**Chart 10 | Mortgage Loans**

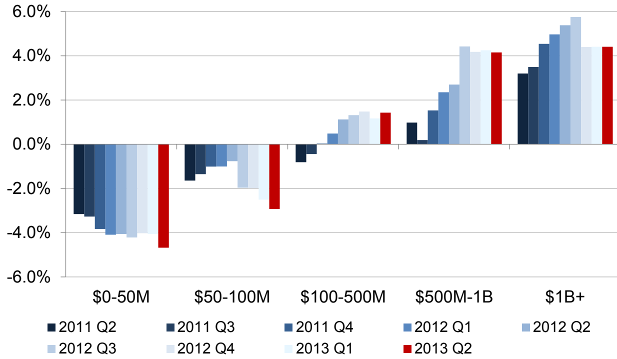



*Source: NCUA FPR*

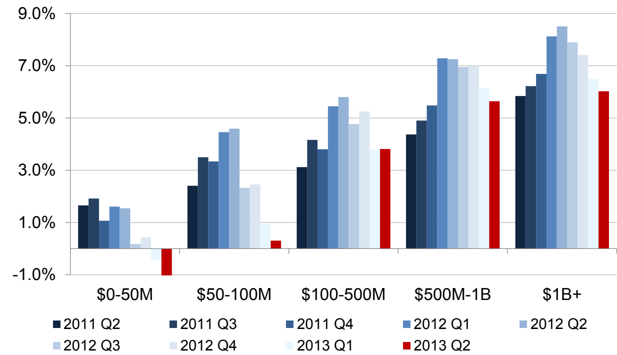
# Challenges Faced by Smaller Credit Unions

While credit unions as a whole are very successful at remaining competitive and serving the financial needs of their members, smaller credit unions are struggling to survive. Member and share growth is lower at smaller credit unions, and the trend is declining rather than improving. Loan growth is also lower at smaller credit unions, and their loan/share ratio is lower as a result. As the overall cost of doing business rises, smaller credit unions fall behind, and consolidation and mergers are becoming more common in the credit union industry.

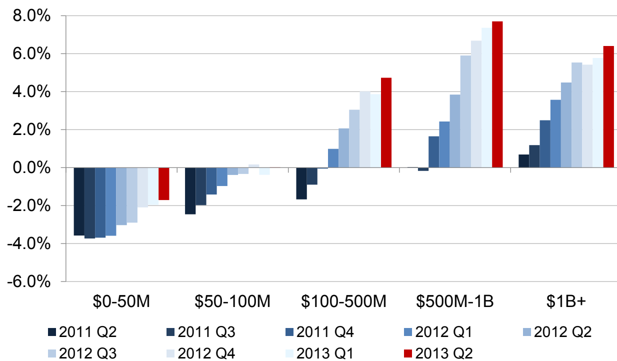
### Chart 1 | Member Growth by Asset Class



