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NASCUS History and Purpose

Good morning, Chairman Shelby, and distinguished members of the Committee on Banking, Finance and Urban Affairs. I am Linda Jekel, Director of Credit Unions for the Washington Department of Financial Institutions and the chair of the National Association of State Credit Union Supervisors (NASCUS). I appear today on behalf of NASCUS, which represents the 48 state and territorial credit union agencies that charter and supervise the nation's more than 3,600 state-chartered credit unions. NASCUS is advised by the NASCUS Credit Union Advisory Council, composed of more than 500 state-chartered credit union chief executive officers dedicated to defending the dual chartering system for credit unions.

Since its inception in 1965, the mission of NASCUS has been to enhance state credit union supervision and regulation and to promote policies that ensure a safe and sound state credit union system. NASCUS is the sole organization dedicated to the promotion of the dual chartering system and to advancing the autonomy and expertise of state credit union regulatory agencies. We achieve these goals by serving as an advocate for a dual chartering system that recognizes the traditional and essential role that state government plays in the national system of depository financial institutions.

NASCUS appreciates this Committee's commitment to regulatory relief for financial institutions. We believe it is an important part of ensuring a safe and sound environment for credit unions and the consumers they serve.

We have provided input for the financial services regulatory relief matrix, started during the 108th Congress. We are pleased to have this additional opportunity to share our priorities for regulatory relief. When drafting regulatory relief legislation, we encourage Committee members to consider the provisions we present.

NASCUS Priorities for Regulatory Relief

The financial services regulatory relief matrix details 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 address regulatory relief provisions that are vital to the future growth and safety and soundness of state-chartered credit unions. They are as follows:

- Reforming credit union capital.

- Providing for representation on the NCUA Board by an individual with state credit union regulatory experience.
- Allowing non-federally insured credit unions to join the Federal Home Loan Banks (FHLBs).
- Expanding member business lending provisions to 20 percent of total assets of a credit union, furthering the goal to provide loans for consumer members.
- Amending the definition of a member business loan (MBL) from $50,000 to at least $100,000.
- Providing Securities and Exchange Commission (SEC) regulatory modernization for credit union parity with other financial institutions;
- Preserving the dual chartering system and protecting against the preemption of state laws.
- Converting a state-chartered credit union to another financial institution charter is a matter that should be determined by state law and regulation, not dictated in federal legislation.

Credit Union Capital Reform

Credit unions need capital reform in three distinct areas. First, the definition of net worth in the Federal Credit Union Act (FCUA) should be changed to include more than just retained earnings; second, credit unions need access to risk-based capital; and third, credit unions should have access to alternative capital. From a state regulatory perspective, capital reform that addresses these three issues makes logical sense for the safety and soundness of credit unions and the members they serve.

Amending the definition of net worth in the FCUA

To begin, credit unions need an amendment to the Prompt Corrective Action (PCA) provision of the FCUA. This amendment would obligate federally insured credit unions to include all forms of capital when calculating the required net worth ratio. Under the current federal statute, credit union net worth is defined as and limited to retained earnings.

The exclusive reliance on retained earnings limits a credit union's ability to implement new programs or expand services to meet the changing needs of American consumers within its membership. The failure to authorize these credit unions to include all forms of capital in their PCA net worth calculation distorts the credit union's actual financial position. NASCUS believes this change has been necessary since 1998, when the current PCA standards for credit unions were established in federal statute. We have consistently noted this important provision in prior testimony, as well as in the financial services regulatory relief matrix.

NASCUS is encouraged by the May 2005 American Institute of Certified Public Accountants (AICPA) letter to the NCUA acknowledging the disparity in regulatory reporting among insured institutions. AICPA correctly recognizes that credit unions may use only retained earnings when calculating net worth. Further, it noted that all other federal agencies recognize total equity as determined in accordance with GAAP, as a basis for calculating regulatory capital. In addition, the AICPA further states that retained earnings are only one component of GAAP equity.

NASCUS supports this position and firmly believes that the equity section of a credit union's balance sheet should include more than just retained earnings. NASCUS asks for this Committee's support in amending the definition of net worth in the FCUA to include more than retained earnings. This would provide consistency in capital standards with the other federally insured depository institutions. In addition, it would allow credit unions to better serve their members.

