



National Association of  
Federally-Insured Credit Unions

# NAFCU REPORT ON CREDIT UNIONS



# 2022

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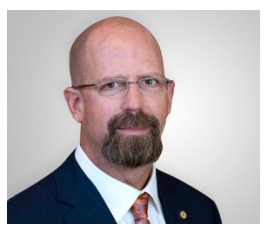
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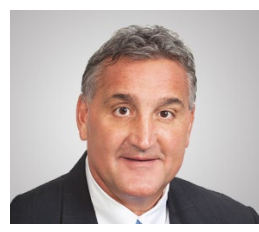
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# BACKGROUND

The National Association of Federally-Insured Credit Unions (NAFCU), founded in 1967, is the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions (FICUs). NAFCU provides its members with representation, information, education, and assistance to meet the constant challenges that cooperative financial institutions face in today's economic environment. Membership in NAFCU is direct; there are no state or local leagues, chapters or affiliations standing between NAFCU members and NAFCU's Arlington, Virginia headquarters.

## NAFCU Membership

NAFCU's membership consists of the nation's most innovative and dynamic FICUs, having various and diverse membership bases and operations. NAFCU proudly represents many smaller credit unions with relatively limited operations, as well as some of the largest and most sophisticated credit unions in the nation. NAFCU represents 78 percent of total federal credit union (FCU) assets and 42 percent of all FICU assets. NAFCU's membership includes over 220 federally-insured state chartered credit unions (FISCUs).

## NAFCU's "Why"

NAFCU's employees are driven by their "why." In their hearts, they believe credit unions are the best financial partner for American consumers. Due to that belief, NAFCU's staff and board of directors will do whatever it takes to empower credit unions by creating avenues for growth, removing unnecessary regulatory burdens, and highlighting how credit unions serve and support America's Main Streets.

# THE CREDIT UNION UNIVERSE

## Federally Chartered Credit Unions

FCUs obtain their charters from, and are regulated by, the National Credit Union Administration (NCUA). Their member shares (deposits) are insured by the National Credit Union Share Insurance Fund (NCUSIF), which is administered by the NCUA. As of June 2022, there were 3,076 FCUs, with assets of \$1.07 trillion and a membership base of 69 million.

## Federally-Insured State Chartered Credit Unions

FISCUs are chartered by their state, and their primary regulator is the state supervisory authority. Their member shares are insured by the NCUSIF. As of June 2022, there were 1,827 FISCUs, with assets of \$1.05 trillion and a membership base of 51 million.



## Federally-Insured Credit Unions

All FCUs are required to be insured by the NCUSIF. State chartered credit unions in some states are required to be federally insured, while others may elect to be insured by the NCUSIF. The term “federally-insured credit unions” refers to both federal and state-chartered credit unions whose accounts are insured by the NCUSIF.

## Corporate Credit Unions

Corporate credit unions are credit unions that serve other credit unions. Corporate credit unions provide services such as investment products, advisory services, item processing and loans to their members. As of June 2022, there were 11 corporate credit unions with assets of \$32 billion.

# NAFCU RESEARCH

NAFCU devotes considerable resources towards the goal of keeping its finger on the pulse of its members’ operations by surveying membership regularly. In this report, we reference several research instruments.

## Economic & CU Monitor Survey

NAFCU’s *Economic & CU Monitor* is a monthly report based in part on survey responses by NAFCU member credit unions on a special topic. The report includes a review of the survey responses, along with commentary on economic and industry trends.

## Federal Reserve Meeting Survey

NAFCU produces the association’s *Report on Credit Unions* annually ahead of a meeting with the Federal Reserve Board of Governors. Prior to preparing the report, NAFCU surveys its membership on a broad array of strategic and advocacy-oriented topics. This year’s *Federal Reserve Meeting Survey* was conducted between August 1 and August 24.

This year marks the 29<sup>th</sup> year for these meetings. NAFCU appreciates the opportunity to engage in consistent dialogue with the Federal Reserve on topics critical to the credit union industry.

# KEY FINDINGS

## The Credit Union Difference

- › Over 133 million Americans are credit union members, and membership growth is near an all-time high. That growth is the result of credit unions' steadfast commitment to serving everyday Americans and small businesses.
- › Data show that credit unions devote a far greater share of their resources toward Main Street lending than banks. The disparity grows with asset size, demonstrating the inherent distinctions between banks and credit unions in how they deploy resources.
- › Credit unions are reaching disadvantaged communities at a far higher rate than banks. Credit unions originate a higher share of mortgage loans to low- and moderate-income areas than banks.
- › Credit unions promote financial wellbeing by offering low-cost financial products, robust financial literacy programs, and by volunteering in the communities they serve.

## Industry Profile

- › The credit union industry is in solid financial condition, with delinquencies at historic lows and improving net worth.
- › Loan growth surged in the second quarter of 2022 as a result of strong auto lending, but is likely to slow as the rising interest rate environment is impacting mortgage loan demand.
- › Credit union earnings have fully recovered their pre-COVID level, but credit unions report concerns about rising staffing expenses and declining fee income.
- › Industry mergers are rising due to the ongoing pressures of a low interest rate environment. It is imperative that policymakers recognize these challenges and do not exacerbate them by imposing unnecessary regulatory burdens.
- › The Share Insurance Fund is on a positive trajectory, with the NCUA projecting a four-basis point increase by year end in the fund's equity ratio versus 2021.
- › Credit unions are committed to investing in technology solutions that will ensure a robust offering of financial products and services. Ninety-two percent of survey respondents anticipate tech investments will be a significant driver of spending in the future.

## Policy Priorities

- › NAFCU remains staunchly opposed to the Durbin Amendment’s cap on debit interchange, as it has failed to deliver promised benefits to consumers. Extending price controls to credit interchange would have a devastating impact on the industry.
- › NAFCU objects to the CFPB’s characterization of overdraft fees as “junk fees.” Overdraft programs are popular with the public, and credit unions run them responsibly and at low margins.
- › The NCUA has made progress in addressing certain areas in need of field of membership reform, but more work remains to be done. Key areas for policymakers to address are restrictions on credit union entry into underserved areas and frictions associated with generational account transfers.
- › The NCUA’s standardized approach to supervising interest rate risk is often at odds with more detailed, institution-specific analyses. Following NAFCU engagement, the agency agreed to reduce its reliance on the supervisory test in favor of greater examiner discretion.
- › NAFCU has devoted substantial effort to address the Treasury Department’s Community Development Financial Institution (CDFI) program. Credit union interest in the program is growing, but extended processing times are delaying approval.
- › NAFCU members report heightened interest in the Federal Reserve’s FedNOW real-time gross settlement system, which is expected to be unveiled in the second quarter of 2023. Their main concerns center on fraud protection.
- › Credit unions face increasing challenges in resolving member payment disputes, many of which originate with third-party payment providers. NAFCU remains steadfast in its advocacy for a fair and secure payment system.

## Central Bank Digital Currency

- › NAFCU has long regarded government involvement in banking as a slippery slope fraught with risk and often lacking in a clear value proposition.
- › The development of a CBDC is a costly undertaking that raises financial stability risk and concentrates exposure to a cyber attack.
- › The financial inclusion goals touted by CBDC proponents can be fulfilled by credit unions using existing payments infrastructure and enhanced with narrower and less costly regulatory improvements.



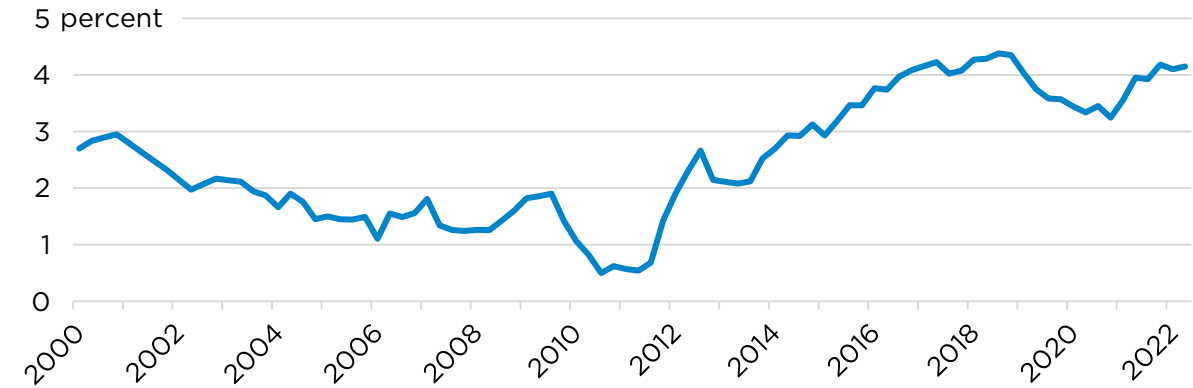
# THE CREDIT UNION DIFFERENCE

## What Sets Credit Unions Apart

The financial services marketplace grows more crowded by the day. New entrants are leveraging technology to challenge multinational incumbents. The most prosaic and fundamental aspects of banking are being reimaged in a digital context. Any discussion of the credit union difference may seem out of place by comparison. But the distinctive features of credit unions—that they are member-owned, not-for profit cooperatives—are no mere footnotes. They are the elements which set credit unions on a different path from their competitors, enriching the lives of their members. It is NAFCU’s conviction that when it comes to financial services, credit unions are the best option for everyday Americans.

And Americans are taking notice. Over 133 million are credit union members, and membership growth is near an all-time high. That is no anomaly, as credit unions have enjoyed elevated membership growth since the mid-2010s. The durability of this era of above-average growth is a testament to credit unions’ commitment to member service. The members they gain, they keep, and those new members tell friends and family of the superior quality, prices, and service they receive from their credit union.

Chart 1.1: Credit Union Membership Growth



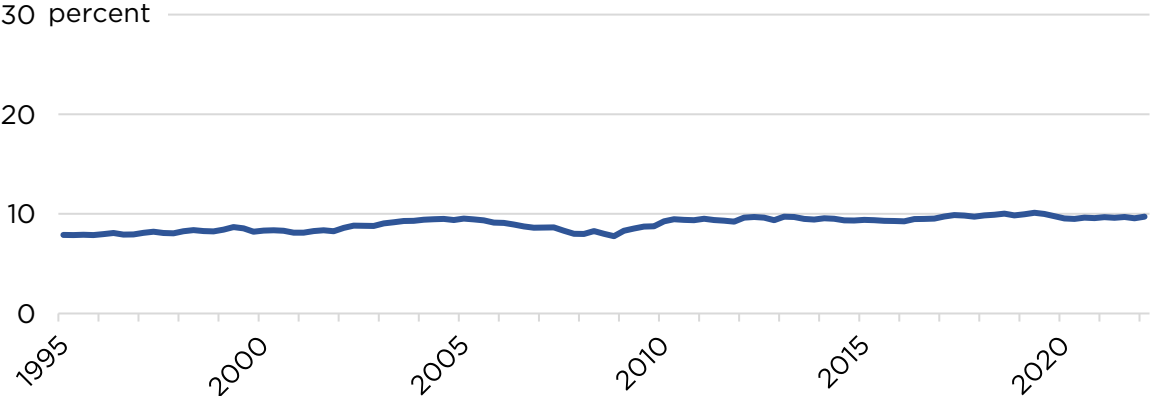
Growth measured on a year-over-year basis. Prior to June 2002, credit unions with under \$50 million in assets only reported membership in June and December. Growth rates for non-reported periods are interpolated.

Sources: NCUA, NAFCU analysis

In spite of the industry’s growth, the vast majority of credit unions are much smaller than their bank counterparts. The median credit union holds just over \$50 million in assets and operates with nine full-time employees. The median bank has over \$320 million in assets and 50 employees. Each of the two largest banks manages more assets than the entire credit union industry combined.

In a similar vein, above-average membership growth has not resulted in an increase in the industry’s overall share of the financial services market. As of March 31, 2022, credit unions maintained 10 percent of household deposits, a figure which has remained stable for decades. The stable deposit share highlights the fact that credit union growth has not come at the expense of their focus on Main Street. Middle- and working-class Americans make up the majority of credit union membership.

Chart 1.2: Credit Union Share of U.S. Household Deposits



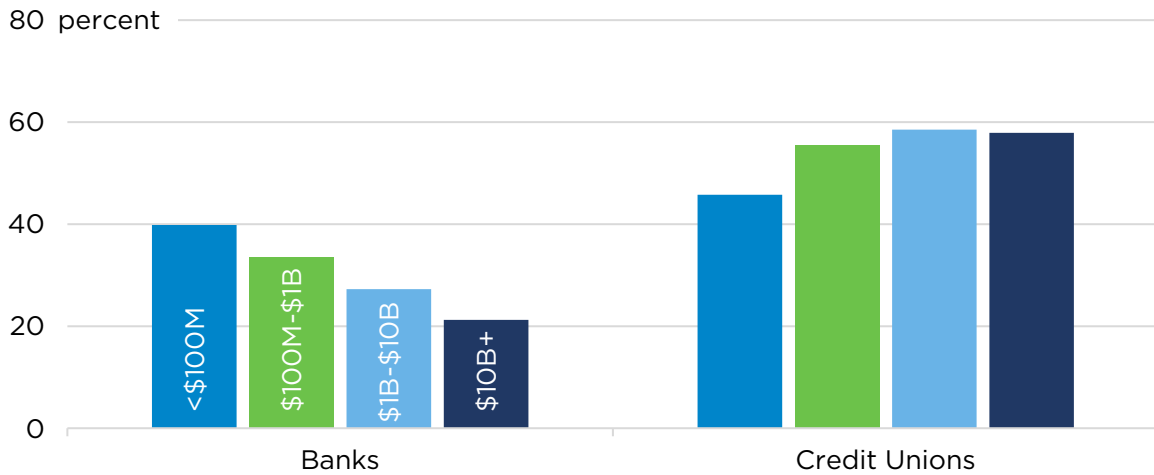
Data on commercial deposits are available for credit unions beginning in 2013, when they represented 1.5 percent of total deposits. That ratio is assumed to have held for prior periods.  
 Sources: Federal Reserve *Financial Accounts of the United States*, NAFCU analysis

Credit unions’ focus on average Americans and small businesses is further exemplified by their lending record. As compared to banks, credit unions devote a much larger share of their balance sheet toward “Main Street” loans—consumer loans, residential mortgage loans, and small business loans. At year-end 2021, these loans constituted 58 percent of credit union assets compared to just 23 percent for banks.<sup>1</sup>

Segmenting those results by asset size yields further insight (see Chart 1.3). For any given asset size, credit unions issue more Main Street loans than banks. However, the disparity grows with size. Where bank issuance of Main Street loans declines with growth, the opposite is true for credit unions. This suggests that as banks achieve greater scale, they tend to migrate away from serving Main Street toward more lucrative areas. But credit unions that are equipped with more resources provide greater benefits to their member-owners.

<sup>1</sup> For banks, Main Street Loans are calculated as the sum of residential real estate loans, loans to individuals, and small business loans. For credit unions, Main Street Loans are calculated as total loans minus the non-small business loan portion of total commercial loans. Credit unions do not report small business loans directly, therefore NAFCU applies the ratio of small business loans to commercial loans observed at community banks. Based on past NAFCU surveys of distribution of credit union commercial loan size, this is likely a conservative approach.

Chart 1.3: "Main Street" Loans as Share of Total Assets, by Institution Type and Asset Class



Banks include mutual savings institutions. Data as of June 30, 2022. See Footnote 1 for Main Street Loan calculation.

Sources: NCUA, FDIC, NAFCU calculations

## Lending Where Others Won't

Not only do credit unions make more Main Street loans than other lenders, they also lend to borrowers and communities ignored by other lenders. Credit unions have made tremendous efforts in recent years to extend the benefits of credit union membership to areas where banks are withdrawing. Data from the Home Mortgage Disclosure Act illustrates this best and shows that, despite operating within the confines of field of membership restrictions and regulatory obstacles, credit unions are eager to reach disadvantaged communities.

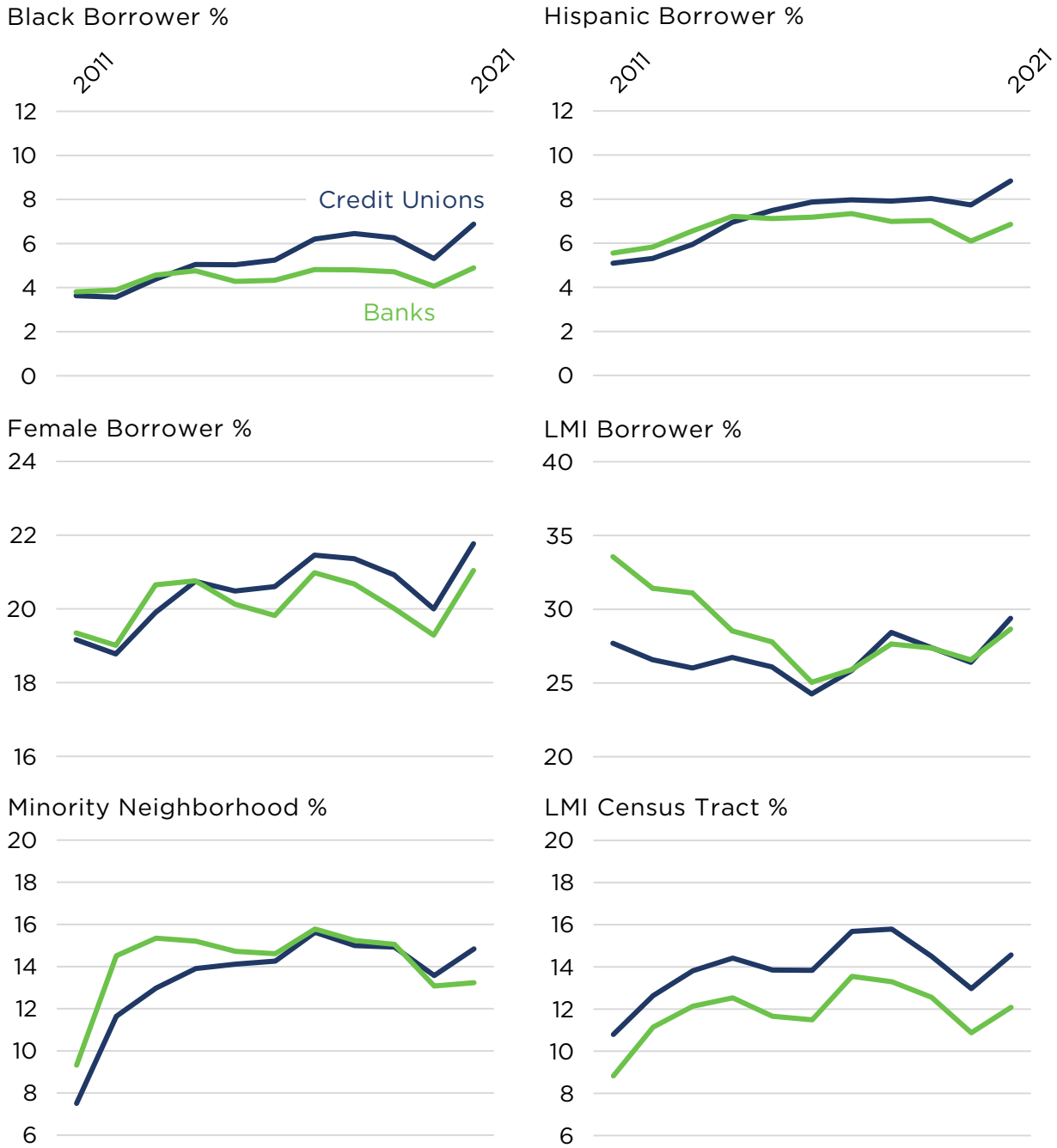
The list of cross-sections that credit unions are expanding into is long and varied. Since 2011, credit unions have increased their share of loans to Black, Hispanic, Female, and Low-to-Moderate Income (LMI) borrowers.<sup>2</sup> In terms of geographies, they have also increased lending to minority neighborhoods<sup>3</sup> and LMI census tracts.<sup>4</sup> These trends are markedly different from those of banks, which have sharply cut their lending share to LMI borrowers over the past decade, and which have raised their share of loans in the remaining categories by a more modest amount. As a result, credit unions rank ahead of banks in all six categories. That was true of only one category (LMI census tracts) in 2011.

<sup>2</sup> "LMI" refers to low-to-moderate income. LMI borrowers are those with incomes less than 80 percent of area median family income (AMFI).

<sup>3</sup> "Minority neighborhood" refers to a census tract in which the racial/ethnic minority share of the population is greater than or equal to 50 percent.

<sup>4</sup> LMI census tracts are those with median family incomes less than 80 percent of AMFI.

Chart 1.4: A Decade in Mortgage Lending (2011-21 HMDA Data)



Notes: (1) Data reflect shares of annual owner-occupied purchase + refinance loans originations. (2) "Banks" include mutual savings institutions. (3) See footnote in text for definitions of LMI and Minority Neighborhoods.

Sources: Home Mortgage Disclosure Act data (FFIEC, CFPB); NAFCU calculations

These results are important ones for policymakers to absorb. There is widespread interest in expanding financial inclusion to disadvantaged communities. Credit unions offer affordable services and deliver them in a responsible way due to their focus on member-owners. However, regulatory obstacles prevent credit unions from doing more. Expanded field of membership authorities and a greater ability to move into underserved areas would allow credit unions to pursue these goals to a greater extent.

## Serving and Strengthening Communities

If credit unions were merely the most affordable option for financial services, they would still be doing far more than other depository institutions to promote financial wellbeing. A recent study finds that banking with a credit union “causes borrowers to have fewer unpaid bills, higher credit scores, and a lower risk of bankruptcy.”<sup>5</sup> Another demonstrates that the benefits associated with credit unions’ superior rate offerings extend locally even to bank customers due to competitive effects.<sup>6</sup>

But credit unions do much more than simply offer great rates. Part of credit unions’ commitment to financial inclusion is a focus of providing resources to help members make smart financial decisions. In a May 2022 survey of NAFCU members, the vast majority of respondents (88 percent) reported that they offered financial literacy programs. Among those who measured the impact of their programs on underserved and low-income members, 56 percent observed a positive impact.

A large share of respondents (83 percent) also reported that they sponsored financial literacy events in their community during the last year by providing financial literacy curricula to local schools, offering financial coaching, and providing scholarships. Although access to schools has been limited due to the pandemic, 63 percent of respondents offered scholarship programs to support students within their communities.

A majority of respondents (68 percent) said that employees had also volunteered time in their communities and nearly all (92 percent) said that their credit union supported local nonprofit organizations. As an association, NAFCU has also worked collaboratively with the CFPB and the NCUA to help educate consumers about the importance of savings and has offered suggestions on how the NCUA can leverage its Advancing Communities through Credit, Education, Stability and Support (ACCESS) initiative.

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<sup>5</sup> Shahidinejad, Andres, *Are (Nonprofit) Banks Special? The Economic Effects of Banking with Credit Unions* (November 8, 2021). Available at SSRN: <https://ssrn.com/abstract=4131721> or <http://dx.doi.org/10.2139/ssrn.4131721>.

<sup>6</sup> Feinberg, Robert and Douglas Meade, *Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy* (September 2021). Available at: <https://www.nafcu.org/data-tools/credit-union-federal-tax-exemption-study>.

# INDUSTRY PROFILE

## Financial Conditions

The onset of COVID-19 sparked fears of prolonged, large-scale economic turmoil, with spillovers impacting the credit union industry. For the most part, those concerns have gone unrealized, and by many measures credit unions are extremely healthy. The rapid recovery of the labor market along with the support of stimulus payments have contributed to the lowest delinquency ratio in recent history. As of March 31, 2022, 0.2 percent of total insured shares in the industry were held by credit unions deemed to be in “troubled condition” due to its supervisory rating,<sup>7</sup> which is the lowest share on record dating back at least 20 years.

The net worth ratio dipped by a full percentage point due to extreme levels of asset growth, which diluted capital. However, moderation in credit union share growth has allowed for some improvement recently. For the first time since the start of the pandemic, the net worth ratio improved year-over-year in the first quarter of 2022. As of June 30, 2022, the net worth ratio had increased 26 basis points from the prior year, retracing one-quarter of the 2020-21 decline.

Industry earnings likewise recovered far faster than most expected. As of June 30, return on average assets stood at 93 basis points, which is almost identical to where it ended 2019. Yet the similarity at the bottom line hides massive changes within earnings components. When scaled by assets, both revenues and expenses have declined over that period.

On the income side, net interest margins have plummeted due to low interest rates and strong asset growth. While the post-COVID economy was not credit unions’ first experience with a near-zero interest rate environment, the impact was aggravated by unprecedented share growth. Loan demand was sufficiently depressed through early 2021 that credit unions had little option but to turn that tidal wave of new deposits into low-yielding investments. The result was a drop in the net interest margin to a level 20 basis points lower than the previous all-time low in early 2014. Although interest rates are up sharply in 2022, improvement in net interest margins will be slow as a substantial share of credit union assets were booked during the time when rates were much lower.

