



2014 NAFCU REPORT *on* CREDIT UNIONS

NAFCU

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December 2014

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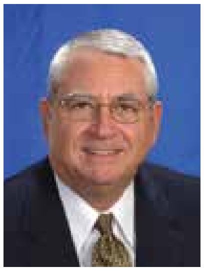
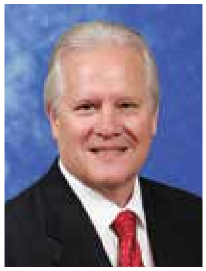
This material was prepared for a meeting on December 4, 2014 between the
NAFCU Board of Directors and the Board of Governors of the Federal Reserve System

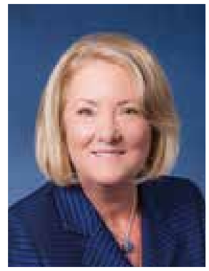
Board of Directors and President and CEO of the National Association of Federal Credit Unions



Ed Templeton
Chair
Director-at-Large
SRP FCU
North Augusta, SC
Asset Size: $684M
Members: 101,749
FOM: Community

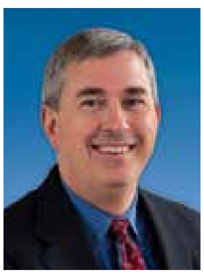


Richard Harris
Vice Chair
Region V Director
Caltech Employees FCU
La Canada, CA
Asset Size: $1.3B
Members: 31,316
FOM: Multi-Occupational



Jeanne Kucey
Treasurer
Region III Director
JetStream FCU
Miami Lakes, FL
Asset Size: $163M
Members: 20,126
FOM: Community

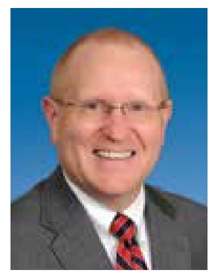
Debra Schwartz
Secretary
Director-at-Large
Mission FCU
San Diego, CA
Asset Size: $2.5B
Members: 170,795
FOM: Community



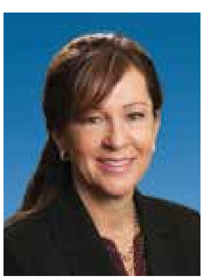
Martin Breland
Region II Director
Tower FCU
Laurel, MD
Asset Size: $2.7B
Members: 132,994
FOM: Multi-Occupational

Cutler Dawson
Director-at-Large
Navy FCU
Merrifield, VA
Asset Size: $60.5B
Members: 5,106,925
FOM: Defense

Thomas W. DeWitt
Region IV Director
State Farm FCU
Bloomington, IL
Asset Size: $3.9B
Members: 131,999
FOM: Service

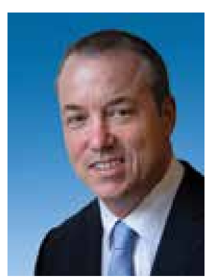


Michael Parsons
Region I Director
First Source FCU
New Hartford, NY
Asset Size: $397M
Members: 36,268
FOM: Community

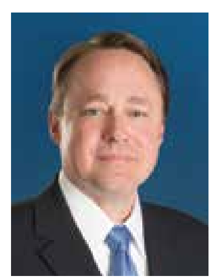


Jan N. Roche
Director-at-Large
State Department FCU
Alexandria, VA
Asset Size: $1.6B
Members: 66,539
FOM: Multi-Occupational

Rod Taylor
Region IV Director
Barksdale FCU
Barksdale AFB, LA
Asset Size: $1.2B
Members: 112,647
FOM: Multi-Occupational



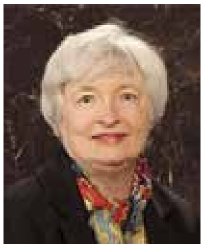
Daniel Weickenand
Director-at-Large
Orion FCU
Memphis, TN
Asset Size: $544M
Members: 57,426
FOM: Multi-Occupational



B. Dan Berger
President and CEO

FOM is Field of Membership.

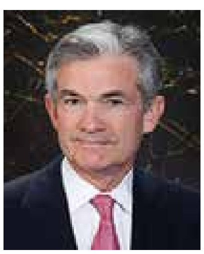
Board of Governors of the Federal Reserve System



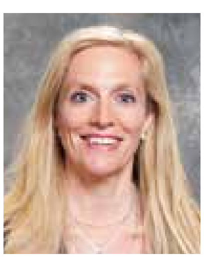
Janet Yellen, Chair of the Board of Governors. Her four-year term as Chair expires February 3, 2018, and her 14-year term as member ends January 31, 2024. She began her term as Chair on February 3, 2014. Prior to her appointment, Dr. Yellen was Vice Chair of the Board of Governors and was previously a president of the Federal Reserve Bank of San Francisco. She is Professor Emeritus at the University of California at Berkeley and has been a faculty member since 1980. She was also chair of the President's Council of Economic Advisers.

Stanley Fischer, Vice Chair of the Board of Governors. His term as Vice Chair expires on June 12, 2018, and his term as a member ends January 31, 2020. He began his term on May 28, 2014. Prior to his appointment, Dr. Fischer was governor of the Bank of Israel from 2005 through 2013. Dr. Fischer was a professor of economics at the Massachusetts Institute of Technology (MIT). Prior to joining MIT faculty, Dr. Fischer was an assistant professor of economics and postdoctoral fellow at the University of Chicago.

Daniel Tarullo, member of the Board of Governors. His term expires January 31, 2022. He took office on January 28, 2009. Before becoming a member of the Board, Mr. Tarullo was professor at Georgetown University Law Center. He also worked in several senior staff positions during the Clinton Administration, including Deputy Assistant to the President for Economic Policy and Assistant to the President for International Economic Policy. Prior to serving in the Clinton Administration, he was Chief Counsel for Employment Policy on the staff of Senator Edward Kennedy.



Jerome H. Powell, member of the Board of Governors. He took office on May 25, 2012, to fill an unexpired term ending January 31, 2014. He was reappointed and sworn in on June 16, 2014 for a term ending January 31, 2028. Prior to his appointment, Mr. Powell was a visiting scholar with the Bipartisan Policy Center, where he focused on federal and state fiscal issues. From 1997 through 2005, he was a partner at The Carlyle Group. Mr. Powell also served as Assistant Secretary and as Undersecretary of the Treasury under President George H.W. Bush.



Lael Brainard, member of the Board of Governors. She took office in June 16, 2014 to fill an unexpired term ending January 31, 2026. Prior to her appointment, Dr. Brainard served as Undersecretary of the U.S. Department of Treasury and Counselor to the Secretary of the Treasury. Dr. Brainard also was previously the Vice President and Founding Director of the Global Economy and Development Program, and held the Bernard L. Schwartz Chair at the Brooking Institution. She was also Assistant and Associate Professor of Applied Economics at the Massachusetts Institute of Technology.

Abbreviations

ACH	Automated Clearing House
ATM	Automated Teller Machine
ATR	Ability to Repay
CFPB	Consumer Financial Protection Bureau
CLF	Central Liquidity Facility
CUMAA	Credit Union Membership Access Act
CUSO	Credit Union Service Organization
DTI	Debt-to-Income Ratio
FCRA	Fair Credit Reporting Act
FCU	Federal Credit Union
FHFA	Federal Housing Finance Agency
FHLB	Federal Home Loan Bank
FICU	Federally Insured Credit Union
FOM	Field of Membership
GLBA	Gramm-Leach-Bliley Act
HMDA	Home Mortgage Disclosure Act
IOLTA	Interest on Lawyers' Trust Accounts
IRR	Interest Rate Risk
MBL	Member Business Loan
MSR	Mortgage Servicing Rights
NAFCU	National Association of Federal Credit Unions
NCUA	National Credit Union Administration
NCUSIF	National Credit Union Share Insurance Fund
PCA	Prompt Corrective Action
QM	Qualified Mortgage
RBNW	Risk-Based Net Worth
RESPA	Real Estate Settlement Procedures Act
ROA	Return on Assets
TILA	Truth in Lending Act

BACKGROUND

The National Association of Federal Credit Unions (NAFCU), founded in 1967, is the only trade association that exclusively represents the interests of federal credit unions (FCUs) before the federal government and the public. 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 nearly 800 of the nation's most innovative and dynamic federal credit unions having various and diverse membership bases and operations. NAFCU takes pride in representing many smaller credit unions with relatively limited operations, as well as many of the largest and most sophisticated credit unions in the nation. In fact, as of June 2014, 84 of the 100 largest FCUs were NAFCU members. NAFCU represents 68 percent of total FCU assets and 63 percent of all FCU member-owners.

In addition, NAFCU's membership includes several state-chartered credit unions that were formerly federally chartered credit unions, which chose to retain their NAFCU membership.

The Credit Union Universe

Federally Chartered Credit Unions

Federally chartered credit unions 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 2014, there were 4,029 FCUs, with assets of $593 billion and a membership base of approximately 53.4 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" (FICUs) refers to both federal and state-chartered credit unions whose accounts are insured by the NCUSIF. Thus, FCUs are a subset of FICUs. As of June 2014, there were 6,429 FICUs with assets of $1.1 trillion and a membership base of over 98 million.

Privately Insured Credit Unions

Private primary share insurance for state-chartered credit unions has been authorized in a number of states. Currently there are privately insured credit unions operating in nine states.[1] There is only one private insurance company (American Share Insurance of Dublin, Ohio) offering credit unions primary share insurance and excess deposit insurance. Another private insurer (Massachusetts Share Insurance Corporation) offers only excess deposit insurance coverage. As of June 2014, there were 131 privately insured credit unions with assets of $13.8 million.

Corporate Credit Unions

Corporate credit unions are credit unions for credit unions. Corporate credit unions provide services such as investment products, advisory services, item processing and loans to their members. As of June 2014, there were 15 corporate credit unions with assets of $19.3 billion.

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[1] The nine jurisdictions where state-chartered credit unions have obtained primary private insurance are Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio and Texas.

