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The Honorable Rodney Hood
Chairman
National Credit Union Administration Board
1775 Duke Street
Alexandria, VA 22314

Dear Chairman Hood:

On behalf of America's credit unions and their more than 120 million members, thank you for opening the National Credit Union Administration's (NCUA) budget process to credit unions and credit union stakeholders.

CUNA commends the agency for continuing to provide comprehensive budget information as well as rationalization of the budget and agency expenditures in the context of a well-communicated strategic plan. Providing budget items in advance, holding an open briefing where stakeholders are invited to testify, and soliciting written comment is good public policy and reflects the agency's commitment to government transparency.

CUNA and our member credit unions recognize that NCUA is the only Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) agency that has embraced this level of transparency and engagement. We greatly appreciate this distinction. Please keep doing this. This process is incredibly important. As advocates, our ability to see these details and connections helps us better articulate to our member-credit unions exactly what the agency is doing and why you're doing it.

Given their unique ownership structure, credit unions deserve to know how and where their members' money is being spent. They deserve to see the link between those expenditures and their mission of improving financial well-being for all. And they deserve to weigh-in (directly or indirectly) when they perceive a significant disconnect in spending plans when compared to core 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 strategic initiatives (such as the Virtual Examination Project and Enterprise Solution Modernization) that the agency has previously detailed and that CUNA has analyzed, discussed, and broadly encourages and supports. It also appropriately responds to significant operational challenges and changing supervisory priorities arising from the COVID-19 crisis.

The NCUA's Proposed 2021 Budget reflects a 1.4% decrease in expenditures overall. The operating budget (which accounts for 92% of total agency expenditures) reflects a modest 0.1% decline. This all seems reasonable against a backdrop of the current 1.2% annual increase in inflation (measured by the CPI). It is likewise in line with increases in credit union operating expenses—the point of reference for most credit union CEOs—which appear to have increased at an approximate 5% annualized rate this year (based on the recent third quarter call report data release).

However, as outlined in the Budget Justification document, a big part of the apparent fiscal restraint reflected in the numbers is related to the decline in travel expenses in 2020, and the expectation that travel will continue to be restricted into the new year.

Within the 2021 Operating Budget, pay and benefits represent roughly 76% of total expenditures—and the $241 million proposed total is up 4.1%. This is primarily related to adjustments required by the agency's Collective Bargaining Agreement. Furthermore, about 25% of the increase can be traced to the combination of mandatory employer contributions for retirement and health benefits and the addition of five new employees.

The Justification document is a fairly high-level summary that—perhaps by design—omits some of the detail necessary to adequately assess the need and rationalization for some expenditures. A good example of this is the proposed expenditures for each of the individual five new positions proposed. We know the duties to be performed—but little about the need for those duties to be performed. Similarly, we know about additional outlays arising from plans for office renovations—but know little about how the agency might have contemplated a "new normal" that might involve more remote and less in-person work and the potential effects on renovations associated with those changes.

This is important. Abstracting for the savings arising from changes in travel the budget appears to be up by nearly 10%. More detail around the motivation and rationale for these additional personnel expenses would be helpful.

As I've stated before, CUNA believes that the efficiency of NCUA's operation is (by definition) essential to responsibly using credit union members' resources as NCUA seeks to become a world class regulator. 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 nimble, stronger, more efficient and more effective regulator.

Consumer-Focused Exams

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

There are three key reasons we strongly object to these impulses:

1. First, as its mission statement makes clear, the NCUA's exists chiefly to ensure the safety and soundness of the credit union system. Its examination program should remain focused on that primary objective.

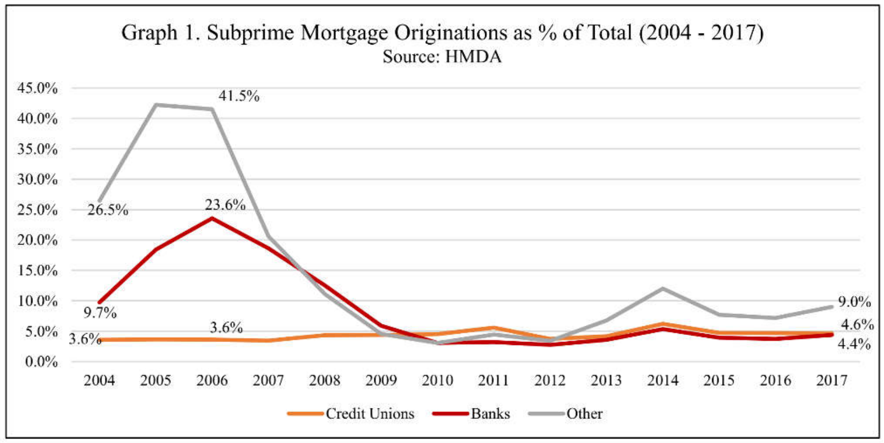
2. Second, the NCUA uncovers and cites occasional individual instances of credit union behaviors and member interactions it deems concerning. This suggests the agency already has—through the risk-focused examination process and consumer complaint hotline—the requisite resources and tools in place to investigate, uncover and evaluate any deficiencies in an individual credit union's consumer compliance program.

