Testimony of

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on Behalf of

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"Current Issues in Deposit Insurance"

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Introduction

Good afternoon, Chairman Johnson, Ranking Member Crapo and Members of the Subcommittee. My name is David Wright and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the CEO of Services Center Federal Credit Union, headquartered in Yankton, South Dakota. I have been CEO of Services Center FCU for the last 33 years. Services Center FCU is a low-income designated credit union operating in six counties. Four of the counties are in southeastern South Dakota and two are in northeastern Nebraska. This is a very rural part of the country. One of the counties has an average population of just 6 people per square mile. My credit union has some 6,200 members and assets of $37.5 million. Services Center FCU was selected as NAFCU's Credit Union of the year in 1990 and again in 2008.

I was selected as NAFCU's credit union professional of the year in 1993 and have served on numerous committees for the association, including the NAFCU Awards Committee, Membership Committee and Regional Advisory Committee.

NAFCU is the only national organization exclusively representing the interests of the nation's federally chartered credit unions. NAFCU–member credit unions collectively account for approximately 65.4 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding deposit insurance issues for America's credit unions.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche that credit unions fill today for nearly 89 million Americans. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes." (12 USC 1752(1)). While nearly 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation's approximately 7,800 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions, to electing the board of

directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true "volunteer spirit" permeating the credit union community.

Credit unions have grown steadily in membership and assets, but in relative terms, they make up a small portion of the financial services marketplace. Federally insured credit unions have approximately $813.4 billion in assets as of year-end 2008. By contrast, Federal Deposit Insurance Corporation (FDIC) insured institutions held $13.9 trillion in assets and last year grew by an amount that exceeds the total assets of credit unions. The average size of a federal credit union is $92.5 million compared with $1.673 billion for banks. Over 3,200 credit unions have less than $10 million in assets. The credit union share of total household financial assets is also relatively small, just 1.4 percent as of December 2008.

Size has no bearing on a credit union's structure or adherence to the credit union philosophy of service to members and the community. While credit unions may have grown, their relative size is still small compared with banks. Even the world's largest credit union, with $36.4 billion in assets, is dwarfed by the nation's biggest banks with trillions of dollars in assets.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) a decade ago. In the "findings" section of that law, Congress declared that, "The American credit union movement began as a cooperative effort to serve the productive and

provident credit needs of individuals of modest means … [and it] continue[s] to fulfill this public purpose."

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided but also—more importantly—to quality and cost. Credit unions are second to none in providing their members with quality personal financial service at the lowest possible cost.

While the lending practices of many other financial institutions led to the nation's subprime mortgage debacle, data collected under the *Home Mortgage Disclosure Act* (HMDA) illustrates the value of credit unions to their communities. The difference between credit unions and banks is highlighted when one examines the 2007 *HMDA* data for loans to minority applicants with household incomes under $40,000. According to the 2007 *HMDA* data, banks have a significantly higher percentage of mortgage purchase loans (20.8 percent) charging at least 3 percent higher than the comparable Treasury yield for minority applicants with household income under $40,000. Credit unions, on the other hand, had only 4.4 percent of their loans in that category.

The National Credit Union Share Insurance Fund (NCUSIF)

I am pleased to share with the subcommittee NAFCU's assessment of how the National Credit Union Share Insurance Fund (NCUSIF) is structured, and our thoughts on current issues in deposit insurance.

As you may know, the primary reason credit unions came together in 1967 and formed NAFCU was to lobby Congress for the establishment of a federal insurance fund for credit unions – a goal that was realized in 1970. Like the credit unions whose accounts it insures, the NCUSIF is itself *cooperative* in nature. Unlike FDIC insurance, which was initially funded with taxpayer dollars from the United States Treasury as seed-money, every dollar that has gone into the NCUSIF since its inception has come solely from the credit unions it insures.

The NCUSIF was originally structured in the same manner as the FDIC, i.e. the source of funding was based on premium collected from insured institutions. In 1985 the amount of money at NCUSIF began to dwindle because of mounting losses, low earnings on investments and extensive growth in credit union insured savings. Credit unions realized that NCUSIF needed to be recapitalized and in 1985 every insured credit union made a deposit of 1 percent of its members insured savings to NCUSIF. By making this deposit, the mutual or cooperative structure of NCUSIF began. As of January 2009 NCUSIF has $7.5 billion in total assets with a total equity of $7.3 billion. As a percentage of total insured savings NCUSIF has an equity ratio of 1.28 percent.