NAFCU Research

NAFCU devotes a great deal of institutional resources to keeping its finger on the pulse of its members' operations by surveying its membership regularly. In this report, we reference several research instruments:

Economic & CU Monitor

NAFCU's *Economic & CU Monitor* is a monthly survey of NAFCU-member credit unions, which is compiled into a report with updates on our members' financial data, as well as their responses to questions on a special monthly topic.

CU Industry Trends Report

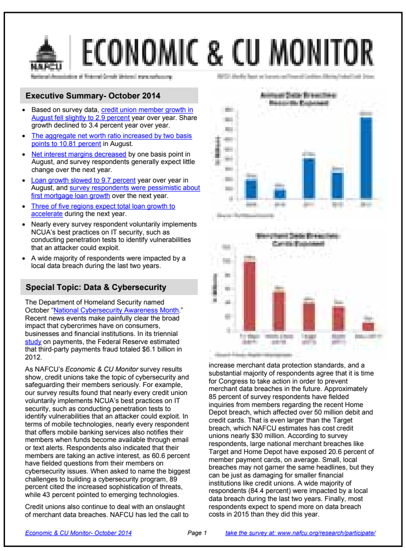
NAFCU's *CU Industry Trends Report* is a quarterly analysis of trends in the credit union industry, with key financial ratios summarized and aggregated by region and asset class.

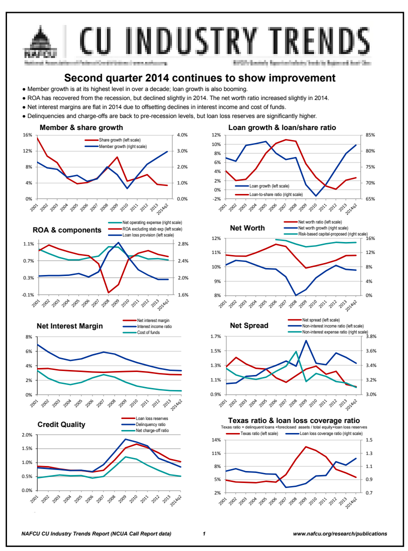
NAFCU Report on Credit Unions

NAFCU's *Federal Reserve Meeting Survey* is an annual assessment of NAFCU members covering topics we discuss in the annual *NAFCU Report on Credit Unions*. Survey data for the current report was collected in September 2014.

Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy

NAFCU commissioned a special study in 2012 to examine what would happen to the U.S. economy if the presence of credit unions was reduced significantly as a result of eliminating the credit union federal tax exemption. The study quantifies the benefits to all consumers – both credit union members and bank customers – of having a strong credit union presence in financial markets. The study shows that reducing the number of credit unions would weaken competition for consumer financial services and lead to higher interest rates on consumer loans and lower interest rates on deposits for consumers. The study also estimates the broader economic impact of these lost consumer benefits.





KEY FINDINGS

Credit union trends

- Federally insured credit unions' (FICUs) net worth ratio increased from 10.5 percent in June 2013 to 10.77 percent as of June 2014, and over 97 percent of FICUs are considered "well capitalized."
- As of June 2014, FICUs' year-over-year loan growth (9.8 percent) far outpaced year-over-year share growth (3.4 percent). FICUs' loan-to-share ratio of 71.7 percent is still well below its pre-recession level.
- According to NAFCU's 2014 *Federal Reserve Meeting Survey*, more credit unions are loosening lending standards for vehicle loans and tightening standards for credit card, real estate and business loans.

Credit union service to members and use of Federal Reserve services

- Electronic services provided by credit unions continue on an upward trend, as do the number of credit unions offering these services.
- A majority of credit unions offer internet banking and a growing number offer mobile banking.
- NAFCU members hold a positive view on the quality of Federal Reserve services, rating most as "above average."

Legislative issues facing credit unions

- Preserving the credit union tax exemption is the top legislative priority of NAFCU. Credit unions provide over $17 billion annually in benefits to the economy.
- Credit unions continue to be challenged by the ever-increasing regulatory burden in the post Dodd-Frank environment and desperately need comprehensive regulatory relief.
- Any housing finance reform package must maintain a government guarantee and ensure credit union access to the secondary market with fair pricing.
- Data security and cyber security are serious issues for credit unions, as they often are the ones who pay to make their members "whole" when a data breach occurs. Congress needs to enact national standards of security for retailers who hold sensitive financial information.

Regulatory issues facing credit unions

- Credit unions continue to remain engaged on faster payments issues and provide their unique perspective.
- Regulation D limitations should reflect the reality of new technology and consumer habits.
- Any changes to interchange fees and rules would have a major impact on all credit unions.
- Credit unions continue to devote significant resources toward compliance solutions related to the CFPB's mortgage rules and Truth in Lending Act and Real Estate Settlement Procedures Act integration.
- The National Credit Union Administration should significantly amend its risk-based capital rule to ensure credit unions are not negatively impacted.

Interest rate risk

- The percentage of credit union shares held in core deposits is similar to 2003, immediately prior to the last period of rising rates.
- Credit unions have begun to make sizeable reductions to their long-term investment portfolio.
- Credit unions compare favorably with community banks in terms of their real estate concentrations.

CREDIT UNION TRENDS

General Financial Conditions

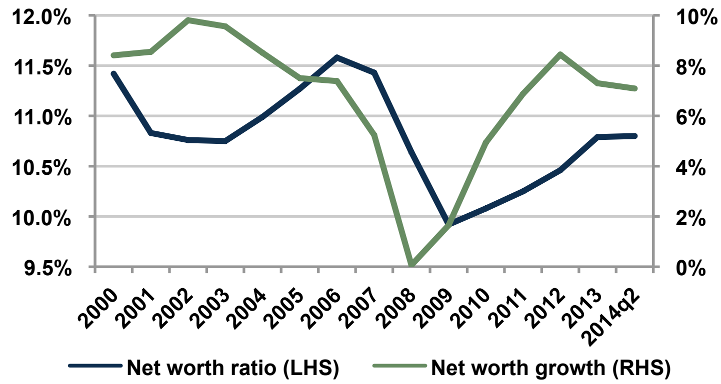
Credit unions are conservatively run, well-capitalized institutions, which enabled them to weather the recession (December 2007 through June 2009). FICUs' net worth ratio has risen steadily since 2009 (Chart 1), and as of June, year-over-year growth in net worth (7.1 percent) far exceeded asset growth (4.5 percent). Throughout the recession, credit unions fared better than banks in terms of their failure rate. As of June 2014, NCUA reported that there were 295 problem credit unions with a CAMEL rating of 4 or 5. These credit unions constitute 1.5 percent of industry shares, which is down from 5.7 percent in 2009.

The recession resulted in a spike in share growth for FICUs due to a flight to safety (Chart 2). However, share growth has moderated recently while loan growth has surged. As of June 30, 2014, total loans at FICUs increased 9.8 percent year over year, while shares were up 3.4 percent. The loan-to-share ratio increased from 67.5 percent in June 2013 to 71.7 percent in June 2014. By historical norms, there is still a substantial amount of liquidity in the industry.

The recession reshaped credit union balance sheets. As compared to 2007, new vehicle loans as a share of total loans dropped and were replaced with used vehicle loans. Likewise, the share of HELOCs and other real estate loans fell while first mortgage loan share increased (Chart 3).

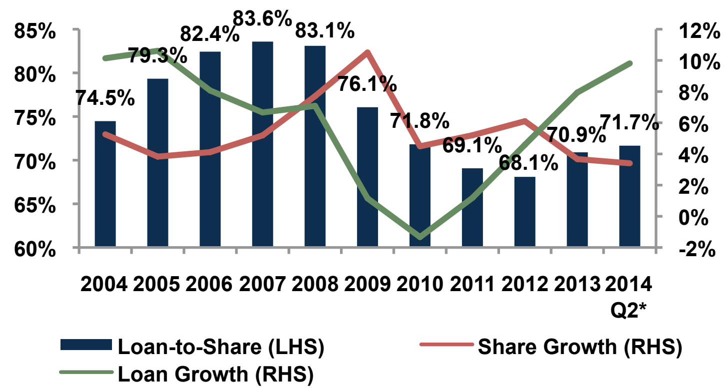
The extended period of low interest rates resulted in a shift in liabilities as members opted out of share certificates and into core deposits (share drafts, regular shares and money market shares). From 2007 to June 2014, the percent of credit union shares in core deposits increased from 55.5 percent to 70.4 percent. This has resulted in a lower cost of funds for credit unions, but that trend is likely to be reversed if and when interest rates increase.

Chart 1 | FICU Net Worth Ratio



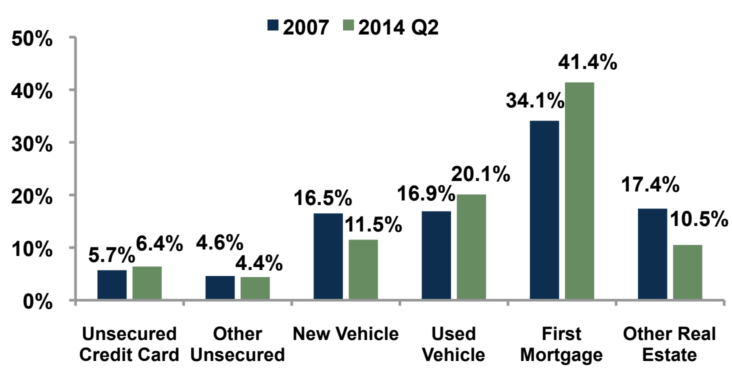
Source: NCUA Financial Performance Report (FPR)

Chart 2 | FICU Loan and Share Growth



** Growth rates are year over year.*
Source: NCUA FPR

Chart 3 | FICU Loans by Type



Source: NCUA FPR

FICUs' June 2014 annualized ROA (0.82 percent) is slightly lower than it was a year ago (0.88 percent) (Chart 4). In general, ROA has recovered since the recession thanks to reductions in provision for loan and lease loss expense. Nevertheless, declining fee income is placing downward pressure on ROA and is the primary reason for the drop in earnings over the past year. In this regard, the Federal Reserve's cap on debit interchange fees presents another hurdle for all credit unions as they strive to maintain the products and services that members have grown accustomed to, such as free share draft accounts.