Addressing the Unintended Consequences of FASB Standard No. 141

Another benefit to amending the definition of net worth is that it will cure the unintended consequences for credit unions of the Financial Accounting Standards Board (FASB) amendments to business combination accounting rules. FASB's Financial Accounting Standard No. 141 would require the acquisition method for business combinations and effectively eliminate the pooling method for the combinations of mutual enterprises.

In brief, the acquisition accounting method would require the valuation of the target credit union at fair value, the recognition of identifiable intangibles, when relevant (i.e., core deposit intangibles and/or goodwill), and the application of a market-based acquisition model to a non-bargained transaction. The retained earnings of the merging institution would no longer be combined with those of the continuing credit union. This creates a potentially significant dilution of statutory net worth and an unintended impediment to credit union mergers. Mergers are a safety and soundness tool both federal and state regulators use to protect funds deposited by American consumers and to preserve the National Credit Union Share Insurance Fund (NCUSIF).

NASCUS is pleased by the introduction of H.R. 1042, and its passage in the House of Representatives. The legislation amends the definition of net worth to include the net retained earnings of a merging credit union with that of the surviving credit union. We understand that H.R. 1042 has been forwarded to the Senate Committee on Banking, Housing and Urban Affairs for review. Similar language is also included in provision number 24 in the regulatory matrix.

There are important reasons to address the consequences of FASB Standard No. 141. As a regulator, it concerns me that credit unions cannot be merged due to PCA concerns caused by the inability to add the capital of a merged credit union. This may cause credit unions in a weakened condition to face liquidation. There may also be more requests for NCUA to provide financial assistance in merger transactions. An increase in liquidations may cause greater reputation risk, severe loss of confidence for the credit union industry, greater losses to the NCUSIF and increased costs to the industry and ultimately to consumers. It eliminates an important tool for regulators when we have to determine the most appropriate method to handle a troubled credit union; a method that has the least impact on American consumers.

The entire credit union community agrees on the importance of this provision. It is also included in Section 104 in H.R. 2317 and in Section 314 of H.R. 3505. We respectfully request this Committee introduce similar provisions in the regulatory relief bill that is currently being drafted. Hopefully, the consequences of FASB 141 will soon be resolved.

Risk-Based Capital

NASCUS has a long-standing policy supporting risk-based capital for credit unions. Risk-weighted capital reform should be flexible. NASCUS believes that any new 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. Today, every insured depository institution, with the exception of credit unions, uses risk-based capital to successfully build and monitor capital levels. In fact, after more than 15 years of successfully applying risk-based capital, the financial community is devising methods to make risk-based capital an even better tool. Risk-based capital enables financial institutions to measure capital adequacy and to avoid additional risk on their balance sheets. It is a system that acknowledges diversity of complexity in financial institutions. It provides for increased capital levels for financial institutions that choose to maintain a more complex balance sheet, while reducing the burden of capital requirements for institutions with less complex assets.

NASCUS supports a risk-based capital plan. We believe additional enhancements that work in tandem with risk-based capital would be prudent and provide even greater safety and soundness for credit unions. NASCUS' support of risk-based capital is reflected in the financial services regulatory relief matrix.

Alternative Capital for Credit Unions

We support capital reform beyond risk-weighted capital and a FASB merger fix. NASCUS believes that an important part of capital reform is providing credit unions access to alternative capital. We believe that alternative capital authority and a risk-based system are complementary capital reforms. The combination of current PCA requirements and a potentially changing economic landscape create a regulatory dilemma for many state-chartered credit unions. As noted above, the FCUA defines credit union net worth as retained earnings. The NCUA has 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 FCUA to rectify this statutory deficiency.

NASCUS has long supported the concept of alternative capital for credit unions. After study, NASCUS created a white paper illustrating both equity and debt models for alternative capital. NASCUS believes that alternative capital is a viable method for credit unions to build net worth. The white paper demonstrates this belief. (Please find a copy of the white paper at the end of the NASCUS testimony.)

Additional Reasoning for Alternative Capital

Some state-chartered credit unions have indicated that alternative capital is necessary for them to continue meeting the financial needs of their members in a changing financial environment. This is especially true for credit unions striving to understand and meet specific member needs. These needs can include financing for home ownership, financial education and even credit counseling, each an important component of managing one's personal finances.