Fee income as a percent of assets is also down, which partly reflects the rapid expansion of assets. In 2020 fee income did drop substantially as lower consumption eroded interchange

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<sup>7</sup> According to the *Federal Credit Union Act*, a credit union is deemed to be in troubled condition if it is assigned a 4 or 5 CAMEL composite rating by the NCUA or a state supervisor. Beginning April 1, 2022, the rating system was changed to include an “S” component (CAMELS), which captures sensitivity to market risk. See 86 FR 59282.

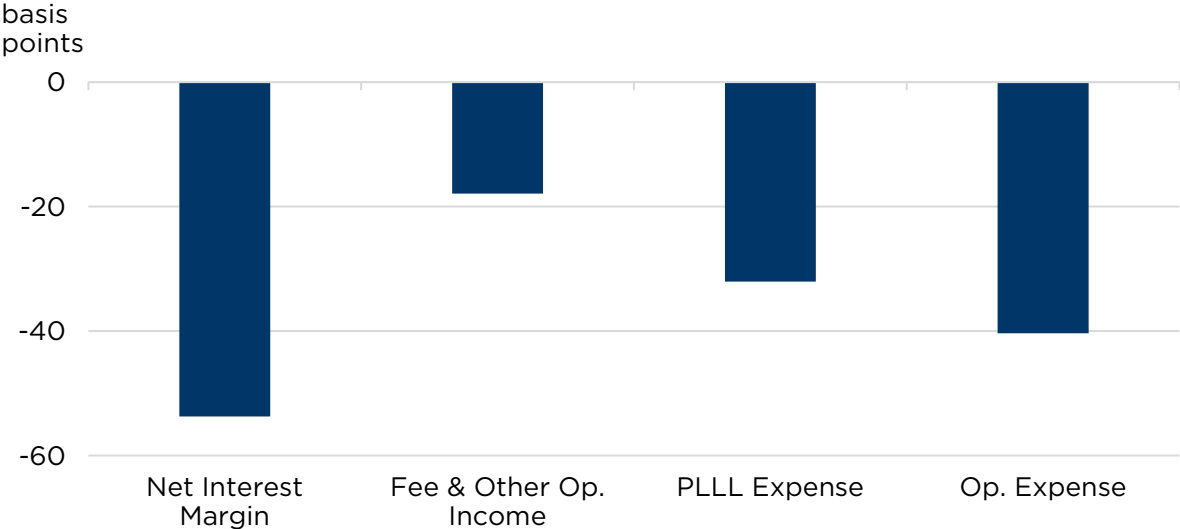


revenue. However, the rebound of consumption coincides with modestly higher credit union fee income purely in dollar terms; as of June 30, it was up 3.4 percent from 2019.

Both provision for loan and lease loss (PLLL) expense and operating expenses are down since 2019. The former reflects the large improvement in the delinquency ratio and, hence, the outlook for future loan losses. However, credit unions are preparing for that trend to reverse somewhat if the economy comes under greater stress in 2023 and as the CECL accounting standard goes into effect (see *Current Expected Credit Loss Standard*, page 37). The drop in the operating expense ratio mostly reflects the fact that expenses have grown more slowly than assets.

Taking into account the movement in earnings components, NAFCU expects credit union earnings to decline somewhat over the near term. Net interest margins will likely improve but may remain a drag despite the higher rate environment since margins respond slowly to changes in spot rates. But expense ratios are expected to return to their 2019 levels more quickly.

Chart 2.1: Change in Income/Expense Items (2019Q4 - 2022Q2)



PLLL = Provision for Loan & Lease Loss  
 Sources: NCUA, NAFCU calculations

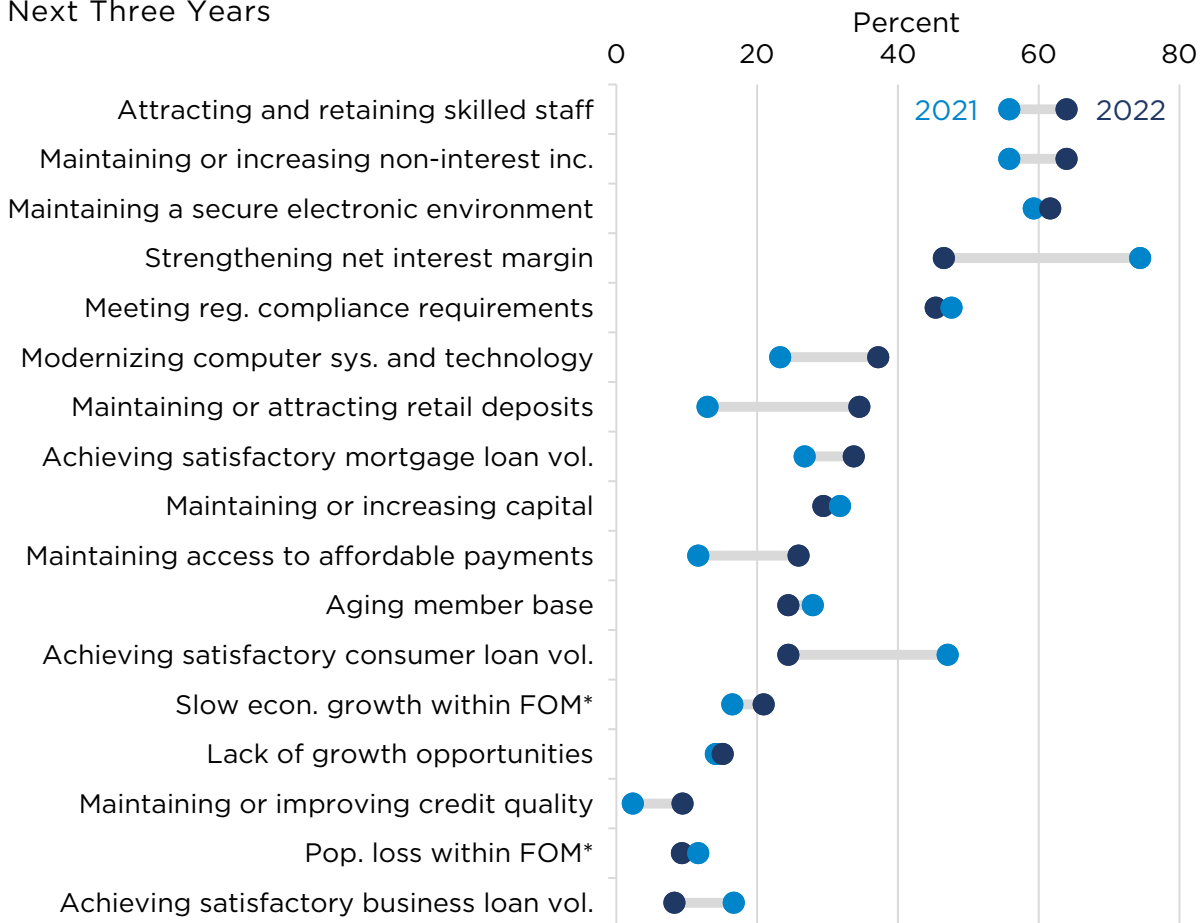
In NAFCU’s 2022 *Federal Reserve Meeting Survey*, respondents were asked to rate a variety of strategic considerations on how challenging they are expected to be over the next three years. Several earnings-related challenges feature prominently. Tied at the top of the list were staff hiring and retention—which factors heavily into operating expenses—and maintaining fee income. Concerns over fee income are likely related to current regulatory and potential legislative interest in interchange and overdraft fees (see *Interchange*, page 33 and *Overdraft and Other Service Fees*, page 35). Net interest margin, which was the top-ranked concern in

last year's survey, fell down the list in 2022 as the outlook for interest rates improved. However, it remains one of the chief concerns among credit unions.

## Lending

With the dramatic rise in inflation and interest rates in 2022, lending conditions are starkly different than they were a year ago. Although loan performance remains extremely high, credit unions are cognizant of volatile economic conditions and their potential impact. In last year's *Federal Reserve Meeting Survey*, respondents reported that they were easing credit standards across a number of loan products, particularly auto and mortgage loans. That is not the case in the 2022 survey, as consumer and mortgage loan standards were generally unchanged and commercial loan standards were tightened.

Chart 2.2: Share of Credit Unions Viewing as a "Significant" Challenge over the Next Three Years

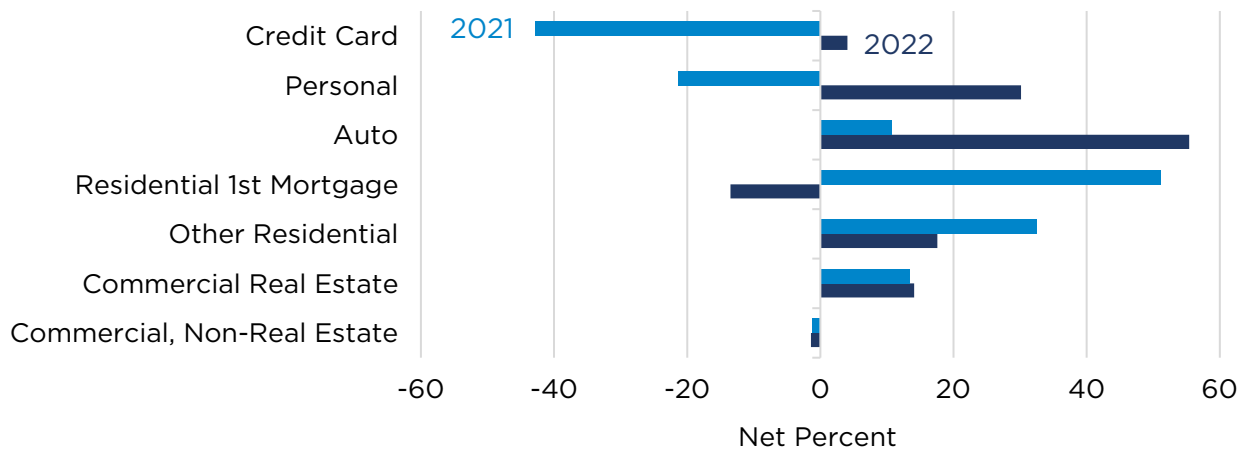


\*FOM = Field of Membership

Source: NAFCU *Federal Reserve Meeting Surveys*

Loan activity in 2021 was heavily tilted towards residential mortgages as refinance and home equity loans surged. One year later, mortgage lending has receded due to higher rates, but auto lending is booming. Credit unions are historically strong used auto lenders, and they have been somewhat shielded from the ongoing supply chain issues impacting new vehicle inventory. During the first half of 2022 alone, credit union used car loans grew by 10.9 percent, the highest level of growth for that segment over a six-month period on record. A net positive share of respondents also indicated strong demand for credit card and personal loans, which is starkly different from a year earlier. As households struggle to make ends meet, credit unions are providing short-term loans at better terms than competitors (see *Small Dollar Lending*, page 42). Finally, other residential loan demand was noticeably stronger in 2022 than in the prior year. As housing affordability deteriorates in the wake of surging mortgage rates, many households are opting to upgrade current dwellings rather than trade up.

Chart 2.3: Net Percent of Credit Unions Reporting Strong Loan Demand Over Past Three Months



"Net percent" refers to the share of respondents reporting strong demand minus the share reporting weak demand.

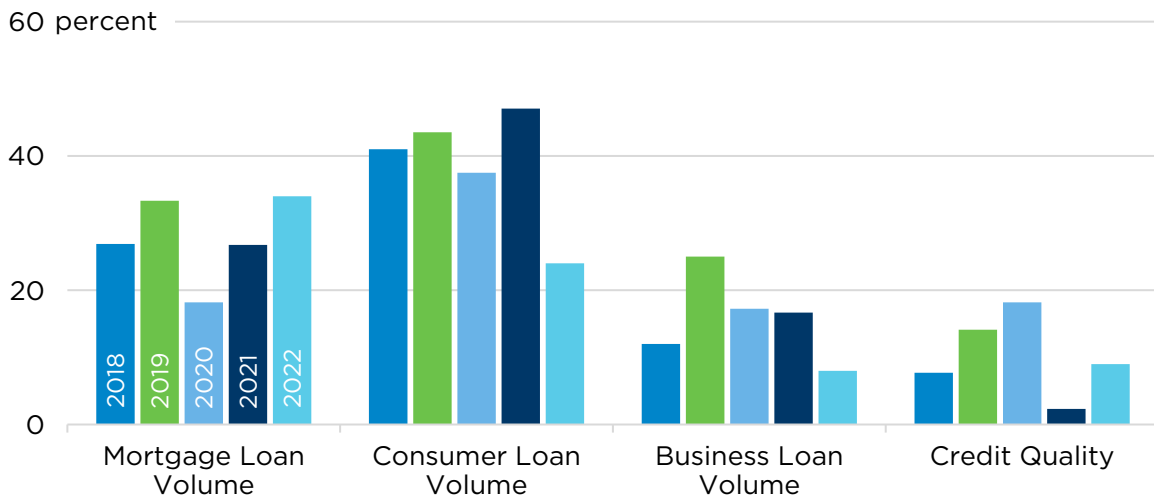
Source: NAFCU *Federal Reserve Meeting Surveys*

NAFCU members' evolving lending outlook is also reflected in the areas where they anticipate challenges over the next three years. Thirty-four percent of respondents expected mortgage lending to be a challenging area, which was the highest share in five years. That result reflects the significant drop in loan volume in 2022; originations over the first half of the year were 43 percent below the first six months of 2021, according to one estimate.<sup>8</sup> However, concerns about consumer loan volume are easily the lowest of any year since 2018, as respondents are confident that their recent growth will persist. The share of respondents seeing credit quality

<sup>8</sup> Mortgage Bankers Association, *Mortgage Finance Forecast* (September 19, 2022).

as a significant challenge over the next three years increased over the 2021 survey result, but it remained comfortably below both 2019 and 2020.

Chart 2.4: Share of Credit Unions Viewing as a "Significant" Challenge over the Next Three Years



Source: NAFCU *Federal Reserve Meeting Surveys*

## Secondary Mortgage Market

The secondary mortgage market is vital to many small financial institutions with mortgage loan portfolios, both as a source of liquidity and as a tool to manage interest rate and concentration risks. Over the first six months of 2022, credit unions sold 22 percent of first-lien mortgage loans originated. This is down from 2021 when 35 percent of originations were sold. Credit unions that participated in NAFCU's 2022 *Federal Reserve Meeting Survey* indicated that, on average, 67 percent of their outstanding first mortgage loans qualify to be sold on the secondary market, which is up six percentage points from the prior year's survey. As compared to the most recent 12 months, 30 percent of respondents said that they expect to sell a larger share of mortgage originations over the next 12 months, while 19 percent expect to sell a smaller share. That represents a departure from the 2020 and 2021 surveys, where roughly equal shares of respondents expected to sell larger and smaller shares.

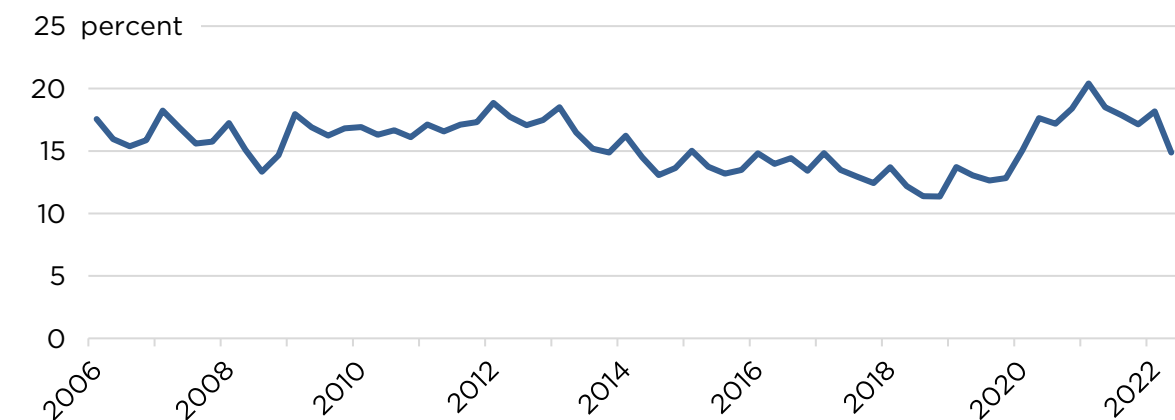
Government-sponsored enterprises (GSEs) are another important partner for the industry, allowing credit unions to manage risks while still providing mortgage loans to their members. Based on Home Mortgage Disclosure Act (HMDA) data, 65 percent of mortgage loans that credit unions sold in 2021 were sold to Fannie Mae and Freddie Mac. That figure is down just slightly from 2020 (67 percent). Among survey participants that sell to Fannie Mae and Freddie Mac, 75 percent indicated that pricing was a key consideration in utilizing the GSEs,

while 57 percent cited ease of access. In conversations with policymakers, NAFCU has prioritized access and fair pricing for the credit union industry as critical and necessary elements of any housing finance reform efforts.

## Liquidity

Financial institutions were met with a wave of deposits in 2020 and 2021. The personal saving rate, which averaged 7.6 percent of disposable income in 2019, jumped to 16.3 percent in 2020 and 12.1 percent in 2021. However, the end of federal stimulus payments combined with high inflation has prompted a steady decline in the saving rate to 5 percent as of July 2022.

Chart 2.5: Credit Union Liquidity Ratio



Liquidity ratio is the sum of cash and investments with maturities under 1 year, divided by total assets.

Source: NCUA, NAFCU calculations

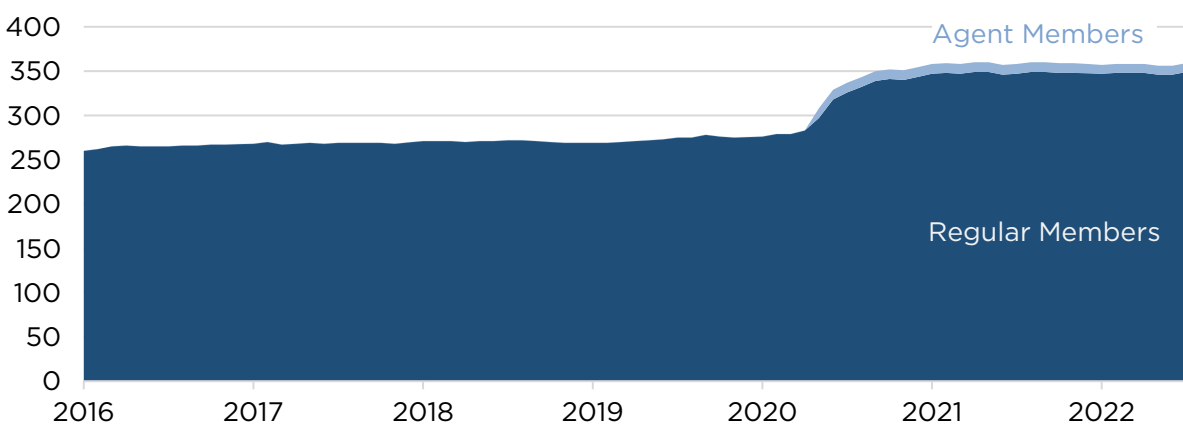
Credit union share growth reached unseen heights during those high savings periods. On a year-over-year basis, share growth peaked at 23 percent in the first quarter of 2021. However, as of June 30, 2022, that figure had fallen to 8.2 percent, just above the historical average. The surge in balance sheet liquidity diluted credit union net worth and created a drag on net interest margins. The industry liquidity ratio has declined sharply over the past year but remains higher than its 2019 level.

NAFCU members are eyeing liquidity conditions carefully. In this year's *Federal Reserve Meeting Survey*, 35 percent of respondents expected that defending deposits would be a challenge over the next three years. That figure is much higher than 2021 (13 percent), but still lower than 2019 (53 percent). In the year prior to the pandemic, the cost of funds ratio increased by over 20 basis points, and deposit pricing strategy was one of the most pressing challenges for credit unions.

Federal Home Loan Banks (FHLBs) serve as a key partner for credit unions. The share of credit unions that are FHLB members reached 31 percent in mid-2022, an all-time high. Forty-three percent of survey respondents described FHLBs as being “very important” to their liquidity strategies, which is an all-time high in the *Federal Reserve Meeting Survey*.

Currently the *Federal Home Loan Bank Act* only recognizes FDIC-insured institutions up to \$1.239 billion in assets as community financial institutions (CFIs). Under the Act, a CFI is exempt from the requirement that FHLB members hold 10 percent of their assets in residential mortgages and may pledge an expanded class of assets as collateral for advances. NAFCU has urged Congress to include credit unions in this definition and raise the threshold to \$10 billion in order to provide greater lending capacity for credit unions. In NAFCU’s 2022 *Federal Reserve Meeting Survey*, 67 percent of respondents who are not FHLB members said they would join an FHLB if the requirement to hold 10 percent of total assets in residential mortgages was lowered, or if credit unions could join as CFIs.

Chart 2.6: Central Liquidity Facility Membership



Note: As agent members, Corporate Credit Unions provide access to the Facility to thousands of their members. Without legislative action, agent membership to the Facility will expire in the fourth quarter of 2022.

Source: NCUA Central Liquidity Facility Monthly Reports

Corporate credit unions are another important partner, helping many credit unions to manage liquidity needs. As of June 30, 2022, over 200 credit unions reported outstanding borrowings from corporate credit unions, which represents a four-fold increase over the prior year. Seventy-nine percent of natural-person credit unions maintain lines of credit with corporate credit unions.

The Central Liquidity Facility (CLF) is a mixed-ownership government corporation which serves as a liquidity source for its member credit unions. Hundreds of credit unions have access to the Facility as regular members. However, as a result of CARES Act modifications,

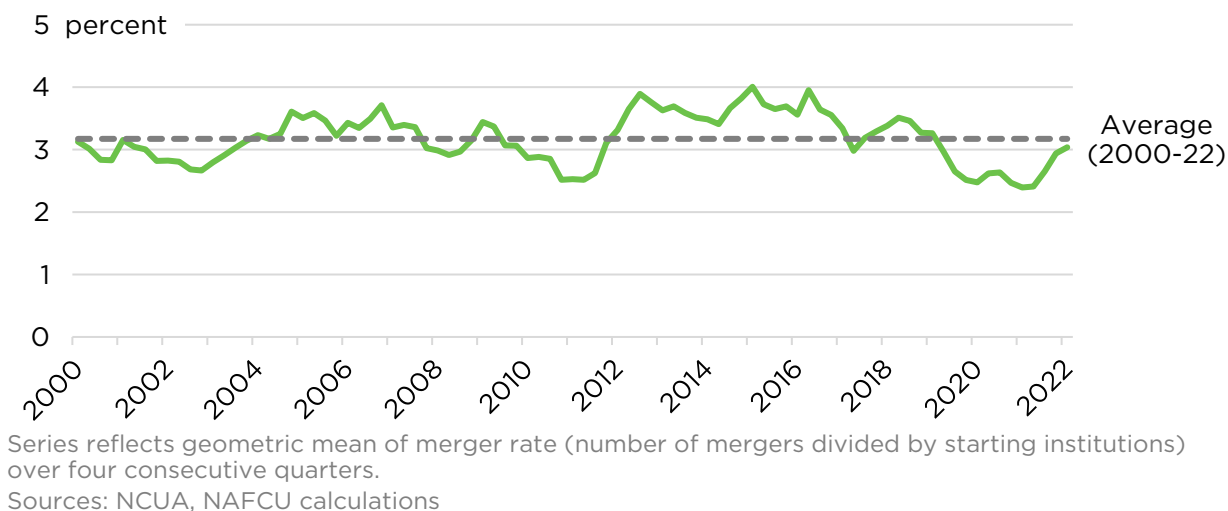


corporate credit unions acting as agent members of the Facility acquired added flexibility with respect to purchases of CLF capital stock beginning in 2020 and used this flexibility to extend greater support to their members. Barring legislative action, corporate credit unions will have to scale back their role as agent members at the end of 2022 or else purchase CLF capital stock for all member credit unions (see *Central Liquidity Facility*, page 28).

## Industry Consolidation

The credit union industry has been shrinking for over 50 years. The median credit union is still small at just over \$50 million in assets, and in many cases, credit union mergers are beneficial for members of the absorbed institution. For example, in the years following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) in mid-2010, many small credit unions struggled to deal with the onslaught of regulation and opted for a merger. In the intervening years, 35 percent of credit unions have merged out of existence.