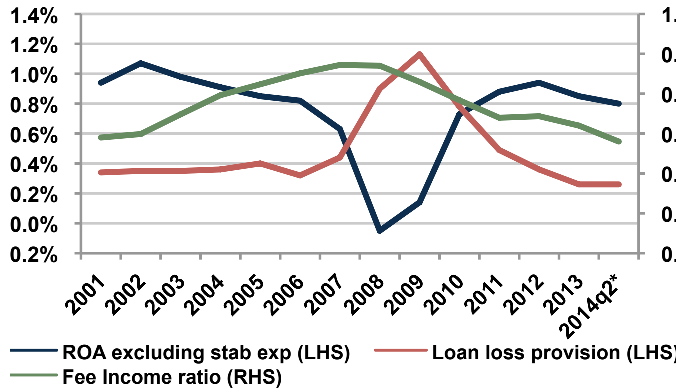
By and large, credit unions did not participate in the type of lending activities that precipitated the financial crisis, and yet, FICUs experienced some deterioration in their overall asset quality as a result of the recent financial turmoil. However, asset quality has improved since 2009 and returned to pre-crisis levels. The delinquency ratio for the credit union industry as of June 2014 was 0.9 percent, which is a 19 basis point improvement over a year ago. This compares to a delinquency ratio of 2.2 percent for all banks and 1.6 percent for community banks (Chart 5). The FICU net charge-off ratio is down to 0.5 percent, which is nine basis points lower than a year ago.

Lending Standards

NAFCU's annual *Federal Reserve Meeting Survey* includes questions on lending standards, and a comparison between 2013 and 2014 shows mixed results (Chart 6). For credit card lending, slightly more respondents indicated that they were tightening loan standards, which is a reversal from 2013. By a wide margin, respondents indicated that they were easing standards on new and used vehicle loans in 2014, even more so than in 2013. Finally, respondents generally tightened real estate loan standards, although not by as wide a margin as in 2013.

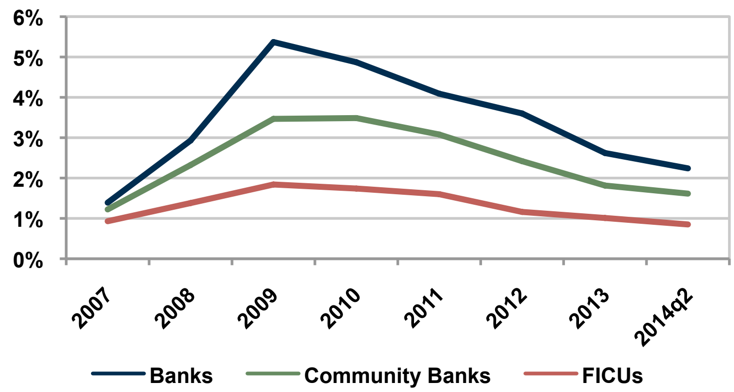
For those instances where respondents tightened lending standards, the most commonly cited reasons were increased

Chart 4 | ROA



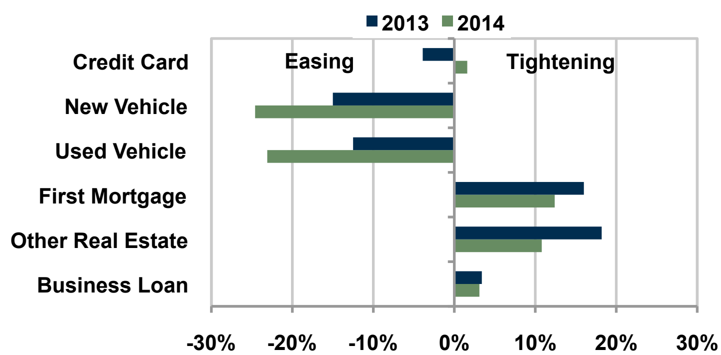
Source: NCUA FPR

Chart 5 | Delinquency Ratios



Source: NCUA FPR

Chart 6 | Net Percentage Tightening Loan Standards



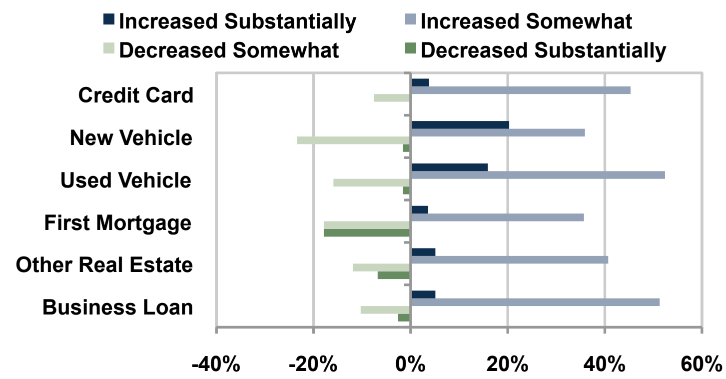
Source: NAFCU 2014 Federal Reserve Survey concerns about legislative changes (80 percent "somewhat" or "very important") and a reduced tolerance for risk (80 percent). As for the reasons respondents eased lending standards, the most commonly cited were increased tolerance for risk (94.3 percent) and more favorable or less uncertain economic outlook (85.7 percent).

Year-over-year loan growth is near its highest point in a decade, and survey respondents indicated broad-based increases in loan demand over the past year. The strongest increases were seen in credit card, vehicle and business loan demand, while first mortgage loan demand softened somewhat versus last year (Chart 7). At the same time, the creditworthiness of applicants has improved for all loan types except for credit card loans (Chart 8).

Respondents to NAFCU's 2014 *Federal Reserve Meeting Survey* indicated that the CFPB's ability-to-repay/qualified mortgage (ATR/QM) rules are having a significant chilling impact on lending. In response to ATR/QM, the vast majority of survey participants have either ceased to originate or reduced their originations of non-QM loans (Chart 9). When asked the specific part of the rule that was most impactful, respondents cited the requirement of a 43 percent or lower debt-to-income ratio (92.1 percent considered it "somewhat" or "very" impactful) as well as the burden for the creditor to evaluate a borrower's credit history and expected income (89.5 percent).

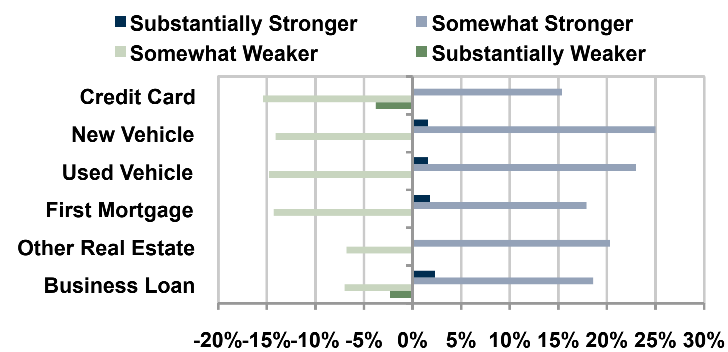
The CFPB created a second, temporary classification of QM loans which includes loans with debt-to-income ratios above 43 percent, but which still meet GSE underwriting standards. When asked if this temporary classification impacted their lending standards, 22.2 percent of survey respondents said their standards would be somewhat tighter without it and 15.6 percent would have substantially tighter standards without the classification. The CFPB intends to phase out the temporary classification no later than 2021.

Chart 7 | Change in Loan Demand (last 12 months)



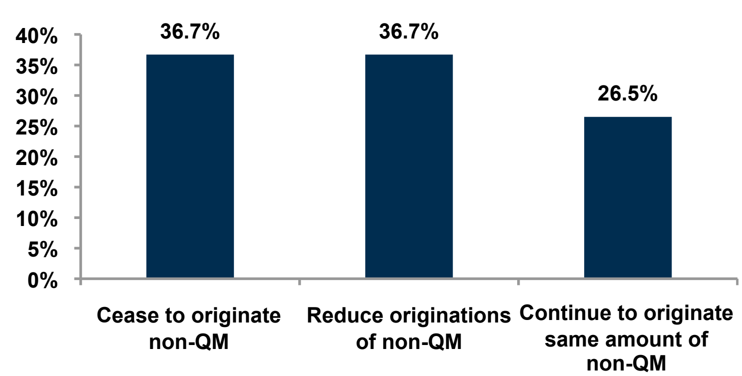
Source: NAFCU 2014 Federal Reserve Survey

Chart 8 | Change in Applicant Creditworthiness (last 12 months)



Source: NAFCU 2014 Federal Reserve Survey

Chart 9 | Response to Qualified Mortgage (QM) Rule



Source: NAFCU 2014 Federal Reserve Survey

Liquidity

Prior to the recession, credit unions relied heavily on corporate credit unions for their short-term liquidity needs. However, a number of corporate credit unions failed in the wake of the financial crisis, which also impacted the NCUA's Central Liquidity Facility (CLF). When U.S. Central Bridge Corporate Credit Union shut its doors in October 2012, the CLF's borrowing authority was reduced by 96 percent, from $46 billion to just $2 billion.

In October 2013, NCUA passed a rule requiring credit unions with over $250 million in assets to establish a contingent liquidity funding source through either the Federal Reserve Discount Window or the CLF. Based on NAFCU's 2014 *Federal Reserve Survey* results, credit union respondents with over $250 million have tended to migrate toward the Discount Window. Federal Home Loan Banks (FHLBs), which NCUA did not include as an approved provider of contingency funding in their rule, are also an important source of liquidity for credit unions, and especially for those with over $250 million. Credit union respondents under that threshold have utilized corporate credit unions more heavily.