We believe that even with the lower leverage ratio and risk-based capital proposed in H.R. 2317, some state-chartered credit unions may not be able to rely solely on retained earnings to meet the capital base required by PCA standards. As credit unions expand and serve the needs of more consumers, their assets grow. When assets grow, credit unions experience reduced net worth ratios as earnings retention lags growth in assets.

From a regulatory perspective, it makes sound economic sense for credit unions to access other forms of capital to improve their safety and soundness. We need to take prudent steps to strengthen the capital base of this nation's credit union system. NASCUS requests your support in providing credit unions with access to alternative capital. Alternative capital for credit unions should be included in regulatory relief legislation proposed by this Committee.

Strong capital reform requires that state and federal regulators work together. In 1998, the Credit Union Membership Access Act (CUMAA), H.R. 1151, provided that NCUA consult and cooperate with state regulators when constructing PCA and member business lending (MBL) regulations, as required by the FCUA. NASCUS always stands ready to discuss and assist in the implementation of new regulations affecting state-chartered credit unions. We firmly believe that cooperation results in better regulation and a stronger and safer credit union system.

Representation on the NCUA Board

NASCUS included a provision in the financial services regulatory relief matrix that would amend the FCUA to require that one NCUA Board member shall have state credit union regulatory experience.

We believe this will result in better regulation and a stronger and safer credit union system. About forty percent of credit unions are state-chartered. The majority of them have federal insurance provided by the NCUSIF. This fund is managed by the NCUA. We believe that comprehensive experience in regulating state-chartered credit unions would provide a more balanced perspective when overseeing the NCUSIF. In addition, as the NCUA promulgates regulations to further safety and soundness, a person with state-chartered credit union supervisory experience will greater understand how proposed regulations will impact state-chartered, federally insured credit unions.

This is not a new idea. A similar provision requiring state bank supervisory experience is included in Section 1000 of the Federal Deposit Insurance Act.

We believe a person with state regulatory experience will create an even stronger and safer credit union system, and we would appreciate your support for this provision.

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

As NASCUS has noted since the creation of the financial services regulatory relief matrix, not all credit unions operate with access to the same benefits. Federally insured credit unions have access to the Federal Home Loan Banks (FHLBs), while privately-insured credit unions do not. NASCUS supports non-federally insured credit unions being eligible to join the FHLBs. This provision is included in H.R. 2317.

Today, there are approximately 200 credit unions that are non-federally insured. These credit unions are regulated and examined by state regulatory agencies to ensure they are operating in a safe and sound manner. Regulatory functions are a primary determinant of the safety and soundness of the credit union system. The function of the credit union regulator is to assure consumers that their deposits are safe and sound. This is accomplished through regulatory action, the examination process and by taking enforcement actions, when necessary.

Nine state legislatures have made private insurance available to their state-chartered credit unions. NASCUS promotes the rights of state legislators to determine what is in the best interest for state-chartered credit unions in their state.

If a state determines that state-chartered credit unions should have access to private insurance, NASCUS supports its decision. NASCUS does not advocate for private insurance; however, we do believe in the rights of state legislators to determine if state-chartered credit unions in their state should have access to private insurance.
These credit unions should be allowed access to the same privileges as their federally insured counterparts (the competition down the street with federal insurance).

Both federal and private share insurance systems have been established to protect credit union shareholders. To manage and price insurance risk, each share insurer relies significantly on the examination reports of the institution's primary regulator. Nearly all state credit union agencies use the NCUA Automated Integrated Regulatory Examination Software (AIRES) examination platform when they examine state-chartered credit unions for safety and soundness purposes. NASCUS agencies participate in the development and testing of NCUA's AIRES examination program and procedures. In short, there is an excellent working relationship between NASCUS agencies and the NCUA, as well as substantially similar examination standards for both federally and state-chartered credit unions.

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

FDICIA also dictates the manner and extent to which institutions opting for private deposit insurance disclose fully that their deposits are privately insured. Therefore, there should be no concern that these credit unions are not operated in a safe and sound manner.

Permitting non-federally insured institutions to join the FHLB System would not establish a new precedent. When the Federal Home Loan Bank Act of 1932 was passed, insurance companies were allowed access to the system. At the time, they were a means to mortgage lending. Insurance companies continue to have access to FHLB system. Insurance companies have never been federally insured; they are state chartered and regulated by state governments without federal oversight or insurance.

As of December 31, 2005, 111 insurance companies enjoyed access to the FHLB system. There are no federally insured insurance companies, negating the argument that insurance status is the reason institutions may or may not have access to the FHLB system.

