



*Testimony of*

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*on Behalf of*

The National Association of Federal Credit Unions

"H.R. 2351, The Credit Union Share Insurance Stabilization Act"

Before the

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Subcommittee on Financial Institutions and Consumer Credit

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### *Introduction*

Good afternoon Chairman Gutierrez, Ranking Member Hensarling and Members of the Subcommittee. My name is Jim Bedinger and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the Chief Operations Officer (COO) of Chicago Patrolmen's Federal Credit Union, headquartered in Chicago, Illinois. I have been COO of Chicago Patrolmen's FCU for the last four years, have worked at the credit union for the last 12 years, and have been in the credit union community for the last 15 years. Chicago Patrolmen's FCU field of membership includes all Chicago Police Officers, regardless of their rank, all full-time civilian employees of the Chicago Police Department and the Office of Emergency Management (911 Center), and all employees of the credit union. The credit union has some 20,800 members and assets of \$318 million. Chicago Patrolmen's FCU offers a broad range of products and services to our members, including a Financial Planning and Education Center, which offers both investment services and free financial counseling for all members.

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 share insurance corporate credit union 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 90 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 they did in 1934:

- credit unions remain fully 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 all of 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, institutions insured by the Federal Deposit Insurance Corporation (FDIC) 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 to \$1.672 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 when compared with banks. Even the world’s largest credit union, Navy Federal Credit Union, with \$36.4 billion in assets, is dwarfed by the nation’s biggest banks, which hold 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.

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 as indicated by recent consumer satisfaction surveys.

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 their mortgage purchase loans (20.8 percent) charging at least 3 percent higher than the comparable Treasury yield to minority applicants with household income under \$40,000. Credit unions, on the other hand, had only 4.4 percent of their mortgage purchase loans charging the higher interest rate in to the same applicant category.

***The National Credit Union Share Insurance Fund (NCUSIF)***

I would like to share with the subcommittee how the National Credit Union Share Insurance Fund (NCUSIF) is structured, and our assessment of the current challenges facing credit unions and their impact on the fund.

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 just three years later, in 1970. Like the credit unions whose accounts it insures, the NCUSIF itself is *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, meaning that the source of funding was based on premiums collected from insured institutions. In 1985, the amount of money at the NCUSIF began to dwindle as a result of losses, low earnings on investments and extensive growth in credit union insured savings. Credit unions realized that the NCUSIF needed to be recapitalized, and in 1985, every insured credit union made a deposit of one percent of its members' insured savings to the NCUSIF. By making this deposit, the mutual or cooperative structure of the NCUSIF began. As of March 2009, the NCUSIF has \$23.4 billion in total assets with a total equity of \$8 billion. As a percentage of total insured savings, the NCUSIF has an equity ratio of 1.3 percent.

Credit unions insured by the NCUSIF are required by statute to maintain an “insurance deposit” equal to one percent (1%) of their 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)) on an annual basis. If the equity level of the NCUSIF is in the 1.2 percent to 1.3 percent 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 percent, the statutory floor, the NCUA Board is required to assess an insurance premium to restore the fund to a 1.2 percent equity level (12 USC 1782(c)(2)(C)).

### *Current Challenges*

While the credit union industry has fared much better than most financial institutions in these turbulent economic times, many individual credit unions 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 in January 2009, NCUA noted 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.” 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 “all” the uninsured shares of corporate credit unions (i.e. shares owned by natural person 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). NCUA subsequently extended the program to accommodate a two-year rolling expiration date and provide the option of quarterly extensions through December 2012. If the option to extend each quarter is fully utilized, the final guarantee would expire December 31, 2014;

- 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.

Additionally, the NCUA contracted with Pacific Investment Management Company LLC (PIMCO) to perform an analysis on the portfolios of U.S. Central Federal Credit Union and Western Corporate Federal Credit Union. The resulting analysis led the NCUA to estimate that the resulting impact on the NCUSIF will be approximately \$5.9 billion, dropping the NCUSIF's equity ratio to an estimated 0.31 percent. PIMCO's analysis also provided a range of possible results, which included the possibility that the impact could be greater than \$5.9 billion. Because credit unions follow Generally Accepted Accounting Principles (GAAP), there is an immediate impairment to the one percent deposit. FICUs have to recognize this impairment by setting aside enough money in a contingency liability account to bring the deposit at the NCUSIF back to the one 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 the NCUA, absent legislation, will bring the NCUSIF equity ratio up to 1.3 percent by assessing a premium of



0.3 percent later this year. The impairment and the premium combined will have an approximate 99-basis-point impact on all natural person credit unions in 2009.