Chart 2.7: Credit Union Merger Rate



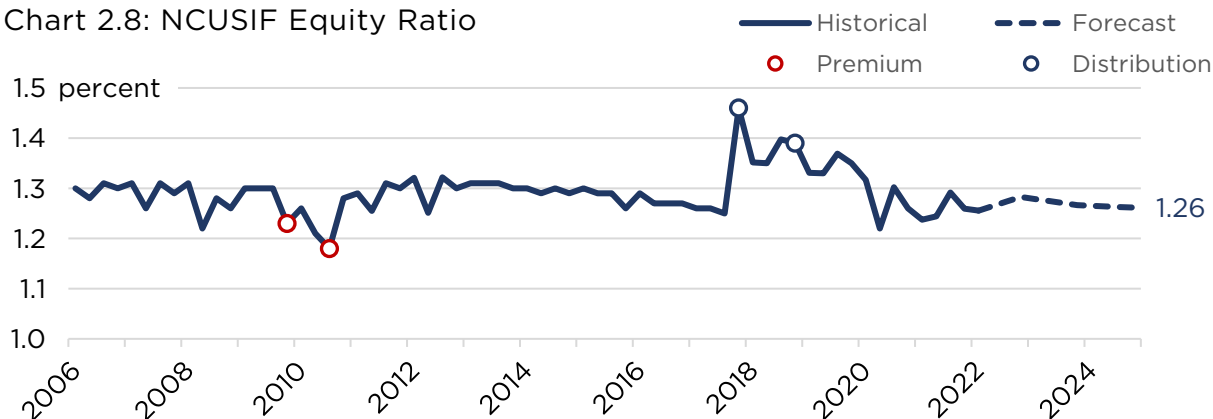
As of June 30, 2022, the credit union merger rate was slightly below its long-run average. However, the rate has risen noticeably over the past year. At the same point in 2021, the industry merger rate fell to its lowest point in at least two decades at 2.4 percent. It is not surprising that merger activity would decline following the onset of COVID-19, and it is important to remember that two parties are involved in mergers. Many larger institutions were facing their own challenges and were not in a position to initiate a merger. NAFCU anticipates that the increase in mergers over the past year is a sign of things to come as small credit unions struggle with low-yielding assets that accumulated during 2020-21, and the premium on scale grows.

In such an environment, it is critical that policymakers consider the impact of regulatory burdens. Respondents to NAFCU's *Federal Reserve Meeting Survey* indicated that 22 percent of staff time is currently devoted to regulatory compliance. However, for small credit unions with under \$250 million in assets, that figure grows to 27 percent. Many credit unions simply do not have the staff resources to meet unrealistic regulatory expectations.

## Share Insurance Fund

The National Credit Union Share Insurance Fund (NCUSIF or SIF) has been a model of stability over its history. Due to their prudent business model, credit union failures are relatively rare. However, in the aftermath of COVID-19, the SIF equity ratio<sup>9</sup> fell sharply due to the extreme growth in insured shares. At one point, the equity ratio was two basis points above the statutory minimum, and the NCUA Board warned credit unions that a premium assessment may be forthcoming.<sup>10</sup> Adding to the stress was a peculiar timing feature which artificially lowers the equity ratio, and which is more pronounced when share growth is stronger.<sup>11</sup> NAFCU urged the NCUA to use caution in assessing any premium due to ongoing stresses of the pandemic and the fact that some of the apparent decline in the equity ratio was a product of the timing discrepancy.

Chart 2.8: NCUSIF Equity Ratio



Historical data through 2022q1. Equity ratio spike at the end of 2017 is due to the merger of the NCUSIF with the Temporary Corporate Credit Union Stabilization Fund, which had a net equity position of \$2.6 billion at the time of the merger. Forecast from 2022-24 is only calculated as of December 31 for each year respectively.

Sources: NCUA, NAFCU (forecast)

<sup>9</sup> Calculated as the sum of credit unions' 1 percent capitalization deposit and retained earnings, excluding net cumulative unrealized gains and losses on investments, divided by aggregate insured shares.

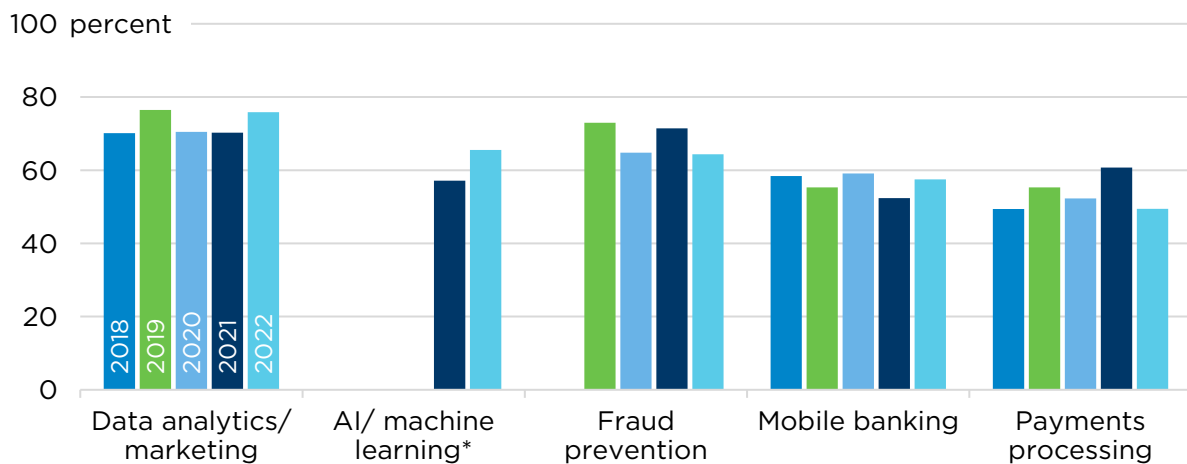
<sup>10</sup> NCUA Chairman Todd M. Harper Statement on the Share Insurance Fund Briefing (February 18, 2021), available at: <https://www.ncua.gov/newsroom/speech/2021/ncua-chairman-todd-m-harper-statement-share-insurance-fund-briefing>.

<sup>11</sup> Credit unions contribute one percent of their insured shares to the SIF, which constitutes the majority of the fund's equity. Depending on their size, credit unions rebalance these accounts once or twice per year. However, there is a lag between the recognition of new insured shares—which serves as the denominator of the equity ratio—and the billing and collection of credit unions' one-percent contributions.

The NCUA did refrain from charging an assessment, and as of June 30, 2022, the outlook for the SIF has substantially improved. The combination of a reduction in share growth along with higher interest rates has arrested the decline in the equity ratio. The NCUA has determined that it is safe to resume purchasing longer-dated Treasury securities, which will help investment yield in the future.<sup>12</sup> Agency staff anticipate that the fund's equity ratio will reach 1.30 percent by the end of 2022; this would represent a four-basis point improvement over the prior year.<sup>13</sup> Furthermore, NCUA Board Member Rodney Hood has spearheaded an effort to address the timing mismatch so that the SIF equity ratio better reflects the true financial condition of the fund.

This positive outlook contrasts with the current status of the Federal Deposit Insurance Corporation (FDIC) Deposit Insurance Fund (DIF). The DIF reserve ratio (the analogue to the equity ratio) experienced a sharp drop for reasons similar to those that impacted the SIF equity ratio, but the magnitude was more severe. On June 21, 2022, the FDIC announced that it would be raising assessment rates to address a shortfall in the reserve ratio, which as of March 31 was 12 basis points below the statutory minimum.<sup>14</sup>

Chart 2.9: IT Projects Responding CUs Anticipate Investing in over the Next Three Years



Fraud prevention was added to the survey in 2019; AI/machine learning in 2021  
 Source: NAFCU Federal Reserve Meeting Surveys

<sup>12</sup> The NCUA reduced the duration of the investment portfolio beginning in 2017 to improve fund liquidity following the failure of several large credit unions.

<sup>13</sup> NCUA Board Briefing, Share Insurance Fund Quarterly Report (September 22, 2022), available at: <https://www.ncua.gov/files/agenda-items/share-insurance-fund-board-briefing-20220922.pdf>.

<sup>14</sup> FDIC, Financial Institution Letter: Amended Restoration Plan and Notice of Proposed Rulemaking on Assessments, Revised Deposit Insurance Assessment Rates (June 21, 2022), available at: <https://www.fdic.gov/news/fact-sheets/amended-restoration-plan-and-rate-increase-june-21-2022.pdf>.

## Investments in Technology

The challenge of offering a full slate of financial products grows as technology advances and consumer tastes evolve. Credit unions recognize the importance of investing in areas that will enable them to compete with the largest financial institutions in the world. Ninety-two percent of respondents to NAFCU's *Federal Reserve Meeting Survey* expect that technological investments will spur spending increases over the next three years, making it the top-ranked driver in this year's survey, beating out employee compensation and training (84 percent).

The top investment priority was data analytics and marketing, with 76 percent of respondents expecting to invest in that area over the next three years. That was followed by artificial intelligence and machine learning (66 percent) and fraud prevention (64 percent).

With an expanding list of faster payment providers, credit unions are clearly prioritizing investments in that area. For the fifth year in succession, at least half of respondents to NAFCU's *Federal Reserve Meeting Survey* expect to invest in payments processing over the next three years.

NAFCU has led the industry's engagement with the Federal Reserve throughout its investigation of faster payments capabilities and continues to provide input on the development of the FedNow Service that will launch in 2023. As the Federal Reserve builds out its faster payments infrastructure, the availability of tools and strategies to mitigate fraud will be a critical first step toward achieving ubiquity across financial institutions while still allowing credit unions to continue offering robust, affordable services to their members.

# POLICY PRIORITIES

As a direct membership association led by a Board of Directors made up entirely of credit union CEOs, NAFCU is uniquely positioned to represent the interests of the credit union industry before lawmakers and regulators. NAFCU has five advocacy priorities for 2022:

- I. Growth – Advocating for legislation and regulation that helps credit unions grow membership, loans and retained earnings
- II. Regulatory Relief – Reducing regulatory burden through targeted rulemaking and clear rules of the road
- III. Technology & Innovation – Supporting innovation so credit unions can use developing technologies to better compete in the marketplace
- IV. Data Protection – Encouraging federal standards for data privacy and data security that recognize existing regulatory requirements for credit unions
- V. Fair Market – Fighting back against meritless banker attacks and ensuring under-regulated market participants do not have an unfair advantage

These priorities are premised on NAFCU’s belief in the credit union difference, and that among financial service providers, credit unions are the best option for consumers.

## I. Growth

### Preserving the Credit Union Tax Exemption

Preservation of the credit union tax exemption remains a top NAFCU priority. The Federal Credit Union Act (FCU Act) exempted credit unions’ income from federal taxation because credit unions are not-for-profit, cooperative organizations operated exclusively by and for their members. These defining characteristics of the credit union system have been a constant over its nearly 90-year history, and, today, more than 133 million American credit union members benefit from the higher dividend rates and lower borrowing rates their credit unions are able to offer as a direct result of the credit union tax exemption.

NAFCU commissioned an independent study in 2021 which estimated that the removal of the credit union tax exemption would cost the federal government \$56 billion in lost tax revenue over the following ten years.<sup>15</sup> Over the same period, US gross domestic product would be

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<sup>15</sup> Feinberg, Robert and Douglas Meade, *Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy* (September 2021). Available at: <https://www.nafcu.org/data-tools/credit-union-federal-tax-exemption-study>.

reduced by \$120 billion, and US employment would drop by nearly 80,000 jobs per year. The study also shows that, due to credit unions' competitive influence on for-profit banks, the credit union tax exemption's benefits extend well beyond the credit union system's current membership. According to the study, benefits to credit union members over the past decade totaled \$72.5 billion across all deposit and loan products, while the combined benefits to members and non-members totaled \$153 billion over that period. Given its unique simultaneous ability to drive total federal tax revenue, GDP, employment, and consumers' access to affordable, high-quality deposit and lending products across the economy and not just within the credit union system, preservation of the credit union tax exemption is imperative.

However, every year, the Independent Community Bankers of America (ICBA) and other for-profit banking trades expand their attacks on the credit union tax exemption. Recently, a point of focus has been a handful of voluntary bank and credit union mergers. As NAFCU explained in a July 2021 letter written to Treasury Secretary Yellen, whether or not a bank can be acquired is exclusively within the control of the bank's board of directors. Neither a bank nor a credit union can acquire a bank without the consent of the would-be-acquired bank's board of directors. Despite this and despite the for-profit banking system's years of eye-watering earnings, for-profit banking trades routinely characterize their own members as all too vulnerable to acquisition by not-for-profit credit unions, constantly call on Congress to implement an exit fee on credit union acquisitions of banks, and even seek Government Accountability Office studies on the credit union system and its supervision by the NCUA.

When the for-profit banking trades make these calls, NAFCU answers by educating lawmakers on the demonstrated value of the credit union tax exemption, not only to the more than 133 million Americans and their communities already served by credit unions but to the entire economy.

## Field of Membership

A key focal point for NAFCU in its promotion of credit union growth is the complex set of rules governing field of membership (FOM). NAFCU has long argued for field of membership reform that keeps pace with ongoing virtualization of banking services, changing social dynamics, and evolving consumer habits in today's digital era. The NCUA has made progress in addressing certain areas in need of FOM reform, but more work remains to be done. According to NAFCU's *Federal Reserve Meeting Survey*, 65 percent of respondents identified at least one area where FOM constraints were inhibiting growth.

Under the FCU Act, in order for a multiple common bond credit union to expand by adding a select group to its FOM, the credit union must be within "reasonable proximity" to the location



of the group. The Chartering Manual interprets the term “reasonable proximity” geographically, meaning the group must be “within the service area of one of the credit union’s service facilities.” In 2021 the NCUA finalized a substantial expansion to credit unions’ ability to grow and serve their communities when it modernized the definition of “service facility” to include a shared branch, shared ATM, or shared electronic facility for an FCU that participates in a shared branching network. NAFCU applauds these efforts; however, NAFCU was disappointed in the NCUA’s decision to exclude ATMs and online and mobile banking platforms under the definition of a service facility in its rule.

As the Baby Boomer generation continues to age, credit unions have seen an accelerated transfer of shares out of member accounts. This trend is due, in part, to outdated membership eligibility limitations that only extend the option of becoming a member to a deceased member’s surviving spouse. Credit unions have reported that the experience with immediate family members of a deceased member can be confusing and cause friction when the immediate family member wants to join the credit union and maintain existing accounts but is unable to do so because of the current regulatory restrictions. This is borne out in NAFCU survey data which indicates that the single FOM constraint that has imposed the greatest obstacle to growth is an aging membership.

In the interest of assisting credit union members by providing a streamlined means of maintaining long-held member relationships, NAFCU has urged the NCUA to initiate a rulemaking to amend the Chartering Manual to expand the current exemption for membership to include all “immediate family” surviving a decedent member. The NCUA should also redefine the term “immediate family” to encompass a broader range of blood and legal relatives. Further, NAFCU continues to advocate for legislation that would relax statutory constraints on chartering, such as the arbitrary limit on the type of credit union eligible to add underserved communities to their field of membership.

Collectively, these reforms will help federal credit unions reach potential members who need affordable financial services, including those in underserved areas, as well as provide much needed regulatory relief by streamlining the field of membership process for community, multiple common bond, and Trade, Industry, or Profession (TIP) charters.

## **Capital Reform and Liquidity**

Credit unions continue to boast strong capital and liquidity despite economic turbulence in 2022 and the implementation of the NCUA’s Risk Based Capital (RBC) Rule. Asset growth driven by the pandemic and government stimulus has also accelerated many credit unions’ plans for transitioning to new regulatory asset thresholds, and this has produced

corresponding adjustments to the NCUA's supervisory approach for large credit unions supervised by the Office of National Examinations and Supervision (ONES).

Reflecting on the regulatory era that existed prior to the implementation of the NCUA's RBC framework and the imminent arrival of CECL, 47 percent of credit unions characterized the regulatory burden of capital rules as having increased significantly over the past five years, and 53 percent expected those burdens to continue to increase over the next five.

Despite guarded sentiment concerning the future of regulatory capital compliance, the NCUA was able to provide some relief in 2022. NAFCU's advocacy for reforms and alternatives to the NCUA's 2015 Final RBC Rule reached a positive conclusion at the start of the year, with the NCUA finalizing a simplified approach for RBC compliance that was adopted before the RBC Rule took effect. Years of persistent advocacy helped secure the introduction of an RBC alternative, the Complex Credit Union Leverage Ratio (CCULR), which has seen relatively strong adoption so far.

### **Risk-Based Capital Simplification**

In 2022, the NCUA finalized a rule that permits complex credit unions to adopt an alternative measure of risk-based capital adequacy called the CCULR. Complex credit unions that meet the CCULR's minimum net worth requirement are regarded as well capitalized and avoid the administrative burden of calculating a risk-based capital ratio (RBC ratio) as described in the 2015 RBC Rule. The NCUA's final rule, which was published at the very end of 2021, incorporated revisions requested by NAFCU. Most significantly, the agency lowered the required CCULR eligibility threshold for net worth from 10 percent to 9 percent or greater, which helped secure a major win for complex credit unions who otherwise may have not felt it worthwhile to maintain an extremely elevated net worth ratio.

In the NCUA's final rule, the agency also removed a burdensome notification requirement for credit unions choosing to opt out of the CCULR. NAFCU's concerns regarding the treatment of excluded goodwill in the 2015 RBC rule were also addressed favorably through elimination of the sunset date for goodwill acquired in a supervisory merger. Under the final rule, credit unions are not required to deduct excluded goodwill from the risk-based capital numerator, even after January 1, 2029.

Since publishing the final rule, the NCUA has been responsive to NAFCU's requests for greater industry education to promote the CCULR and changes to Call Reports. In February 2022, the NCUA hosted industry webinars covering the CCULR framework and corresponding Call Report changes. To date, the CCULR appears to have made a favorable impression as an alternative to full RBC compliance. Second quarter Call Report data revealed that 57 percent of complex credit unions had adopted the CCULR.

### **Capital Adequacy; Prompt Corrective Action (PCA)**

In 2021 the NCUA approved a NAFCU-supported interim final rule (IFR) to provide temporary regulatory capital relief to FICUs. The rule extended temporary, pandemic-related PCA flexibility that was originally granted in 2020. The IFR made two changes that were responsive to unusual and sustained asset growth. First it allowed a reduction to the earnings retention requirement for FICUs classified as adequately capitalized. Second, it permitted undercapitalized FICUs to submit a streamlined net worth restoration plan if the FICU's undercapitalization was due to pandemic-related share growth. In late 2021 and early 2022, NAFCU urged the NCUA to further extend the PCA relief as credit unions continued to observe elevated share growth. Consistent with NAFCU's recommendation, the NCUA Board approved a new interim final rule in February 2022 which extended the PCA relief to March 31, 2023.

### **Central Liquidity Facility (CLF)**

Despite strong capital and liquidity levels, strong loan growth, a rise in interest rates, and an uncertain economic outlook have brought liquidity back into focus for many credit unions. For their emergency liquidity needs, many credit unions utilize the CLF, which is jointly owned by member credit unions and managed by the NCUA. Heightened liquidity management considerations underscore the need to reinstate statutory enhancements to the CLF which expired at the end of 2021.



NCUA Chairman Todd Harper addresses the crowd at NAFCU's 2022 Congressional Caucus. Harper thanked NAFCU for the association's support of legislative modifications to the Central Liquidity Facility.

The CARES Act provided the Board with the discretion to determine which grouping of natural person member credit unions of the applying corporate credit union or corporate credit union group were considered covered by the agent's membership in the CLF. In essence, this authority had the effect of easing the capital stock subscription requirement for corporate agents with respect to their natural-person members with less than \$250 million in assets. This provision expired at the end of 2021, at which point agent members had one year to terminate membership or purchase CLF stock for all its member credit unions.

In 2022, NAFCU helped amplify the NCUA Board's bipartisan support for legislation to make permanent the enhancements to the CLF made under the CARES Act. In the absence of such changes, thousands of small credit unions will lose access to the CLF at the end of 2022.<sup>16</sup> Although legislative action remains pending, a CLF-related amendment to the National Defense Authorization Act (NDAA) for Fiscal Year 2023 passed the House in July 2022 and could help secure an extension of the CLF enhancements if approved by the Senate.

### **Emergency Capital Investment Program (ECIP) and Subordinated Debt**

The ECIP was established by the Consolidated Appropriations Act, 2021 (CAA) and is administered by Treasury. The ECIP was created to encourage low- and moderate-income community financial institutions to augment their efforts to support small businesses and consumers in communities that have suffered disproportionate financial stress as a result of the pandemic. The program authorizes Treasury to provide up to \$9 billion in capital directly to eligible FICUs that are certified community development financial institutions (CDFIs) or minority depository institutions (MDIs) that have a plan to provide loans, grants and forbearance for small businesses, minority owned businesses and consumers in low-income and underserved communities.

NAFCU has supported changes to the definition of Grandfathered Secondary Capital to facilitate efficient deployment of ECIP funding and opposed a maximum maturity for ECIP investments which would truncate the useful life of the funding as regulatory capital.

Apart from ECIP, NAFCU has also encouraged the NCUA to revisit its subordinated debt rule to ensure that the process for issuing these instruments is not overly burdensome relative to the agency's prior secondary capital rule. Streamlined procedures for issuing subordinated debt would help preserve its utility as a regulatory capital instrument, particularly for low-income designated credit unions (LICUs) that have traditionally depended on secondary

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<sup>16</sup> NCUA Chairman Todd M. Harper Remarks at the NAFCU Congressional Caucus (September 14, 2022), available at <https://www.ncua.gov/newsroom/speech/2022/ncua-chairman-todd-m-harper-remarks-nafcu-congressional-caucus>.

capital to grow but may lack the resources to engage in small issuances of subordinated debt under more complex rules which took effect in 2022.

### **Subordinated Debt**

On September 22, 2022, the NCUA issued a proposed rule to amend the subordinated debt regulation to better accommodate 30-year ECIP investments, establish a more flexible framework for determining the maximum maturity of subordinated debt notes, and to ease administrative burdens associated with issuing subordinated debt.

In general, the proposal adopted recommendations that NAFCU had requested last year when ECIP applications were still being processed by the Department of Treasury. At that time, the NCUA was working to resolve uncertainty about whether a credit union could count ECIP investments (functionally, grandfathered secondary capital) as regulatory capital for the entire term of the note. The proposal resolved that uncertainty by permitting grandfathered secondary capital to receive regulatory treatment for a period of 30 years from the later of the date of issuance or January 1, 2022.

The proposal also adopted a more flexible framework for determining the maximum maturity of subordinated debt notes. Rather than impose a maximum 20-year maturity limit, the proposal allows a credit union to provide certain information in its application for preapproval when applying to issue notes with longer maturities. NAFCU had sought this flexibility when it wrote to the NCUA in 2021 advising that the current, 20-year maturity limit did not reflect a reasonable interpretation of the legal tests used to determine whether a security is debt versus equity.

NAFCU continues to advocate for additional streamlining of the NCUA's subordinated debt rule to ensure that all eligible credit unions, including those that are low-income designated, can leverage alternative forms of capital without the burden of excessive administrative costs.

### **Changes to ONES Supervision**

NAFCU has long advocated for a regulatory framework that is tailored to the complexity and risks of individual institutions. In 2022, the NCUA acknowledged that the supervisory framework for covered credit unions would benefit from readjustment and in February 2022 issued a proposed rule to recalibrate the asset threshold used for determining whether a natural person credit union is subject to supervision by ONES.

In response to the proposal, NAFCU submitted comments to the NCUA supporting adjustments to the asset threshold for determining ONES supervision. NAFCU also recommended changes to data collection procedures for covered unions to reflect practical

limits on the resources of the Regional Offices, and urged appropriate coordination between the NCUA Regions, ONES, and the CFPB to ensure consistency and harmonize expectations.

At its July 21, 2022, meeting, the NCUA Board unanimously approved a final rule that raised the asset threshold for assigning a natural person credit union to ONES from \$10 billion to \$15 billion (the threshold that defines a Tier I credit union). All natural person FICUs meeting or exceeding the \$10 billion asset threshold remain subject to NCUA capital planning and stress testing data collection regulations applicable to Tier I covered credit unions. The final rule included NAFCU-sought clarification that ONES would continue to manage the data collection process for Tier I credit unions and would remain the point of contact for resolving any data collection issues. In response to NAFCU's concerns about member credit unions' inconsistent examination experiences across the Regional Offices, the NCUA Board noted in the final rule that ONES would develop a capital plan training program for the Regional Offices.

## NCUA Budget

NAFCU continues to advocate for transparent actions by regulators. Section 212 of the Economic Growth, Regulatory Relief and Consumer Protection Act (S. 2155) amended section 209(b) of the FCU Act, requiring the NCUA to publish a draft of its annual budget in the Federal Register, hold a public hearing on the draft, and address comments submitted by the public. In September the NCUA released a proposed budget through 2024.<sup>17</sup> The proposal would increase the agency's Operating Budget by 9.6 percent in 2023 and by 10 percent in 2024. Additionally, the draft budget calls for a total of 25 new full-time equivalents (FTEs) in 2023, the bulk of whom would be hired for "critical areas necessary to operate as an effective federal financial regulator capable of addressing emerging issues."

