
NASCUS

**Testimony of George Latham
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On behalf of the
National Association of State Credit Union Supervisors
Before the Subcommittee
on Financial Institutions and Consumer Credit
United States House of Representatives
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NASCUS History and Purpose

Good morning, Chairman Bachus, and distinguished members of the Subcommittee. I am George Latham, Deputy Commissioner of Financial Institutions for the Bureau of Financial Institutions for the Commonwealth of Virginia. I appear today on behalf of the National Association of State Credit Union Supervisors (NASCUS). NASCUS represents the 48 state and territorial credit union agencies and is advised by the NASCUS Credit Union Advisory Council, composed of more than 600 state-chartered credit unions dedicated to defending the dual chartering system for credit unions.

The mission of NASCUS is to enhance state credit union supervision and regulation and promote policies that ensure a safe and sound state credit union system. We achieve those goals by serving as an advocate for a dual chartering system that recognizes the traditional and essential role that state government plays as a part of the national system of depository financial institutions.

NASCUS applauds the introduction of H.R. 3505, the Financial Services Regulatory Relief Act of 2005. We appreciate that a section is dedicated to regulatory relief provisions for credit unions. This Subcommittee's continued commitment to providing ongoing regulatory relief ensures a safe and sound environment for credit unions and the consumers they serve. We are pleased to have this opportunity to share our legislative priorities for regulatory relief and to compare and contrast them with the provisions in H.R. 3505.

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NASCUS Priorities for Regulatory Relief

H.R. 3505 offers many regulatory relief provisions that further the safety and soundness of credit unions. NASCUS priorities for regulatory relief focus on reforms that will strengthen the state system of credit union supervision and enhance the capabilities of state-chartered credit unions. The ultimate goal is to meet the financial needs of consumer members while assuring that the state system is operating in a safe and sound manner.

In this testimony, I will address provisions included in H.R. 3505 that are vital to the future growth and safety and soundness of state-chartered credit unions. In addition, I will share more regulatory relief provisions that NASCUS believes would further strengthen the legislation. They are as follow:

- Regulatory modernization that provides parity for credit unions with other financial institutions.
- Allowing non-federally insured credit unions to join the FHLBs.
- Capital reform including amending the current Prompt Corrective Action (PCA) provision for credit unions, allowing risk-based capital reform and amending the definition of net worth to include the retained earnings of a merging credit union when calculating net worth.
- Member business lending, expanding the lending provision and amending the definition of a member business loan.
- Preservation of the dual chartering system and protection against the preemption of state laws.

Regulatory Relief Provided by H.R. 3505

State regulators appreciate the foresight that went into the provisions provided in this bill. H.R. 3505 offers several important regulatory relief provisions for state-chartered credit unions.

A most important provision is an amendment to the definition of net worth, which cures the unintended consequences for credit unions of the Financial Accounting Standards Board (FASB) business combination accounting rules. FASB's Financial Accounting Standard No. 141 requires the acquisition method for business combinations and effectively eliminates the pooling method for the combinations of mutual enterprises. Chairman Bachus and members of the Subcommittee, NASCUS applauds the inclusion

of this provision in H.R. 3505, as well as the House passage of H.R. 1042. Both amend the definition of net worth to include the net retained earnings of a merging credit union with that of the surviving credit union. Mergers are a safety and soundness tool regulators use to protect funds deposited by American consumers and to preserve the National Credit Union Share Insurance Fund. We recognize and appreciate that a similar provision was introduced in H.R. 2317, the Credit Union Regulatory Improvement Act, commonly called CURIA.

NASCUS is also pleased that H.R. 3505 includes language that provides an exemption from the pre-merger notification requirements of the Clayton Act. Federally insured credit unions would be provided the same exemption from pre-merger notification requirements and fees of the Federal Trade Commission currently enjoyed by other depository institutions.

H.R. 3505 also provides credit unions similar treatment as other depository institutions under securities laws established in the Securities and Exchange Act of 1934.

We believe that both of these parity provisions for credit unions with other financial institutions should be expanded to include all state-chartered credit unions, not just those that are federally insured.

Privately-Insured Credit Unions Should Be Eligible to Join Federal Home Loan Banks (FHLBs)

We applaud the inclusion of Section 301 in H.R. 3505, which enables privately-insured credit unions access to FHLBs. Currently, federally insured credit unions have access to the FHLBs, while privately-insured credit unions do not. NASCUS has long advocated that privately insured credit unions should have access to the FHLBs. We are pleased that H.R. 3505 would allow non-federally insured credit union to join the FHLBs.