The consequence of the 99-basis-point impact is that over 6,000 federally-insured credit unions (approximately 77.4 percent of all FICUs) will be in the “red” in 2009. Approximately 310 FICUs will be downgraded in their Prompt Corrective Action (PCA) levels, which could lead to further NCUA actions to help stabilize those institutions.

NAFCU’s analysis of fourth 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. With a \$5.9 billion reduction 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 reduce total lending by \$41.3 billion, further adversely impacting the economy as the nation strives to rebound from its current economic malaise. At Chicago Patrolmen’s, we estimate that the expense to us of this approach is approximately \$2.24 million, meaning we could face nearly \$14 million in decreased lending capacity to our members in the Chicago area this year.

Given the fact that credit unions provide the funds to operate the NCUA and the significant impact stabilization of the corporate credit union system is having on the credit union community, NAFCU believes it is imperative that the NCUA provide full and open transparency about its actions leading up to and throughout the resolution of the current situation. This should include details of how

NCUA reached the \$5.9 billion figure and the cost to the NCUA of its actions in this regard, since it will impact natural person credit unions (this cost is borne by them, and ultimately their members).

### ***The Credit Union Share Insurance Stabilization Act***

When the NCUA first announced its corporate stabilization plan in late January, NAFCU immediately recognized the detrimental impact it could have on natural person credit unions and strongly urged the NCUA to seek additional legislative solutions to ease the burden, including examining ways to use existing mechanisms such as the Central Liquidity Facility (CLF) or to create new mechanisms such as a stabilization fund. We are pleased that on March 26, Chairman Fryzel and the NCUA Board submitted an alternative proposal to Congress to create a temporary corporate credit union stabilization fund, and we are grateful to Chairman Paul Kanjorski, Chairman Gutierrez, and Representatives Scott, Royce and LaTourette for introducing H.R. 2351, the *Credit Union Share Insurance Stabilization Act*.

NAFCU supports this legislation and urges the immediate adoption of the temporary corporate credit union stabilization fund proposal and updates to the share insurance fund contained in H.R. 2351. NCUA's borrowing authority has not been updated since 1971 and the current \$100 million limit has not been modified for the growth of credit unions and their member deposits over time. Establishing a restoration plan to rebuild the Share Insurance Fund within eight years (or such longer period as the NCUA Board may determine to be necessary due to extraordinary circumstances) will allow the NCUA Board to ease the burden on credit unions when the fund experiences a drop, while limiting any potential negative "ripple" throughout the credit union community that the current one-year restoration would otherwise create.

We would offer two suggested changes to improve the bill's ability to help natural person credit unions. First, we urge an increase in initial NCUA borrowing authority from \$6 billion to \$10 billion. Second, we ask that the repayment period for the stabilization fund be extended to eight years. By lengthening the repayment term of the stabilization fund, Congress would help credit unions focus more of their resources on making loans that will strengthen the economy, rather than having to divert more resources annually to the fund, and would provide increased flexibility should the economy continue to deteriorate.

While NAFCU is pleased the legislation would increase in emergency borrowing authority for the NCUSIF to \$30 billion, we urge the House to adopt a higher initial borrowing authority of \$10 billion. This change is long overdue, 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. While NCUA's initial request for borrowing authority was only \$6 billion, we believe more prudent action would be to enact an amount of \$10 billion, in case additional factors emerge that would increase the current estimate of \$5.9 billion. The extended emergency borrowing authority of up to \$30 billion will help ensure the NCUA has the tools it needs should a new crisis emerge in these difficult times and serves as an important addition to the legislation.

If these provisions were to be enacted, NAFCU believes it is important that the agency provide clarification on how credit unions would treat or reverse the present write-down resulting from the impairment of the one percent NCUSIF deposit, if and when the NCUSIF is no longer impaired.

This is an important issue given NCUA's recent guidance regarding treatment of the impairment in the current environment.