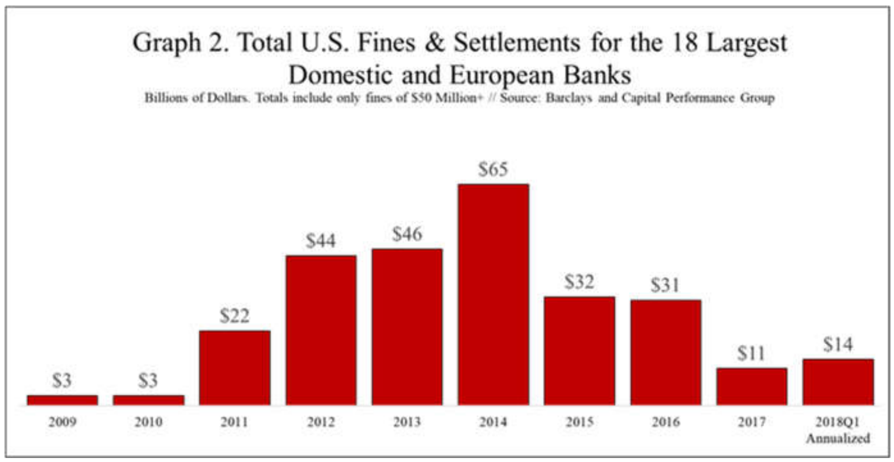
   We assume this is a reasonable conclusion because the NCUA presents no detailed supplementary evidence rationalizing the need for reimagining the current approach to consumer compliance. If the agency is suggesting credit union consumer compliance has become a risk area warranting an increased expenditure of agency resources, then it must show its work. No study that we are aware of reveals credit unions broadly, intentionally engage in behaviors aimed at systemically harming consumers. Individual instances of concern can undoubtedly be cited but these exceptions certainly do not prove the rule.

   Similarly, if anecdotes are to be the basis of decision-making on this topic then the NCUA should collect and report a comprehensive list of all experiences. Just yesterday, we heard from a multi-billion-dollar state-chartered credit union that was written up by a federal examiner (in a preliminary examination report). The examiner uncovered non-compliance with Housing and Urban Development (HUD) rules requiring an Equal Housing Opportunity poster be "*prominently displayed so as to be readily apparent to all persons seeking housing accommodations or seeking to engage in residential real estate transactions.*" The credit union had multiple posters prominently displayed throughout its lobby. However, after actually <u>measuring</u> the credit union's commercially produced and purchased poster the examiner discovered that it was a fraction of an inch shy of the 11"x14" required size. Now, some might say "rules are rules." And some might see the experience as ridiculous—an absurd example of examiners going too far. Perhaps reasonable people can disagree on that point. Generalizing from this anecdote, however, most would probably agree that it does suggest that NCUA examiners are keenly focused on any hint of anti-consumerism and that they take their jobs very seriously.

3. Third, it is important to recognize that the unique credit union member-ownership structure and not-for-profit status establishes powerful incentives that discourage anti-consumer behavior. These underlying characteristics set credit unions apart and encourage strong pro-social and pro-consumer behaviors. They provide a clear and powerful deterrent to anti-consumer behaviors. Does the NCUA really believe that 120 million credit union members need a massive investment of <u>their</u> resources to protect them from the institutions they own?

History provides important clues to that question. One of the most compelling experiences in this regard was seen during the formation of the real estate bubble in 2003-2007. As shown in Graph 1 below, commercial banks and other for-profit lenders (almost exclusively with outside stockholder ownership) greatly increased the share of mortgage loans they originated to subprime borrowers—saddling many of those unsuspecting consumers with loans they simply could not afford. These activities were not simply anti-consumer, they led directly to the global financial crisis and subsequent Great Recession.