Access to the FHLB system brings many safety and soundness benefits, including the ability to borrow funds and better manage assets and liabilities. And, providing access to state-chartered privately insured credit unions does not inflict any new or unusual exposure on the FHLB system.

Moreover, it provides an additional layer of financial analysis and market discipline for privately insured credit unions. The FHLB system performs ongoing credit analysis of members, particularly for those who borrow. Each FHLB 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. Indeed, even during the savings and loan debacle, we understand that no FHLB suffered a loss on advances extended to their members.

NASCUS believes that credit unions in states that allow private insurance should not be disadvantaged by a lack of access to the FHLB System and the benefits it provides. A credit union's choice of insurance should not determine its access to a wholesale lending system that would allow it to best serve its members.

In the past, Congress has expanded the membership eligibility for the FHLB system to help local financial institutions meet the housing and home ownership needs of their communities. Enabling state-chartered, privately insured credit unions to be eligible to join the FHLB System, is merely one more step in making home ownership a reality to credit union members. We urge the Committee to include this provision to help achieve our nation's housing and home ownership goals.

Expanding Member Business Lending Authority

Regulatory relief is important for credit unions in the area of member business lending. NASCUS has a vision of providing well-thought-out member business lending regulations to best position credit unions to serve their members. The financial service regulatory relief matrix includes the following provisions, which are also included in H.R. 2317.

Title II of H.R. 2317 provides an opportunity for economic growth for credit unions through member business lending. Credit unions should be given greater authority to meet their member business lending needs; this better positions them to service consumers. Raising the statutory limit on credit union MBLs to 20 percent of total assets, as proposed in Section 201 of H.R. 2317, facilitates member business lending without jeopardizing safety and soundness at participating credit unions.

Further, we support Section 202 of H.R. 2317, which amends the current definition of an MBL by granting NCUA the authority to exempt loans $100,000 or less. This increases the definition of business loans subject to the current amount of $50,000 to $100,000. We urge that the statutory definition of a credit union MBL be changed from the current $50,000 limit contained in the FCUA. In fact, we support redefining credit union MBLs to the Fannie/Freddie conforming loan limit of $417,000, increased in January 2006. We believe this is a safe and sound, well established and readily understandable index that has served lenders and the public interest well for many years.

Both of these provisions provide credit unions with regulatory relief as it concerns member business lending. We request that these provisions be included in regulatory relief bill drafted by this Committee. Additionally, you will find these provisions in the financial services regulatory relief matrix.

Regulatory Modernization

It is time to update regulations to reflect parity of treatment between credit unions and other financial institutions. It makes sound business sense and provides for equitable competition. NASCUS supports the following provisions, as included in the financial services regulatory relief matrix.

NASCUS believes that all federally insured credit unions should have the same exemptions as banks and thrift institutions from Federal Trade Commission pre-merger notification requirements and fees, a requirement of the Clayton Act. In fact, we believe this provision should be expanded to include all state-chartered credit unions. This provision is in Section 311 of H.R. 2317 and in Section 312 of H.R. 3505.

Additionally, NASCUS supports providing federally insured credit unions parity treatment with commercial banks with regard to exemptions from SEC registration requirements. Banks were provided these exemptions in the Gramm-Leach-Bliley Act. NASCUS is pleased this provision is included in Section 312 of H.R. 2317 and in Section 313 of H.R. 3505.

If state-chartered credit unions are not accorded the same SEC treatment as commercial banks and savings institutions, we believe the powers granted to credit unions by state legislatures and state regulators might be unnecessarily preempted by SEC regulation. Unless appropriate regulatory relief is provided, credit unions offering these services may be subject to redundant and costly examination. We urge that credit unions be accorded similar regulatory treatment as other financial institutions.

Federal Preemption of State Regulation

The debate about state and federal powers is not a new discussion. I can imagine our founding fathers in 1787 at the Constitutional Convention participating in many healthy debates about how to protect the powers of the states. The question confronting our founding fathers was how to limit the central government's power so it could not take away from people's rights.

