



Testimony of

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On behalf of

The National Association of Federal Credit Unions

Before the

House Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

United States House of Representatives

February 1, 2012

Introduction

Good afternoon, Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee. My name is Jeanne Kucey, and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). Thank you for holding this important hearing. We appreciate the opportunity to share our views on H.R. 3461, the *Financial Institutions Examination Fairness and Reform Act*.

I am the President and CEO of JetStream Federal Credit Union, headquartered in Miami Lakes, Florida. Jetstream has \$126 million in assets and serves more than 16,000 members in our seven locations, including one in Puerto Rico. I also serve on the Board of Directors of NAFCU.

Prior to joining JetStream, I was President and CEO of Retail Employees Credit Union in Atlanta, Georgia. I have more than 20 years of executive level experience including serving as both Vice President of Operations at Atlanta City Employees Credit Union and Vice President at San Diego County Credit Union.

NAFCU is the only national organization that exclusively represents the interests of the nation's federally chartered credit unions. NAFCU is comprised of over 800 member-owned and operated credit unions. NAFCU member credit unions collectively account for approximately 62 percent of the assets of all federally chartered credit unions.

Background on Credit Unions

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an Act of Congress in 1934, the federal credit union system was created—and has been widely recognized—as a way to promote thrift and to make financial services available to all Americans who would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to fill a precise public need—a niche that credit unions fill today for nearly 94 million Americans.

Every credit union is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 U.S.C. §1752(1)). While more than 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- Credit unions remain singularly committed to providing their members with efficient, low cost, personal service; and
- Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation’s approximately 7,200 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members—while banks strive to make a profit for their shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—“one member,

one vote”—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors. Federal credit union directors also generally serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

Today, credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation among financial depository institutions has progressed with the resulting de-personalization in the delivery of financial services by some large banks, the emphasis in consumers’ minds has begun to shift not only to services provided but also—and in many cases more importantly—to quality and cost. While many large banks have increased their fees and curtailed customer service as of late, credit unions continue to provide their members with high quality personal service at the lowest possible cost. This is evidenced, most recently, as thousands of Americans turned to local credit unions after several large national banks proposed new fee increases.

Current Examination Process

Credit unions were not the cause of the financial crisis, yet often feel the effect of punitive measures designed to reel in the practices of bad actors and other financial institutions.

Part of the response to the economic crisis was to create new layers of regulations and institute more aggressive enforcement of existing law. In order to aggressively enforce new and old regulations and to avoid a repeat of the crisis, regulators have increasingly tightened examinations standards. For example, since the start of the crisis, examination cycles for credit

unions have gone from 18 months to 12 months. Having examiners visit an institution adds its own burden to the institution, as they must dedicate staff time and resources to prepare and respond to the examination.

NAFCU supports effective exams that are focused on safety and soundness and flow out of clear regulatory directives. However, the examination process, by its very nature, can be inconsistent. Regulatory agencies in Washington try to interpret the will of Congress, examiners in the field try to interpret the will of their agency, and financial institutions often become caught in the middle as they try to interpret all three as they run their institution. Unfortunately, the messages are not always consistent. NAFCU members have long had issues with the examination process, as have other regulated entities. NAFCU supports efforts to help reduce the regulatory burden on credit unions. This is one of the reasons that NAFCU urges the committee to consider improvements to the examination process.

Many credit unions, including mine, have positive professional relationships with their examiners. We believe that this working relationship is important in having a successful examination process focused on safety and soundness.

Unfortunately, not all institutions have this positive relationship with their examiner. It is with this in mind that we believe that consistency, the handling of guidance versus regulation, the management of examiner expectation and managing the exam relationship are all areas where improvement in the examination process could occur.

Areas where Congress can help improve the examination process through H.R. 3461 and beyond include:

Congressional Intent

Identifying and adhering to Congressional intent is key to the proper promulgation and implementation of regulations. Congress must make its intent clear to regulators. One result of the rhetoric and regulations stemming from the *Dodd-Frank Wall Street Reform and Consumer Protection Act* has been a message to regulators to conduct draconian supervision and apply rigid parameters in examinations. As a result, credit unions find themselves using precious resources trying to navigate a new and unfamiliar exam process while simultaneously trying to guide their member-owners through the worst financial crisis since the Great Depression.

