

CUNA Oral Comments - NCUA Budget Briefing

Mike Schenk, CUNA Chief Economist

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Good morning. I'm Mike Schenk, Chief Economist for the Credit Union National Association (CUNA). I appreciate the opportunity to share some observations on the National Credit Union Administration (NCUA) budget process, thoughts about the budget itself and the agency's strategic direction implicit in this proposed budget.

As you know, CUNA is the largest trade association serving America's credit unions. CUNA membership stands at its highest level in over a decade with nearly 90% of the nation's federal and state credit unions affiliated. On behalf of these credit unions and their 120 million members, thank you for opening the NCUA budget process to credit unions and credit union stakeholders.

I'll share a handful of our general observations and conclusions in these brief remarks and provide a substantially more detailed written document to you following this briefing.

Let me first be very clear that we recognize that the NCUA is the only FIRREA agency that publishes a detailed draft budget that rationalizes agency expenditures in the context of well-communicated strategic plan, soliciting public comment on that draft in a meeting like this - with the Board and a number of the agency's senior staff present.

CUNA and our member credit unions greatly appreciate this distinction and we applaud the agency for its leadership and transparency.

Given their unique ownership structure, credit unions deserve to know how and where their members' money is likely to be spent. They deserve to see the link between those expenditures and their core mission of improving financial well-being for all. And they definitely deserve to weigh-in when they perceive a significant disconnect in those spending plans when compared to the mission.

We, once again, find the NCUA's Budget Justification document to be clear, comprehensive, and well-developed. The proposed activities and expenditures described generally align with previously announced and vetted strategic initiatives including the Virtual Examination Project and Enterprise Solution Modernization. It also appropriately responds to changing supervisory priorities especially in light of the COVID-19 Crisis.

The NCUA's Proposed 2021 Budget reflects a 1.4% decrease in expenditures overall. And the operating budget (which accounts for 92% of Agency expenditures) reflects a modest 0.1% decline. This seems reasonable in the context of the current 1.2% year-over-year inflation

rate and with the 4% annualized first-half 2020 increase in credit union operating expenses - which is the point of reference for most credit union CEOs.

However, as outlined in the Budget Justification document, a good deal of the apparent fiscal restraint reflected in those numbers arises in large part due to the decline in travel-related expenses in 2020, and the expectation that travel will continue to be restricted into 2021.

Within the 2021 Operating Budget, pay & benefits represent 76% of total expenditures – and the \$241 million proposed total is up 4.1%. This mostly covers pay and benefit adjustments for merit & locality pay changes required by the Collective Bargaining Agreement. Furthermore, about 25% of the increase can be traced to the combination of mandatory employer contributions for retirement/health benefits and the addition of five new employees.

The Budget Justification document is a fairly high-level summary that – perhaps by design - omits detail necessary to adequately assess the need and rationalization for each of the individual new positions proposed. We know the duties to be performed – but little about the need for those duties to be performed. In that regard, CUNA believes that the efficiency of NCUA's operation are paramount to responsibly using credit union members' resources as NCUA seeks to become a world class regulator. As we've said in the past, we believe there is immense capacity for NCUA to reduce its footprint, right-size the organization and come out of the resulting transition as a nimbler, stronger, more efficient and more effective regulator.

Furthermore, we have real concerns around any obvious expansion in consumer protection examination activity. Our members believe altering the agency's risk-focused examination process and substantially increasing examination-related expenditures is simply not warranted.

The agency provides no supplementary evidence to suggest credit unions' consumer compliance management has become a risk area warranting an increased expenditure of agency resources. As its mission statement makes clear, the NCUA exists to ensure the safety and soundness of the credit union system, and its examination program should remain focused on that objective. In addition, the agency already has the tools in place to further evaluate a credit union's consumer compliance program when a need is identified through the risk-focused examination process.

Regrettably, the COVID-19 Crisis has paused some of the anticipated progress on realizing efficiencies. But it has also seemingly better positioned the agency for the possibility of a more seamless roll-out of important programs in 2021. For example, while the Crisis has interrupted in-person MERIT system training, it has also clearly demonstrated the Agency's resiliency and ability to adapt quickly – with the pandemic-necessitated switch to off-site examinations providing key learnings that are likely to improve (and perhaps accelerate) progress toward goals in the not-to-distant future – especially within the Virtual Examination Project.