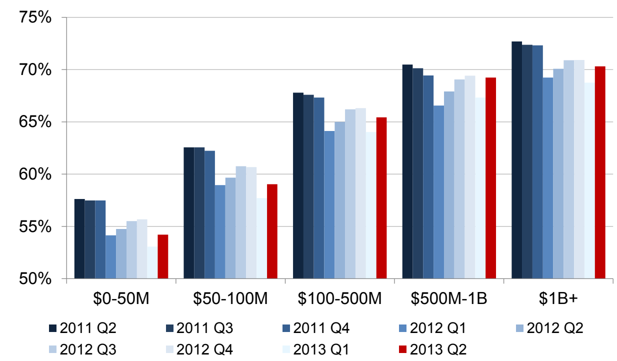

### Chart 2 | Share Growth by Asset Class




### Chart 3 | Loan Growth by Asset Class

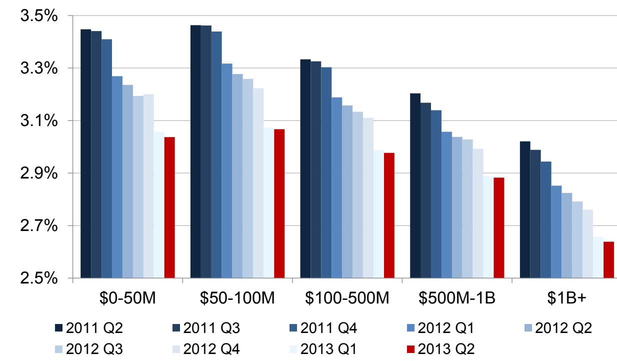



### Chart 4 | Loan/Share Ratio by Asset Class

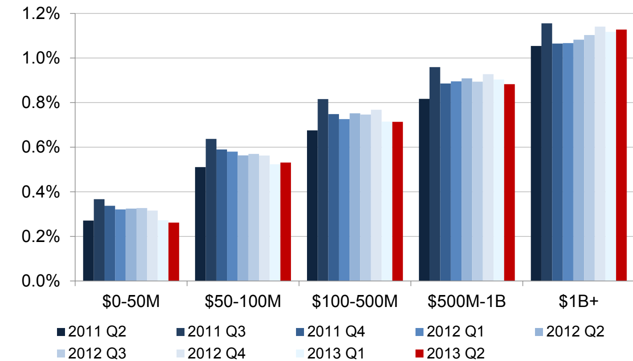



Smaller credit unions offer lower rates on shares and higher rates on loans on average, so their net interest margins are higher than margins at larger credit unions. That does not translate into higher ROA however, due to higher expenses and lower loan volume. Net interest margins are shrinking at all credit unions, but the impact is especially severe for smaller credit unions, which are being squeezed out of existence at a time when low cost financial services are increasingly in demand by American consumers. The burden of new regulations and compliance is a factor in the escalating costs faced by these small community-based credit unions.

### Chart 5 | Net Interest Margin by Asset Class




### Chart 6 | ROA Excluding Stabil. by Asset Class



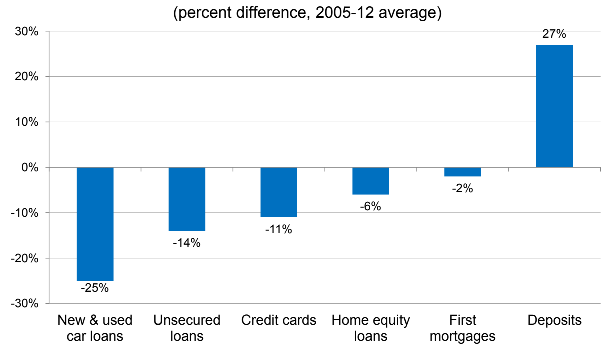
# ECONOMIC BENEFITS OF CREDIT UNIONS TO CONSUMERS

NAFCU commissioned a study to examine what would happen to the U.S. economy if the presence of credit unions was reduced significantly as a result of eliminating the credit union tax exemption. Previous studies demonstrated that changes to the credit union tax status in Canada and Australia led to a severe reduction in credit union presence. The reduced competition for consumer financial services led to higher interest rates on consumer loans and lower interest rates on deposits for consumers in those countries.

- Credit union rates outperformed bank rates across the board. Average rates on deposits were 27% higher, and on car loans they were 25% lower than bank rates.
- The direct benefits to credit union members of these better loan and deposit rates were estimated to range from $4.3 to $8.0 billion annually from 2005-2012.
- Total direct benefits to credit union members of these better loan and deposit rates were estimated to be $48.2 billion.
- Bank customers saved money too, due to competition from credit unions. A 50% reduction in the credit union market share would have cost bank customers almost $30 billion from 2005-2011.
- The total benefit to U.S. consumers from the presence of tax-exempt credit unions in financial markets is about $10 billion per year, with direct consumer benefits totaling $78 billion from 2005-2012.
- The results were modeled by Inforum's Long-term Interindustry Forecasting Tool (LIFT) to estimate the broader economic impact of these lost consumer benefits. The elimination of the credit union tax exemption would reduce U.S. GDP by about $148 billion (in 2010 dollars) over the next decade and result in a loss of 1.5 million job-years.
- The model also estimates that the $178 billion reduction in personal income would lead to a loss of $1.5 billion per year in Federal income tax revenue. The Federal government would ultimately lose tax revenue by taxing credit unions.