Table 1 | Credit Union Liquidity Sources

	Increased available lines of credit in past 12 months	Accessed lines of credit in past 12 months	Tested access in backup liquidity plan in past 12 months	Intend to gain access to funds in next 12 months
Banks				
<$250 million	2.5%	2.5%	2.5%	0%
>$250 million	9.7%	3.2%	22.6%	3.2%
FRB Discount Window				
<$250 million	12.5%	2.5%	10.0%	2.5%
>$250 million	25.8%	9.7%	61.3%	12.9%
FHLBs				
<$250 million	20.0%	2.5%	20.0%	12.5%
>$250 million	19.4%	25.8%	41.9%	12.9%
Corporate CUs				
<$250 million	32.5%	30.0%	37.5%	10.0%
>$250 million	6.5%	9.7%	29.0%	0%
Central Liquidity Facility				
<$250 million	7.5%	0%	2.5%	2.5%
>$250 million	0%	3.2%	3.2%	0%

Source: NAFCU 2014 Federal Reserve Survey

Secondary Mortgage Market

The secondary mortgage market is vital to many small financial institutions with mortgage loan portfolios, as a source of liquidity and as a tool to manage interest rate and concentration risks. Through June, credit unions sold 32 percent of real estate loans originated. This is down from 2013 when 46 percent of real estate originations were sold, but still in line with historical averages. Credit unions that participated in NAFCU's 2014 *Federal Reserve Meeting Survey* indicated that, on average, 59 percent of their outstanding first mortgage loans qualify to be sold on the secondary market (down from 63.8 percent in last year's survey). Fewer respondents securitized or sold mortgage loans over the conforming limit to Fannie Mae or Freddie Mac in this year's survey versus last year's (5.5 percent of respondents in 2014 to 13.2 percent in 2013), and fewer respondents are planning to increase sales of conforming jumbo loans in the next 12 months (10.7 percent of respondents in 2014 to 18.4 percent in 2013).

CREDIT UNION SERVICE TO MEMBERS AND USE OF FEDERAL RESERVE SERVICES

Credit unions carry on their commitment to offering their members superior service and modern financial products. This is evident in the growth in the percentage of institutions offering home banking services and mobile banking services.

Electronic Financial Services

Account Balance Inquiry is the most common online service offered by FICUs, with 75.8 percent reporting that they currently offer this service (Table 1). This is up from last year's 74.2 percent. The electronic services that saw the largest increase in usage were Remote Deposit Capture (15.2 percent, up from 9.2 percent last year) and e-Statements (63.6 percent, up from 59.9 percent).

The largest year-over-year increase in banking access services was in mobile banking, which is offered at 40.3 percent of credit unions, up from 31.9 percent a year ago (Table 2). More credit unions are offering their members ATM and internet banking services, as well (72.1 percent and 73.4 percent, respectively). These figures are up from last year's 70.8 percent and 71.6 percent, respectively.

Through shared branching and tens of thousands of free ATMs across the country, including some at key 7-Eleven locations, credit union members have access and convenience that surpasses other financial institutions. The institutions that provide these services hold over 98 percent of the total assets held by all FICUs.

Table 1 | Financial Services Offered Electronically by Credit Unions

Online Service Offered	Provided in 2013	Provided in 2014
Account Aggregation	9.4%	10.9%
Account Balance Inquiry	74.2%	75.8%
Bill Payment	57.6%	59.6%
Download Account History	62.6%	64.5%
Electronic Cash	3.7%	3.8%
Electronic Signature Services	6.6%	10.4%
e-Statements	59.9%	63.6%
External Account Transfers	14.6%	17.6%
Internet Access Services	14.2%	15.4%
Loan Payments	65.9%	68.0%
Member Application	30.4%	32.1%
Merchandise Purchase	5.5%	5.6%
Merchant Processing Services	4.3%	4.7%
New Loans	43.0%	45.3%
New Share Account	19.8%	21.6%
Remote Deposit Capture	9.2%	15.2%
Share Account Transfers	71.2%	73.0%
Share Draft Orders	58.0%	59.4%
View Account History	72.2%	74.1%

Source: NCUA June 2013 & 2014 Call Reports

Table 2 | How Do Your Members Access/Perform Electronic Financial Services?

Electronic Service	Percentage of # of Institutions		Percentage of Assets	
	2013	2014	2013	2014
Audio Response/Phone-Based	58.0%	58.4%	96.3%	96.4%
Automatic Teller Machine (ATM)	70.8%	72.1%	98.4%	98.6%
Home Banking via Internet Website	71.6%	73.4%	98.8%	98.9%
Mobile Banking	31.9%	40.3%	82.7%	90.5%
Kiosk	5.6%	5.8%	31.0%	31.4%

Source: NCUA June 2013 & 2014 Call Reports

Federal Reserve Services

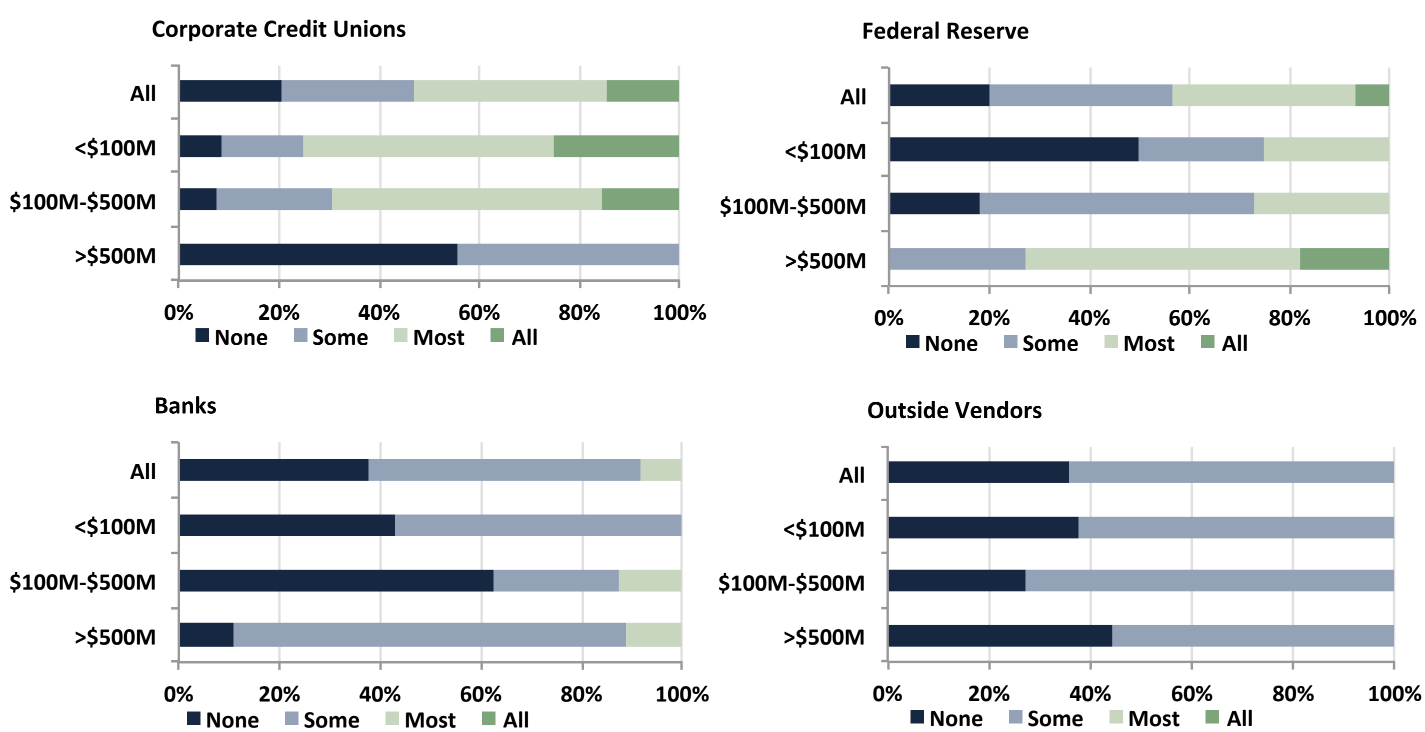
In NAFCU's 2014 *Federal Reserve Meeting Survey*, participants were asked to indicate their use of intermediaries for transaction services (Table 3). Corporate credit unions continue to fill an important role in the credit union industry, and have seen an increase in usage. Nearly 80 percent of respondents use corporate credit unions for at least some of their transaction services. As compared to last year, there was a higher percentage of respondents that used the Federal Reserve for most or all of their transaction services.

Table 3 | Which Intermediaries Does Your Credit Union Use for Transaction Services?

	Corporate Credit Unions		Banks		Federal Reserve		Outside Vendors	
	2013	2014	2013	2014	2013	2014	2013	2014
None	32.1%	20.6%	45.2%	37.5%	15.8%	20.0%	31.1%	35.7%
Some	28.4%	26.5%	49.3%	54.2%	46.1%	36.7%	62.2%	64.3%
Most	28.4%	38.2%	4.1%	8.3%	32.9%	36.7%	6.8%	0%
All	11.1%	14.7%	1.4%	0%	5.3%	6.7%	0%	0%

Source: NAFCU 2013 Federal Reserve Meeting Survey

Chart 1 | Use of Intermediaries by Asset Class



Source: NAFCU's 2013 & 2014 Federal Reserve Meeting Surveys

Looking at the responses by asset class, it becomes clear that smaller credit unions rely more heavily on corporate credit unions for their transaction services than larger credit unions (Chart 1). The over $500 million asset class is much more likely to utilize banks for some of their transaction services. The Federal Reserve is also utilized by the over $500 million asset class at a higher rate than the smaller asset classes. Meanwhile, respondent usage of outside vendors was not heavily influenced by the size of the credit union.