In stark contrast, as a group, not-for-profit and member-owned credit unions clearly DID NOT engage in similar behaviors: While bank subprime mortgages ballooned from less than 10% of total originations in 2004 to nearly 25% of total originations by 2006, credit union subprime share of total mortgage originations remained below 5% during the entire run-up to the Great Recession. Unlike banks, credit unions most assuredly put "people before profits." The credit union movement's collective focus on healthy members and healthy communities was on full display.

Within credit unions, the absence of outside owners demanding a market rate of return on the invested capital clearly and powerfully encourages desirable behaviors and clearly and powerfully discourages undesirable behaviors.

It's worth noting that the fall-out associated with bank misdeeds is shown very clearly in Graph 2. U.S. fines and settlements for the 18 largest domestic and foreign banks totaled approximately $260 billion between 2009 and 2018 (a total that includes only fines of $50 million or more). We are not aware of any similar fines paid by credit unions.

An overwhelming majority of CUNA members reflect this resistance to additional NCUA consumer protection oversight.

However, it also is important to emphasize that CUNA has significant concerns around the Consumer Financial Protection Bureau's (CFPB or Bureau) oversight of large ($10 billion+) credit unions. As you know, we believe the CFPB has clear authority to recognize credit unions as distinct from and different than other depository institutions (which is obviously reflected in the example above). The Bureau's refusal to use that authority in any meaningful way is one of our biggest ongoing concerns.

Policy makers have uniformly and consistently acknowledged that credit unions played no role in formation of the housing bubble. They recognize that credit unions behaved responsibly and ethically—and have said so publicly. Yet, the CFPB routinely burdens credit unions (especially the large credit unions under their direct purview) with a wide variety of costly and unnecessary regulations designed to reign-in other bad actors in the banking arena.

In that regard, CUNA supports the NCUA's inclination to have CFPB transfer authority of examinations for credit unions over $10 billion back to NCUA. We thank NCUA for supporting this change. We strongly support it and look forward to the day when credit union members can begin to more fully enjoy the benefits of that change.

Supporting Credit Unions as First Responders

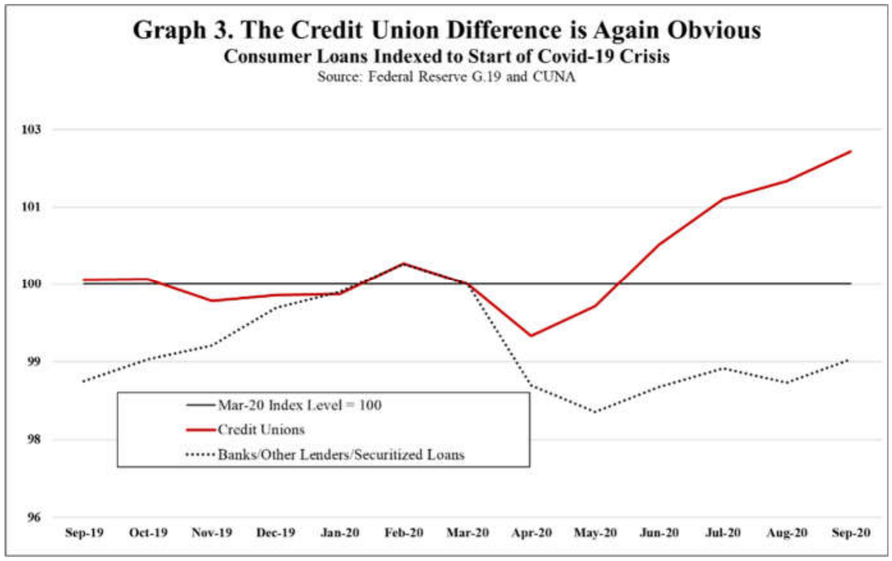
The COVID-19 pandemic and the uncertain economic environment has stressed credit unions. And—as outlined in the Budget Justification document—it might continue to do so. Perhaps in more obvious ways.

The NCUA has been responsive to a variety of CUNA requests throughout the COVID-19 crisis and has worked diligently to help reduce friction and streamline credit union operations and service provision. The agency has consistently listened to ideas and has actively looked for constructive solutions to complex challenges. Your 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 situations with as little disruption as possible. In contrast, for-profit institutions, which generally focus on preserving stockholder value during economic dislocation, have a clear tendency to hunker down and turn borrowers away.