While we agree that the unregulated bad actors that caused the crisis are in desperate need of regulations to curtail their risky and abusive practices, credit unions certainly do not fall in that category. Unfortunately, credit unions now face many of the same costly and burdensome regulations as the bad actors, in addition to a restrictive examination environment.

Transparency

Ensuring transparency in government is a laudable goal embraced by many members of the Committee and the Administration. Transparency is critically important at our nation's regulatory agencies. The standards of a regulatory regime must be articulated with a level of clarity and definition that provides for as little ambiguity as possible. We believe there are two ways to go about this.

First, regulations and any subsequent guidance must include clear tangible criteria which credit union executives can follow. Furthermore, credit unions should have access to all materials and guidance that examiners use or reference during examinations. Since credit unions do not have all the guidelines used by examiners, it is understandably difficult to comply to the extent that the credit union or the NCUA may prefer.

Second, credit unions should always receive constructive feedback in regard to issues an examiner may identify. Some credit unions have reported receiving unclear or inadequate responses. In other instances they have received information that is inconsistent with published examination guidelines. Improving this process should help both the examiner and the institution.

Ultimately, more transparency in the regulatory process will lead to more consistency and promote safety and soundness throughout the system.

Consistency

Maintaining a consistent supervisory and examination environment is vital to ensuring compliance with both safety and soundness as well as consumer protection regulations. Notwithstanding changes in regulation, the standards by which a credit union is evaluated during examinations should not change from examination to examination. Unfortunately, this is not always the case and credit unions are too often left guessing which particular business area will

receive the most emphasis by an examiner. For example, while one examiner may find mortgage lending to carry the most importance, another may place emphasis on business lending.

Additionally, regulators should ensure that their regulations are consistently applied from one examiner to another. Inconsistent application of laws and regulations among examiners increases uncertainty. This increased uncertainty adds another unnecessary layer of difficulty for credit unions to maintain the highest levels of compliance.

More importantly, it is also unclear how an examiner will evaluate compliance. In addition to actual regulations, the NCUA also routinely provides “guidance” in any one of a number of different forms. Some examiners treat the guidance as just that; a tool to be used for credit unions to comply with regulations or implement best practices. Some examiners, however, treat the “guidance” as if it were part of the regulation itself, and consider failure to comply with the guidance as something roughly equal to failing to comply with the regulation. Examiners’ misuse of and misplaced reliance on guidance documents is an increasing concern for credit unions. More should be done to ensure that all examiners treat both regulations and guidance consistently and for the purpose each was issued. Asking credit unions to comply with fluctuating standards, based on each individual examiner’s reliance on informal guidance, ultimately increases compliance costs without any clear benefit.

Examination Report Appeal Process

NAFCU understands that some of our concerns cannot be addressed by regulators. Generally, NCUA and its examiners do a satisfactory job, but every inconsistency that forces credit unions

to divert more resources to compliance reduces their ability to better serve their members. This ultimately translates to lower interest rates on savings, higher interest rates on loans, and in some cases, the inability to extend credit to a member that would receive credit otherwise.

It is with this delicate balance in mind that NAFCU urges reforms to the current appeal process. The appeal process should provide an opportunity to identify inconsistencies and serve as a quality assurance check. The existing appeal process does not promote either. It is worth noting that NCUA should not be blamed for the shortcomings of the appeal process. The true issue is the structure of the process.

NCUA currently serves as the prosecutor, judge, and jury. Under the existing process, if an examiner makes a determination to take action against the credit union, the credit union must first address the issues with the examiner. The second step is to contact the supervisory examiner, who evaluates the facts and reviews the analysis. If the issue is still not resolved, the credit union may send a letter to the regional director.