Non-federally insured credit unions are regulated by the same state regulatory agencies as those credit unions with federal insurance. The mission of the examination process is to ensure that state credit unions, regardless of their insurance type, operate in a safe and sound manner. Federal and private share insurance systems have been established to protect credit union shareholders.

The regulatory and examination functions performed by a state examiner primarily determine the safety and soundness of state-chartered credit unions. State agencies perform examinations and issue rules that ensure safe and sound financial practices. The exam process includes safeguards to ensure that financial and operational deficiencies are corrected. When necessary, state agencies may take enforcement action to ensure that financial and operational remedies are implemented. All of these actions, working together, ensure a safe and sound state credit union system.

To manage insurance risk, state and federal regulators must work together. In fact, often the National Credit Union Administration (NCUA) relies significantly on the examination reports produced by state examiners. Moreover, in a vast majority of cases, state agencies use the same computerized examination platform (AIRES) as used by the NCUA. NASCUS agencies cooperatively participate in the development and testing of NCUA's examination program and procedures.

In addition, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) established a series of safety and soundness requirements both for entities that offer private deposit insurance to credit unions and for credit unions that opted for private deposit insurance.

Granting non-federally insured institutions access to the FHLBank system does not establish a new membership principle. Today, more than 50 insurance companies, chartered and regulated by state governments with no federal oversight or insurance, are members of these Banks.

NASCUS believes that allowing FHLB membership for privately-insured credit unions follows the same basic principle. Moreover, since state examination of privately insured credit unions is so strong and at least comparable to NCUA's examination program, it does not inflict any new or unusual exposure on the FHLB system.

Further, it introduces an additional layer of financial discipline. Each Federal Home Loan Bank has a sophisticated credit screening system to assure that any borrower, federally insured or not, is credit worthy. In addition, every advance is secured by marketable collateral.

Expanding State Agency Regulatory Authority

In addition to providing regulatory relief for non-federally insured credit unions, we are pleased H.R. 3505 provides additional authorities to state regulators. It provides amendments to FDICIA that allow the state supervisor of a state-chartered credit union, that receives deposits insured by a private deposit insurer, to examine and enforce compliance disclosure regulations.

While expanding state regulatory authority, this legislation repeals examination and enforcement authority of the Federal Trade Commission (FTC) for credit unions with private insurance. Section 315 of H.R. 3505 confirms that the FTC retains enforcement authority of the disclosure requirements and the manner and content of the disclosures necessary for a credit union with private insurance. NASCUS supports the language included in H.R. 3505 that recognizes state supervisory authority as the overseer of

examination and enforcement authority of compliance of disclosure requirements for credit unions with private insurance.

Expanding H.R. 3505

Two areas that would be beneficial in the regulatory oversight of state-chartered credit unions are additional capital reform and a change in the definition of a member business loan.

Capital Reform

Capital reform continues to be a critical concern for the nation's credit unions. NASCUS strongly believes regulatory relief for credit unions must include capital reform that amends the Prompt Corrective Action (PCA) provision of the Federal Credit Union Act (the Act). It is imperative that the Act include more than retained earnings when calculating a credit union's net worth ratio. There are many reasons other forms of capital should be permitted for credit unions.

At the beginning of this month, we witnessed the devastation of Hurricane Katrina. State credit union regulators in the affected states helped ensure branch operations continued in a safe and sound manner and that members had access to cash. These regulators' concerns will soon shift to concerns about capital requirements imposed statutorily by PCA.

Section 216 of the Act establishes mandatory net worth categories for credit unions and does not provide flexibility to temporarily waive PCA requirements. Further, it restricts the net worth of a credit union to just its retained earnings. The statutory language establishing mandatory net worth categories, coupled with the narrow definition of retained earnings, is problematic for credit unions.

Many of the credit unions affected by Hurricane Katrina will need retained earnings to rebuild their credit unions. In addition, it is predicted that many members will walk away from loan obligations because their car or home, which secured their loan, no longer exists. As retained earnings are reduced for relief efforts, regulators in these states may have to downgrade credit unions for not meeting PCA requirements.

As this happens, under the current PCA regulation, these credit unions will lose investment authorities and other privileges associated with being a well capitalized institution. Many of these authorities enable them to better serve members. This example demonstrates how viciously this cycle affects and potentially hurts American consumers.