Table 4 | Credit Union Usage and Rating of Federal Reserve Services

Federal Reserve Service	2014 Respondent Usage				Average Rating: 1 to 5 (5=excellent)	
	Total	Declining	Same	Increasing	2013	2014
Fedwire Funds Service	58.06%	3.23%	45.16%	12.90%	3.8	4.0
Account Services	56.25%	0%	53.13%	3.13%	3.8	4.0
FedLine Advantage	55.17%	0%	51.72%	3.45%	4.0	3.9
ACH Receipts	54.84%	0%	32.26%	22.58%	3.8	4.0
Fed Discount Window	54.84%	0%	51.61%	3.23%	3.7	3.8
Check 21 Enabled Service	53.13%	3.13%	37.50%	15.63%	3.9	4.1
Customer "Help" Services	51.61%	3.23%	45.16%	6.45%	3.8	4.0
Coin and Currency Orders	51.52%	6.06%	36.36%	15.15%	3.8	3.9
ACH Originations	50.00%	0%	28.13%	21.88%	3.8	4.0
Educational Seminars	50.00%	0%	43.33%	6.67%	3.6	3.7
Coin and Currency Deposit	48.48%	3.03%	30.30%	18.18%	3.8	3.8
FedImage Services	42.42%	3.03%	33.33%	9.09%	3.9	4.2
FedLine Web Services	40.00%	3.33%	33.33%	6.67%	3.8	4.2
FedMail	33.33%	0%	33.33%	0%	3.5	3.9
Presentment Point Services	30.30%	0%	27.27%	3.03%	3.6	3.9
Foreign Check Services	29.03%	6.45%	25.81%	3.23%	3.4	3.8
Fedwire Securities Service	26.67%	0%	23.33%	3.33%	3.8	3.8
FedLine Direct	26.67%	0%	23.33%	3.33%	3.4	3.8
Paper Check Clearing	24.24%	9.09%	21.21%	3.03%	3.6	4.0
National Settlement Service	20.00%	0%	16.67%	3.33%	3.6	4.0
ACH Risk Management Services	16.67%	0%	16.67%	0%	3.6	3.6
FedPayments Reporter Service	16.67%	0%	16.67%	0%	3.7	3.5
FedComplete Package	16.67%	0%	16.67%	0%	3.2	3.8
FedTransaction Analyzer Service	13.33%	0%	13.33%	0%	3.4	3.6
FedGlobal ACH Payments	10.00%	0%	10.00%	0%	3.4	4.0
FedLine Command	10.00%	0%	10.00%	0%	3.7	3.3

Source: NAFCU 2013 & 2014 Federal Reserve Meeting Survey

NAFCU's 2014 Federal Reserve Meeting Survey asked participants about their usage rates of Federal Reserve services with respect to last year and to rate the service provided (Table 4). The most widely-used Federal Reserve service was Fedwire Funds Service (58 percent), followed by Account Services (56.3 percent), FedLine Advantage (55.2 percent), Automated Clearinghouse (ACH) Receipts (54.8 percent) and Fed Discount Window (54.8 percent). The least-used services were Fedline Command (10 percent), FedGlobal ACH Payments (10 percent), and FedTransaction Analyzer Services (13.3 percent).

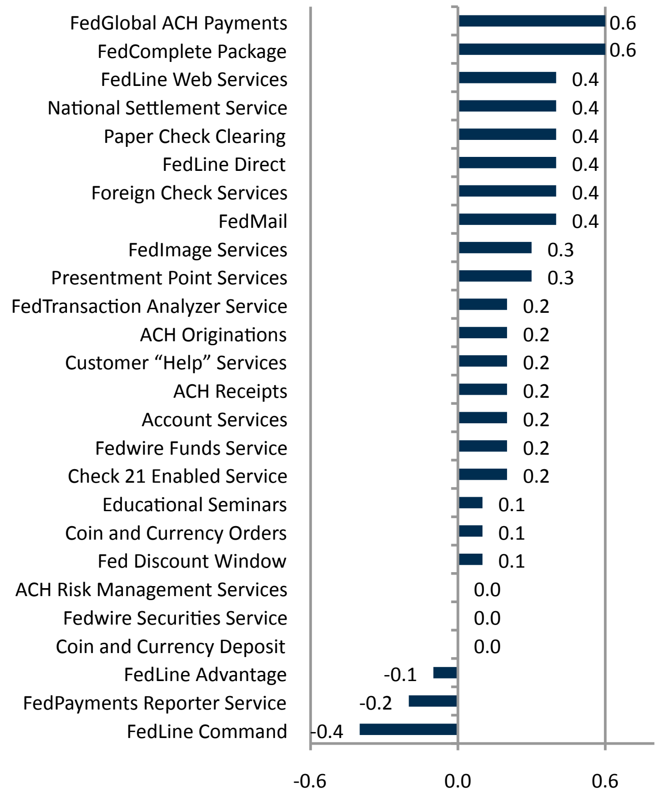
The services in which the greatest number of respondents noted a decline in usage were Paper Check Clearing (9.1 percent), Foreign Check Services (6.5 percent), and Coin and Currency Orders (6.1 percent). The services with the largest increases in usage were ACH Receipts (22.6 percent), ACH Originations (21.9 percent), and Coin and Currency Deposit (18.2 percent). The majority, or 19, of Federal Reserve services had respondents that noted increasing usage, while only nine services had declining services. Overall, the majority of respondents reported the same level of usage of Federal Reserve services over the past year.

Participants were asked to rate the Federal Reserve services on a scale of one to five with five indicating an "excellent" rating. Credit unions participating in the survey were generally pleased with the quality of Federal Reserve services. All 26 of the services included in the survey received a rating above three, or "average." The Federal Reserve services with the highest ratings were FedImage Services (4.2 rating) and FedLine Web Services (4.2 rating), while FedLine Command (3.3 rating) had the lowest rating.

Twenty of the services received a higher average rating than in 2013, while three received a lower rating. The services that saw the largest increases in their average ratings were FedGlobal ACH Payments (+0.6) and FedComplete Package (+0.6), followed by FedLine Web Services, National Settlement Service, Paper Check Clearing, FedLine Direct, Foreign Check Services and FedMail, which all increased by 0.4 (Chart 2). The services with the largest ratings declines were FedLine Command (-0.4), FedPayments Reporter Service (-0.2) and FedLine Advantage (-0.1).

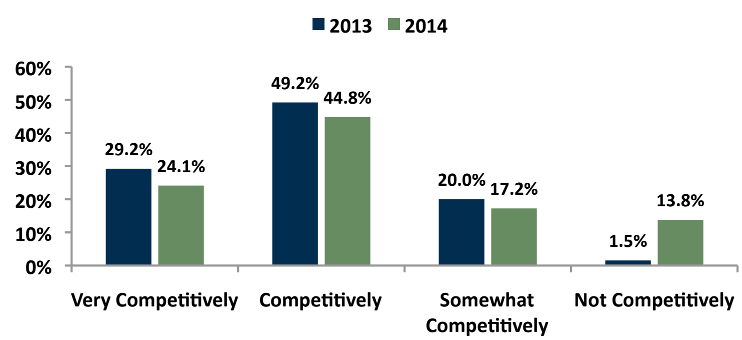
Survey participants were asked to review the overall competitiveness of Federal Reserve services. A large majority (68.9 percent) felt that the Federal Reserve services were either "competitively" or "very competitively" priced (Chart 3). This is a decrease from 2013, when 78.4 percent rated Federal Reserve service pricing as either "competitive" or "very competitive." The specific service identified as "most competitively-priced" was Check 21 Services, while the service viewed as "least-competitively priced" was Wire Processing.

Chart 2 | Change in Rating of Fed Services



Source: NAFCU's 2013 & 2014 Federal Reserve Meeting Surveys

Chart 3 | Overall Rating of Federal Reserve Services



Source: NAFCU's 2013 & 2014 Federal Reserve Meeting Surveys

LEGISLATIVE ISSUES FACING CREDIT UNIONS

Preserving the Credit Union Tax Exemption

While the discussion of comprehensive tax reform has slowed on the Hill, preserving the credit union tax exemption is NAFCU's top legislative priority. No member of Congress has proposed eliminating the credit union tax exemption, and the discussion draft released by House Ways and Means Committee Chairman Dave Camp (R-Mich.) in February of 2014 preserved the credit union tax exemption. A NAFCU study on the benefit of the tax exemption, also released in February of 2014, found that the presence of credit unions provided an average of $17 billion annually in benefits to consumers, businesses and the U.S. economy.

Regulatory Relief

Credit unions continue to face an ever-increasing tidal wave of compliance burden in today's regulatory environment. This partially stems from the fact that many new and updated regulations continue to be promulgated in the post Dodd-Frank environment, while old and outdated regulations are rarely revisited or removed. A May 2013 survey of NAFCU's credit union members found that 88 percent have seen an increase in the cost of compliance since the passage of the Dodd-Frank Act. Over 1,000 credit unions have disappeared since the passage of the Dodd-Frank Act in 2010, and over 96% of those were small institutions with under $100 million in assets. Many smaller institutions simply cannot keep up with the new regulatory tide and have had to merge out of business or be taken over.

Dover Federal Credit Union President and CEO David Clendaniel testifies on behalf of NAFCU before a House Financial Services subcommittee in a hearing on regulatory relief.

In February 2013, NAFCU sent the new Congress a comprehensive 5-point plan to address the regulatory relief efforts that are essential to the credit union industry's ability to serve its members. While Congress has yet to pass these measures, there are three small elements of the plan that have passed the House and await Senate action. These include: parity for credit unions with banks on the insurance coverage on Interest on Lawyers Trust Accounts (IOLTAs), removing the requirement to mail redundant annual privacy notices and a fix on how affiliated title and escrow charges are calculated in the points and fees on Qualified Mortgages.

XCEL Federal Credit Union President and CEO Linda McFadden told the Senate Banking Committee that "enough is enough" when it comes to regulating the credit union industry.

Data Security

Data security breaches are a serious problem for both consumers and businesses. Financial institutions such as credit unions bear a significant burden as they often incur steep losses to reestablish member safety after a data breach occurs. The slew of recent data breaches, including the massive breaches at both Target and Home Depot, have had a significant financial impact on credit unions, with NAFCU estimating that the Target breach alone will cost credit unions around $30 million. The recent Home Depot breach is expected to ultimately be the same in scale, as an October 2014 survey of NAFCU members found that nearly 85% of responding credit unions had already been contacted by their members concerning the Home Depot breach.