Credit unions insured by the NCUSIF are required by statute to maintain a deposit equal to one percent (1%) of its insured shares in the insurance fund (12 USC 1782(c)(1)(A)(i)). This "insurance deposit" is adjusted annually in the case of a credit union with total assets of not more than $50 million, and semi-annually for those credit unions with total assets of $50 million or more (12 USC 1782(c)(1)(A)(iii)). The National Credit Union Administration (NCUA) Board has a statutory obligation to establish a "normal operating level" for the fund which "shall not be less than 1.2 percent and not more than 1.5 percent" (12 USC 1782(h)(4)). If the equity level of the NCUSIF is in the 1.2% to 1.3% range, the NCUA Board may assess a premium in order to restore the equity level back to the normal operating level. If it falls below 1.2%, the statutory floor, the NCUA Board is required to assess an insurance premium to restore the fund to a 1.2% equity level (12 USC 1782(c)(2)(C)).

While the NCUSIF is now fundamentally structured differently than FDIC insurance, we believe it is imperative that there be parity in coverage levels between the two funds. Failure to do so could create public confusion and concern over the safety of their deposits and destabilize the current system. We believe that an important aspect of this parity has to include giving the NCUA the authority it needs to take actions to maintain the stability of the fund.

Current Challenges in Deposit Insurance

As part of the *Emergency Economic Stabilization Act* of 2008, Congress increased the coverage on FDIC and NCUSIF insured accounts to $250,000 through December 31, 2009. This change serves to maintain public confidence in insured depository institutions in the current economic environment. This temporary increase prohibited the NCUA from using this higher amount to

calculate any insurance premiums. NAFCU urges the Senate to enact legislation to permanently extend this increase. Failure to do so could lead to decreased confidence in financial institutions and lead people to withdraw funds, creating additional challenges for financial institutions.

While credit unions have faired better than most financial institutions in these turbulent economic times, many have been impacted, through no fault of their own, by the current economic environment.

In particular, the corporate credit union system has felt the biggest impact. In examining the corporates, NCUA notes that, "Nearly 80 percent of the securities held in the corporate credit union system remain highly rated, but a portion of the securities has been downgraded below investment grade due to underlying collateral performance." The expected losses from these investments by corporate credit unions are approximately $4.7 billion. It is with these facts in mind that on January 28, 2009, the NCUA Board approved a series of actions regarding the corporate credit union system.

Among the actions taken, NCUA:

- Guaranteed the uninsured shares of "all" corporate credit unions through February 2009 and established a voluntary guarantee program for the uninsured shares of 23 corporate credit unions through December 31, 2010 (the guarantee will cover all shares, but does not include paid in capital and membership capital accounts);

- Issued a $1 billion capital note to U.S. Central Federal Credit Union;

- Issued an Advance Notice of Proposed Rulemaking (ANPR) on restructuring the corporate credit union system; and,

- Will be declaring a premium assessment to restore the NCUSIF equity ratio to 1.30 percent, to be collected in late 2009.

The resulting impact on NCUSIF will be approximately $4.7 billion, dropping the NCUSIF's equity ratio from the current 1.28 percent equity ratio (as of January 2009) to an estimated 0.49 percent. Because credit unions follow GAAP accounting there was an immediate impairment to the 1 percent deposit. FICUs had to recognize this impairment by setting aside enough money in a contingency liability account to bring the deposit at NCUSIF back to 1 percent level. As previously noted, the *FCUA* requires NCUA to assess a premium when the fund's equity ratio drops below 1.2 percent. That premium assessment must occur before the end of 2009 and NCUA intends to bring the NCUSIF equity ratio up to 1.30 percent by assessing a premium of 0.3 percent later this year. As part of the same actions on January 28th, NCUA also announced a systematic review of the $64 billion in mortgage backed securities held by corporate credit unions in order to refine the ultimate liability and subsequent charge to each credit union. That review was recently completed, but results have not yet been made public.

The consequence is that over 5,350 federally-insured credit unions (approximately 68.6% of all FICUs) will be in the "red" in 2009. Approximately 203 FICUs will be downgraded in PCA

(Prompt Corrective Action) levels, which could lead to further NCUA actions to help stabilize those institutions.

NAFCU's analysis of 4th quarter call report data on credit unions indicates that, absent legislation, FICU member services will be adversely impacted in 2009. Such adverse impacts could include increased fees, higher rates, lower dividends, and/or decreased lending. In fact, as FICUs will suffer a reduction in $4.7 billion in capital in 2009, the impact on consumer and business lending alone (based on NCUA estimates that credit unions make approximately $7 worth of loans for every $1 in capital) could total $33B, further adversely impacting the economy as the nation strives to rebound from its economic malaise.