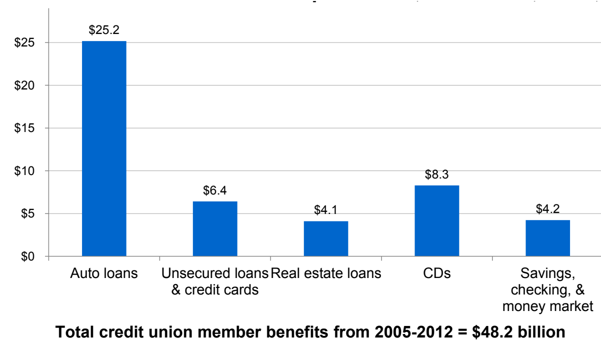
The authors of the study are Robert Feinberg Ph.D., Professor of Economics at American University; and Douglas Meade, Ph.D., Director of Research at Interindustry Economic Research Fund.

### Chart 1 | Interest Rate Differences, Credit Unions vs. Banks

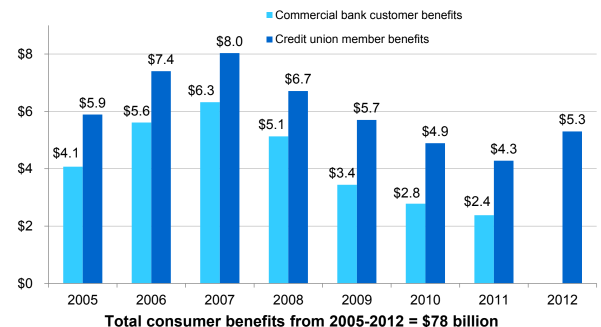



*Source: NAFCU's Credit Union Federal Tax Exemption Study, http://www.nafcu.org/cutaxexemption*

### Chart 2 | Direct Benefits to Credit Union Members from Better Loan and Deposit Rates, 2005-2012 ($billions)




### Chart 3 | Total Consumer Benefits of Competition from Credit Unions ($billions)



## Credit Union Business Lending Outpaces Banks

Credit union business lending provides a significant benefit to the economy. Credit union member business loans (MBLs) far outpaced the growth in bank loans to small businesses. This comes in spite of regulations limiting credit union outstanding MBLs to 12.25% of assets. The growing presence of credit unions in supplying loans to small businesses supports business owners and the wider economy through lower rates and a more stable source of credit.

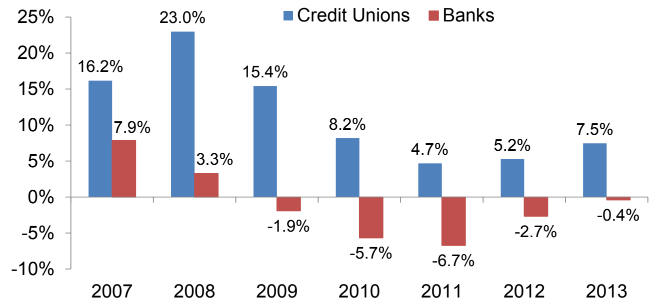
Even though MBLs have surged in recent years, results from NAFCU surveys make it clear that credit unions are supplementing the supply of credit to small business owners, not substituting for bank loans. A comparison with FDIC's business loan portfolio shows that NAFCU survey respondents' loans are generally smaller than those made by banks. Moreover, 18.4 percent of respondents to NAFCU's March 2013 survey indicated that within the past 12 months, they had made a business loan to a member who had been turned down by a bank.

Credit union MBLs also diverge from bank commercial loans in terms of asset quality. At the bottom of the recession in 2009, delinquencies on credit union MBLs were a full 46 percent lower than delinquencies on bank business loans.