Despite the fact that they are rarely the source of data breaches, credit unions are still mandated to protect data consistent with the provisions set out in the Gramm-Leach-Bliley Act. However, there is no similar comprehensive regulatory structure to ensure that retailers and merchants are protecting a consumer's financial data. While the recent breaches have led to a number of hearings on Capitol Hill, legislative action has been slow in coming. NAFCU supports legislation introduced by Senators Tom Carper (D-DE) and Roy Blunt (R-MO), the Data Security Act of 2014 (S. 1927), that would require minimum data security measures and breach notification requirements for all U.S. businesses. Given the jurisdictional challenges of the data security issue in Congress, NAFCU has also called on Congressional leadership to establish a bipartisan- bicameral working group to come up with legislative solutions to address the ongoing issue of data breaches. The issue of data security is also one of the provisions of NAFCU's 5-point plan on regulatory relief.

Cyber Security

Cyber security is an important issue for credit unions, as some institutions have found themselves victims of denial of service attacks, in addition to other cybercrimes that threaten to compromise the financial information of a member, especially with the growth of online commerce and banking. As an industry, credit unions and other financial institutions must increase their collaboration and work together to combat these crimes. An October 2014 survey of NAFCU members found that over 60% of responding credit unions had been contacted by their members with questions about cyber security.

The public sector should play a larger role in information sharing so that "known" threats are shared and can be protected against. NAFCU supports efforts to create a new cyber security framework which encourages or even mandates a greater level of collaboration, not only between financial institutions, but also between the public-private sectors, in addition to protecting our nation's cyber infrastructure. As Congress addresses cyber security, data security measures should also be considered, as the two issues are intertwined.

Housing Finance Reform

The development and reform of housing finance policy, in particular maintaining access to a viable secondary market with fair pricing, is vitally important to credit unions.

With the Obama Administration, the House Financial Services Committee, and the Senate Banking Committee all actively working on the future of the secondary mortgage market, NAFCU has remained engaged on all fronts. NAFCU member credit unions are especially sensitive to the level of government involvement in the market and believe that a government guarantee on mortgage-backed securities is essential to a robust secondary market. While each bill has some positive aspects, the current legislative proposals reported by the House Financial Services Committee and the Senate Banking Committee do not fully address the concerns of credit unions on this issue.

NAFCU continues to promote a set of core principles that would help guarantee secondary market access for credit unions, give them fair pricing based on loan quality and maintain a government role in the market. We believe these key principles must be maintained in order to ensure that credit unions are treated equitably in any housing finance reform process.

Member Business Lending

When Congress passed the Credit Union Membership Access Act (CUMAA- P.L.105-219) in 1998, it put in place artificial restrictions on the ability of credit unions to offer business loans to their members. CUMAA codified the definition of a member business loan and limited a credit union's member business lending to the lesser of either 1.75 times the net worth of a well-capitalized credit union or 12.25 percent of total assets and set the standard for a member business loan at $50,000 and above.

In the current economic environment, many credit unions have capital available that could help small businesses create jobs. However, due to the outdated and arbitrary member business lending cap, their ability to help stimulate the economy by providing credit to small businesses is hampered. Removing or modifying the credit union member business lending cap would help stimulate the economy and create jobs without using taxpayer funds.

NAFCU and its members are committed to pursuing all legislative avenues possible to lift the credit union member business lending cap in this Congress. Identical bipartisan legislation, the Credit Union Small Business Jobs Creation Act (H.R. 688) and the Small Business Lending Enhancement Act (S. 968) has been introduced in both chambers; in the House by Reps. Ed Royce (R-CA) and Carolyn McCarthy (D-NY), and in the Senate by Sens. Mark Udall (D-CO) and Rand Paul (R-KY). Under these pieces of legislation, credit unions would need to meet the following criteria to be deemed eligible for a member business lending increase to 27.5 percent of total assets:

- Must be considered well capitalized (currently seven percent net worth ratio).
- Must have at least five years of member business lending experience.
- Must be at or above 80 percent of the current 12.25 percent cap for at least one year prior to applying.
- Must be able to demonstrate sound underwriting and servicing practices (based on historical performance), and strong leadership and management.

Separate bills have also been introduced in the House to exempt certain residential real estate loans from counting against the business lending cap (H.R. 4226, the Credit Union Residential Loan Parity Act) and to exempt loans made to veterans from counting against the cap (H.R. 5061).

Capital Issues

On January 23, 2014, the NCUA Board issued a proposed rule regarding risk-based capital for credit unions. The problematic nature of this proposal has led over 350 members of Congress to weigh in with the agency with concerns, including leadership of both the Senate Banking Committee and the House Financial Services Committee. While NAFCU does support the concept of risk-based capital for credit unions, we believe that effective implementation of such a system includes legislative changes, such as those found in H.R. 2572, the Regulatory Relief for Credit Unions Act of 2013.

In addition to a legislative solution to risk-based capital, NAFCU is also seeking access to supplemental capital for credit unions. Last year, Reps. Pete King (R-N.Y.) and Brad Sherman (D-Calif.) introduced the Capital Access for Small Businesses and Jobs Act, H.R. 719. This legislation would allow the NCUA to authorize forms of supplemental capital for credit unions provided certain criteria are met, most particularly that of maintaining a credit union's mutuality. NAFCU continues to advocate for capital reform for credit unions.

REGULATORY ISSUES FACING CREDIT UNIONS

Credit unions continue to feel the pressure from regulatory burden. A number of provisions prescribed under the Dodd-Frank Act went into effect this past year, but the credit union industry continues to see far-reaching proposed changes. For example, the almost 1,900-page Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) regulation goes into effect in August 2015. The CFPB is also proposing a number of changes to the Home Mortgage Disclosure Act requirements. The CFPB's rules require a seemingly limitless supply of resources and credit unions are still struggling to continue to comply with those already in effect.

House Financial Services Subcommittee on Financial Institutions and Consumer Credit Chairman Shelley Moore Capito, R-W.Va., with NAFCU witness Daniel Weickenand.

The CFPB's mortgage rulemakings, however, are only part of a growing regulatory drain on credit union resources. While the CFPB's rules will make existing activities and authorities more difficult to carry out, NCUA continues to take actions that seek to restrict or encumber current credit union authorities. Further, the FHFA has proposed many new regulations that NAFCU fears will constrain an already very fragile and tight lending market.

Federal Reserve

Payments

NAFCU and its members continue to be engaged in the Federal Reserve's evolving payments initiative and Roadmap for the U.S. Payments System. NAFCU has appreciated the Federal Reserve's efforts thus far in gathering industry stakeholders and input on what features would help both financial services providers and their customers. However, NAFCU continues to believe that it is best for the industry to lead the way in reform rather than for the Federal Reserve to attempt its own reforms and risk unintended consequences in doing so. Credit unions have a long established history of innovation and member-focused reform. However, because of their unique business model and sensitivity to each credit union's members' particular needs, a one-size-fits-all reform would likely not benefit the credit union industry as much as reform that occurred organically based on the industry's specific needs. For example, the speed of payment, an issue identified by the Federal Reserve's Public Consultation Paper, is not a top priority for all users. NAFCU looks forward to working with the Federal Reserve and other industry stakeholders in the future to create a payments model that is more efficient, secure, and cost sensitive for its members.

Debit Card Interchange Fees

NAFCU continues to believe that the current cap on interchange fees remains too low. NAFCU's Federal Reserve Meeting Survey (survey) indicated that approximately 24.3% of our members' non-interest income came from debit card interchange fees. Although a low fee cap does not directly influence fees charged by smaller issuers, market forces have driven down the fees financial institutions of all sizes can charge. Further, the impact of this low fee cap is substantially greater for credit unions compared to other institutions because, unlike other financial institutions, credit unions cannot raise capital simply by going to the open market. The only capital they can raise comes from their members.

In an era of continuous data breaches and cybersecurity concerns, fraud monitoring costs are the highest yet. While the Federal Reserve made a one cent adjustment for fraud in 2011, additional adjustments must be made to adequately capture all of the costs associated with fraud protection.

Regulation D

The restriction on "convenience transfers" under Regulation D presents an ongoing concern for NAFCU and its members. The current law is burdensome, confusing, and prevents depositors from enjoying unfettered access to their funds. Consumers are often unable to understand and remember the arbitrary limits on the number and types of transfers the regulations permit them to make from their savings account. The regulation is outdated and, as a consequence, the transfer restrictions are incoherent. Consumers would benefit from a modification to the regulation that reflects their current needs and the present financial services environment.

Consumers expect to have the ability to transfer their funds with ease to and from particular accounts, and the regulation's six-transfer limitation from savings accounts creates an undue burden for both consumers and financial institutions. NAFCU believes that this six-transfer limitation should be updated and increased, while still making a distinction between savings and transaction accounts. NAFCU strongly recommends increasing the limit to at least nine convenience transfers per month.

Regulation CC

In general, NAFCU believes that the Federal Reserve Board should closely evaluate and modernize the language of Regulation CC in order to bring it in line with the rest of the Board's current regulatory framework and applicable requirements under the Dodd-Frank Act and other legislation. The outdated terminology and requirements still found in Regulation CC are both confusing and misleading for financial institutions and pose serious compliance and safety and soundness concerns.

In 2011, the Federal Reserve Board issued a proposed rule to amend Regulation CC. NAFCU believes that the regulation's timeframe for making personal checks available should be increased from two business days to three business days. The current requirement creates undue risk for both the credit union and the credit union member because two days is insufficient time to determine if a check could be counterfeit or there are insufficient funds. In addition, NAFCU urges the Federal Reserve to allow a credit union to hold a cashier's check or money order, rather than requiring them to make funds available the day after receiving the check or money order, to enable a credit union to mitigate against the risk of fraud committed upon the credit union or the credit union member. Approximately 62% of respondents to NAFCU's 2014 *Federal Reserve Meeting Survey* reported seeing an increase in check fraud in recent years due to restrictions on hold times.

Additionally, NAFCU does not support eliminating provisions regarding case-by-case holds. Many credit unions employ such holds to protect against bounced checks and, although the absence of non-local checks makes the extended hold period less useful, it is still a worthwhile instrument compared to a complete lack of protection for many credit unions. Further, NAFCU does not support eliminating entirely the notice in lieu of return. Although there are fewer instances where such notice is necessary as processing systems become more digitized, there remain situations where the notice serves as the best method available to a credit union returning a check and the additional flexibility thus provides an important and continuing benefit.