*Additional Changes to the Corporate Credit Union System*

The corporate credit union system is an important resource for natural person credit unions. At Chicago Patrolmen's FCU, we are members of two corporate credit unions. We use over two dozen corporate services that are key to providing many of the services we offer to our membership. We employ them for electronic services such as the Automated Clearing House, funds transfers, wire transfers and more. We also use savings and lending products and services, check clearing/payment services, investment services, and lines of credit, and we have used them for consultation and asset liability management services. We currently have approximately \$45 million in overnight accounts and certificates. This is in addition to the \$1.5 million of Membership Capital Shares in Members United Corporate and \$900,000 in Corporate One.

NAFCU believes that the NCUA and Congress should work to find additional ways to help stabilize and strengthen the corporate credit union system as well. Going forward, other changes such as a modernization of the Central Liquidity Facility (CLF) should be examined. 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 but cannot loan directly to corporate credit unions. We believe some changes to the FCUA to allow the CLF to directly help the corporate credit union system and a modernization of the CLF's operations could help address future challenges when they occur.

NAFCU also supports separating the risk of insuring member shares at corporate credit unions with the risk of insuring member shares at natural person credit unions. It is NAFCU's belief that the industry-wide crisis has made it apparent that the risks posed by corporate credit unions and natural person credit unions are so different that it is no longer advisable for NCUA to insure them under one share insurance structure, without implementing additional measures to protect natural person credit unions. We have asked the NCUA to create a permanent buffer between the corporates and natural person credit unions, either through a proper capital regime or other mechanism.

*NAFCU's Corporate Credit Union Task Force and NCUA's ANPR*

After NCUA released its Advance Notice of Proposed Rulemaking (ANPR) on corporate credit unions in January, the NAFCU Board of Directors appointed a task force to examine the various issues surrounding corporate credit unions addressed in the ANPR and construct principles on which NAFCU would base its comments. The principles, which were refined by the NAFCU Board of Directors, are set out below.

- *Corporate credit unions should continue to serve the liquidity and operational/payment systems needs of natural person credit unions.*

1. Any solvent corporate credit union should be permitted to survive; voluntary mergers will achieve economies of scale.
2. Corporates investment authority should be carefully regulated: for investment authority going forward, knowledge is key and independent risk analysis must be performed.

- *Corporate credit unions should operate under a risk-based capital system.*

1. Maintaining membership capital should not be mandatory.
2. Voluntary membership capital should be structured with a maximum cap and assessments based on usage.

- *Corporate credit unions should operate under corporate governance standards created and policed within the industry.*

1. Board members should consist of only qualified natural person credit union directors and staff.
2. There should be term limit requirements such as 3 years, 3 terms.
3. There should be no trade association or league staff members allowed on corporate boards.
4. There should be an independent supervisory committee that can hire outside expertise as needed.
5. There should be an investment oversight committee; it should be permissible for outsiders to be members of the committee to access requisite expertise.

In our comments to the NCUA Board, NAFCU also provided more specifics in these areas. These are included in our ANPR comment letter to the NCUA, which is attached to the end of my statement.

### ***Conclusion***

In conclusion, NAFCU supports H.R. 2351 and urges expeditious enactment of its provisions. Once enacted, the NCUA should provide clarification on how credit unions would treat or reverse

the present write-down resulting from the impairment of the one percent NCUSIF deposit, if and when the NCUSIF is no longer impaired. Enactment of this legislation, coupled with a reversal of the impairment, could help credit unions make billions more in consumer and business loans this year to aid in our nation's economic recovery.

Maintaining a healthy and well-regulated corporate credit union system is important, as many natural person credit unions rely on corporates for essential services. Additional legislative changes to the CLF and action by NCUA and/or the Congress to separate the risk from insuring corporates from the risk of insuring member shares at natural person credit unions would help in this regard.

As NCUA works to restructure the corporate credit union system, NAFCU believes that three overarching principles should be adhered to:

- *Corporate credit unions should continue to serve the liquidity and operational/payment systems needs of natural person credit unions.*
- *Corporate credit unions should operate under a risk-based capital system.*
- *Corporate credit unions should operate under corporate governance standards created and policed within the industry.*

Thank you for the opportunity to appear before the Subcommittee today. I welcome any questions that you may have.