A legislative change is needed to broaden the definition of net worth in the Act. The statutory requirements discussed above are not similar to statutory requirements of other financial institutions, and potentially have a negative effect on the survival of a credit union. NASCUS has long advocated for a broader definition of net worth. Therefore, NASCUS applauds Section 314 that amends the definition of net worth to include the retained earnings of any credit union that merges into another credit union. NASCUS further recommends the addition of language modifying the definition of the net worth ratio to exclude from the numerator and the denominator a credit union's deposit in the National Credit Union Share Insurance Fund. Such language is included in CURIA.

Risk-Based Capital

Beyond an amendment to the Act that provides a broader definition for net worth, NASCUS endorses and has a long-standing policy supporting risk-based capital for credit unions. Risk-weighted capital reform should be flexible. New statutes and regulations should be progressive and not designed to regulate to the lowest common denominator. We believe risk-based capital is a sound and logical approach to capital reform for credit unions. NASCUS recommends that the risk-based net worth language in Section 102 of CURIA be included in H.R. 3505. Risk-based net worth and alternative capital authority are also complimentary capital reforms.

Alternative Capital Authority for Credit Unions

NASCUS supports capital reform beyond the risk-weighted capital and FASB merger fix. We believe that an important part of capital reform is providing credit unions access to alternative capital. The combination of current PCA requirements and a review of many state credit union balance sheets by their CEOs have revealed a need for alternative capital.

As noted above, the Act defines credit union net worth as retained earnings only. The NCUA determined that it lacks the regulatory authority to broaden the net worth definition to include other forms of capital as a part of PCA calculations. Thus, credit unions require an amendment to the Act to rectify this statutory deficiency.

NASCUS's Credit Union Advisory Council members have shared that even with the lower leverage ratio and risk-based capital as proposed in H.R. 2317 (CURIA), some state-chartered credit unions may not be able to rely solely on retained earnings to meet the capital base required by PCA standards. Many NASCUS regulators have concurred with this conclusion, as well. As credit unions grow and serve more consumers in their fields of membership, their assets will grow. As assets grow, credit unions experience reduced net worth ratios as earnings retention lags growth in assets.

We firmly believe alternative capital is necessary for credit unions to continue meeting the financial needs of their members. This is especially true for credit unions providing services such as financing for home ownership, or financial education and credit counseling—each an important part in achieving the American dream.

In July, the NASCUS Alternative Capital Task Force released a white paper that presents both equity and debt models for alternative capital. The instruments and arrangements discussed in this paper are designed to preserve the not-for-profit, mutual, member-owned and cooperative structure of credit unions. Moreover, these instruments ensure that ownership interest remains with the members. The white paper has been shared with the credit union community for study and feedback. The Alternative Capital white paper is attached to this testimony for review. We look forward to working with members of Congress and congressional staff in the coming weeks on the models presented.

As regulators, we should take every financially feasible step to strengthen the capital base of this nation's credit union system. NASCUS recognizes that strong capital reform requires that state and federal regulators work together. In 1998, the Credit Union Membership Access Act, H.R. 1151, provided that NCUA consult and cooperate with state regulators in constructing PCA and member business lending (MBL) regulations as required by the Act. Legislation or not, NASCUS firmly believes that cooperation results in better regulation and a stronger and safer credit union system.

Member Business Lending

NASCUS is pleased Section 306 of H.R. 3505 includes a provision that provides member business lending exclusions to nonprofit religious organizations. The purpose of this provision is to enhance community development activities of these organizations. However, NASCUS believes that further regulatory relief for member business lending is necessary.

NASCUS supports amending the definition of a member business loan in the Act. Section 201 of H.R. 2317 raises the statutory limit on credit union member business loans to 20 percent of total assets. We recommend that a similar provision be added to H.R. 3505. This provision would provide an opportunity for economic growth for credit unions by facilitating business lending without jeopardizing safety and soundness.

Regulatory relief for member business lending is important for consumers. In today's fast-paced economy, it is vital that lending is available to consumers who want to start a new business. Entrepreneurship is part of fulfilling the American dream. NASCUS has a vision of providing well-thought-out regulations to best position credit unions to make members' dreams become reality.

We further support the language in Section 202 of H.R. 2317, and recommend it be included in H.R. 3505. This provision amends the current definition of a member business loan by granting NCUA the authority to exempt loans of \$100,000 or less. The recommended inclusion of Section 202 of H.R. 2317 into H.R. 3505 would increase the definition of business loans from the current amount of \$50,000 to \$100,000.

The addition of both of these provisions would provide credit unions with regulatory relief as it concerns member business lending. NASCUS supports an amendment to H.R. 3505 that includes both provisions.