While the penetration of MBL programs among credit unions has grown, the industry is clearly constrained in the amount of credit it can supply to small businesses. The Credit Union Membership Access Act restricted credit union MBLs to 12.25% of assets, and according to NAFCU's March 2012 Economic & CU Monitor survey, 10.3 percent of respondents had to turn down a business loan due to the cap. In the March 2013 survey, 10.7 percent of those who did not have a business lending program said that the MBL cap discouraged their credit union from starting one.

- Credit union member business loans grew 77.7 percent since 2007, while bank lending to small businesses shrank 14.3 percent.
- In 2008, the first year of the recession, credit unions grew their MBL portfolios by 23 percent as banks grew their business lending only 3.3 percent.
- Since 2008 credit unions' MBL growth slowed but still maintained a positive trend throughout the period.
- Banks cut back on small business lending every year since 2008, and are still cutting back.

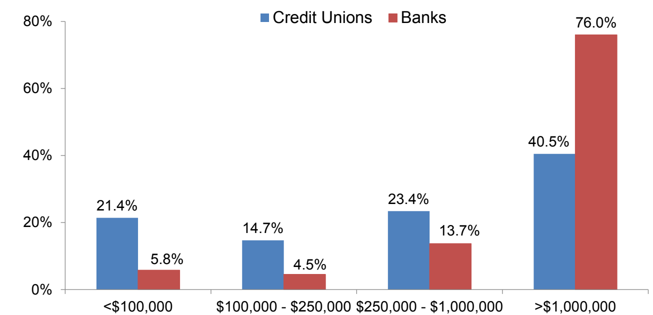
### Chart 4 | Credit Union Member Business Loan Growth Outpaces Bank Small Business Loan Growth*




** As defined by FDIC "Consolidated Report of Condition and Income" (generally those under $1 million)*
*Note: All figures show June-to-June growth. Credit union member business loans grew 77.7 percent since 2007, while bank lending to small businesses shrank 14.3 percent*

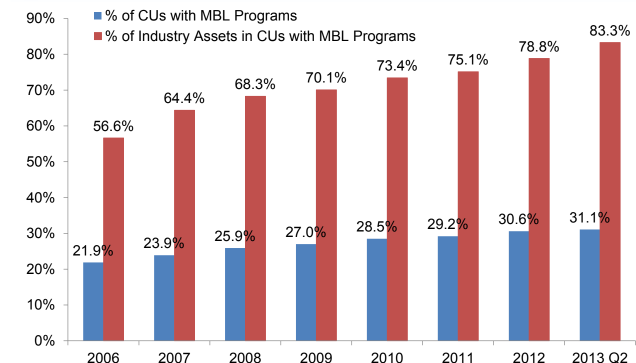
*Source: NCUA 5300 call report, FDIC "Statistics on Banking"*

### Chart 5 | Credit Union Concentrate on Smaller Loans to Businesses than Banks



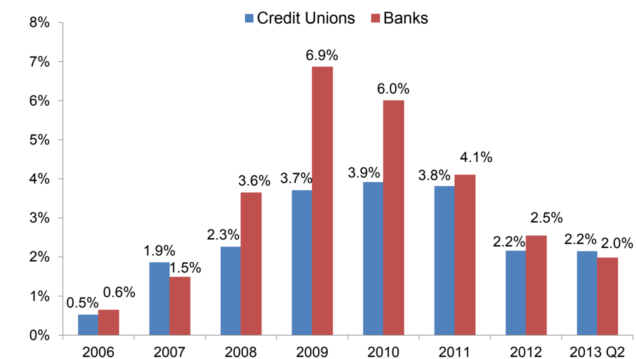

*Source: FDIC, NAFCU Economic & CU Monitor survey*

### Chart 6 | More Credit Unions Are Offering Member Business Loans




*Source: NCUA*

### Chart 7 | Credit Unions Have Lower Delinquency Rates on Business Loans




*Source: FDIC, NCUA*

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