The COVID-19 pandemic and uncertain economic environment has stressed credit unions. And – as outlined in the Budget Justification document - it may continue to do so. Perhaps in more obvious ways.

The NCUA has been responsive to CUNA requests throughout the COVID-19 Crisis and has worked to streamline credit union operations and service provision. The agency has consistently listened to ideas and has actively looked for constructive solutions to complex challenges. Helpful responses have ranged from pursuing increased access to the Central Liquidity Facility to postponing implementation dates of various regulations, as well as embracing initiatives like easing troubled debt restructuring provisions and proposing the capitalization of interest. These activities have helped thousands of credit unions ease the burden on millions of consumers.

For their part, credit unions continue to behave like credit unions always have in crisis. The nation's cooperative financial institutions, with depositor ownership and democratic control, view capital as a war chest – to be built up during good times and used during tough times – to get members through crisis with as little disruption as possible.

This was obvious during the Great Recession and its aftermath, reflected in a 13% increase of credit union loan portfolios between 2007 and 2012 while bank loans declined by 3% over that same period.

Credit union performance during the current COVID-19 crisis also stands out. A CUNA survey conducted soon after the crisis unfolded concluded that 95% of credit unions offered loan modifications, 90% waived fees and 86% created new loan products to meet members' pressing needs.

In addition, the nation's credit unions collectively originated nearly 200,000 Small Business Administration Paycheck Protection Program loans totaling \$10 billion. Credit unions reported an average PPP loan size of \$49,000 – less than half the bank average and a clear indication that credit unions were firmly focused on small, independent, mom-and-pop businesses – not national chain restaurants, professional sports teams and the like. Cornerstone Advisors, a consultancy, reported that credit unions had the biggest jobs impact per million lent among all lenders – including banks, fintech firms and others.

Credit union supervisory authorities – including the NCUA and state-level prudential regulators – must continue to cultivate and encourage these natural pro-social behaviors. The transformative power of cooperative finance cannot be fully realized by treating not-for-profit financial institutions as though they are for-profit institutions.

Our members believe strongly that credit union regulators must resist any temptation to view the institutions they supervise through a same lens used by regulators in the banking arena, and must constantly look for ways to increase consumer access to support improved financial well-being for all.

In that regard, CUNA members urge the agency to view capital as they do – resisting the temptation to pursue legislation that transforms the Share Insurance Fund into a bank-like

entity and to commit to reduce the Normal Operating Level to a level closer to its 1.30% historic norm. While the FDIC has operated in the red twice over the past thirty years, the NCUSIF has never finished a year below 1.20% over that period of time. Collecting premium assessments has never been an issue historically – even in tough times. The need to recast the nature of the NCUSIF – transforming it into a bank-like fund - is simply unwarranted and should be strongly resisted.

In that regard, we hope the NCUA will use the COVID -19 Crisis as a reference point for meaningful field of membership reform. This issue isn't fully explored in the budget document. In many respects, however, the COVID-19 Crisis has laid bare key FOM challenges and deficiencies and has produced a heightened awareness of safety and soundness concerns that concentrates risk in specific industries.

Of course, industries that require employees to interact face-to-face with customers have been especially hard-hit in the COVID-19 Crisis. For example, the leisure and hospitality industry (including restaurants, hotels, theme parks and the like) saw a near-immediate decline in employment with 8.3 million jobs lost in the two months ending April 2020. As local economies opened, the employment situation in this industry improved, but overall employment remains over 20% lower than February's pre-pandemic level. Some credit unions – though certainly not all – with narrow FOMs serving these hard-hit sectors are highly vulnerable.

FOM was contemplated during the initial conception of credit unions as a way to minimize the negative effects of asymmetric information in the credit process - before the existence of widespread credit reporting. But times have changed.

We appreciate NCUA's efforts to work within the law to explore ways to bring credit union service to a wider diversity of average Americans. Field of Membership changes have been impactful and beneficial – and more can and should be done.

On behalf of CUNA, thank you for the opportunity to speak to you today. I'd be happy to address any questions you may have.