NAFCU opposes the dramatic budget increases. The additional FTEs would predominantly staff newly created programs for consumer and bank secrecy compliance. Prior to the release of the draft budget, the NCUA had not expressed a need for these positions, and no explanation was provided in the draft budget. The draft budget also includes an \$11.1 million increase in contracted services for the Modern Examination & Risk Identification Tool (MERIT). NCUA staff presented material at the agency's budget hearing indicating that the costs involved in operating and maintaining MERIT will increase by an average of 9.2 percent through 2025 in the agency's base case.<sup>18</sup> NAFCU also objected to the substantial increase in travel expenses in the 2023 budget, reflecting 75 percent of pre-COVID spending on travel. Given the experience that both the NCUA and credit unions gained in completing

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<sup>17</sup> NCUA, Staff Draft: 2023-2024 Budget Justification (September 29, 2022), available at: <https://www.ncua.gov/files/publications/budget/budget-justification-proposed-2023-2024.pdf>.

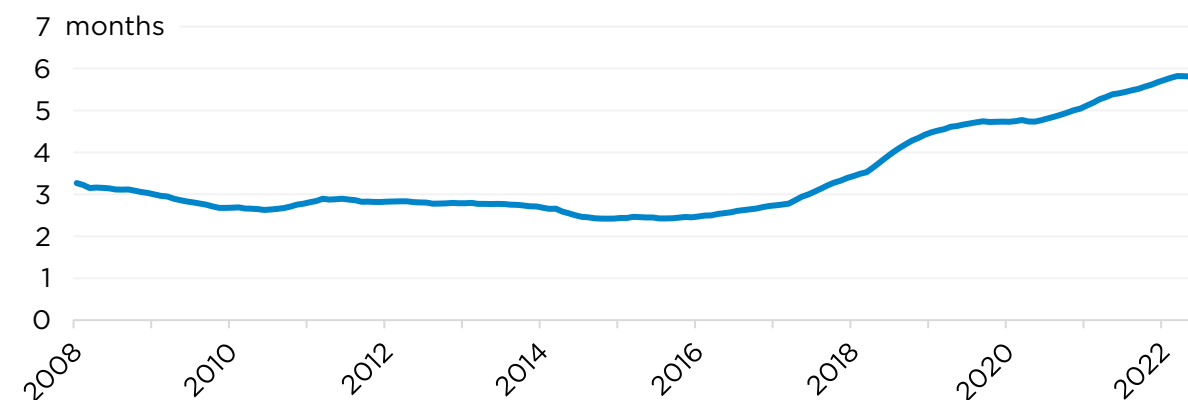
<sup>18</sup> NCUA, *Board Briefing, NCUA's 2023-2024 Budget* (October 19, 2022), available at: <https://www.ncua.gov/files/agenda-items/budget-2023-board-briefing-20221019.pdf>.



examinations remotely during the pandemic, NAFCU urged the NCUA to consider carefully whether the benefits of on-site examinations exceed the costs.

Cybersecurity supervision represents a rapidly growing portion of the NCUA budget. NAFCU supports efforts to strengthen the NCUA’s cybersecurity and resilience to security threats, but requests that the NCUA seek to measure, through transparent metrics, the added value of new cybersecurity investments included in each budget cycle.

Chart 3.1: NCUA Operating Fund Cash Balance, in months of annual budgeted expenses



Series reflects 12-month moving average  
Sources: NCUA, NAFCU calculations

The 2022 NCUA budget included a NAFCU-sought return of excess cash to credit unions. The cash balance in the NCUA Operating Fund had grown over time as agency expenditures fell short of budgeted expenses, including early in the pandemic. As part of the NCUA’s budget process, the agency announced that Federal Credit Union operating fees would be reduced by \$15 million in 2022 in recognition of the cash held in excess of spending needs. Despite the refund, the Operating Fund cash position is little changed one year later. NAFCU once more calls on the NCUA to closely scrutinize its cash needs and to return any excess balance to credit unions.

## Housing Finance

NAFCU has been focused on ensuring that non-depository institutions in the housing finance sector are properly regulated to reduce the risks posed to consumers and the entire housing finance system. At the same time, NAFCU has successfully advocated for credit unions and convinced Ginnie Mae to exclude credit unions from its capital requirements, providing them parity with banks.

In January, the Federal Housing Finance Association (FHFA) announced that it will increase the upfront fees for high-balance loans and second home loans for deliveries and acquisitions. NAFCU's 2022 *Federal Reserve Meeting Survey* shows that 75 percent of responding credit unions that use the GSEs find pricing to be a key factor in that decision. In the same survey, 57 percent of respondents find that the imposition of fees on mortgage refinances have had or is expected to have a material impact on their credit union.

In August, the FHFA announced that it will conduct a comprehensive review of the Federal Home Loan Bank (FHLB) system beginning in the fall of 2022. FHLBs serve as important partners for a large and growing number of credit unions (see *Liquidity*, page 18).

The GSEs—which remain under FHFA conservatorship—also serve an important role for many credit unions, and NAFCU respondents anticipate utilizing them to a greater extent next year (see *Secondary Mortgage Market*, page 17). NAFCU supports a sustainable secondary mortgage market that offers a level playing field for credit unions, and where pricing is based on the risk and quality of loans.

## II. Regulatory Relief

### Interchange

Interchange income is the most important component of non-interest income for credit unions, and NAFCU has long sought the repeal of Dodd-Frank's cap on interchange fees (Durbin amendment) as the benefits have not been passed on to consumers. In 2022, credit unions reported that interchange fees accounted for 58 percent of their total fee income. Interchange income supports investments in debit reward programs, security enhancements, and other features that help credit union members conveniently make digital payments both online and in-person. Despite the value that interchange income provides to the broader economy by connecting merchants to consumers through seamless digital transactions, misleading attacks against interchange persist and have even included calls to extend price controls on credit cards.

NAFCU opposes any efforts to expand interchange price caps to credit products. The loss of interchange revenue has contributed to a decline in fee income for credit unions in recent years, and, unlike other institutions, credit unions are bound by restrictions in the FCU Act regarding raising capital to stabilize net worth levels. Although the Durbin amendment affects credit unions with over \$10 billion in assets, its effects are trickling down to those under the threshold.

In 2021, the Federal Reserve, concurrent with merchant lobbying on the Durbin Amendment, issued a proposal to extend the routing and exclusivity provisions, which require issuers to

enable, and allow merchants to choose from, at least two unaffiliated networks, to card-not-present (CNP) transactions. In practice, this necessitates issuers enabling one single-message network and one dual-message network. Enabling a single-message network for CNP transactions would result in transactions routed over that network being PINless. If this requirement is finalized as proposed, it would likely require issuers to enable new network functionality and reissue debit cards. According to NAFCU's 2022 *Federal Reserve Meeting Survey*, 58 percent of credit union respondents reported that the impact of reissuing debit cards would be significant. Reissuance of debit cards would be just one of many devastating costs to credit unions associated with the proposal. The proposal would also force credit unions that prefer to use dual-message networks, which support sophisticated security systems, to use less secure PINless, single-message networks. Forty-seven percent of respondents report that this proposal would have significant fraud related impacts. Through this proposal, the Federal Reserve would expand the catastrophic impacts of the Durbin amendment to online retail transactions, at a time when consumers increasingly utilize this form of payment.



NAFCU CEO Dan Berger (right) moderates a panel session on interchange regulation. Panelists included (from left to right): Amanda Slater, SVP and head of U.S. federal affairs with Mastercard; Meredith Ritchie, SVP/general counsel and chief ethics and government affairs officer with Alliant Credit Union; and Jeff Tassey, chairman of the Electronic Payments Coalition.

On July 28, 2022, Senators Durbin, D-Ill., and Roger Marshall, R-Kansas, introduced legislation to expand the Durbin Amendment, which was enacted in 2010 as part of the Dodd-Frank Act. The NAFCU-opposed legislation, the Credit Card Competition Act of 2022, aims to expand interchange price controls by creating a new credit card routing mandate, which would be a

direct detriment to credit unions and their members. The new legislation essentially imposes a back-door price control on credit card interchange fees. While the bill seeks to limit these new requirements to only institutions over \$100 billion in assets, the history of the failed exemption in the Durbin Amendment has shown that these price controls will negatively impact all institutions. NAFCU believes that the Durbin Amendment has failed to deliver for consumers and should ultimately be repealed. The association also strongly opposes any efforts to extend any provisions from the Durbin Amendment to card-not-present transactions or credit cards and urges lawmaker to reject this latest ploy by the merchant community by not sponsoring or supporting such legislation.

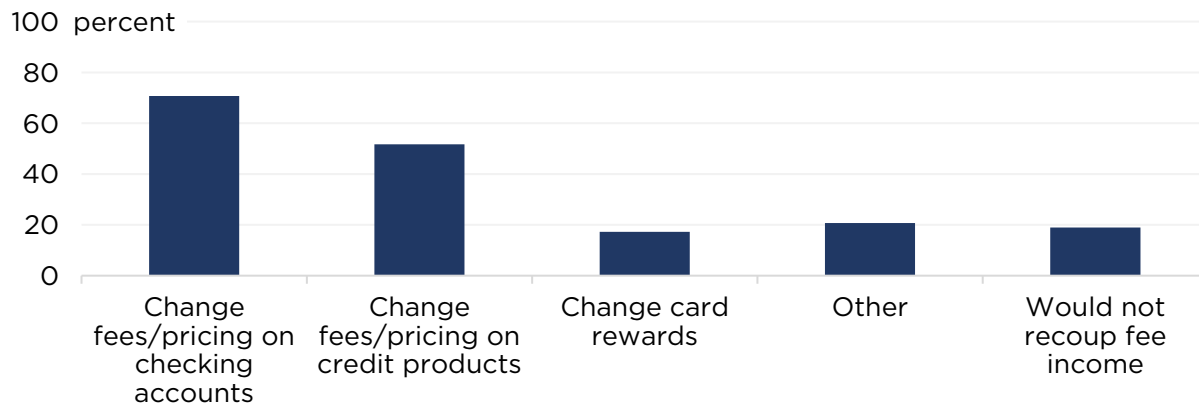
In addition to legislative attacks on interchange, regulatory interpretations of Regulation II have presented parallel challenges. Regulation II requires, among other things, that a debit card issuer (1) allow an electronic debit transaction to be processed on at least two unaffiliated payment card networks, and (2) not restrict the network's operation to a particular type of transaction. On October 3, 2022, the Board of Governors of the Federal Reserve System published a final rule amending Regulation II to clarify that debit card issuers must enable, and allow merchants to choose from, at least two unaffiliated networks for card-not-present transactions. Credit unions must configure their debit cards so that card-not-present transactions can be processed on at least two unaffiliated networks. Under the final rule, a credit union will need to determine whether card-not-present transactions performed with its debit cards can already be processed on at least two unaffiliated networks; if the credit union is not already compliant with the final rule, it will need to adjust its debit card processing arrangements to meet the final rule's requirements by July 1, 2023.

## Overdraft and Other Service Fees

Overdraft programs continue to be popular with credit union members despite the CFPB's persistent attacks on fee income. Respondents to NAFCU's 2022 *Federal Reserve Meeting Survey* indicated that overdraft use has steadily increased, and now a majority of credit union members (56 percent) have opted into these programs, up nearly 6 percent from 2021. On June 16, 2022, the CFPB published a blog post touting its information gathering and supervisory efforts toward financial institutions "with a higher share of frequent overdrafters or a higher average fee burden for overdrafts." The CFPB intends to use the information gathered to identify institutions for further examination and review. Of note, the CFPB praised the banks and credit unions that have changed their overdraft and NSF programs to be less reliant on fees. But for many financial institutions, a reduction in fee income will necessitate increased fees or pricing on other products. Seventy-one percent of *Federal Reserve Meeting Survey* respondents said that such a decrease in income would cause them to raise fees on checking accounts and 52 percent would change pricing on credit products. The share of survey respondents reporting that they expect maintaining access to affordable payments to

be a significant challenge over the next three years climbed from 12 percent in 2021 to 26 percent in the 2022 survey.

Chart 3.2: How would you recoup fee income if overdraft fees were limited or capped by regulation?



Sources: NAFCU 2022 *Federal Reserve Meeting Survey*

The CFPB has expanded its scrutiny of fees beyond overdraft, and on January 26, 2022, the Bureau issued a request for information (RFI) regarding fees on consumer financial products and services, or "junk fees." NAFCU objected to the CFPB's characterization of financial services fees as "junk fees," as these fees are all subject to comprehensive federal or state laws and regulations; are not unfair, deceptive, or abusive; and consumers are well-informed of the fees. The CFPB should consider the current regulatory regime and significant body of existing data concerning consumer understanding of consumer financial products and services and recognize that fees in the consumer financial services market are subject to significant disclosure requirements intended to promote consumer choice and competition. NAFCU urged the CFPB to engage in broad consumer education initiatives regarding financial disclosures. On June 22, 2022, the CFPB issued an advance notice of proposed rulemaking (ANPR) inviting comment on questions related to credit card late fees that financial institutions, including credit unions, collect. Credit card late fees are not surprise fees and are fully disclosed to consumers and NAFCU urges the Bureau not to eliminate or reduce the safe harbor fee amounts for credit card late fees as this could negatively affect communities by tightening credit and increasing industry consolidation while resulting in more expensive products and services to account for the lost revenue, such as increased interest rates for credit products to account for the additional risk and reduced late fee income.

## Regulation CC

Both before and after the pandemic, check transactions have been in decline relative to electronic alternatives such as ACH and card payments. The quarterly volume of commercial

checks collected through the Federal Reserve stood at 886 million items in the second quarter of 2022, a decline of 4.7 percent from the volume reported a year ago.<sup>19</sup> Although commercial checks collected by the Federal Reserve represent only a small share of total check volume in the United States, steady decline in the volume and value of these items reflects a broader trend, and recent figures reported stand in stark contrast with the 4 billion commercial checks collected by the Reserve Banks a decade ago.<sup>20</sup> As long as checks remain in usage, credit unions must comply with the funds availability rules in Regulation CC and maintain vigilance against the fraud risks inherent to check handling.

Given growing consumer preference for faster, electronic payment channels, NAFCU continues to advocate for modernization of Regulation CC to better address check fraud that exploits the idiosyncrasies of check processing. Over the past three years, credit unions have said that either the frequency or dollar amount of check fraud has increased. In 2022, 81 percent of credit unions reported that they had seen an increase in the volume or amount of attempted check fraud compared with 70 percent of credit unions in 2021. NAFCU members have identified check washing schemes (i.e., altering the check by chemical process) and use of counterfeit cashier's checks as common tactics employed by criminals.

Recognizing the diminishing role of checks in the broader payments landscape and availability of more secure electronic payment alternatives, NAFCU continues to encourage the Federal Reserve to consider more reasonable standards for check holds. NAFCU has suggested narrow amendments to Regulation CC's exception hold provisions that would give credit unions more time to investigate whether a check is counterfeit or fraudulently presented. Existing provisions regarding check holds create undue risk for both credit unions and potentially their members because Regulation CC does not always afford sufficient time to conduct an investigation or determine if there are insufficient funds. NAFCU will continue to work with the Federal Reserve to identify reforms which will ensure that members continue to enjoy timely access to funds without creating undue fraud risk.

## Current Expected Credit Loss (CECL) Standard

In 2016 the Financial Accounting Standards Board (FASB) finalized an accounting standard update with the goal of improving recognition and measurement of credit losses on loans and debt securities. The result was the CECL model, which has been called by many the most significant accounting change in the banking industry in decades.

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<sup>19</sup> Federal Reserve, Commercial Checks Collected through the Federal Reserve--Quarterly Data, [https://www.federalreserve.gov/paymentsystems/check\\_commcheckcolqtr.htm](https://www.federalreserve.gov/paymentsystems/check_commcheckcolqtr.htm).

<sup>20</sup> Federal Reserve, Developments in Noncash Payments for 2019 and 2020: Findings from the Federal Reserve Payments Study (January 2022), available at: <https://www.federalreserve.gov/paymentsystems/december-2021-findings-from-the-federal-reserve-payments-study.htm>.

Since it was first proposed, NAFCU has maintained that credit unions should not be subject to CECL because they were not a part of the poor lending practices that precipitated the financial crisis. The fact that it comes into play during a time of heightened economic uncertainty increases the impact on credit union capital. According to NAFCU's 2022 *Federal Reserve Meeting Survey* nearly 30 percent of respondents considered maintaining or increasing capital to be a significant challenge over the next three years. Despite continued advocacy for a credit union exemption, the FASB declined to provide an exemption. As we approach the January 1, 2023, implementation date, credit unions have been working through some of the challenges posed by the CECL standard.

On February 3, 2022, the FASB voted to eliminate troubled debt restructuring (TDR) accounting guidance for creditors who have adopted the CECL standard, with an effective date of Dec. 15, 2022. Following NAFCU-led concerns about a potential mismatch in the NCUA's three-year phase-in relief of CECL's effect on a credit union's net worth ratio, on August 5, 2022, the NCUA issued accounting guidance determining that the term "fiscal year" should not be interpreted to mean "calendar year." This clarification resolved the mismatch as it affected non-calendar year filers that wanted to adopt the CECL phase-in.

The NCUA has provided educational materials and been conducting targeted examiner training in the second half of 2022. Additionally, on September 14, 2022, the NCUA released a simplified method for implementing CECL, derived from the weighted average remaining maturity (WARM) method that has been adopted by the other federal banking regulators. This method integrates with credit union call report data and is intended to spare credit unions from having to pay excessive fees to contractors to develop a CECL model.

## Member Business Lending

NAFCU continues to seek permanent legislative solutions to the unnecessary member business loan (MBL) restrictions imposed on credit unions by the *Credit Union Membership Access Act* (CUMAA) and the FCU Act. Despite the CUMAA's MBL net worth and total assets caps and the FCU Act's 15-year general loan maturity limit constraining credit unions' ability to increase member businesses' access to affordable, high-quality credit, research from the Federal Reserve shows credit unions routinely receive higher marks for borrower satisfaction than other small business lenders.<sup>21</sup>

The NAFCU-sought *Member Business Loan Expansion Act*, introduced in September 2021 by U.S. Reps. Vicente Gonzalez, D-Texas, and Brian Fitzpatrick, R-Pa., would make clear the NCUA can provide credit unions relief from the FCU Act's 15-year general loan maturity limit and

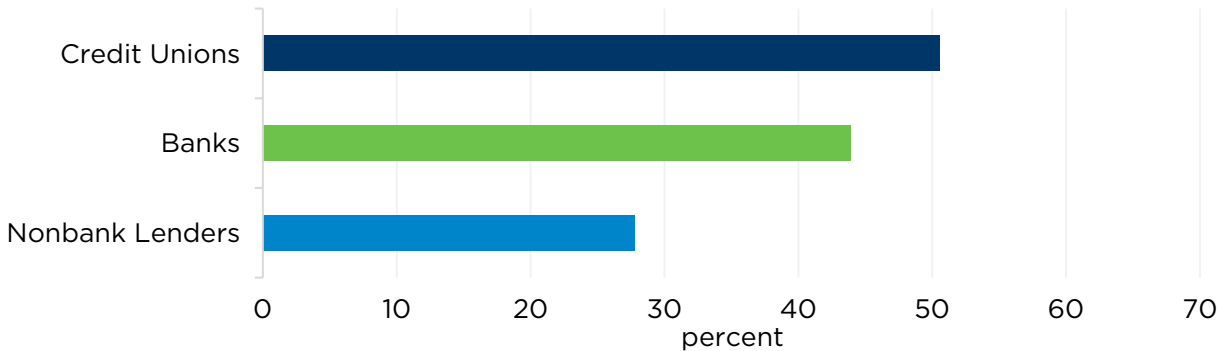
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<sup>21</sup> See "Lender Satisfaction," *Small Business Credit Survey: 2021 Report on Employer Firms*, Federal Reserve, available at: <https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2021-sbcs-employer-firms-report>.



would double the *de minimis* MBL threshold from \$50,000 to \$100,000. The bill would also amend the definition of "community financial institution" under the FHLB Act to include credit unions and thereby permit more credit unions to offer affordable, high-quality mortgage loans to more consumers, including the underserved and unserved.

Chart 3.3: Number of SBA 7(a) Loan Originations Under \$150,000 as a Share of Total 7(a) Originations, by Lender Type



Lender type determined on the basis of whether a FDIC certificate ID or NCUA charter number is reported. Data cover loans originated from 2018 through 2022 Q2, with period assigned as of approval date.  
Sources: U.S. Small Business Administration, NAFCU calculations

### SBA Direct Lending

The Small Business Administration's (SBA) 7(a) and 504 loan programs have maximum loan limits as high as \$5 million. However, the roughly one-third of NAFCU members that participate in the SBA's 7(a) and 504 loan programs have historically focused on expanding member businesses' access to affordable, smaller dollar loans. Over the past five years, 51 percent of credit unions' 7(a) loans were for \$150,000 or less, the highest of any lender type. For credit unions to continue to build on these and other member business successes, it is important that the SBA lending market remain well-regulated and fair.

Though the Small Business Act permits the SBA to lend directly to small businesses under the SBA's existing 7(a) and 504 loan programs, the SBA has not operated a direct lending program since 1998. Currently, credit unions and other SBA-approved lenders participating in existing 7(a) and 504 loan programs use their own capital to originate, disburse, and service small business loans that are eligible for partial or full SBA guarantees—85 percent for most 7(a) loans up to \$150,000 and as high as 100% for some 504 loans. The value that credit unions bring to SBA loan programs has perhaps never been on greater display than it was during the SBA's Paycheck Protection Program (PPP). In-community support was crucial for many small business borrowers that were unable to reliably communicate with the SBA and were turned away by large for-profit banks and out-of-community PPP lenders, many of whom are online-only bank startups.





NAFCU's Chad Adams talks to Rep. Blaine Luetkemeyer (R-Mo.) at NAFCU's Congressional Caucus. Luetkemeyer introduced legislation that would prohibit the SBA from engaging in direct lending.

However, in September 2021, the House Small Business Committee reported out, as part of its review of the Build Back Better Act, a bill that would dramatically reshape the smaller dollar SBA 7(a) loan market in favor of those least capable or willing to help small businesses during times of extreme economic stress. Under the bill, the SBA could make 7(a) loans of \$150,000 or less directly to borrowers or “through partnerships with third parties.” Though credit unions could still participate in the SBA’s 7(a) loan program much as they do now, the bill would not only encourage the SBA to restart direct lending efforts but would expand the list of entities eligible to become SBA-approved lenders to include non-depository financial technology companies. In short, if this or a substantially similar bill is passed, NAFCU members participating in the SBA’s 7(a) loan program could expect to face not only renewed competition from the SBA but also new competition from a slew of online-only, much less regulated fintechs.

NAFCU strongly opposes any expansion of the SBA’s direct lending authority and any weakening of the SBA’s lender approval process and, therefore, supports the IMPROVE the SBA Act, introduced in the House in late April 2022 by Rep. Blaine Luetkemeyer (R-Mo.). The bill, if passed, would prohibit the SBA from engaging in direct lending under any of its existing loan programs and preserve the existing requirements of the SBA’s lender approval process, which largely preclude non-depository fintechs from becoming SBA-approved lenders.

## Section 1071

In September 2021, the Bureau released its much-anticipated proposed rule to amend Regulation B to implement changes made by section 1071 of the Dodd-Frank Act. The Bureau proposed to require that credit unions and credit union service organizations (CUSOs) that originated at least 25 covered small business credit transactions in each of the two preceding calendar years collect and report certain small business credit application data, including data related to the ethnicity, race, and sex of business applicants' principal owners.

In response, NAFCU urged the Bureau to, among other recommendations, (1) revise its proposed loan-volume threshold for covered financial institutions upward from 25 to 500; (2) adopt the SBA \$1 million prior-year gross annual revenue small business definition; (3) establish a de minimis covered credit transactions threshold that tracks the NCUA Call Report threshold, currently \$50,000; (4) exclude small business credit cards and commercial real estate loans from the definition of a covered credit transaction; and (5) extend the proposed mandatory compliance schedule from 18 months to no less than three years. NAFCU also unequivocally opposes the Bureau's adoption of any regulation or examination practice that operates to require that any individual make any visual observation concerning any protected demographic information or similarly sensitive data of a small business applicant's owners.

NAFCU, alongside other trade associations representing a variety of financial industries, is currently seeking information related to the Bureau's section 1071 rulemaking efforts under a series of Freedom of Information Act (FOIA) requests. NAFCU has consistently advocated for credit unions' exemption from any small business lending data collection and reporting rulemaking. NAFCU notes credit unions have a long track record of robustly supporting small businesses despite the CUMAA's and the FCU Act's unnecessarily restrictive MBL caps. NAFCU also highlights the outsized impact additional compliance burdens would have on credit unions, many of which themselves fall below the SBA's \$1 million small businesses gross annual revenue threshold and rely on three or fewer employees to perform predominantly manual member business lending tasks.