Bank Secrecy Act Provisions

NASCUS appreciates the importance of the Bank Secrecy Act (BSA), and the recognition in H.R. 3505 that a balance must be met between the burden of producing the required reports for BSA compliance and the benefit of filing such reports. Title VII, BSA Compliance Burden Reduction, of H.R. 3505 recognizes that financial institutions experience a compliance burden when meeting money-laundering laws necessary to prevent terrorist acts.

Currently, the Secretary of the Treasury (the Secretary) has regulatory authority to define exemptions that financial institutions may file concerning currency transaction reports (CTRs). H.R. 3505 provides further flexibility to the Secretary to grant CTR exemptions for certain parties.

NASCUS believes this review by the Secretary under Section 701, including consideration of exemptions, will better balance the burden of reporting with the analytical and investigative needs of the federal government. We recognize the proposed language in Section 701 (c)(2)(C), discussing the review, is consistent with current regulatory trends concerning the risk-based assessment of new customers.

NASCUS believes the language in Title VII of H.R. 3505 will yield positive results by attempting to reduce the inconsistencies in monetary transaction recording and reporting enforcement and examination requirements.

NASCUS further appreciates the proposed requirement that the Comptroller General conduct a study of CTRs that are filed with the Secretary to help financial institutions best use the exemption provisions and mitigate issues that limit their effective use. In addition, it requires a feasibility study be performed by the Treasury to develop electronic communications interfaces between financial institutions and FinCEN, potentially reducing regulatory burdens on state-chartered credit unions.

NASCUS believes that state credit union regulators have a safety and soundness responsibility to encourage state-chartered credit unions to comply with all applicable

laws and regulations. We recommend that Section 702(b), Enforcement Programs, of H.R. 3505 should reference state regulators as contributing members of FFIEC. Referencing state regulators reinforces the importance of the partnership between state and federal regulators in enforcing and monitoring BSA and anti-money laundering compliance.

NASCUS appreciates the provisions in H.R. 3505 that attempt to reduce the regulatory burden of financial institutions. We believe it is a step in the right direction to balance the reporting burden with the needed information of policy makers, financial regulators, law enforcement and intelligence agencies. We suggest that future reviews of BSA also address filing of Suspicious Activities Reports (SARs) and the monitoring activities required.

Conclusion

In conclusion, NASCUS strongly supports the following issues for regulatory relief:

- NASCUS supports Section 314 of H.R. 3505 that amends the definition of net worth to include the retained earnings of a merging credit union with that of the surviving credit union.
- NASCUS supports Section 301 of H.R. 3505 that allows non-federally insured credit unions to be eligible to join the FHLBs.
- NASCUS supports Section 315 of H.R. 3505 that recognizes state supervisory authority as the overseer of examination and enforcement authority of compliance of disclosure requirements for credit unions with private insurance.
- NASCUS supports Section 312 of H.R. 3505 that provides all federally insured credit unions the same exemptions as banks and thrift institutions from pre-merger notification requirements of the Clayton Act.
- NASCUS supports Section 313 of H.R. 3505 that provides credit unions similar treatment as other depository institutions under securities laws established in the Securities and Exchange Act of 1934.
- NASCUS supports expanding H.R. 3505 to include an amendment to the Prompt Corrective Action (PCA) provision of the Act to include all forms of capital when credit unions calculate their net worth ratio.
- NASCUS believes H.R. 3505 should include risk-based capital reform.

- NASCUS believes H.R. 3505 should be expanded to allow credit unions to issue alternative capital.
- NASCUS believes H.R. 3505 should include an expanded definition of member business lending to 20 percent of total assets of a credit union, furthering the goal of providing loans for consumer members.
- NASCUS believes H.R. 3505 should amend the definition of a member business loan by granting NCUA the authority to exempt loans \$100,000 or less.
- NASCUS believes the BSA provisions in H.R. 3505 are a step in the right direction of balancing the reporting burden with needed information of policy makers, financial regulators, law enforcement and intelligence agencies.
- NASCUS believes Section 702(b), enforcement programs, of H.R. 3505 should reference state regulators as contributing members of FFIEC.
- NASCUS believes future reviews of BSA should address filing of Suspicious Activities Reports (SARs) and the monitoring activities required.

NASCUS appreciates the opportunity to testify today on the provisions in H.R. 3505. We welcome further participation in the discussion and deliberation of this legislation and other legislation that provides regulatory relief for state-chartered credit unions. We urge this Subcommittee to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have discussed in our testimony.

Thank you.

Attachment –“Alternative Capital for Credit Unions...Why Not?”