After the previous steps have been taken, if the appeal concerns a material supervisory determination, the credit union may appeal to the NCUA Supervisory Review Committee. Material supervisory determinations are limited to: (1) composite CAMEL ratings of 3, 4, and 5 and all component ratings of those composite ratings; (2) adequacy of loan loss reserve provisions; (3) loan classifications on loans that are significant as determined by the appealing credit union; and (4) revocations of Regulatory Flexibility Program (RegFlex) authority. The

NCUA Supervisory Review Committee consists of three regular members of the NCUA's senior staff appointed by the NCUA Chairman.

The appeal process has a number of inherent flaws, not the least of which is the exclusion (in most instances) of a review by an independent third party at any level of the process. Under these circumstances it is almost impossible to avoid conflicts of interest and approach each situation objectively. A number of issues result from this lack of independent review.

Any regulatory agency would be hesitant to support an appeal of an internal decision. Undoubtedly, and understandably, agency officials have more faith in their examiners than the regulated entity. Overturning the decision of a field examiner could be extremely difficult for a supervisory examiner or regional director, especially in the absence of clear cut evidence that an examiner has acted in conflict with agency guidance. Approving an appeal may reflect poorly on the examiner and possibly the supervisory examiner or regional director. For example, NCUA's Supervisory Review Committee, which is comprised of senior staff of the agency, could unintentionally be influenced by the impact that overruling an examiner could have on the agency. It is clearly evident that at some point in the appeal process, the appeal needs to be heard by someone without any interest in the outcome.

Consumer Financial Protection Bureau

H.R. 3461 will help foster a stronger relationship between the CFPB and the financial services industry by encouraging a transparent and consistent examination process. Certainly, the legislation will have a similar impact on all financial regulators, but the impact with regard to the

CFPB is magnified because it is a new agency with little to no precedent on which to rely. As institutions are examined and interact with the CFPB, providing clear guidance as to the basis for material supervisory determinations will help institutions comply with this new regulatory landscape.

H.R. 3461, the Financial Institutions Examination Fairness and Reform Act

Several provisions in the *Financial Institutions Examination Fairness and Reform Act* will address concerns with the examination process. We support this bill as it will improve transparency and consistency in a meaningful manner. A provision in Section 2 of the legislation would require examiners to disclose all examination and other factual information relied upon in support of a material supervisory determination. This would help ensure that regulatory guidance is being applied consistently. NAFCU strongly supports this provision; however, it can be improved by removing the requirement that financial institutions request this information. This information should always be provided to financial institutions upon completion of the examination process.

The establishment of the Office of Examination Ombudsman in the Federal Financial Institutions Examination Council will promote consistency and eliminate the current conflict of interest inherent in the process. Currently, for some issues, such as certain cease and desist proceedings, there is a formal independent appeal process available to credit unions. However, an expanded right to appeal all actions to an administrative law judge will ensure that appeals receive an independent review.

Disclosure of the information used in support of a material supervisory determination combined with an independent review of appeals will assist in exposing any disconnect between the guidance given by agency leadership in Washington and field examiners.

Finally, as the committee considers this legislation, we ask that you ensure the costs associated with these improvements are not simply passed on to credit unions and other financial institutions. There are many ways to enhance the efficiency of the examination process to help offset any potential cost increases that may arise as a result of these much needed reforms. In some instances the establishment of a new office or increased disclosure can provide a reason for increased assessments on financial institutions or requests for additional taxpayer funds that may not be necessary. With the fiscal situation facing our country, we must ensure every segment of government is maximizing all available resources.

Conclusion

In conclusion, I would note that NAFCU supports effective, demonstratively necessary regulation. We believe that credit unions should have a respectful non-adversarial professional relationship with examiners. We do not support new regulatory burdens that detract from credit unions serving their members without providing a clear tangible benefit.

NAFCU believes the legislation under consideration is a positive first step in improving the examination process and we support it. Introducing an independent third party to the appeal process will ensure that consistent standards are applied and will help bring more certainty to the examination process.

Thank you again, Chairman Capito, Ranking Member Maloney, and Members of the Subcommittee for the invitation to testify before you today. We appreciate the opportunity to share our views on H.R. 3461, the *Financial Institutions Examination Fairness and Reform Act*.