Forty-nine percent of respondents to NAFCU's 2022 *Federal Reserve Meeting Survey* said their credit unions are either very likely or somewhat likely to reconsider participating in the business lending market if section 1071's requirements are implemented. More than half of respondents said it is very likely or somewhat likely that their credit union would reduce the number of small business credit products in section 1071's requirements were implemented. Seventy-one percent believe it is at least somewhat likely that their credit union would raise member business lending fees to cover section 1071 compliance costs. NAFCU will continue to monitor changes in credit union small business lending that occur in anticipation of a final rule, which the CFPB expects to release sometime in March 2023.

## Home Mortgage Disclosure Act (HMDA)

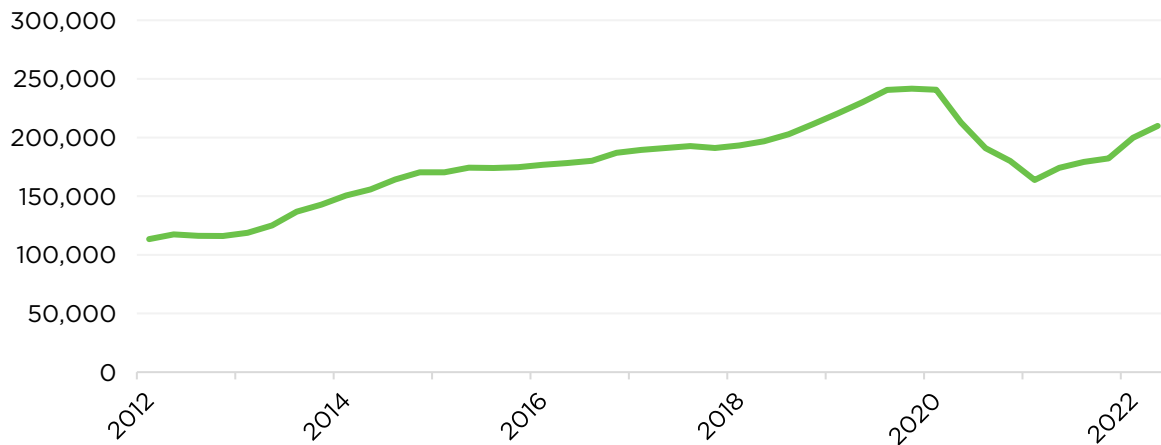
Credit unions support fair lending and legal mechanisms to detect and prevent discrimination. HMDA provides financial regulators with an important tool for enforcing fair lending laws; however, NAFCU remains concerned that certain reporting burdens exceed their useful contribution to HMDA's stated purpose. According to NAFCU's 2022 *Federal Reserve Meeting Survey*, 65 percent of respondents noted an increase in regulatory burdens associated with HMDA in the last five years. Over 71 percent of respondents expect HMDA-related burdens to increase in the next five years, and 20 percent expect to increase staff, in the next three years, devoted to HMDA compliance.

The Bureau is prioritizing a Section 1022 of the Dodd-Frank Act, which requires a review of all significant rulemakings at least five years from their effective date. Upon that review, the Bureau will determine if further changes to HMDA are necessary. NAFCU continues to advocate for the elimination of data points adopted pursuant to the Bureau's discretionary authority, and only require the data points mandated by the Dodd-Frank Act.

## Small Dollar Lending

In February 2019, the Bureau issued a proposed rule to amend the payday, vehicle title, and certain high-cost installment loans rule (payday rule). The proposed rule maintained the safe harbor for NCUA Payday Alternative Loans (PAL) but did not account for the new iteration of PAL loan finalized in 2019 (the PAL II loan). On July 22, 2020, the Bureau published a final payday rule rescinding all mandatory underwriting requirements for making an ability-to-repay (ATR) determination while retaining the original rule's payment provisions. NAFCU supported the rescission of the mandatory ATR underwriting requirements to enhance access to responsible small-dollar loans. After the final payday rule was published, litigation challenging the entirety of the Bureau's payday lending rule provisions was allowed to proceed in *Consumer Financial Services of America v. CFPB* with the court issuing a stay of the final rule's compliance date. In August 2021, the Court upheld the Payment Provisions in the Bureau's 2017 payday lending rule and marked the effective date as June 13, 2022. NAFCU will remain in close contact with the Bureau on this topic and continue to inform credit unions of changes that may impact their ability to offer these types of loans. On July 12, 2022, the Bureau filed a federal lawsuit against Ace Cash Express, a non-bank payday lender, after the Bureau alleged they had engaged in unfair, deceptive and abusive acts or practices by failing to disclose to borrowers that there were state-law protections that could allow a borrower to avoid certain fees when renewing or rolling over a payday loan.

Chart 3.4: Number of Payday Alternative Loans (PALs) Originated by Federal Credit Unions



Origination totals span the prior 12-month period  
Source: NCUA

In addition to opposing regulatory burdens imposed by the CFPB, NAFCU has sought additional regulatory flexibility from the NCUA that recognizes credit unions' good conduct as small dollar lenders. NAFCU continues to advocate for expansion of the NCUA's PAL program to provide additional options for credit unions to help members in need of responsible short-term, small-dollar loans.

On December 16, 2021, the CFPB issued market monitoring orders requiring five providers of buy-now-pay-later (BNPL) products to provide information about their size, scope, and business practices. Very few credit unions are currently offering BNPL products or even considering offering them according to NAFCU's 2022 *Federal Reserve Meeting Survey*. No respondent currently offered BNPL, and only 20 percent were considering offering the product in the future. On January 24, 2022, the Bureau issued a notice and request for comment (RFC) to gain further information about the BNPL market. The Bureau specifically targeted in its inquiry split-pay companies that offer installments of four or less, i.e. "Pay in 4," and has excluded longer-term point-of-sale installment loans. NAFCU submitted a comment letter urging the Bureau to release a comprehensive report regarding its findings from the market monitoring orders and RFC, and if warranted, take steps to ensure that under-regulated lenders institute adequate consumer protection practices.

On September 15, 2022, the CFPB issued a report on BNPL that incorporated data collected from BNPL providers who were subject to the 2021 market monitoring inquiry. The CFPB's analysis of typical BNPL product features revealed that some market participants' offerings appeared to be structured to evade certain federal consumer lending requirements—a quality

NAFCU noted in its comments to the CFPB which drew attention to discrepancies in regulatory oversight and the need for a level playing field for nonbank lenders and credit unions. In a press release, the CFPB stated that it would address consumer harms associated with BNPL through potential interpretive guidance or rules with the goal of ensuring BNPL lenders comply with the “baseline protections” that Congress has provided for credit cards. The CFPB also declared that BNPL lenders, like credit card companies, would be subject to appropriate supervisory examination.

## Defense Issues

Credit unions have a strong track record of helping active-duty members of the armed forces and their families avoid the predatory lending practices which precipitated Congress’s enactment of the Military Lending Act (MLA). NAFCU supports efforts to protect servicemembers and their families from financial exploitation and has urged the Department of Defense (DoD) to provide clear rules that do not unduly restrict access to financial products or services.

NAFCU and its members have repeatedly sought rescission to the DoD’s Question and Answer #2 (Question #2) of its 2016 interpretive rule which appeared to prohibit access to GAP insurance when the MLA-covered borrower tried to finance the GAP insurance with the loan used to purchase the vehicle. In February 2020, the DoD published an interpretive rule which rescinded Question #2 and reverted to a prior interpretation. However, the interpretive rule remains silent on the issue of GAP financing, possibly suggesting that the DoD did not intend to exclude it from an exception within the regulation.

In June 2021, the CFPB published an interpretive rule explaining the agency’s authority to conduct examinations related to the MLA at its supervised institutions. The interpretive rule does not make any substantive changes to any federal law, but it refutes the 2018 determination that the Bureau lacks the authority to conduct MLA-related examinations.

NAFCU has also defended credit unions’ ability to maintain nominal cost leases on military installations in recognition of the services they provide to both the base and military personnel stationed there. The DoD has authority to lease space on military bases at a nominal rate to credit unions provided they meet certain statutory and regulatory requirements for providing financial services on base. These nominal leases have been the target of recent banker attacks claiming that credit unions are required to pay rent at fair market value; however, the DoD has the authority to consider “in-kind consideration.” In August, the DoD issued a report underscoring the consistent availability of financial institutions on military installations. The House’s version of the NDAA for fiscal year 2023 includes language that

would protect the status of credit union leases on military bases and prevent efforts to allow banks to operate rent-free on military basis.

## Exam Modernization

At the center of the NCUA's exam modernization efforts is NCUA Connect, a user interface through which credit unions may access recently released and forthcoming NCUA examination, data collection, field of membership, and reporting applications. The Modern Examination & Risk Identification Tool (MERIT) is replacing the NCUA's legacy examination platform, the Automated Integrated Regulatory Examination System (AIRES). MERIT enables credit unions to "transfer files within the context of an examination, provide status updates and request due date changes on examination findings and action items, and retrieve completed examination reports." Finally, the NCUA's new data ingest tool, the Data Exchange Application (DEXA), enables a credit union to securely import loan and share account data, upload a mapping schema for the credit union's loan and share account type codes, validate imported and mapped data prior to submission, and view the status of submitted files.

NAFCU met with the Director of the NCUA's Office of Examination and Insurance (E&I) and other NCUA staff in July 2022 and learned the NCUA's Information Security Examination (ISE) pilot is scheduled to wrap in the second half of 2022. The NCUA will be rolling out related training for agency staff by year end. Approximately two-thirds of credit unions were able to meet the March 2022 call report modernization deadline without issue. Most of the remaining one-third of credit unions initially experienced errors with submitting data for the new risk-based capital and complex credit union leverage ratio fields but were able to successfully resubmit by using an NCUA-provided Call Report data tool. Through engagement with the NCUA, NAFCU has communicated credit union concerns about duplicative requests for information and documents from remote examiners failing to communicate and coordinate with one another. The NCUA has shared that it is aware of and working to address the issue.

NAFCU continues to stress the need for the NCUA's virtual examination program to prioritize reductions in exam burden and duration. NAFCU also continues to advocate for extended examination cycles for low-risk, well-run credit unions.

## Interest Rate Risk (IRR) Supervision

In 2017 the NCUA implemented its Net Economic Value (NEV) Supervisory Test as a measure of interest rate risk. Importantly, the test applies a standardized premium to credit union non-maturity shares in both the base case (1 percent) and the 300-basis point shocked scenario (4 percent). In establishing those parameters, the NCUA acknowledged that there was no market standard, but claimed that due to the size of non-maturity shares as a percentage of total credit union liabilities, a standardized approach was needed. If the chosen parameters



deviated from a credit union’s historical experience, the NCUA reasoned that “the past may not accurately predict future behavior.”<sup>22</sup>

While NAFCU has consistently heard from members over the years that the results of the NEV Supervisory Test represented sharp departures from their own internal analysis as well as that of third-party specialists, the issue became more significant in 2022 as interest rates rose at the fastest pace in decades. NAFCU recognizes that the agency needs to supervise the system for risks which could expose the Share Insurance Fund to losses, but the NEV Supervisory Test relies heavily on the non-maturity share assumptions which have thin justification and are, on the basis of reports from NAFCU members, systematically too low. These test results pushed many healthy credit unions into a high or even extreme IRR risk category, the latter result requiring de-risking procedures.

NAFCU met with NCUA staff in July 2022 to discuss the issue, during which time NAFCU learned that the agency was in the process of developing examiner guidance to address the situation. On September 1, 2022, the agency announced changes to its IRR supervision, which included the elimination of the extreme IRR risk classification, the removal of any presumption of a document of resolution (DOR) based strictly on the IRR risk classification, and providing examiners with greater discretion in assigning risk ratings.<sup>23</sup> NAFCU appreciates the sensible changes and encourages the agency to apply them consistently across the system.

## Community Development Financial Institutions (CDFIs)

CDFIs are mission-focused financial institutions that provide services to underserved communities while also helping to grow local economies by providing affordable housing and supporting small, minority-owned businesses. There are nearly 500 CDFI credit unions today, an increase of more than 50 percent over the last two years. Currently, credit unions make up one-third of all CDFIs; they collectively serve nearly 17 million predominantly low-income consumers and communities of color and have combined assets of over \$230 billion.<sup>24</sup>

NAFCU is committed to ensuring that CDFIs are able to successfully operate in the underbanked communities that are typically low-income and minority populations. Fifty-one percent of respondents to NAFCU’s 2022 *Federal Reserve Meeting Survey* are interested in applying to become a CDFI. Access to small-dollar loan programs, credit builder loan programs, first-time home buyer programs, and financial literacy training are among the top

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<sup>22</sup> NCUA, *Fact Sheet - NCUA Revised Interest Rate Supervision* (October 2016), available at: <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/fact-sheet-ncua-revised-interest-rate-supervision>.

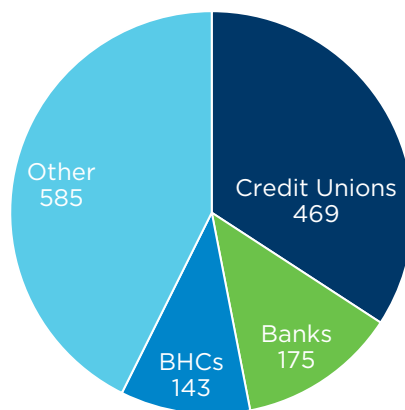
<sup>23</sup> NCUA, *Updates to Interest Rate Risk Supervisory Framework* (September 2022), available at: <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/updates-interest-rate-risk-supervisory-framework-0>.

<sup>24</sup> U.S. Treasury Department, *List of Certified CDFIs with Contact Information* (July 14, 2022), available at: <https://www.cdfifund.gov/programstraining/certification/cdfi>.

benefits that respondents to NAFCU's 2022 *Federal Reserve Meeting Survey* associate with anticipated CDFI award funding or technical assistance.

As industry interest in CDFI certification grows, credit unions have reported that applications are taking longer to process. For many credit unions, a decision on their CDFI application is standing between them providing needed services to their members. In February 2022, the NCUA announced that the streamlined application process was being phased out and applications would be consolidated under one process. NAFCU immediately objected to the phase-out of the streamlined application, which has helped many LICUs and MDIs become CDFIs. In April NAFCU requested that the Treasury Department devote more resources to address the backlog and streamline the application process as soon as possible.

Chart 3.5: Community Development Financial Institutions, by Type



BHC = Bank Holding Company; "Other" includes Loan Funds and Venture Capital Funds  
Data as of July 14, 2022  
Source: U.S. Treasury Department

Several credit unions have requested certification based on minority target populations as borrowers to satisfy the target market requirement under the other targeted populations (OTP) criteria. The CDFI Fund is currently penalizing credit unions that submit this data by placing their applications on hold and discouraging applicants from relying on this data at all. Furthermore, credit unions are being decertified, in part, due to their reliance on OTP data for their annual recertification. In July the CDFI Fund announced that it will pause acceptance of new CDFI Certification Applications and requests for Target Market modifications for six months beginning in October. NAFCU continues to advocate for a more streamlined CDFI certification application process, transparency from the CDFI Fund, and the allowance of OTP data to be used for certification and annual recertification.



## Unfair, Deceptive, or Abusive Acts and Practices (UDAAP)

Although most banking laws are accompanied with detailed regulations, UDAAP has no implementing regulations. Former CFPB Director Richard Cordray defined and expanded the Bureau's UDAAP authority through enforcement actions, consent orders, and occasional supervisory guidance. From the start, NAFCU has asked for clear, transparent guidance from the CFPB on its expectations for credit unions under the law and its regulations.



CFPB Director Rohit Chopra speaks at NAFCU's Congressional Caucus

On March 16, 2022, the CFPB published a revised examination procedure guide for UDAAP that indicated the agency is targeting discrimination as an “unfair” practice in connection with all financial products and services and not just credit products. This is a serious shift in the CFPB's stance on UDAAP that is likely to result in a more opaque UDAAP landscape and an increase in compliance costs. NAFCU continues to encourage the CFPB to provide clarity on the specific factual bases for violations. Details on and examples of the specific factual bases for violations will assist credit unions in mitigating the risks of a violation. Credit unions should not be unnecessarily worried about facing potential UDAAP violations during a period of economic instability due to an unclear standard and unpredictable enforcement. In protecting consumers from UDAAP, the CFPB should initiate a rulemaking to define the “abusiveness” standard, or, alternatively, reinstate its previous policy statement clarifying the standard. Additionally, NAFCU has asked that the CFPB work closely with the NCUA to resolve questions regarding whether certain credit union powers conferred by the FCU Act may be subject to the CFPB's UDAAP authority

Compliance with UDAAP continues to be a concern for credit unions as significant resources are necessary to monitor and track the Bureau's supervision and enforcement actions to

determine how best to design or modify internal practices and procedures to avoid a UDAAP violation. According to NAFCU's *2022 Federal Reserve Meeting Survey*, credit union respondents experienced a 45 percent increase in regulatory burden related to UDAAP over the past five years and 62 percent of respondents expect to experience an increase in UDAAP related burdens over the next five years.

On September 28, 2022, a group of associations led by the U.S. Chamber of Commerce filed a lawsuit in the United States District Court for the Eastern District of Texas challenging the CFPB's March 2022 update to the UDAAP section of its examination manual. The complaint alleges that the CFPB's attempt to regulate discriminatory conduct under UDAAP violates the Administrative Procedures Act (APA), exceeds the CFPB's statutory authority, and is arbitrary and capricious.

### **Bank Secrecy Act (BSA)**

On January 1, 2021, the Anti-Money Laundering Act of 2020, which included the Corporate Transparency Act (CTA), was signed into law as part of the National Defense Authorization Act (NDAA). The legislation provides for robust Bank Secrecy Act (BSA)/anti-money laundering (AML) reform that will be implemented over the next few years. The Financial Crimes Enforcement Network (FinCEN) has initiated rulemaking efforts to implement various provisions, one of which includes a proposal regarding changes to beneficial ownership. FinCEN is required to create a database whereby legal entities must submit their beneficial ownership information and lodge any updates.

Presently, financial institutions will only be able to access the database with the consent of the reporting party. NAFCU supported the creation of the database but has urged that to maximize utility, FinCEN should allow for a pre-authorization mechanism either from credit unions or from the agency. In addition, FinCEN should allow credit unions that obtain consent to receive updated beneficial ownership information provided by reporting companies. Most importantly, FinCEN must clarify examination and supervisory expectations for credit unions that rely on beneficial ownership information for customer due diligence compliance.

BSA/AML compliance continues to be burdensome for credit unions. In December 2021, FinCEN published an ANPR that would require persons involved in real estate transactions to collect, report, and retain information for non-financed transactions. In 2021, NAFCU urged FinCEN not to impose additional reporting requirements on financial institutions, as they are not best suited to provide the requested information.

According to NAFCU's *2022 Federal Reserve Meeting Survey*, 86 percent of respondents expect BSA/AML regulatory burdens to increase over the next five years. This increase may

be due, in part, to the implementation of the NDAA's provisions. Historically, credit unions have increased staff in times when additional compliance is expected, and 54 percent of credit unions expect to increase FTEs related to BSA/AML compliance in the coming years.

The implementation of national AML/Combating the Financing of Terrorism (CFT) priorities, which are set by Treasury and FinCEN every four years, also brings significant change to the traditional BSA/AML landscape. In June 2021, FinCEN and the federal banking regulators preliminarily introduced these priorities; however, a rulemaking is expected soon regarding how credit unions must incorporate these priorities into their risk assessments. Until such a rulemaking is final, the NCUA will not examine credit unions for their compliance with incorporating the priorities into their risk assessments.

FinCEN issued a request for information on ways to streamline, modernize, and update the AML/CFT framework focusing on the current record keeping and reporting requirements as part of a review required by the AML act of 2020. Upon completion of this review, FinCEN will provide a report to Congress including recommendations that may include regulatory changes. NAFCU has long sought reform of the current reporting thresholds for currency transaction reports and suspicious activity reports, and the NDAA requires a study of the thresholds to be completed every five to 10 years. This periodic assessment will provide more opportunities for the thresholds to change. NAFCU will continue to advocate for BSA/AML reform that fulfills the goal in providing valuable information to law enforcement while not being overly burdensome.

## **Telephone Consumer Protection Act (TCPA)**

Unlawful robocalls continue to generate the greatest number of consumer complaints received by the Federal Communication Commission (FCC). At the same time, credit unions and other commercial callers lawfully use automated or pre-recorded messages to communicate important information, such as fraud alerts, to members in a timely, cost-effective manner. Voice service providers operating in the United States have a legal responsibility under the TCPA and related FCC regulations to help limit unlawful robocalls. When a voice service provider flags a call as potentially unlawful and blocks the call from reaching its recipient, the voice service provider is required to notify the caller.

Currently, the vast majority of voice service providers use a Session Initiation Protocol (SIP) Code 603 message for this purpose. Unfortunately, in most cases, the message details of a SIP Code 603 or a voice service provider's remediation processes are insufficient to enable a credit union to remedy its lawful calls being falsely labeled and blocked from reaching members. Calls sometimes cross the networks of a dozen or more voice service providers and can be blocked at any point. Even when a credit union can identify at which point its falsely

labeled lawful call was blocked, many credit unions simply do not have the resources to wade through voice service providers' labyrinthine call-blocking remediation processes.

Under its Advanced Methods to Target and Eliminate Unlawful Robocalls final rule issued in April 2021, the FCC set a January 1, 2022, deadline for voice service providers to move on from SIP Code 603 notifications and adopt new SIP Code 607 and SIP Code 608 notifications designed to provide callers with more information about why, when, and by which voice service provider a call is blocked. Voice service providers later argued, and the FCC agreed, that the deadline was "infeasible." Despite concerted efforts by NAFCU and other trade associations representing lawful commercial callers across the economy, the FCC has failed to set a new deadline for voice service providers' mandatory adoption of SIP Codes 607 and 608.

NAFCU continues to engage the FCC on this and a range of issues impacting credit unions, including the FCC's need to expand affordable access to its reassigned phone number database.

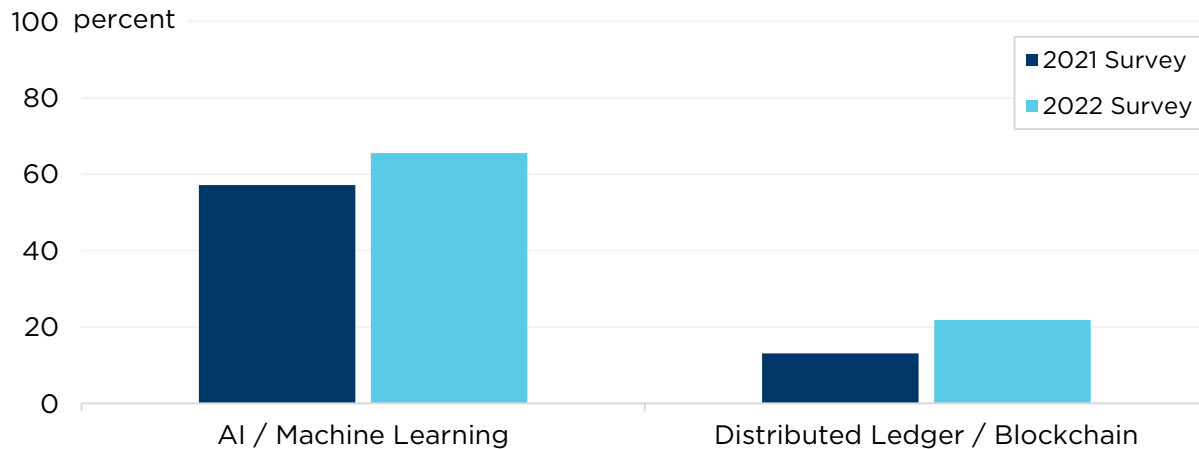
### III. Technology & Innovation

#### Financial Technology (Fintech)

Innovation remains a priority for credit unions as fintech companies continue to drive disaggregation of traditional banking services and the ability to maintain cost effective operations increasingly depends upon strategic use of new technology (see *Investments in Technology*, page 23). Although many credit unions leverage partnerships with fintech companies to improve business functions and offer new services to their members, a key priority for NAFCU is the cultivation of a fair playing field for all financial sector participants. To achieve this goal and reduce the influence of regulatory arbitrage within markets for financial services, NAFCU has informed lawmakers that fintech firms engaged in traditional banking activities must be held to the same rigorous standards as credit unions.

For the past four years, competitive pressure from fintech companies has overshadowed that of community and large banks in terms of its overall significance to credit unions. In 2022, most credit unions reported that the degree of pressure from fintech firms had increased significantly in recent years. These sentiments coincide with overwhelming prioritization of IT-related investments among NAFCU-surveyed members, 92 percent of whom reported that they expected such investments to drive budgetary increases over the next three years.