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

Credit union performance during the current COVID-19 crisis also stands out. While we do not have monthly data on mortgage market trends, comprehensive data from the Federal Reserve's G.19 Consumer Credit release (which includes loans and securitized loans) shows a similar pattern to what we saw in the Great Recession: As shown in Graph 3, credit union loans have generally increased while loans at other providers have generally declined.



Further, 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 (PPP) loans totaling $10 billion. The typical credit union PPP lender reported a loan size of $49,000—less than half the size reported by banks—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.[1]

We recognize the critical importance of NCUA's commitment to view credit union financials in the context of member service during the pandemic and as the economy recovers. And we fully support the agency's continued provision of regulatory relief to reduce the burden on credit unions and facilitate the flow of credit and liquidity within the system.

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.

Average working Americans need help—and especially during economic disruption and crisis. But they will get less help—not more—if the credit union prudential regulator starts with a false presumption that there are essentially no meaningful behavioral differences between credit unions and banks.

Our members believe strongly that credit union regulators must resist any temptation to view the institutions they supervise through the same lens used by regulators in the banking arena.

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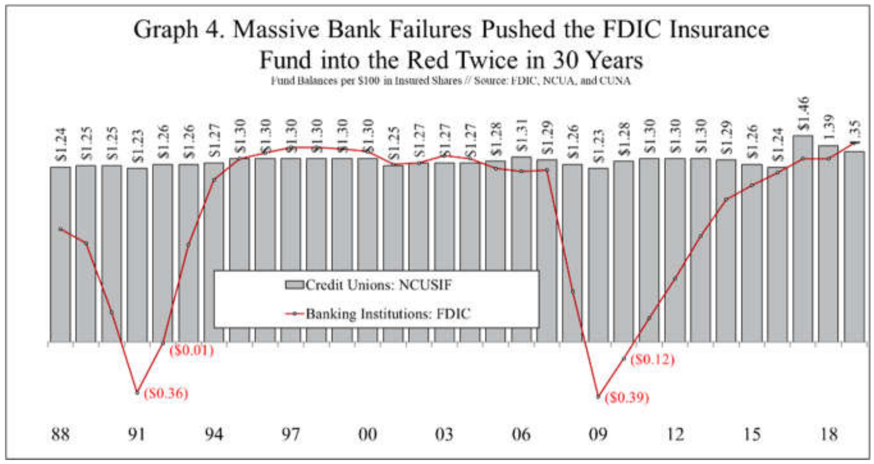
[1] Shevlin, Ron. 2020, July 13th. Forbes. *PPP Loans: Who Got What And How Well Did The Loans Perform?*

And they 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 **<u>they</u>** do—resisting the temptation to pursue legislation that transforms the National Credit Union Share Insurance Fund (NCUSIF) into a bank-like entity and committing to reduce the Normal Operating Level to a level closer to its 1.30% historic norm.

As shown in Graph 4, the Federal Deposit Insurance Corporation (FDIC) operated in the red twice over the past thirty years, while the NCUSIF has never finished a year below 1.20% over that period of time. In addition, collecting premium assessments has never been an issue historically—even in the toughest of 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.



Graph 4. Massive Bank Failures Pushed the FDIC Insurance Fund into the Red Twice in 30 Years

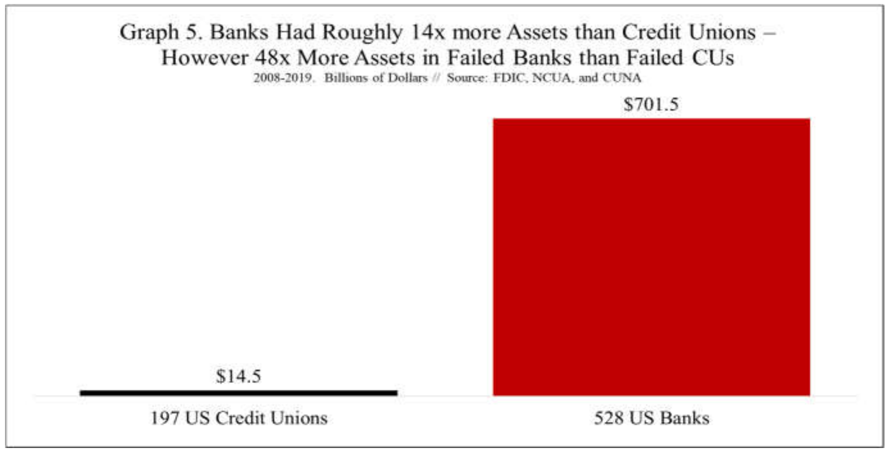
Some view this record and object. During the Great Recession, they say, without Corporate Stabilization, the NCUSIF (like the FDIC) would have also surely operated in negative territory. This is a false equivalence and (more importantly) it distorts the NCUSIF's current exposure to risk.