Today, we are confronted by this same issue. In fact, preventing federal preemption of state laws and regulations continues to be a priority for state legislatures and state regulators. Federal preemption overrides states' rights in several fundamental ways. It preempts state legislatures from creating laws for the citizens of a state. Potentially, laws that override state laws and regulations affecting the consumers in a state could be decided by individuals not elected by the citizens of a state. Preemption does not stop here; it has the potential to stop a state's Governor, a state's Attorney General and a state's financial regulators from making decisions for their state. NASCUS believes states are in the best position to decide the laws and regulations for consumers in their states.

NASCUS is uncomfortable with federal rulemaking that preempts state authority or the trend of federal banking authorities to preempt state consumer protection. Such initiatives have been touted as establishing exclusive national standards for regulating almost all aspects of consumer lending practices. We believe it overrides state law and provides less protection for consumers. NASCUS is concerned that there may be a contagion impact on the credit union dual chartering system as the powers of the state banking regulators are curtailed.

Each time a federal agency acts to preempt state law, it is a chink in the armor of state protections that our founding fathers sought to preserve. It threatens the dual chartering system as we know it. Congress should resolve the conflicts rather than delegate these fundamental issues to the federal financial institution regulators to determine.

When I think of dual chartering of financial institutions, I think of strong communities. I think of economic enhancements and job creation. Dual chartering and the state supervision that comes with it have been essential elements of the credit union system since its beginning. State credit union regulatory agencies have been instrumental in making new rules and regulations that have influenced even the federal credit union system. States have rightfully been called the laboratories for innovation. Federal preemption takes away innovations created by the state system.

One current issue confronting the credit union system is credit union conversions to mutual savings banks. NASCUS believes that state law should dictate the conversion process for state-chartered credit unions, as well as the terms and conditions that allow state-chartered credit unions to terminate federal insurance.

The chartering of a state credit union is an issue determined by state law. Approval authority for a conversion is determined, likewise, by state law, which typically authorizes the state chartering authority to determine if a credit union may convert and the processes for a conversion. A conversion is a function of a credit union's original charter, separate from insurance oversight. As we have learned from recent events, NCUA regulations dictate disclosures and approval authority for state-chartered credit union conversions.

NASCUS asks for this Committee's support in changing conversion rules that would place the responsibility on the chartering authority. The authority for federal credit unions resides with the federal regulator; likewise, the authority for state-chartered credit unions should reside with state regulators.

Conclusion

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

- NASCUS supports amending the definition of net worth in the FCUA to include more than just retained earnings.
- NASCUS supports amending the definition of net worth to include the retained earnings of a merging credit union with that of a surviving credit union, as included in both H.R. 1042, Section 104 of H.R. 2317 and in Section 314 of H.R. 3505.
- NASCUS supports a risk-based capital regime for credit unions.
- NASCUS believes credit unions should be permitted to issue alternative capital. NASCUS proposes three alternative capital models in its white paper that preserve the not-for-profit structure of credit unions.
- NASCUS supports representation on the NCUA Board by an individual with state credit union regulatory experience.
- NASCUS believes non-federally insured credit unions should be eligible to join the FHLBs.
- NASCUS supports expanding member business lending provisions to 20 percent of total assets of a credit union, furthering the goal to provide loans for consumer members. This is also included in Section 201 of H.R. 2317.
- NASCUS supports amending the definition of a member business loan from $50,000 to at least $100,000, as included in Section 202 of H.R. 2317.

- NASCUS supports that all federally insured credit unions should have the same exemptions as banks and thrift institutions from FTC pre-merger notification requirements and fees. Additionally, we support expanding this provision to include all state-chartered credit unions. This provision is in Section 311 of H.R. 2317 and in Section 312 of H.R. 3505.

- NASCUS supports amending the definition of bank in the SEC Act of 1934 to provide federally insured credit unions with the same registration exemptions as those provided to commercial banks. This provision is included in Section 312 of H.R. 2317 and in Section 313 of H.R. 3505.
- NASCUS encourages Congress to intervene and block the continuing preemption of state laws.
- NASCUS believes that the process for converting a state-chartered credit union to another financial institution charter is a matter that should be determined by state law and regulation, not dictated by federal legislation.

NASCUS appreciates the opportunity to testify today and share our priorities for regulatory relief. The provisions discussed are outlined further in the financial services regulatory relief matrix. In addition, we attached a copy of the NASCUS white paper about alternative capital at the end of our testimony.

We urge this Committee to protect and enhance the viability of the dual chartering system for credit unions by acting favorably on the provisions we have presented in our testimony. We welcome questions from Committee members.

Thank you.