Chart 3.6: Share of Credit Unions Anticipating Investments Over the Next Three Years; 2021 Survey vs. 2022 Survey



Sources: NAFCU Federal Reserve Meeting Surveys

Certain IT investments identified by credit unions as targets for future investment represent technologies that are still relatively new to regulators. For example, 66 percent of NAFCU-surveyed credit unions indicated that they planned to invest in projects related to artificial intelligence (AI) and machine learning. A growing share of credit unions (22 percent) anticipated that they would invest in blockchain and distributed ledger applications—whereas only 13 percent identified similar technologies as investment candidates in 2021. Consideration of these evolving technologies alongside more traditional IT projects (such as online and mobile banking enhancements) demonstrates the credit union industry’s adaptability and innovative spirit.

To make credit union adoption of new technology easier, NAFCU has advocated for regulatory clarity in the domain of AI and machine learning, sought additional investment authority for credit unions’ hoping to forge strategic relationships with fintech startups, and cautioned against expansive rulemaking efforts that could degrade the business value and security of consumer financial data. NAFCU has also requested greater clarity and authority for credit unions to engage in digital asset related activities (see *Digital Assets*, p. 60).

### Regulation of AI in the Financial Services Marketplace

Credit unions continue to demonstrate growing interest in the use of artificial intelligence (AI) to improve business operations, reduce risk, and expand access to credit for borrowers who might not otherwise qualify under traditional decisioning models. The share of credit union respondents that anticipated future investments in AI and machine learning applications in 2022 was 65 percent—an 8 percent increase compared to a year prior and an 18 percent

increase compared to 2019.<sup>25</sup> The vast majority of those who anticipated making AI related investments expected to use a fintech vendor as a partner rather than pursue development in-house or through a CUSO.

AI-powered fraud analytics have enhanced credit union risk management practices and efforts to prevent financial crime by improving detection of irregular financial behaviors. Many credit unions are already using third-party technology bundled with debit and credit card products to prevent fraudulent transactions or to flag suspicious transactions. In some cases, this technology leverages AI and machine learning processes (e.g., neural networks) to develop predictive models for fraud mitigation purposes.

Another common implementation of AI technology involves the use of chatbots to enhance customer service. AI-enhanced call centers are becoming increasingly common among credit unions and offer a cost-effective means of responding to routine member questions. The use of AI technologies for resolving member questions can enhance the consumer response function of a compliance management system and regulators should accommodate the use of such technology.

Although there is broad acknowledgment that the use of AI can yield significant operational efficiency and expand access to high-quality credit among lower-income populations, regulatory agencies such as the CFPB have also warned that use of opaque algorithms could invite supervisory concern.<sup>26</sup> In a May 2022 press release, the CFPB warned that the Equal Credit Opportunity Act (ECOA) does not permit creditors to use technology that prevents them from providing specific and accurate reasons for adverse actions. An accompanying statement from Director Rohit Chopra characterized credit decisioning tools that lack algorithmic explainability as black boxes.<sup>27</sup>

Regulatory barriers that stand in the way of responsible AI innovation risk compromising the quality of member services and long-term industry viability. NAFCU continues to advocate for a flexible regulatory framework that encourages AI experimentation, which will allow credit unions to better and more cost-effectively serve members and remain at the forefront of engaging unbanked and underbanked Americans.

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<sup>25</sup> See NAFCU, *Report on Credit Unions (2021)*; see also NAFCU, *Economic & CU Monitor (July 2019)*, available at: <https://www.nafcu.org/economic-and-cu-monitor-special-topic-fintech-july-2019>.

<sup>26</sup> In 2017, the CFPB granted a No-Action Letter (NAL) to Upstart Network, Inc., a company that uses alternative data and machine learning in making credit underwriting and pricing decisions. As a condition of approval, Upstart agreed to provide the Bureau with information comparing outcomes from its underwriting and pricing model against outcomes from a hypothetical model that uses traditional application and credit file variables. After the CFPB announced in a May 2022 press release that complex algorithms might frustrate supervisory objectives, Upstart voluntarily requested termination of its NAL, which required the company to seek review and approval from the CFPB before making updates to its model. See *CFPB Press Release, CFPB Issues Order to Terminate Upstart No-Action Letter (June 8, 2022)*, available at: <https://www.consumerfinance.gov/about-us/newsroom/cfpb-issues-order-to-terminate-upstart-no-action-letter/>.

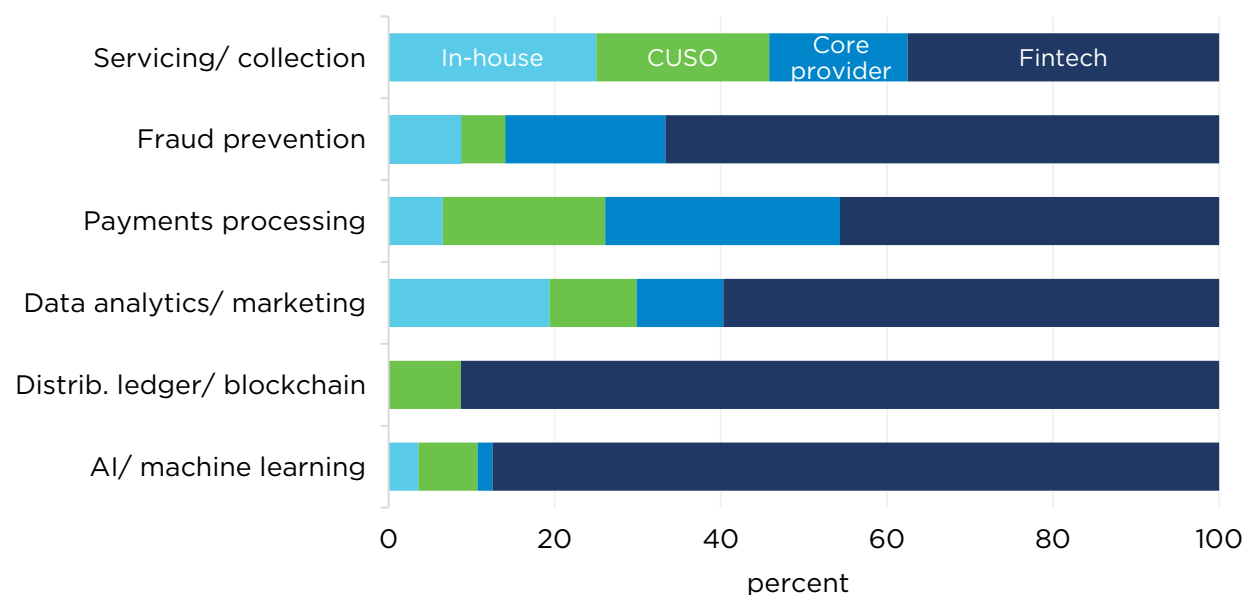
<sup>27</sup> *Id.*

## CUSO Investment Authority

NAFCU supports the NCUA reconsidering its interpretation of the lending and investment authorities in the FCU Act. Investment in financial technology should not be limited to investments in CUSOs, whose organizational characteristics can present obstacles due to having quasi-regulated status and a smaller addressable market. To remain competitive in a fintech landscape where larger banks can easily acquire startup talent and innovative products in their infancy, credit unions need the authority to invest as stakeholders in promising technology companies without needing to rely on the limited functionality of a CUSO to make strategic inroads with financial product developers.

The need for additional investment flexibility is particularly critical in areas such as artificial intelligence. Results from NAFCU's 2022 *Federal Reserve Meeting Survey* indicate that fintech companies are overwhelmingly preferred as vendors of AI and machine learning products. The same preference holds true for credit unions that anticipate making investments in distributed ledger technology and fraud prevention tools. While CUSOs remain popular for loan servicing and payments processing, fintech vendors generally dominate the field as technology service providers. Recognizing that fintech partnerships will be increasingly vital to the credit union industry's continued growth and dynamism, NAFCU remains optimistic that a planned NCUA rule "to make more flexible a federal credit union's ability to take advantage of advanced technologies and opportunities offered by the fintech sector" will reflect the association's recommendations.

Chart 3.7: Most Likely Partner or Provider for Future IT Projects



Source: NAFCU 2022 *Federal Reserve Meeting Survey*



## Consumer Financial Data Rulemaking

In 2022, NAFCU engaged with CFPB leadership to convey the importance of requiring all entities handling consumer financial data, such as nonbank data aggregators, to follow the same rigorous data security standards applicable to credit unions. As the CFPB prepares to engage in a new rulemaking to implement consumer financial data rules under section 1033 of the Dodd-Frank Act, NAFCU continues to emphasize the need for parity in terms of supervisory expectations and appropriate limits on what data a third-party can request on behalf of a consumer.

In August 2022, NAFCU joined a group of financial industry trades in a letter to the CFPB expressing concern that nonbank financial aggregators were not be subject to the same level of supervision as credit unions and banks.<sup>28</sup> In prior letters to the CFPB, NAFCU noted that these supervisory gaps were one reason the CFPB should proceed with caution before implementing section 1033 of the Dodd-Frank Act, which could grant nonbank fintechs, aggregators, and other third-party entities unprecedented access to consumer financial information. To address these discrepancies and risks, NAFCU has asked the CFPB to exercise its larger participants authority to supervise nonbank data aggregators as covered persons under the Consumer Financial Protection Act.

Although the CFPB has not specifically declared fintech data aggregators larger participants subject to the agency's supervisory jurisdiction, the agency appears to acknowledge NAFCU's concerns. The CFPB's prior market monitoring inquiries targeting large technology companies operating payment services and related focus on business models that emphasize data monetization should help flag risks associated with formal recognition of open banking rights under section 1033.

## Payments

To facilitate consumer choice and the desire for frictionless user experiences, credit unions continue to invest in innovative technologies to support faster and more secure payment options for their members. Most credit unions indicate that development of FedNow, the Federal Reserve's real time gross settlement service, has accelerated their plans to adopt faster payment options. For a subset of credit unions, use of third-party broker-dealers has helped facilitate member interaction with cryptocurrencies and other digital assets, and these partnerships could pave the way for entirely new forms of payment in the future.

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<sup>28</sup> See *Joint Letter to the Hon. Rohit Chopra, Re: Petition for Rulemaking Defining Larger Participants of Aggregation Services Market* (August 2, 2022), available at: <https://www.nafcu.org/joint-petition-cfpb-larger-participant-rulemaking-data-aggregation-services-File>.



While payments innovation remains a priority, credit unions have also expressed a more cautious outlook regarding the overall cost of payments. More credit unions expressed concern about future access to affordable payments in 2022 (26 percent) compared to a year prior (12 percent). This change in sentiment may reflect concern about the state of fintech competition (96 percent of credit unions believe that P2P providers are not competing on a fair playing field), regulatory burden (94 percent anticipate greater compliance burden in the future), the risk of fraud, and renewed threats to interchange (44 percent of credit unions anticipate a negative impact to interchange revenue if the Federal Reserve finalizes amendments to Regulation II).

Recognizing the variety and complexity of factors that can influence the total cost of sending a single electronic payment, NAFCU has cast a broad net in terms of its advocacy efforts—defending interchange, seeking appropriate regulation for fintech payment providers, and resisting calls to expand financial institution liability under the Electronic Fund Transfer Act (EFTA) and Regulation E. NAFCU's goal is to ensure that existing and future payment systems are cost-effective, operationally effective, and scalable for credit unions of all sizes. To support this goal, NAFCU continues to inform lawmakers and regulators about the value of credit union payment services, the policies needed to maintain a resilient and secure payment ecosystem, and the strategies that can help support continued payment innovation.

## **FedNOW**

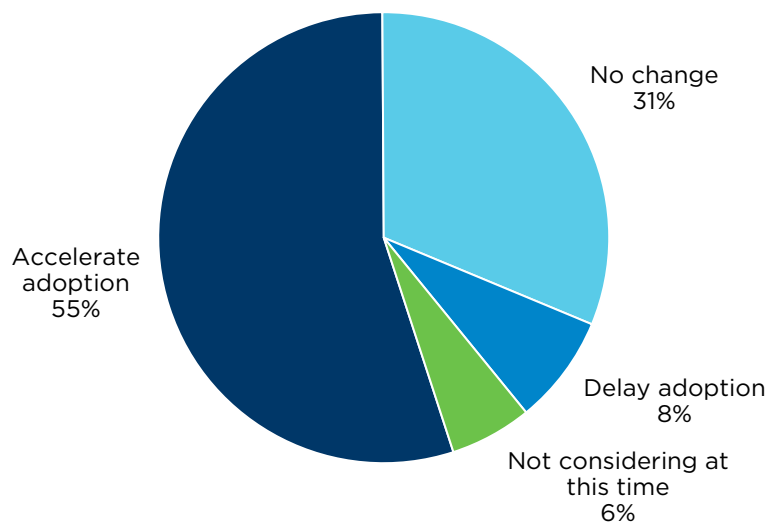
NAFCU supports development of the FedNow Service, the Federal Reserve's 24x7x365 real time gross settlement system, which is expected to debut sometime between May and July of 2023. In early 2021, the Federal Reserve announced that over financial institutions would be participating in the FedNow pilot program. Several NAFCU member credit unions were selected as participants. Since then, NAFCU has provided feedback to the Federal Reserve regarding amendments to Regulation J, which governs financial institution use of the Federal Reserve's payment services. NAFCU has also advocated for clarity around the rules and expectations for handling payment errors that may occur on FedNow. Although consumer FedNow payments are unlikely to be prevalent during the early, post-launch period, as the service matures and consumer interest in real-time payments grows, the applicability of Regulation E will have a more meaningful impact for financial institutions that use FedNOW to facilitate consumer-to-consumer payments.

NAFCU's engagement with the Federal Reserve on FedNow's development has also emphasized the importance of conducting extensive industry outreach, delivering priority features at launch, supporting interoperability with other real time payment networks, and ensuring equitable access for credit unions, regardless of payment volume. NAFCU has also encouraged early testing of critical day-one features, such as core clearing and settlement

functionality, development of a request-for-payment capability, and tools to manage liquidity and the risk of fraud.

Many of NAFCU's recommendations have been addressed favorably by the Federal Reserve. On August 29, 2022, Vice Chair Lael Brainard stated the Federal Reserve has worked closely with The Clearing House on message specifications to support routing interoperability with the RTP instant payment network.<sup>29</sup> In September 2022, the Federal Reserve announced that it would be assembling a work group to support consideration of a request-for-payment capability. The Federal Reserve has also shared next steps for FedNow, stating that Pilot Program participants, which include NAFCU member credit unions, could begin testing the service as early as September 2022 and would complete a certification process to ensure operational and messaging readiness. On October 8, 2022, the Federal Reserve published new Operating Circular 8 in anticipation of FedNow's launch. Operating Circular 8 addresses participant and service availability expectations, fraud mitigation and reporting, as well as ISO 20022 messaging used within the FedNow Service.

Chart 3.8: Impact of FedNOW Availability on Faster Payments Adoption



Source: NAFCU 2022 *Federal Reserve Meeting Survey*

For several years, NAFCU has sought to measure credit union interest in FedNow and faster payments. In NAFCU's June 2022 *Economic & CU Monitor*, half of respondents (50 percent) indicated that their credit union's overall interest in providing members with real-time

<sup>29</sup> Speech by Vice Chair Lael Brainard, Board of Governors of the Federal Reserve, "Progress on Fast Payments for All: An Update on FedNow," (August 29, 2022), available at: <https://www.federalreserve.gov/newsevents/speech/brainard20220829a.htm>.

payments in the next 1-2 years was moderate, and 42 percent said that their interest was significant. This positive expectation is consistent with past NAFCU surveys and has likely been reinforced by FedNow's development progress. Most respondents (58 percent) surveyed in NAFCU's June 2022 survey indicated that their credit union was "somewhat likely" to use FedNow as a real-time payments solution in 2023 or 2024. As FedNow has moved closer to launch, more credit unions than ever before have indicated that future availability of the service has accelerated their own plans to adopt faster payment options. Furthermore, nearly half (49 percent) of NAFCU surveyed credit unions anticipate making general investments in payments processing over the next three years.

Despite measurable enthusiasm for faster payment options, credit unions still have concerns about the fraud risk associated with real-time payments and future demand. Nearly all credit unions surveyed in NAFCU's June 2022 survey said that they would consider adopting limits on the value of real-time transactions to manage fraud exposure. Respondents in the same survey also cited their credit union's uncertainty about future demand as another obstacle, with half expressing uncertainty about consumer demand. Fewer respondents (17 percent) held this concern for member businesses, suggesting that the initial path forward for real-time payments deployment will involve prioritization of B2B use-cases.

## **Regulation E**

Credit unions are committed to providing safe, affordable, and fast payments to all their members, while also ensuring compliance with Regulation E. However, such a commitment depends on a fair and stable regulatory environment where the plain language of the EFTA does not expand beyond what was originally envisioned by Congress. NAFCU continues to urge the CFPB to refrain from upsetting this balance and has asked that the agency instead find ways to support continued payments innovation through tech sprints or studies aimed at addressing the root cause of fraud on P2P platforms

The EFTA and Regulation E require financial institutions to investigate payment errors when a consumer provides notice, communicate the results of investigations within specific timeframes, resolve errors that are verified, and limit the consumer's liability if the error involves an unauthorized transaction. In the context of investigating payment errors that are unauthorized electronic fund transactions (EFTs), the law places the burden of proof on financial institutions to establish that an allegedly unauthorized transfer was in fact authorized.<sup>30</sup>

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<sup>30</sup> CFPB, Regulation E FAQs, Error Resolution: Unauthorized EFTs # 7 (June 4, 2021) ("Regulation E sets forth the conditions in which consumers may be held liable for unauthorized transfers, and its commentary expressly states that negligence by the consumer cannot be used as the basis for imposing greater liability than is permissible under Regulation E."), available at: <https://www.consumerfinance.gov/compliance/compliance-resources/deposit-accounts-resources/electronic-fund-transfers/electronic-fund-transfers-faqs/>.

Credit unions invest significantly in both security and compliance management systems to prevent unauthorized EFTs and support faster, innovative payment options for their members. The credit union industry's commitment to relationship banking also gives members confidence that if they have a problem with a particular payment, they can count on their credit union to make every effort to resolve the issue. This emphasis on high touch service means that members will often seek and receive the help of their credit union even when a transaction primarily implicates the services of a third party with whom the credit union has no formal, direct relationship.

Member interaction with such services, particularly nonbank payment platforms, can complicate error resolution procedures, place strains on a credit union's compliance resources, and magnify exposure to fraud. Yet these relationships are also important and necessary because credit unions are committed to supporting consumer payment choice. Credit unions are eager to embrace seamless payment technologies, but to compete effectively against larger banks and nonbank financial giants with similar service offerings requires a fair regulatory environment.

In February 2022, NAFCU wrote to the CFPB to explain how P2P-related error resolution of responsibilities place a disproportionate burden on credit unions in the context of pass-through transactions involving non-partner payment platforms, particularly in instances where a member prefers contacting their credit unions instead of the P2P provider.<sup>31</sup>

In July 2022, NAFCU learned that the CFPB was considering issuing new interpretations of Regulation E that would allow consumers to seek redress from financial institutions for unauthorized transactions that they initiated—an interpretation that does not currently align with the definition of an unauthorized transaction under the EFTA. Additionally, Democratic members of Congress have written to the CFPB seeking similar realignment of consumer liability. In response, NAFCU's President and CEO wrote to CFPB Director Rohit Chopra in August 2022 warning of severe negative consequences for credit unions if the CFPB were to proceed with issuing new Regulation E guidance that exposes credit unions to an even greater share of fraud related liability.

Although no new Regulation E guidance has been issued, NAFCU remains steadfast in its advocacy for a fair and secure payment system that protects consumers and recognizes reasonable limits on the extent of fraud-related liability that can be passed onto credit unions. To develop faster, more convenient payment experiences, credit unions must also balance the benefits of increased speed with the risk that bad actors will exploit Regulation E's benefit of the doubt framework to perpetuate fraudulent schemes. Striking the appropriate balance is

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<sup>31</sup> NAFCU, *Letter to CFPB re: Agency Information Collection Activities: Comment Request (Regulation E)*, Docket No. CFPB-2021-0021 (February 14, 2022), available at: <https://www.nafcu.org/comment-letter-cfpb-regulation-e-error-resolution-File>.

more important than ever, as credit unions reported more attempted fraud in 2022 compared to a year ago.

## Digital Assets

In July 2021, the NCUA published a request for information and comment regarding how credit unions use and may use digital assets and distributed ledger technology (DLT). NAFCU's responsive comments encouraged the NCUA to issue a Letter to Credit Unions confirming that a credit union may directly or indirectly host digital wallets for members and that a credit union may engage a CUSO or other third-party vendor to facilitate members' buying, holding, selling, transferring, and exchanging of digital assets. NAFCU further encouraged the NCUA to adopt a form-agnostic approach to assessing credit unions' adoption of digital assets and related technologies and to develop a digital asset adoption sandbox or pilot program to facilitate responsible innovation. Thirty-seven percent of all respondents to NAFCU's 2022 *Federal Reserve Meeting Survey* expressed at least moderate interest in helping members more directly engage with digital assets.

In a December 2021 Letter to Credit Unions,<sup>32</sup> the NCUA confirmed that a federally insured credit union (FICU) may engage in a reasonably broad range of finder activities, including establishing relationships with third-party digital asset service providers that facilitate members' buying, holding, and selling of uninsured digital assets outside of the FICU. In a May 2022 Letter to Credit Unions,<sup>33</sup> the NCUA exhibits a form-agnostic regulatory approach to FICU's use and exploration of new and developing technologies, including DLT, clarifying that the NCUA's regulations do not prohibit FICU's responsible participation in financial and technological innovation and laying out the agency's supervisory expectations related to FICU's due diligence and ongoing oversight of third-party service providers.

NAFCU continues to engage the NCUA and other agencies on key digital asset issues, including direct custody of members' digital assets—a potential authority that garnered the highest level of interest among respondents to NAFCU's 2022 *Federal Reserve Meeting Survey*.

## IV. Data Protection

### Cyber and Data Security

Investments in cybersecurity reflect the industry's commitment to keeping members' data safe at a time of heightened geopolitical tension and growing criminal sophistication. Not surprisingly, these investments weigh heavily on credit union budgets. On average,

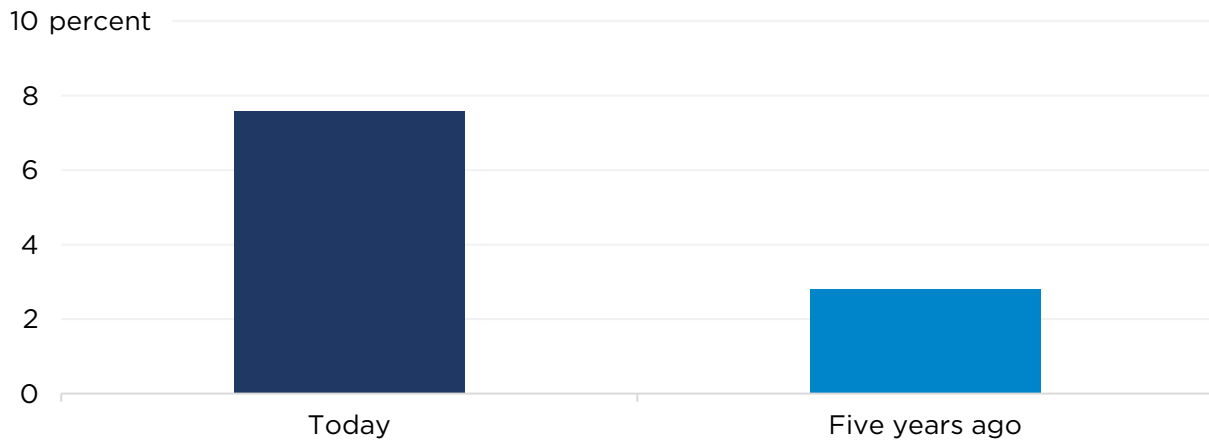
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<sup>32</sup> NCUA, *Letter to Credit Unions 21-CU-16* (December 2021), available at: <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/relationships-third-parties-provide-services-related-digital-assets>.

<sup>33</sup> NCUA, *Letter to Credit Unions 22-CU-07* (May 2022), available at: <https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/federally-insured-credit-union-use-distributed-ledger-technologies>.

cybersecurity programs represented 7.6 percent of credit union operating budgets in 2022. That figure marks a sharp increase from just five years ago, when cybersecurity expenditures represented, on average, 2.8 percent of operating budgets.

Chart 3.9: Share of Operating Budget Devoted to Cybersecurity



Source: NAFCU 2022 *Federal Reserve Meeting Survey*

Elevated investment in cybersecurity corresponds with the industry’s regard of cybersecurity risk as both a top priority and challenge. Nearly three quarters of credit unions (74 percent) reported that managing IT and cybersecurity risk would be a significant concern over the next three years and 62 percent characterized maintaining a secure electronic environment as a “significant challenge” over the same period. When asked what issues were most critical to future success, credit unions’ most frequently selected response (74 percent) was “a financial marketplace with appropriate safeguards against fraud and data breaches.”