Consumer Financial Protection Bureau

The CFPB has rule-making authority for all credit unions, regardless of size, and has examination and enforcement authority over credit unions with more than $10 billion in assets. NAFCU remains opposed to the CFPB's authority over credit unions, as credit unions were not responsible for the financial crisis. The CFPB should recognize the large role that credit unions serve in the financial services industry. In doing so, they should be cognizant of not only the detrimental impact their rules can have, but also focus on the unique benefits that credit unions provide to consumers.

The CFPB is currently working on a number of issues of particular interest to the credit union industry. The CFPB continues to make adjustments to the January 2013 mortgage rules and remittance rule; assist financial institutions and other industry stakeholders in Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) integration efforts; and actively engages in monitoring fair lending issues. The CFPB has also proposed changes to the Home Mortgage Disclosure Act requirements and the regulations governing financial institution privacy under Regulation P. While NAFCU has a number of concerns with all of these rules, the following is a summary of the more important issues raised by the CFPB's proposals.

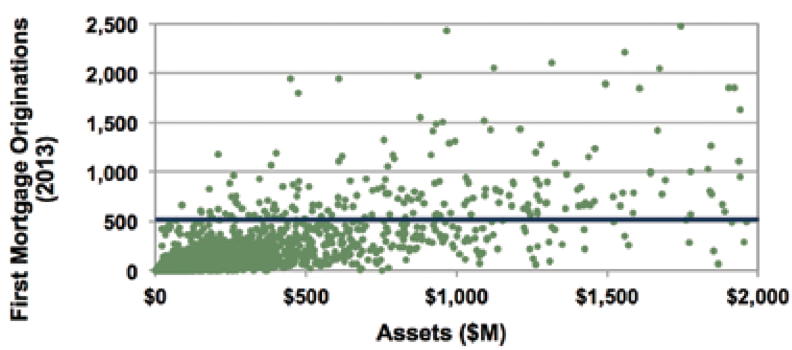
Qualified Mortgages

The CFPB has issued a final rule that imposes requirements on credit unions to assess and verify a borrower's ability to repay a mortgage loan before extending the loan. In that same rule, the CFPB defined "qualified mortgage" and extended legal protections to mortgages that meet the definition. The rule extends a "safe harbor" legal protection to prime loans that meet the qualified mortgage definition, while a rebuttable presumption of compliance would apply to non-prime loans.

Many of NAFCU's members have decided to extend only mortgages that meet the definition of safe harbor "qualified mortgage" as they are concerned that they will not be able to sell non-qualified mortgages and are worried about the legal and regulatory risks associated with extending non-qualified mortgages[2]. Due to the hesitance of lenders to extend non-qualified mortgages, it is NAFCU's position that many otherwise qualified borrowers will not be able to obtain mortgages.

The rule exempts "small creditors" and defines them as lenders with $2 billion or less in assets that originate less than 500 first mortgages per year. As reflected in Chart 1, a large number of credit unions with assets under $2 billion originate more than 500 first mortgages. Accordingly, we recommended that the CFPB increase the threshold to 1,000 first mortgages per year.

Chart 1 | Credit Union First Mortgage Loan Originations by Asset Size



Source: NCUA Call Report data

NAFCU believes the definition of qualified mortgage must be revised in a number of ways to reduce the enormous negative impact the rule will undoubtedly have on credit unions and their members. Our primary concerns include the debt-to-income (DTI) threshold (43% of the total loan) and the inclusion of affiliate fees in the calculation of points and fees. The DTI threshold excludes many otherwise creditworthy borrowers from the market, while the inclusion of affiliate fees hinders the ability of credit unions to find cost savings for their members. The CFPB has proposed a cure for unintentional points and fees overages. While NAFCU supports such a cure, it still believes a legislative change is necessary to clarify points and fees calculations. The CFPB has also solicited feedback as to whether there should be a mechanism for curing debt-to-income ratio overages. While NAFCU is supportive of this cure, it believes the CFPB should go one step further to heighten the DTI threshold so as to not exclude otherwise creditworthy homeowners from receiving a loan.

[2] See "Lending Standards," pages 9-10

Mortgage Servicing

The CFPB's mortgage servicing rule has unnecessarily complicated mortgage servicing, greatly increased costs of servicing and jeopardized credit unions' established practices that center on relationships with members. NAFCU's concerns with the rule include the cost and burden related to the host of new or greatly revised periodic statement, policies, procedures and notices it requires, as well as the timing and inflexible procedural requirements related to how a credit union must deal with delinquent borrowers and take loss mitigation actions. Although the rule does exempt credit unions that service 5,000 or fewer mortgages, along with affiliates, from some of the requirements, the cost of servicing a mortgage will nonetheless greatly increase for all credit unions.

Reputation Risk

The CFPB continues to encourage consumers to utilize its consumer complaint database. The CFPB created the publicly available database in early 2012 to disclose credit card complaints that the Bureau received from consumers. The database has since been expanded to include complaints that the CFPB receives on most financial products, such as mortgages, bank accounts and services, private student loans, other consumer loans, credit reporting, money transfers and debt collection. The database is public and available on the CFPB's website. The disclosures are made for institutions under the CFPB's supervisory authority.

On July 23, 2014, the CFPB issued a proposed policy statement regarding disclosure of consumer complaint narrative data. Under the proposal, the CFPB would expand their current complaint database to include unstructured consumer complaint narrative data. Only those narratives from consumers who opt-in and give their consent to use their narratives will be used. The CFPB assures that all narratives will be scrubbed of information that would make the consumer identifiable. Financial institutions such as credit unions would then be able to submit a narrative response for inclusion in the consumer complaint database.

NAFCU believes that the CFPB Consumer Complaint Database presents a very specific reputational risk concern for financial institutions. These complaints follow a pattern of unverified information that has been given credibility by the mere fact that the CFPB is posting it on their website. There is no current mechanism to ensure the complaints are fully vetted. Consequently, narrative data accompanying unverified complaints filed against each institution could be misleading and could create reputational risk issues that cannot easily be mitigated. Credit unions have unique relationships with their members and NAFCU supports resolution and investigation of valid and verified member complaints by the credit unions, but the reputation risk brought on by unverified complaints is significant.

Remittances

In July 2014, the CFPB finalized amendments to its Remittance Rule. Prior to these amendments, the Bureau, released a series of final rules concerning remittances, all of which became effective on October 28, 2013. The Remittance Rule exempts credit unions that execute less than 100 remittances per year. If a credit union is not already complying with the rule's requirements, it has six months to do so from the day it executes its 100th remittance. The rule also simplifies the disclosure requirements for recurring or preauthorized transfers. Under the final rule, remittance transfer providers are permitted to provide an estimate at the time the consumer requests the transfer and a final receipt within one business day after the remittance is executed.

The regulatory burden that the Remittance Rule places on credit unions has led to a significant reduction in consumers' access to remittance transfer services. NAFCU has heard from a number of its members that, because of the Remittance Rule's compliance burden, they have been forced to discontinue, or will be forced to discontinue, their remittance programs. A 2013 NAFCU survey of our members found that over one-quarter of those that offered remittance services before the CFPB's Remittance Rule have now stopped offering that service to members and even more are considering dropping. Those that continue to offer remittances have been forced to significantly increase their members' fees. This demonstrates that the 100-remittance transfers allowance threshold is too low. Further, 26.9 percent of survey respondents, including one credit union that averages 25,000 remittances per year, said they have dropped their remittance program as a result of the Rule. NAFCU members have also indicated that the compliance costs associated with the Rule have had an impact on their ability to offer other services to their members. Accordingly, NAFCU continues to encourage the CFPB to expand the threshold for the safe harbor from the definition of "remittance transfer provider" in order to ensure that a meaningful safe harbor is established.

Home Mortgage Disclosure Act Requirements

The CFPB is proposing amendments to Regulation C that would make several substantive changes to the reporting requirements under the Home Mortgage Disclosure Act (HMDA). The proposal would, among other things, expand the data financial institutions are required to collect and report under Regulation C. Some of the expanded data collection and reporting is driven by Dodd-Frank, which amended HMDA to require collection of certain new data points. However, the CFPB also appears to be taking this opportunity to propose the collection of significantly more data than Dodd-Frank expressly requires. In addition to expanded data collection, the proposal includes changes to the scope of Regulation C's coverage and generally seeks to clarify existing requirements by including more Staff Commentary.

NAFCU continues to push the CFPB to exempt as many small institutions as possible from HMDA reporting requirements, since the totality of their combined responses would be immaterial to the Bureau's overall data. Further, NAFCU believes that the Bureau should limit the changes to the HMDA dataset to those mandated by Dodd-Frank.

Privacy

The CFPB is proposing amendments to Regulation P that would allow credit unions, under certain conditions, to post their annual privacy notices online rather than delivering them individually. To utilize this new method of delivering privacy notices, a credit union would, among other things, have to not share its members' nonpublic personal information with nonaffiliated third parties in a manner that triggers Gramm-Leach-Bliley Act (GLBA) or Fair Credit Reporting Act (FCRA) opt-out rights.

NAFCU has long advocated for the elimination of duplicative and costly annual privacy notices. This proposed rule constitutes an important step to achieving improved annual privacy notice requirements. NAFCU continues to hear from our members that annual privacy notices provide little benefit, especially when there has been no change in policy or if customers have no right to opt out of information sharing because the credit union does not share nonpublic personal information in a way that triggers such rights. Instead, the mailed privacy notices are often a source of confusion to consumers. Furthermore, they represent an unproductive expense for credit unions that could be better directed toward serving consumers. Accordingly, NAFCU and our members believe that the proposed alternative delivery method will allow consumers to be informed regarding their credit union's privacy policy without being inundated with redundant information.