Proposed modifications to the NCUSIF

NAFCU urges the Senate to enact an amendment that would amend the *FCUA* to establish a restoration plan period for the NCUSIF. This would provide the NCUA Board with the authority to replenish the NCUSIF by restoring the equity ratio through a restoration plan which is consistent with the *Federal Deposit Insurance Act* and could extend the replenishment over a period of up to eight years versus the current one year time frame. H.R. 1106 included such an amendment that would extend the repayment period over five years. Such an amendment would allow NCUA to assess premiums over 8 years to restore the fund from an equity ratio of 1.0 percent to 1.3 percent. Because credit unions must follow GAAP, and it is an impairment, restoration of the fund to the 1.0 percent deposit must, however, still occur in the same year.

NAFCU also strongly urges the Senate to provide the NCUSIF an increase in borrowing authority from the Treasury Department. This change is long due since the current level of $100 million was established in 1971, and has not been modified for the growth of credit unions and their member deposits over time. H.R. 1106 would increase the borrowing authority to $6B.

Furthermore, NAFCU encourages the Senate to provide systemic risk authority to NCUA, on a similar basis to that provided to FDIC. This would be a very important step to address systemic emergencies when the authority provided under Section 208 of the *FCUA* is inadequate. The FDIC has pointed out specific provisions in its Act to provide unlimited deposit insurance coverage for non-interest bearing transaction accounts. Providing NCUA with parallel authority to the FDIC to address systemic risk under extreme circumstances is an important step to provide consumer confidence in these very challenging economic times.

NAFCU believes that the NCUA and Congress should work to find additional ways to help stabilize the corporate credit union system outside of using the NCUSIF. One such approach could be to use the Central Liquidity Facility (CLF) for credit unions. Established by the *FCUA* and funded by Congress, the CLF provides loans to natural-person credit unions to meet their liquidity needs in turbulent times. We believe some changes to the *FCUA* to allow the CLF to help the corporate credit union system could help address the current situation, and provide relief from the current pressure NCUA's actions have had on the NCUSIF. In particular, NAFCU supports an amendment to the *FCUA* which would allow the NCUA to use funds from the CLF directly to help the liquidity and capital needs of all credit unions, including corporate credit unions. This change, if coupled with some form of flexibility on OTTI accounting, would go a long way to helping credit unions.

We would welcome the opportunity to work with the Committee to address this issue. Some suggested language to accomplish this is outlined below.

Proposed Amendments to the Federal Credit Union Act (12 U.S.C. §§ 1751-1795)

Section 1795

The Congress finds that the establishment of a National Credit Union Central Liquidity Facility is needed to improve general financial stability by meeting the *liquidity and capital* needs of credit unions, and thereby encourage savings, support consumer and mortgage lending, and provide basic financial resources to all segments of the economy.

Section 1795a

(1) "liquidity needs" means the needs of credit unions ~~*primarily serving natural persons*~~ for—

(3) …Reserves shall not be considered as part of surplus;

(4) "member" means a Regular or an Agent member of the Facility*; and*

(5) "capital needs" means cash available necessary to meet the needs of credit unions –

(A) to increase net worth or capital; and

(B) to stabilize the credit union system, as determined by the Board.

Section 1795c:

Membership. -- (a) A credit union ~~primarily serving natural persons~~ may be a Regular member…."

Section 1795e

~~Extension of Credit~~ Provision of funds.

(a)(1) A member may apply for an extension of credit from the Facility to meet its liquidity needs. The Board shall approve or deny any such application within five working days after receiving it. The Board shall not approve an application for credit the intent of which is to expand credit union portfolios. The Board may advance funds to the member on terms and conditions prescribed by the Board after giving due consideration to creditworthiness.

(2) A member may apply for the advancement of funds by the Facility to meet its capital needs under such terms and conditions as the Board shall prescribe to allow the funds to be categorized as net worth or capital.

Additional Section of the Legislation

Recoupment.

Upon the expiration of the 5-year period beginning upon the date of the enactment of this Act, the National Credit Union Administration Board shall:

(a) submit a report to Congress on the utilization of the authority conveyed by Section 1795e(a)(2) of the Federal Credit Union Act; and
(b) establish a plan under Board regulations implementing this section, to recoup, over a period of time, necessary amounts to ensure that Section 1795e(a)(2) does not add to the deficit or national debt.

Conclusion

In conclusion, NAFCU continues to support an independent NCUSIF. Furthermore, we believe Congress must make the temporary increase in deposit insurance coverage to $250,000 permanent. Actions by the NCUA to help stabilize the corporate credit union system using the NCUSIF threaten to put a strain on natural-person credit unions. We believe legislative relief in the form of extending the repayment time, increasing borrowing authority for the NCUSIF and modification of the *FCUA* as it relates to the CLF are all steps that will help the continued stability of the NCUSIF. Thank you for the opportunity to appear before the Subcommittee today, I welcome any questions that you may have.