A major component of cybersecurity investment involves hiring staff and cultivating existing IT talent. A majority of credit unions (61 percent) anticipate hiring new full-time equivalent (FTE) employees devoted to IT compliance in the next three years. These adjustments to staffing also reflect the burden associated with maintaining a rigorous cybersecurity program that is not only compliant with the NCUA’s data security rules, but is also responsive to a rapidly changing threat landscape. The vast majority of credit unions (92 percent) reported that the burden of IT compliance had increased over the past five years and 94 percent anticipated that this burden would continue to increase over the next five years.

### Geopolitical Risk

War in Ukraine has prompted the NCUA and other federal agencies, such as DHS, CISA and the FBI to warn of elevated hacking risk throughout 2022, but most urgently during the first quarter when hostilities began. On February 24, 2022, the NCUA issued a cybersecurity alert

to credit unions warning of an increased likelihood of cyberattacks against financial institutions and urged credit unions to review guidance and advisories posted to CISA's "Shield's Up" portal. In conjunction with this announcement, NAFCU President and CEO, Dan Berger, issued a statement in support of the Ukrainian American Credit Union Association and declared that NAFCU would serve as "a helpful resource for the entire credit union community and their members as markets across the world undoubtedly respond to these reckless actions [in Ukraine]." On March 21, 2022, President Biden issued a statement on the nation's cybersecurity which implored private sector critical infrastructure operators to implement best practices and harden cyber defenses.<sup>34</sup>

Although cybersecurity risks remain elevated, the industry has demonstrated resilience and continues to maintain a strong security posture. During the NCUA's April 2022 Board Meeting, agency staff provided a briefing on current cyber threats facing credit unions and noted that the U.S. government had not observed specific attacks against credit unions. However, NCUA staff also acknowledged that beyond the context of geopolitical conflict, the cost of cybercrime has continued to rise. The NCUA's briefing materials incorporated industry research which revealed that over 5 billion stolen credentials existed for sale on the "dark web."<sup>35</sup>

### **NCUA Information Security Examination (ISE) Program**

The NCUA continues to refine its IT-related exam procedures following deployment of the Automated Cybersecurity Examination Toolbox in 2020 and 2021 as part of an overall assessment of industry cyber maturity. During the NCUA's April 2022 Board Meeting, staff described the revamped cyber exam program, formerly referred to as InTREX-CU, as evolving in response to the changing cyber security landscape.

The NCUA's April 2022 briefing revealed that ISE work program testing began on February 28, 2022 and would continue through the third quarter of 2022. Full implementation is planned for the fourth quarter of 2022. So far, the NCUA has revealed that the ISE program will encompass three variations in exam type, tailored to the size and complexity of credit unions.

The NCUA has described ISE development efforts as seeking to advance the goals of transparency, consistency, and accountability within the exam program. At its core, ISE appears to operate as an assessment of Gramm-Leach-Bliley Act compliance, including Parts 748 and 749 of the NCUA's regulations, while incorporating a review of fundamental security

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<sup>34</sup> White House, *Statement by President Biden on our Nation's Cybersecurity* (March 21, 2022), available at: <https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/21/statement-by-president-biden-on-our-nations-cybersecurity/?source=email>.

<sup>35</sup> NCUA, *Cybersecurity Update* (April 21, 2022), available at: <https://www.ncua.gov/files/agenda-items/cybersecurity-update-board-briefing-20220421.pdf>.

controls. NAFCU does not expect ISE to fundamentally change the content of future cybersecurity exams, but has recommended that the NCUA clearly communicate any changes well in advance so that credit unions undergoing a new iteration of the cyber exam for the first time are not caught off guard by procedural changes.

## **Data Security Legislation**

Sophisticated exploitation of security vulnerabilities and software supply chains, coupled with the participation of nation states within the domain of cyberwarfare, has put unprecedented pressure on all economic sectors within the United States, but most directly on entities like credit unions that operate financial sector infrastructure. When asked to identify significant risk management concerns over the next three years, credit unions' top two responses were IT and cybersecurity risk (74 percent) and fraud risk (59 percent).

Credit unions comply with rigorous data security standards that were enacted under the Gramm-Leach-Bliley Act (GLBA) and continue to make significant investments in cybersecurity to safeguard member data. As regulated financial institutions, credit unions are generally held to higher standards relative to non-supervised companies. Merchants who handle consumer financial data are not subject to equivalent supervisory oversight, do not undergo regular cybersecurity focused examinations, and are not expected to follow the detailed IT-related guidance promulgated by FFIEC agencies. Nonbank financial companies also receive different supervisory treatment if they are only subject to the rulemaking and enforcement jurisdiction of the Federal Trade Commission, an agency that lacks examination authority. This disparity and unequal distribution of data security responsibility has produced serious concern with how nonbanks and merchants are addressing fraud and protecting sensitive consumer data.

To address such concern, NAFCU continues to advocate for a national data security standard for merchants and other entities handling consumers' personal information. The Cyber Incident Reporting for Critical Infrastructure Act of 2022, which became law on March 15, 2022, instituted a statutory framework for reporting certain cybersecurity incidents to the Cybersecurity and Infrastructure Security Agency (CISA), but failed to resolve weak links that could exist in sectors that lack formal cybersecurity oversight. As a consequence, NAFCU continues to advocate for a comprehensive data security law that includes six major components:

- › a mechanism to ensure that retailers pay their share for costs associated with data breaches;
- › safeguards comparable to the GLBA;
- › merchant disclosure of data security practices to consumers;



- › breach notification and reporting requirements;
- › penalties for prohibited data retention; and
- › a burden of proof in data breach cases that rests with the negligent entity that incurred the breach.

In June 2022, NAFCU wrote to the House Committee on Energy and Commerce emphasizing that future laws aimed at strengthening data security must delegate enforcement authority to the appropriate sectoral regulator and recognize the NCUA as federal credit unions' sole data privacy and cybersecurity regulator.<sup>36</sup> NAFCU continues to emphasize this message in Congress as the CFPB attempts to wield new regulatory influence within the cybersecurity domain through novel interpretations of its UDAAP authority. By consolidating rulemaking and enforcement functions with credit unions' functional regulator, the NCUA, the industry will benefit from a single source of guidance and avoid the frustration of duplicative exams or potentially conflicting supervisory expectations.

NAFCU has also advised regulators that adoption of consistent cybersecurity and data security safeguards for all entities handling consumer financial data must be a prerequisite for any proposal implementing Section 1033 of the Dodd-Frank Act. A nonbank data aggregator that permits consumers to consolidate control over multiple accounts on a single platform can elevate the risk of fraud for any number of financial institutions and may not be subject to regular cybersecurity examination in the same way that credit unions are under the GLBA. NAFCU has noted that such supervisory gaps are one reason the CFPB should proceed with caution before implementing section 1033 of the Dodd-Frank Act, which could grant third parties unprecedented access to consumer financial information. Fortunately, the CFPB appears to acknowledge these concerns and the agency's recent focus on consumer data monetization activities among nonbanks is likely to inform the scope of a potential rulemaking under section 1033.

### **Third Party Vendor Authority**

NAFCU recognizes that cybersecurity, including the security of vendors that credit unions do business with, is an important issue. Credit unions perform rigorous due diligence before engaging third parties that offer new technology or services and the NCUA already promulgates guidance related to risk assessment best practices. While NAFCU supports initiatives to strengthen confidence in credit union and vendor partnerships, the NCUA is able to best serve the credit union industry when it remains focused on where its expertise lies—

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<sup>36</sup> NAFCU, *Letter to the House Subcommittee on Consumer Protection and Commerce re: Tomorrow's Hearing, "Protecting America's Consumers: Bipartisan Legislation to Strengthen Data Privacy and Data Security"* (June 13, 2022), available at: <https://www.nafcu.org/system/files/files/6-13-2022%20Schakowsky-Bilirakis%20Data%20Privacy%20and%20Security%20Hearing%20Letter.pdf>

regulating credit unions. Accordingly, NAFCU opposes granting additional authority to the NCUA to examine third parties at this time.

Some tools already exist for the NCUA to gain access to information about vendors that serve credit unions. For example, the NCUA sits on the FFIEC with the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve. The FFIEC was created to coordinate examination findings and approaches in the name of consistency, and to avoid duplication. NAFCU has encouraged the NCUA to consider mechanisms for leveraging the resources and reach of the FFIEC to obtain the information it needs. To the extent that legal interpretations might impede the NCUA from fully relying on the other federal banking regulators to access or contribute to vendor examination reports, a reassessment of narrower legal questions (such as whether the NCUA can participate during joint exams of technology service providers) offers a more straightforward and simpler path forward than granting the NCUA new statutory powers with potentially unlimited scope.

Surveys of NAFCU's members also reflect concern about the budgetary and examination impact of granting the NCUA new authority to institute a vendor supervision program. In NAFCU's June 2022 *Economic & CU Monitor Survey*, credit unions were asked about their perspectives on the NCUA's legislative interest in acquiring vendor authority. The vast majority of respondents (82 percent) cited the possibility of longer exams as a key concern associated with proposed vendor supervision, and nearly all (91 percent) expressed concern about the potential for third parties to pass examination costs onto credit unions. In May 2022, NAFCU expressed similar reservations in a letter to the House Financial Services Committee Task Force on Artificial Intelligence regarding a proposal to grant the NCUA vendor authority.

As credit unions navigate strategic challenges related to major technology transitions, NAFCU will continue to advocate for regulatory flexibility and rules that seek to streamline, rather than expand, compliance burdens.

### **CFPB Data Security Circular**

On August 11, 2022, the CFPB issued a press statement and accompanying circular advising that financial companies (including credit unions and nonbanks) will violate the agency's prohibition on unfair, deceptive or abusive acts and practices if they fail to maintain adequate data security safeguards. The circular provided examples of certain minimum security practices, such as the use of multi-factor authentication, and stated that failure to meet these minimum standards would constitute conduct "that will typically meet the first two elements

of an unfairness claim (likely to cause substantial injury to consumers that is not reasonably avoidable by consumers).”<sup>37</sup>

The CFPB’s attempt to leverage its UDAAP authority to promulgate data security standards through circulars represents a significant expansion of its rulemaking and enforcement jurisdiction—at least with respect to FICUs. While NAFCU anticipates that the circular will have greater practical significance for nonbank covered persons subject to the CFPB’s supervisory jurisdiction, it remains unclear how CFPB examiners might apply the circular to federally insured institutions that already have a prudential regulator

NAFCU supports holding nonbank fintech companies to the same data security standards that apply to credit unions and other federally-insured institutions that undergo regular examination by a functional regulator. However, for credit unions already subject to prudential oversight, the NCUA should be the sole agency responsible for administering the safeguard provisions of the Gramm-Leach Bliley Act to ensure that regulatory expectations are consistently applied. To preserve the NCUA’s role as the industry’s primary functional regulator and avoid the potential for conflicting supervisory expectations, NAFCU has urged the NCUA to ensure that appropriate coordination exists with the CFPB. NAFCU continues to advocate for credit union IT compliance to be assessed through the established rules of Part 748 of NCUA’s regulations instead of the lens of UDAAP .

### **NCUA Proposed Rule for Cyber Incident Notification**

On July 27, 2022, the NCUA published a proposal to require a FICU that experiences a reportable cyber incident to report the incident to the NCUA as soon as possible and no later than 72 hours after the FICU reasonably believes that it has experienced a reportable cyber incident.

On September 26, 2022, NAFCU submitted comments in response to the proposal and expressed support for efforts to improve the resilience and operational integrity of the credit union system but noted that important cybersecurity concepts and terms required clarification. NAFCU also cautioned against creating excessive administrative burden on top of normal incident response activities.

While the proposed cyber incident reporting standard will no doubt improve the NCUA’s ability to coordinate incident response activities across the industry, the NCUA must be mindful of balancing the administrative burden of reporting with the actual practice of effective cybersecurity. In this regard, NAFCU was appreciative of the proposal’s emphasis that FICUs providing notice of a reportable incident share only “general information about

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<sup>37</sup> See CFPB, Consumer Financial Protection Circular 2022-04 (August 11, 2022), available at: <https://www.consumerfinance.gov/compliance/circulars/circular-2022-04-insufficient-data-protection-or-security-for-sensitive-consumer-information/>.

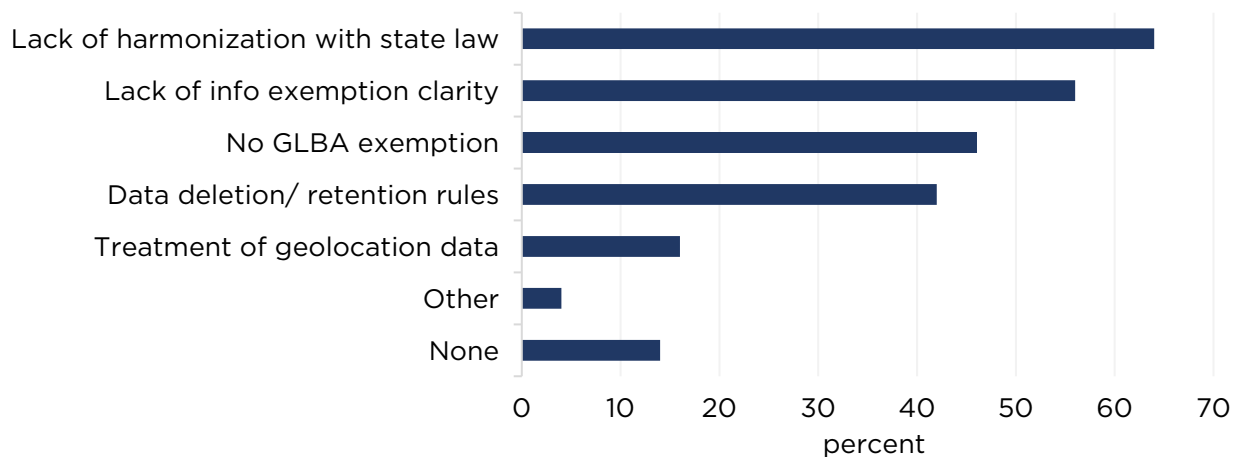
what is known at the time” and that the notice itself “would not need to include a lengthy assessment.”<sup>38</sup>

NAFCU also encouraged the harmonization of cybersecurity standards administered by different federal agencies and recognized that future implementation of the Cyber Incident Reporting for Critical Infrastructure Act of 2022 would ultimately benefit from consistent alignment around a 72-hour reporting period. Finally, as an overarching principle governing future compliance with the proposed reporting standard, NAFCU asked the NCUA to recognize a safe harbor for FICU’s that make good faith efforts to perform a reasonable assessment of a cyber incident

## Data Privacy

The California Consumer Privacy Act (CCPA) went into effect on January 1, 2020, and by the time NAFCU’s 2020 *Federal Reserve Meeting Survey* concluded in late August 2020, 60 percent of respondents had expressed concern about complying with the nation’s first state-level comprehensive data privacy law. Shortly thereafter, during the November 2020 General Election, California voters substantially amended the CCPA when they approved the *California Privacy Rights Act of 2020* (CPRA) by ballot initiative. Four other states have since passed comprehensive data privacy laws of their own – Virginia and Colorado in 2021 and Utah and Connecticut in 2022. Sixty-four percent of respondents to NAFCU’s 2022 *Federal Reserve Meeting Survey* consider lack of state law harmonization to be among the most problematic aspects of enacted and proposed data privacy laws.

Chart 3.10: Most Problematic Aspect(s) of Enacted or Proposed Privacy Laws



GLBA = Gramm-Leach-Bliley Act

Source: NAFCU 2022 *Federal Reserve Meeting Survey*

<sup>38</sup> NCUA, “Cyber Incident Notification Requirements for Federally Insured Credit Unions,” 87 Fed. Reg. 45029, 45023 (July 27, 2022).

Though the Virginia Consumer Data Protection Act, the Colorado Privacy Act, the Utah Consumer Privacy Act, and the Connecticut Data Privacy Act may differ slightly in certain respects, they all fully exempt credit unions from their respective data privacy standards based on credit unions' compliance with the Gramm-Leach-Bliley Act's (GLBA) federal data privacy standards. The CCPA, on the other hand, provides credit unions only an information-level exemption. As amended by the CPRA, the CCPA's requirements do not apply to "personal information collected, processed, sold, or disclosed subject to the [GLBA]." This distinction between a full or entity-level GLBA exemption and a far lesser information-level GLBA exemption is important for at least two interrelated reasons.

First, much of members' personal information with which credit unions most often engage—names, birthdates, and social security numbers—are expressly subject to the GLBA's federal data privacy standards. However, more complex but increasingly common financial services activities, such as the use of advanced identity verification and automated lending software, involve a credit union drawing inferences from more nuanced data, the current regulation of which is arguably less clear.<sup>39</sup> Neither the Office of the Attorney General (AG) for the State of California nor the California Privacy Protection Agency (CPPA), the nation's first and currently only state-level data privacy regulator, has made clear which credit union data and data practices it believes are not subject to the GLBA and, therefore, subject to the CCPA. As a direct result of this regulatory uncertainty, and in addition to ensuring they continue to meet the GLBA's federal data privacy standards, credit unions meeting or exceeding the CCPA's activity thresholds are forced to develop and fund parallel state data privacy compliance programs.

Second, though the CCPA is California law enforceable by the California AG in California courts, ultimately the CCPA's application to credit unions is likely to turn on federal courts' interpretation of what data and data practices are subject to the GLBA. California, home to nearly 40 million people, has four federal district courts, each of which has either already decided a case involving the CCPA or is currently considering at least one case involving the CCPA. Because no federal district court is bound by its nor any other's federal district court's prior caselaw, credit unions in San Francisco, Sacramento, Los Angeles, and San Diego could quickly become subject to conflicting data privacy standards until the overcrowded United States Court of Appeals for the Ninth Circuit is able and willing to weigh in. Unfortunately, the CCPA's failure to fully exclude credit unions and other already well-regulated entities from new California data privacy standards and the complexity of the federal court system in California, taken together, suggests that the CCPA's application to credit unions is likely to remain an open issue for some time.

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<sup>39</sup> Fifty-six percent of respondents to NAFCU's 2022 *Federal Reserve Meeting Survey* expressed concern about the lack of clarity regarding information-level GLBA exemptions.

Following years of little serious data privacy news from Capitol Hill, the American Data Privacy and Protection Act (ADPPA) was introduced on June 21, 2022. The U.S. House of Representatives Committee on Energy and Commerce reported the ADPPA out by a vote of 53-2 on July 20, 2022. The ADPPA will next be considered by the entire chamber. Though NAFCU does not anticipate the ADPPA becoming law, as currently drafted or otherwise, before the 117<sup>th</sup> Congress adjourns in early January 2023, NAFCU is actively advocating for amendments necessary to ensure that the ADPPA preempts the application of state data privacy laws and regulations to credit unions and does not unnecessarily subject credit unions to duplicative federal data privacy standards.

As currently drafted, the ADPPA permits states to maintain, develop, and implement more stringent data privacy laws and regulations and, like the CCPA, affords credit unions only an information-level GLBA exemption from the ADPPA's expansive new federal data privacy standards. Making matters worse, as currently drafted, the ADPPA would provide the Federal Trade Commission (FTC) with supervisory and enforcement authority over all credit unions, including federal credit unions already subject to the NCUA's GLBA-implementing regulations, with respect to data and data practices not covered by credit unions' information-level GLBA exemption.

NAFCU continues to share its principles for comprehensive federal data privacy legislation and monitor data privacy developments at both the state and federal levels.

## V. Fair Market

### Master Account Access

As part of NAFCU's advocacy focusing on the creation of a fair regulatory environment for credit unions, the association has placed increased emphasis on the need for consistent standards to govern payment system access. Recent attempts by fintech companies to obtain Federal Reserve accounts and services have highlighted differences in the supervision of financial institutions that are federally insured versus those that are not. To better manage risks that might arise from granting under-supervised entities access to critical payments infrastructure, NAFCU has encouraged the development of uniform and transparent guidelines for evaluating Federal Reserve account access requests filed by nontraditional applicants, including those with special purpose charters.

On March 8, 2022, the Federal Reserve published a supplemental notice and request for comment regarding proposed guidelines for Federal Reserve Banks (Reserve Banks) to use when evaluating requests for master account access and Federal Reserve services. The proposed guidelines aimed to establish a tiering framework for evaluating access requests

based on a foundation of risk management and mitigation. NAFCU provided comments to the Federal Reserve requesting additional clarity with respect to how the guidelines would apply to entities designated as low risk under the tiered framework, such as credit unions, and those regarded as high risk, such as entities not subject to consolidated federal supervision.

On August 15, 2022, the Federal Reserve finalized the proposal and recognized that credit unions and other federally insured depository institutions would be regarded as low risk and categorized as Tier 1 institutions for the purpose of application processing and due diligence. Applications for accounts and services submitted by higher risk institutions, such as those that are not federally insured or not subject to prudential supervision, would generally receive a higher degree of scrutiny.

## CFPB Reform

Created by the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Consumer Financial Protection Bureau (CFPB) has significantly increased regulatory burdens for credit unions. NAFCU opposes the CFPB's examination and enforcement authority over credit unions, given they were not responsible for the financial crisis and are more highly regulated than any other financial depository institution. NAFCU also strongly supports legislative improvements to change the structure of the CFPB from an unaccountable, single director, who is removable only for cause, to a bipartisan commission. Since the CFPB's inception, credit unions have been the victims of sweeping, one-size-fits-all regulations targeting bad actors.

According to NAFCU's *2022 Federal Reserve Meeting Survey*, overall compliance burdens have increased nearly 85 percent in the past five years and 94 percent of respondents expect overall compliance burdens to increase in the next five years. As a result of this burdensome regulatory environment, the industry has lost over 1,500 credit unions since the CFPB's creation. To counteract this effect, NAFCU has advocated for exemptions for credit unions, regardless of their asset size, and legislative changes that increase the CFPB's transparency and accountability.



# CENTRAL BANK DIGITAL CURRENCY (CBDC)

On January 14, 2022, the Federal Reserve published a discussion paper titled “Money and Payments: The U.S. Dollar in the Age of Digital Transformation” (the discussion paper), inviting credit unions and other financial sector stakeholders to offer input on whether introduction of a central bank digital currency (CBDC) would be a desirable project for the central bank. Several additional publications followed which addressed, among other things, how a hypothetical CBDC transaction processor might function (Project Hamilton), data security considerations for a digital dollar, and the legal treatment of CBDC as a liability of the Federal Reserve. The initial discussion paper offered only a few policy statements to guide public dialogue but emphasized that the Federal Reserve would not act on any particular recommendation until it had acquired both the support of Congress and key stakeholder groups. Since the discussion paper was published, other federal agencies have also solicited public input on the question of CBDC as part of a comprehensive review of digital assets policy compelled by President Biden’s Executive Order on “Ensuring Responsible Development of Digital Assets” (the Executive Order).

NAFCU has long regarded government involvement in banking as a slippery slope fraught with risk and often lacking a clear value proposition. Arguments in favor of CBDC evoke many of the same themes and criticisms that emerged in response to the idea of “FedAccounts.” FedAccounts were envisioned by Democratic lawmakers as a type of government-sponsored deposit account maintained by the Federal Reserve that could be used as vehicles for distributing stimulus money. Like postal banking proposals, FedAccounts represented a burdensome and unproven mechanism for expanding access to financial services that ignored the availability of existing and superior financial sector infrastructure: credit unions.

In 2021, NAFCU warned that pursuit of complex and risky government banking projects would divert valuable administrative resources from traditional financial inclusion strategies and slow efforts to expand unbanked and underbanked households’ access to financial services through credit unions. In 2022, NAFCU has continued this advocacy mission but with greater emphasis on the hazard of introducing a CBDC. Fortunately, regulators appear to recognize that there is little value in rushing to adopt a CBDC without first understanding relevant risks and the potential for destabilizing effects.

## What is a CBDC?

A CBDC is regarded as a digital form of central bank money that is widely available to the general public. “Central bank money” refers to money that is a liability of the central bank. In the United States, there are currently two types of central bank money: physical currency issued by the Federal Reserve and digital balances held by commercial banks at the Federal

Reserve. While Americans have long held and transacted money predominantly in digital form—for example in bank accounts, payment apps or through online transactions—a CBDC would differ from existing digital money available to the general public because a CBDC would be a liability of the Federal Reserve, not of a commercial bank.