First, it is important to note that when the FDIC plummeted into negative territory during the recession in the early 1990s—the NCUSIF remained in positive territory without any assistance whatsoever.

Second, during the 2007-2010 cycle, corporate credit unions held tens of billions in assets with significant inherent risk (including substantial exposures to credit risk, liquidity risk and interest rate risk). At the time, corporate credit unions were thinly capitalized and provided little buffer to the insurance fund. They represented a substantial NCUSIF exposure but provided little capital to offset that exposure.

That is certainly **not** the case today. There can never and will never be an event like the movement's experience during the Great Recession because corporate credit union risk exposure to the NCUSIF—evident in 2007—was essentially eliminated with corporate operational and financial reforms in the wake of the crisis. This, of course, means—all else equal—a NCUSIF fund equity ratio of 1.30% today would be substantially more effective—providing substantially more protection—than the 1.29% equity ratio that existed at the start of the Great Recession (at year-end 2007).

Any serious evaluation of NCUSIF performance during the Great Recession requires isolating natural person credit union performance from corporate credit union performance for an appropriate apples-to-apples historical comparison. Doing this admittedly reveals a lower fund equity ratio than suggested in Graph 4. But it also reflects a fund that operated in the black throughout the financial crisis. It is certainly true that nearly fifteen natural person credit unions with more than $1 billion in assets were severely stressed in the Great Recession. But it is also true that only one natural person credit union with more than $1 billion actually failed in the wake of that recession.



Between 2008 and 2019, banks collectively reported an average of fourteen times more assets than natural person credit unions reported. As shown in Graph 5, however, during the Great Recession and in the years that followed, U.S. banks collectively reported assets in failed institutions that were forty-eight times greater than the assets in failed natural person credit unions.

Finally, when evaluating FDIC performance during the Great Recession and its aftermath it seems reasonable to adjust for the federal government's Troubled Asset Relief Program which provided the banking industry with $250 billion in support via the Capital Purchase Program, Targeted Investment Program and Asset Guarantee Program. In the absence of that support the disparities in FDIC and NCUSIF performance would have been substantially more pronounced.

There is an exceedingly high price associated with attempting to construct a "bullet proof" Share Insurance Fund that will withstand any stress without the need for an insurance premium. Ultimately, that cost is borne by credit union members—who forego significant benefits. All evidence suggests that the NCUSIF is well-positioned to operate effectively within its current construct and at a modestly lower normal operating level that is closer to historical norms.

Field of Membership

Finally, CUNA sincerely hopes the NCUA will use the COVID-19 crisis as a reference point for additional meaningful field of membership (FOM) reform. This issue is not fully explored in the budget document. But it is clear, the COVID-19 crisis has exposed fundamental 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 vulnerable.

The concept of FOM was conceived roughly a century ago 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.

The concept of FOM is not essential to what a credit union is and, in practice, it not only hinders credit unions' ability to improve financial well-being for all but it can expose the Share Insurance Fund to unnecessary risk.

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. The FOM changes the NCUA has implemented have been impactful and beneficial—but we believe more can and should be done.

In closing, I would like to reiterate CUNA's belief that seeking and considering industry feedback prior to proposing regulations, adopting strategic initiatives, and producing detailed budgets helps ensure that those activities are better understood by all stakeholders. Ultimately, this means that they will be more effective.

The NCUA Board—in its approach to the budget process—recognizes and embraces that idea and we encourage continued dialogue and focus on efficiencies and cost savings that allow credit unions to do what they do best: effectively serve and improve the financial health of millions of Americans.

On behalf of America's credit unions and their more than 120 million member-owners, thank you very much for your consideration of our views.

Sincerely,

Michael Schenk

Mike Schenk
Deputy Chief Advocacy Officer for Policy Analysis and Chief Economist