The Federal Reserve has been researching the viability of a CBDC since 2020. In August 2020, Federal Reserve Governor Lael Brainard announced a partnership between the Federal Reserve Bank of Boston and researchers at the Massachusetts Institute of Technology that involved a multiyear effort to build and test “a hypothetical digital currency oriented to central bank uses.” Following this announcement, the Bank for International Settlements (BIS) issued its own report on technical approaches and policy stances on CBDC issuance, which noted that CBDC projects undertaken by other central banks all sought to offer digital currency as a complement, rather than a replacement, to cash. Both in the United States and abroad, these developments coincide with steadily declining use of physical currency in transactions. In 2022, further details about the partnership with MIT were revealed in a paper describing the operational characteristics of a potential CBDC transaction processor.

Interest in developing a CBDC coincides with growing usage of cryptocurrencies and other digital assets. In early 2016, the most prominent cryptocurrency price aggregators estimated the total cryptocurrency market to have a value of roughly \$7 billion. As of mid-September 2021, that estimate had risen to more than \$2 trillion before declining to just under \$1 trillion in September 2022. In recent years, credit unions have seen the number and value of ACH, debit card, and wire transfers from member share accounts to cryptocurrency exchange platforms increase at a dramatic rate, particularly among younger members. While private sector engagement with digital assets may play a role in terms of normalizing public acceptance of CBDC, the value of a CBDC would not necessarily depend on the maturation of digital asset business models. Instead, the appeal of a CBDC might correlate more closely with nonbank interest in accessing the Federal Reserve’s payment system directly, or with public policy objectives related to reducing the cost and improving the speed of wholesale payments (although there are already non-CBDC solutions for advancing this goal).

While a CBDC would not compete directly with most digital assets, such as cryptocurrencies, it would likely compete with stablecoins as an optimal form of riskless, digital money. Furthermore, closer regulation of stablecoins and regulatory guidance recommending that stablecoin issuers be limited to insured depository institutions could undermine the broader appeal of these assets relative to a CBDC for prospective nonbank issuers, particularly if future legislation imposes strict reserve requirements (e.g., 1:1 dollar reserves).

Issuing a CBDC would require overcoming significant technical and policy challenges. Speaking as a member of the Board of Governors in 2017, Federal Reserve Chairman Jerome

Powell noted at the time that a CBDC “would be a global target for cyber attacks, cyber counterfeiting, and cyber theft.”<sup>40</sup> A CBDC would also be a prime target for money laundering activities. Acknowledging these risks, the Federal Reserve’s discussion paper acknowledges that securing CBDC would be challenging.

NAFCU has noted similar cybersecurity and money laundering concerns and has advised Congress that the policy challenges associated with developing a digital currency are numerous and complex. The countervailing interests of protecting financial privacy and deterring financial crime offer one example. Even after a year of public consideration and significant internal investigation at numerous federal agencies named in the Executive Order, it remains unclear how a hypothetical CBDC would strike the appropriate balance between providing sufficient visibility into transactions to enable financial institutions to satisfy BSA and AML requirements while also protecting individual consumer privacy. Even less clear are how costly oversight mechanisms might impact the cash-like qualities of a digital dollar to the extent they are emulated as a matter of policy.

Among credit unions, the possible introduction of a CBDC corresponds with several distinct concerns, the most significant of which relates to the risk of fraud associated with CBDC transactions that may settle in real time. NAFCU’s 2022 *Federal Reserve Meeting Survey* revealed that a significant number of respondents also had concerns about member substitution of credit union deposits with CBDC, competition with nonbank intermediaries offering CBDC accounts, and the potential for greater government involvement in retail banking activities.

### **The Federal Reserve’s Model for Future CBDC**

To date, the Federal Reserve’s discussion paper has served as the foundation for substantive discussion around fundamental CBDC design choices—the most significant of which relates to the degree of financial intermediation that would be necessary to offer a CBDC to the public. While the discussion paper dispels concern that the Federal Reserve would ever act on its own to host digital wallets (e.g., FedAccounts) for the purpose of facilitating direct consumer access to CBDC, the alternative proposal of relying on financial institutions to operate as intermediaries provides little technical detail. The paper discusses this arrangement mostly in conceptual terms:

“Under an intermediated model, the private sector would offer accounts or digital wallets to facilitate the management of CBDC holdings and payments. Potential intermediaries could include commercial banks and regulated nonbank financial service providers, and would

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<sup>40</sup> Speech by Mr. Jerome H Powell, Member of the Board of Governors of the Federal Reserve System, at “Blockchain: The Future of Finance and Capital Markets?”, The Yale Law School Center for the Study of Corporate Law, New Haven, Connecticut (March 3, 2017), available at: <https://www.bis.org/review/r170309b.htm>.

operate in an open market for CBDC services. [...] An intermediated model would facilitate the use of the private sector’s existing privacy and identity-management frameworks; leverage the private sector’s ability to innovate; and reduce the prospects for destabilizing disruptions to the well-functioning U.S. financial system.”

While credit unions would not face direct competition with the Federal Reserve for deposits under this model, indirect competition could emerge in times of severe economic stress to the extent that depositors perceive CBDC as a safer asset compared to commercial bank money. The discussion paper also opens the door to greater competition with nonbank financial firms by inviting consideration of whether these entities should have the ability to issue CBDC and facilitate CBDC payments through the Federal Reserve. Granting nonbank companies access to CBDC payments rails could also have a longer term impact on the viability of interchange as a mechanism of recouping private sector payment system costs.

Another important but unresolved question is whether a credit union could fund loans with CBDC deposits if they are ultimately liabilities of the Federal Reserve. Absent legislative clarification, the maturity transformation of CBDC deposits would be impaired and the value proposition for a credit union relegated to functioning as a compliance intermediary would be doubtful.

### Cost of Issuing CBDC

The use of existing financial sector compliance infrastructure may offer a convenient mechanism for offering general purpose CBDC at minimal cost to the government, but how financial institutions are supposed to benefit from this arrangement remains unclear. Practical details are omitted in the Federal Reserve’s discussion paper regarding how financial institutions would cover the costs associated with verifying CBDC accounts, managing BSA compliance and AML risks, not to mention other consumer compliance obligations related to payments, such as those that exist under Regulation E. In general, all of these functions are expensive for credit unions to perform.

In NAFCU’s 2022 *Federal Reserve Meeting Survey*, credit unions indicated, on average, that 22 percent of their staff’s time was devoted to regulatory compliance, with smaller institutions (under \$250 million in assets) reporting an even greater burden. Historically, credit unions have increased staff during periods of significant regulatory change, and a majority of credit unions with over \$250 million in assets expect to increase FTEs related to BSA/AML compliance in the coming years. The introduction of a CBDC would only add to this pressure and would likely impair credit unions’ ability to prioritize member-focused investments.

Estimating the precise magnitude of CBDC-related compliance costs remains difficult because the discussion paper, to date the most robust source of information concerning a CBDC's potential regulatory footprint, does not offer any solution for how privacy interests will be balanced. The degree of anonymity provided to certain CBDC payments and how related policy decisions will change AML compliance or counter terrorist financing (CFT) activities are open-ended questions.

Proof-of-concept solutions for balancing the countervailing interests of consumer privacy and transaction auditability are often promised on future adoption of new technologies that have yet to be proven in a regulatory environment. Credit union adoption of these solutions (assuming they are even effective) would likely come with significant implementation costs. Given the lack of clarity regarding specific design features for CBDC, many of which depend upon unresolved yet fundamental policy questions, NAFCU does not believe that sufficient evidence exists to justify development of a CBDC. Credit unions are well positioned to improve underserved populations' access to affordable financial products without the costly and technologically complex overlay of a CBDC.

### **Impact on Financial Stability**

Soliciting input on hypothetical models of CBDC without clear regulatory parameters to consider frustrates the public's ability to consistently evaluate the costs and benefits of a so-called digital dollar. Yet even in the absence of a concrete proposal, policies favoring CBDC as a vehicle for equitable growth or financial inclusion must demonstrate that CBDC is superior to alternative methods for promoting these and other goals, such as protecting consumer privacy, guarding against criminal activity, and ensuring financial stability.

Offering CBDC directly to consumers through government accounts would constitute a radical expansion of the Federal Reserve's mission and involvement in the economy, and NAFCU has strongly discouraged any model for issuing CBDC that relies upon such an arrangement due to financial stability concerns. While an intermediated CBDC is preferable to a disintermediated (i.e., direct) model of issuance for the purpose of avoiding the most acute destabilizing effects on the U.S. financial system, significant risks are still present.

For example, a CBDC could strain credit unions' ability to secure liquidity and support lending activity during times of economic stress. In periods of crisis, a flight to safety would favor CBDC and credit unions would have limited ability to compete rate-wise against interest-bearing CBDC or CBDC accounts with no end-user limits. Even a non-interest bearing CBDC could be attractive if consumers or businesses prefer absolute safety or have urgent liquidity needs. Precedent suggests that when severely adverse economic conditions materialize, money will move rapidly to the least risky asset.

A flight to safety that involves commercial deposit substitution could profoundly alter mechanisms for maturity transformation and make it more difficult for credit unions to recover after periods of crisis. If credit unions were to experience a sharp decline in deposit balances as members shifted their money to CBDC, the negative impact on lending activity could simultaneously constrain efforts to increase rates on insured shares. These effects could impair the important role credit unions have played in their communities as dependable and affordable lenders.

If outflows from commercial deposit accounts into CBDC occur during a crisis, the Federal Reserve's management of resulting liquidity stress could also result in greater balance sheet risk. As the Federal Reserve provides more liquidity to commercial banks as deposits are substituted for CBDC, the Federal Reserve would assume the risks associated with acceptance of new bank collateral. If the demand for liquidity is very great, the Federal Reserve might need to accept less liquid assets or riskier securities. In this regard, a CBDC's potential negative effects on the stability of the broader U.S. financial system could impair the financial sector's overall strength and resilience.

### **Payments Innovation Does Not Depend on the Introduction of a CBDC**

In general, the existing alternatives to CBDC already provide a robust payments ecosystem and are capable of supporting future innovation. On the public side, the Federal Reserve maintains several services to facilitate wholesale and retail payments. These include a check-processing service, FedACH (which supports credit transfers and direct debits), the Fedwire Funds and National Settlement Services (which support wholesale payments), and in 2023, the FedNow Service (which will support real-time transfers of interbank payments). On the private side, there is ample evidence that payments innovation is a priority for credit unions as well as other payment system stakeholders.

NAFCU expects that future enhancements to cross-border digital payments will be driven by industry-led investments rather than CBDC. For example, in April 2022, the Clearing House, EBA CLEARING, and SWIFT announced that they would launch a pilot service for immediate cross-border (IXB) payments. Separately, the BIS is pursuing its own cross-border payments improvement project, Nexus, which proposes to streamline the process of linking national banking systems. NAFCU has emphasized that support for existing public and private sector payments improvement initiatives would likely achieve the same objectives of a CBDC but with superior results and at a lower cost.

### **Supporting Credit Union Efforts to Reach Underserved Populations**

Credit unions have uniquely strong relationships with their members and strive to provide affordable financial products and services that are tailored to individual needs. While the



products offered by credit unions can vary based on particular fields of membership, the credit union industry as a whole has embraced new technology over the past twenty years, such as remote deposit capture (RDC) and mobile banking, to improve access to financial services. As noted elsewhere in this report, credit unions have also demonstrated a commitment to maintaining a physical presence in the communities they serve.



Rep. Ed Perlmutter (D-Colo.) speaks at NAFCU's Congressional Caucus. Perlmutter was an original cosponsor of legislation that would provide federal credit unions with greater flexibility to add underserved areas to their fields of membership.

Investment in physical branches located in rural areas shows that credit unions are expanding into underserved areas. This type of brick-and-mortar presence provides tangible evidence of financial inclusion and participation in the affairs of a community; whereas a CBDC provides simply another means of executing electronic payments. To the extent that there are other, theoretical cost savings that can be associated with the introduction of a new CBDC payments rail, these can be realized through existing public and private efforts. Within the credit union industry, there is already significant attention to payments innovation and expanding access to credit for underserved populations through the deployment of new credit decisioning technologies.

To achieve broader financial inclusion objectives that payments improvement alone may not fully address, NAFCU has encourage the Federal Reserve, Treasury and lawmakers to support



legislative proposals to grant all federal credit unions the ability to include underserved areas in their fields of membership. Bills such as the “Expanding Financial Access for Underserved Communities Act” would complement existing credit union efforts to provide low-cost loans and accounts to populations in need and simultaneously fill the gap left by departing bank branches in rural and underserved areas.

## **Executive Order on Ensuring Responsible Development of Digital Assets**

On March 9, 2022, President Biden issued an Executive Order on “Ensuring Responsible Development of Digital Assets”, which set forth distinct policy objectives related to the regulation of digital asset technologies and the possible introduction of a CBDC.

The Executive Order also highlighted digital assets’ relation to consumer and investor protections, data privacy and security standards, financial system stability, illegal and illicit finance, financial equity and inclusion, climate change, and the protection of human rights. To adequately consider these policy questions, the Executive Order directed a broad contingent of federal agencies and departments to develop recommendations and reports responsive to the digital assets issues within their respective regulatory jurisdictions. Several departments, such as the Department of Commerce, Department of Homeland Security and Department of State, were charged with providing consultative input on national security topics and the need for international cooperation and standard setting to promote development of a CBDC.

The Department of Treasury’s responsibilities under the Executive Order are perhaps the most varied and numerous. They include consulting with other federal agencies and producing several different reports. The first of these, titled “The Future of Money and Payments” (Treasury report), was issued on September 16, 2022.

The Treasury report addressed, among other things, the conditions that might drive broad adoption of digital assets, the extent to which technological innovation might influence such an outcome, and implications for the United States financial system. The report also contained observations related to developments in instant payments and stablecoins, along with commentary about design choices for a potential U.S. CBDC.

Prior to the release of the Treasury report, NAFCU had submitted comments recommending that Treasury prioritize a policy framework for digital assets that emphasized several key principles:

1. a level playing field for credit unions, banks, and other financial companies seeking to engage with digital asset technologies;

2. the application of consumer protection laws to entities facilitating consumer engagement with digital assets; and
3. support for responsible innovation within the credit union industry.

With respect to the possible introduction of a CBDC, NAFCU noted that the cost of pursuing such an initiative would far outweigh any of the hypothesized benefits, a point that NAFCU had also emphasized as part of its engagement with the Federal Reserve and Department of Commerce, agencies separately tasked with investigating digital assets under the Executive Order.

Treasury's report offered one specific recommendation related to the introduction of a CBDC, but this was hedged in such a way that made any final policy decision contingent upon further investigation.<sup>41</sup> Additionally, in the context of discussing potential CBDC design choices, the Treasury report emphasized that many of the purported benefits of a digital dollar were merely potential outcomes, but made few guarantees with respect to particular goals, such as financial inclusion, or the odds of success. In fact, the report acknowledged that "a CBDC could also further exacerbate financial exclusion for individuals lacking reliable access to technological services, the ability to pay for any costs associated with the system, the identification or other requirements to establish accounts, or trust in the appropriate use of the data collected with a CBDC system."<sup>42</sup> The Treasury report also acknowledged cybersecurity and privacy risks associated with a CBDC, broader financial stability concerns, and observed that a CBDC's eventual effects on banking intermediation are uncertain.<sup>43</sup> NAFCU continues to emphasize that this uncertainty is perpetuated in no small part by vague design parameters and policy objectives that policymakers anchor to CBDC related reports and whitepapers. With so many critical variables in flux, NAFCU has cautioned that the claimed benefits of a hypothetical CBDC remain difficult to substantiate.

## Comments to the Federal Reserve

Given the lack of clarity regarding specific CBDC parameters and design features, NAFCU does not believe sufficient evidence exists to justify development of a CBDC, particularly when better alternatives for achieving the same objectives already exist. Credit unions are well positioned to improve underserved populations' access to affordable financial products and their efforts could be improved in a more straightforward way by using more targeted improvements, such as streamlining the CDFI certification process, increasing technical assistance or grant funding for LICUs, or advancing legislative proposals to make adding

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<sup>41</sup> See U.S. Department of the Treasury, *The Future of Money and Payments, 2 (2022)* ("Advance work on a possible U.S. CBDC, in case one is determined to be in the national interest."), available at: <https://home.treasury.gov/system/files/136/Future-of-Money-and-Payments.pdf>.

<sup>42</sup> *Id.* at 38.

<sup>43</sup> *Id.* at 22, 41.

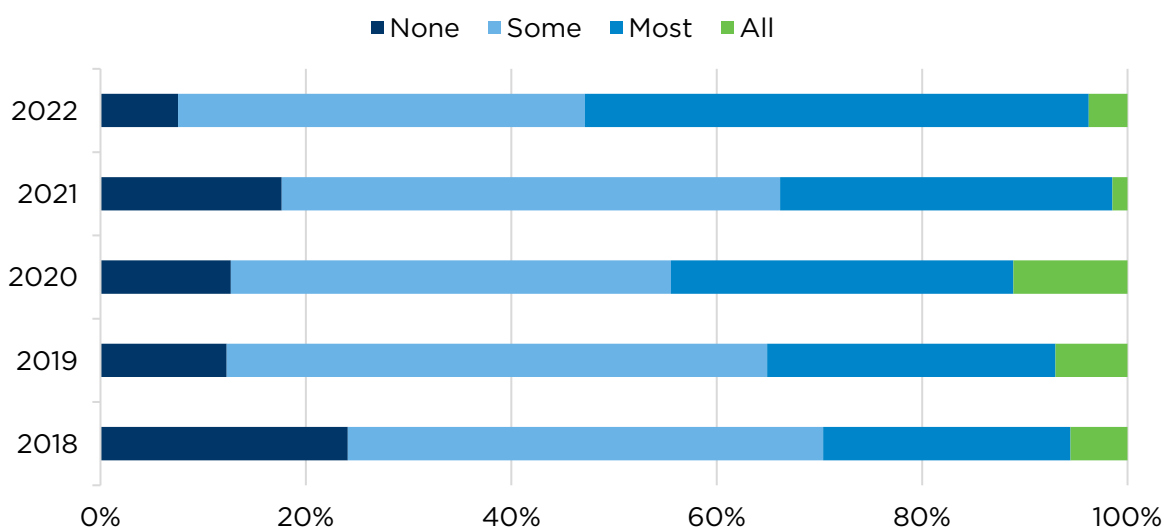
underserved areas a possibility for all federal credit unions. A CBDC, by contrast, would operate primarily as a new payment rail, distract the Federal Reserve from its dual mandate of achieving stable prices and maximum sustainable employment, and risk significant disruption to the stability and role of credit unions and other depository institutions.

Looking ahead to future reports and assessments of CBDC by agencies named in the Executive Order, NAFCU will remain highly engaged in Washington, educating both lawmakers and regulators about the costs and risks of introducing CBDC, particularly a time when credit unions stand ready to deliver the same promised benefits in safer and more reliable manner.

## APPENDIX: USE OF FED SERVICES

NAFCU's 2022 *Federal Reserve Meeting Survey* asked about participants' use of Federal Reserve services. In terms of usage rates, respondents reported increased reliance on the Federal Reserve for transactional service needs. Fifty-four percent of respondents used the Federal Reserve for "most" or "all" of their transaction services, which is up from 34 percent the prior year. Eight percent of respondents reported that they do not use the Federal Reserve for any transaction services. As was the case in prior surveys, respondents' usage of transaction service providers depended largely on their size. Seventy-four percent of credit unions with under \$250 million in assets indicated that they use corporate credit unions for "most" or "all" of their service needs, while 67 percent of credit unions with over \$1 billion in assets use the Federal Reserve for "most" or "all" of their services.

Chart A.1: Share of Responding Credit Unions' Transaction Services Provided by Federal Reserve, by Survey Year



Source: NAFCU *Federal Reserve Meeting Surveys*

Survey respondents continue to rate Federal Reserve services highly. Among service users, 65 percent of respondents rated Federal Reserve services as "excellent" or "above average" (up from 63 percent in 2021). Two percent rated those services as "below average."

Finally, NAFCU asked its members about the pricing of Federal Reserve services. Overall, a net 68 percent of respondents said that services were priced competitively, which is up from 62 percent in 2021. Services mentioned most often by respondents as being priced competitively included ACH and cash services, along with discount window pricing. The service that respondents cited most often as not being competitively priced was wire services.

## ABBREVIATIONS

<b>ACCESS</b>	Advancing Communities through Credit, Education, Stability and Support
<b>ADPPA</b>	American Data Privacy and Protection Act
<b>AG</b>	Attorney General
<b>AI</b>	Artificial Intelligence
<b>AIRES</b>	Automated Integrated Regulatory Examination System
<b>AML</b>	Anti-Money Laundering
<b>ANPR</b>	Advance Notice of Proposed Rulemaking
<b>ATR</b>	Ability-to-Repay
<b>BIS</b>	Bank for International Settlements
<b>BNPL</b>	Buy-Now-Pay-Later
<b>BSA</b>	Bank Secrecy Act
<b>CAA</b>	Consolidated Appropriations Act
<b>CBDC</b>	Central Bank Digital Currency
<b>CCPA</b>	California Consumer Privacy Act
<b>CCULR</b>	Complex Credit Union Leverage Ratio
<b>CDFI</b>	Community Development Financial Institutions
<b>CECL</b>	Current Expected Credit Loss
<b>CFI</b>	Community Financial Institution
<b>CFPB</b>	Consumer Financial Protection Bureau
<b>CFT</b>	Combating the Financing of Terrorism
<b>CISA</b>	Cybersecurity and Infrastructure Security Agency
<b>CLF</b>	Central Liquidity Facility
<b>CNP</b>	Card-Not-Present
<b>CPPA</b>	California Privacy Protection Agency
<b>CPRA</b>	California Privacy Rights Act
<b>CTA</b>	Corporate Transparency Act
<b>CUMAA</b>	Credit Union Membership Access Act
<b>DEXA</b>	Data Exchange Application
<b>DIF</b>	Deposit Insurance Fund
<b>DLT</b>	Distributed Ledger Technology
<b>DoD</b>	Department of Defense
<b>DOR</b>	Document of Resolution
<b>E&amp;I</b>	Examination and Insurance
<b>ECIP</b>	Emergency Capital Investment Program
<b>ECOA</b>	Equal Credit Opportunity Act
<b>EFT</b>	Electronic Fund Transaction
<b>EFTA</b>	Electronic Funds Transfer Act
<b>EO</b>	Executive Order
<b>FASB</b>	Financial Accounting Standards Board
<b>FCC</b>	Federal Communications Commission
<b>FCU</b>	Federal Credit Union
<b>FDIC</b>	Federal Deposit Insurance Corporation
<b>FHFA</b>	Federal Housing Finance Agency

<b>FHLB</b>	Federal Home Loan Bank
<b>FICU</b>	Federally-Insured Credit Union
<b>FinCEN</b>	Financial Crisis Enforcement Network
<b>Fintech</b>	Financial Technology
<b>FISCU</b>	Federally-Insured State Chartered Credit Union
<b>FOIA</b>	Freedom of Information Act
<b>FOM</b>	Field of Membership
<b>FTC</b>	Federal Trade Commission
<b>FTE</b>	Full-Time Equivalent
<b>GLBA</b>	Gramm-Leach-Bliley Act
<b>GSE</b>	Government-Sponsored Enterprise
<b>HMDA</b>	Home Mortgage Disclosure Act
<b>ICBA</b>	Independent Community Bankers of America
<b>IFR</b>	Interim Final Rule
<b>IRR</b>	Interest Rate Risk
<b>ISE</b>	NCUA Information Security Examination
<b>LICU</b>	Low Income Credit Union
<b>LMI</b>	Low- and Moderate-Income
<b>MBL</b>	Member Business Lending
<b>MDI</b>	Minority Depository Institution
<b>MERIT</b>	Modern Examination and Risk Identification Tool
<b>MLA</b>	Military Lending Act
<b>NAFCU</b>	National Association of Federally-Insured Credit Unions
<b>NAL</b>	No-Action Letter
<b>NCUA</b>	National Credit Union Administration
<b>NCUSIF/SIF</b>	National Credit Union Share Insurance Fund
<b>NDAA</b>	National Defense Authorization Act
<b>NEV</b>	Net Economic Value
<b>OCC</b>	Office of the Comptroller of the Currency
<b>ONES</b>	Office of National Examinations and Supervision
<b>OTP</b>	Other Targeted Populations
<b>PAL</b>	Payday Alternative Loan
<b>PCA</b>	Prompt Corrective Action
<b>PLLL</b>	Provision for Loan and Lease Loss
<b>RBC</b>	Risk-Based Capital
<b>RDC</b>	Remote Deposit Capture
<b>RFC</b>	Request for Comment
<b>RFI</b>	Request for Information
<b>SBA</b>	Small Business Administration
<b>SIP</b>	Session Initiation Protocol
<b>TCPA</b>	Telephone Consumer Protection Act
<b>TDR</b>	Total Debt Restructuring
<b>TIP</b>	Trade, Industry, and Professional
<b>UDAAP</b>	Unfair, Deceptive, or Abusive Acts and Practices
<b>WARM</b>	Weighted Average Remaining Maturity