National Credit Union Administration

Capital and risk control are key concerns of the National Credit Union Administration (NCUA). During the last year, NCUA finalized rules on stress testing, derivatives, and Credit Union Service Organizations (CUSOs). The agency also released a proposed "risk-based" capital rule that makes great changes with respect to Prompt Corrective Action (PCA) including replacement of the agency's current risk-based net worth (RBNW) requirements with new requirements for federally insured credit unions over $50 million in assets. Further, the agency has acknowledged that credit unions need to focus on interest rate risk (IRR).

Risk-Based Capital

On January 23, 2014, the NCUA Board issued a proposed rule regarding risk-based capital for credit unions. The proposed rule would make a number of revisions to NCUA regulations regarding PCA including replacement of the agency's current RBNW requirements with new risk-based capital requirements for federally insured "natural person" credit unions with over $50 million in assets.

The proposed rule would also revise the risk-weights for many of NCUA's current asset classifications and require higher minimum levels of capital for federally insured natural person credit unions with concentrations of assets in real estate loans, member business loans (MBLs) or higher levels of delinquent loans. NCUA's proposed rule would differ from other banking regulators and BASEL recommendations by incorporating interest-rate and concentration risk into the risk-weights for a number of types of assets.

Finally, the proposed rule would set forth a process where NCUA could require an individual federally insured natural person credit union to hold higher levels of risk-based capital based on supervisory concerns raised by NCUA examiners.

On September 29, 2014, NCUA Board Chairman Debbie Matz announced that she intends to request that a revised proposed risk-based capital rule be issued with a new comment period as a result of significant structural changes being considered to the proposal. Matz anticipates the NCUA Board could issue an amended proposal before the end of 2014.

NAFCU believes that the credit union regulatory capital system should be updated to better reflect risk, however, under NCUA's current proposed risk-based capital rule some credit unions could be required to shoulder a disproportionate amount of burden related to the safety and soundness of the greater credit union system. While NAFCU appreciates the changes that have been suggested by NCUA for a second proposed rule such as a longer implantation period and changes to some categories of the risk weights, ultimately, NAFCU believes NCUA lacks the legal authority to issue the rule as proposed and supports a legislative solution that institutes fundamental changes to the credit union regulatory capital requirements and strongly urges NCUA to use its resources to work with Congress to construct a fair and sustainable regime.

NAFCU has outlined a legislative solution that will institute fundamental changes to the credit union regulatory capital requirements in our Five-Point Plan for Regulatory Relief. The plan, as it relates to capital reform: (1) Directs the NCUA to, along with industry representatives, conduct a study on PCA and recommend changes; (2) Modernizes capital standards to allow supplemental capital, and direct the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks; and, (3) Establishes special capital requirements for newly chartered federal credit unions that recognize the unique nature and challenges of starting a new credit union.

Department of Defense Proposal – Payday Alternative Loans

On September 29, 2014, the Department of Defense released a proposed rule that would amend the definition of "consumer credit" to align with Regulation Z. This amendment would expand the scope of the Military Lending Act's protections to other credit products not currently covered by the regulations. This change could produce unintended consequences that will affect credit unions, such as the proposed amendment to the definition of "finance charge" to align with the definition of finance charge in Regulation Z. If finalized, this proposed rule could impact credit unions' ability to provide credit products to servicemembers due to the interest rate restrictions already imposed on credit unions and how NCUA defines finance charges for these purposes.

NAFCU strongly supports consumer financial protections for our nation's servicemembers, and credit unions have a proven track record of protecting the interests of those who serve. However, NAFCU will work to ensure that there are no unintended consequences with the proposed changes to the definition of consumer credit that would prevent credit unions from providing essential credit products to members who serve in the military.

Investment Authority

Earlier this year, NCUA approved revisions to part 703 of NCUA's Rules and Regulations that expanded FCU investment authorities by granting qualified credit unions authority to engage in derivatives transactions. The rule allows certain credit unions to engage in a limited set of derivatives transactions solely for the purpose of reducing interest rate risk and managing balance sheets. The NCUA also proposed an asset securitization rule.

NAFCU has urged NCUA to continue its focus on evaluating new products and services that would serve as beneficial investment opportunities for FICUs. In particular, NAFCU and our members have asked that the agency allow credit unions to purchase Mortgage Servicing Rights (MSRs). The credit union industry, like each credit union, is a cooperative system. Many credit unions, especially small credit unions, have neither the capacity nor the resources to perform certain functions. As a result, they often choose to rely on third parties to perform such functions. NAFCU and our members believe it is in the best interest of these credit unions and the industry as a whole if as many of these functions as possible may be performed by other credit unions.

Increased investment authority is essential to mitigating against interest rate risk and balancing the ever increasing regulatory burden and compliance requirements credit unions face.

Federal Housing Finance Agency

Federal Home Loan Bank Membership Eligibility Requirements

The Federal Housing Finance Agency (FHFA) has released a proposed rule that would amend the regulations governing Federal Home Loan Bank (FHLB) membership. The proposal would require FHLB members and applicants to keep one percent of assets in "home mortgage loans' and at least ten percent of assets in "residential mortgage loans" on an ongoing basis. NAFCU has serious concerns with this proposal.

The requirement that members retain at least ten percent of assets in "residential mortgage loans" on an ongoing basis is unnecessary and prohibitive. Credit unions have not, and do not, engage in the type of activities this proposal is trying to prevent. It is important to credit unions to continue and foster their relationship with their members. Credit unions' cooperative business model revolves around this goal and it would thus be very unlikely that a credit union reduce or eliminate its mortgage loan holdings after becoming a member of a FHLB. Credit unions continued to lend throughout the housing crisis when many other financial institutions did not and have an established history of supporting residential housing finance. Currently there are 1,221 FICUs who are FHLB members (19% of all FICUs). In times of tight lending, NAFCU would like to see this number grow. However, the proposed rule would make it more difficult for credit unions to provide credit to their communities, and has the potential to terminate the membership of many credit unions that have been FHLB members for many years without issue.

Fannie Mae and Freddie Mac Guarantee Fees

The FHFA is seeking information about the level of guarantee fees that Fannie Mae and Freddie Mac may charge lenders.

NAFCU believes that guarantee fees should remain at their current level. Any changes to guarantee fees could have potentially devastating impacts on an already very fragile and uncertain housing market. The primary goal of the FHFA in setting guarantee fees should be to ensure that Fannie Mae and Freddie Mac remain sustainable, while not raising fees to a level that would significantly drive up the cost of borrowing and reduce lending.

Secondary mortgage market access is vital for our nation's credit unions and Fannie Mae and Freddie Mac enable credit unions to obtain the necessary liquidity to create new mortgages for credit unions' member-owners.

Raising guarantee fees would have a negative impact on the housing market. The cost of borrowing would greatly increase and lending would inevitably slow down. In NAFCU's August 2014 *Economic and CU Monitor* survey, 81% of NAFCU members polled indicated that the current level of guarantee fees should remain. Further, loan originations would inevitably decrease if the Enterprises continued to raise guarantee fees because the rising cost of mortgage lending would either need to be absorbed by the lender or passed on to the borrower in the form of risk-based fees or higher interest rates. In short, imposing additional costs to borrowing, especially on those borrowers who are creditworthy and finally ready to enter or re-enter the housing market, is both unfair to the borrowers and damaging to the housing market as a whole.

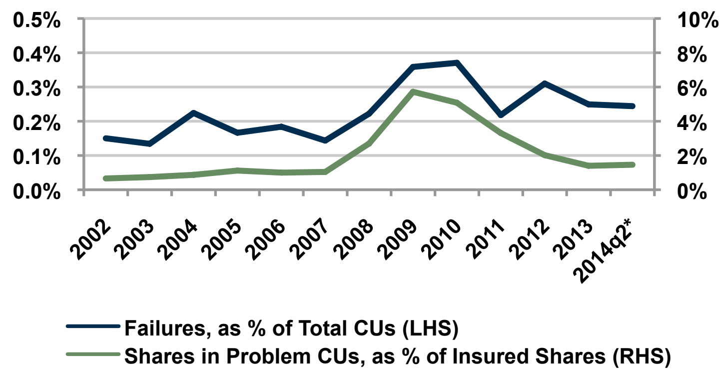
INTEREST RATE RISK

Economic conditions have improved markedly since the depths of the recession, and the era of historically-low interest rates appears set to end. As credit unions position their balance sheets for a period of rising rates, the topic of interest rate risk has come under close scrutiny. In January, NCUA led its list of key areas of supervisory focus for 2014 with interest rate risk, and a page devoted to interest rate risk resources was recently added to the NCUA website.

The question of how much interest rate risk exists within the credit union industry is a complex one. Interest rate risk can arise from a number of sources such as shares, investments and real estate loans. Additionally, it depends on factors which may be difficult to quantify, such as prepayment risk and members' rate sensitivity. Because of its complexity, credit unions' vulnerability to interest rate risk is difficult to pinpoint.

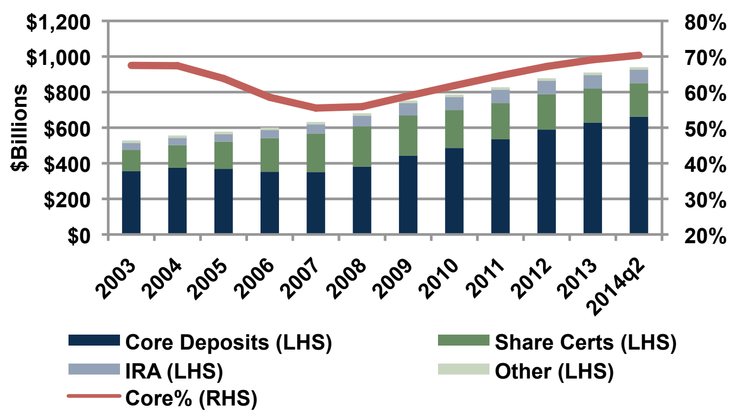
It is important to remember that credit unions have historically managed interest rate risk successfully. From 2004-2006, the effective federal funds rate increased over 400 basis points. During that time, neither failures nor problem credit unions (those with a CAMEL rating of 4 or 5) were high by historical standards (Chart 1).

Chart 1 | Failures and Problem Credit Unions



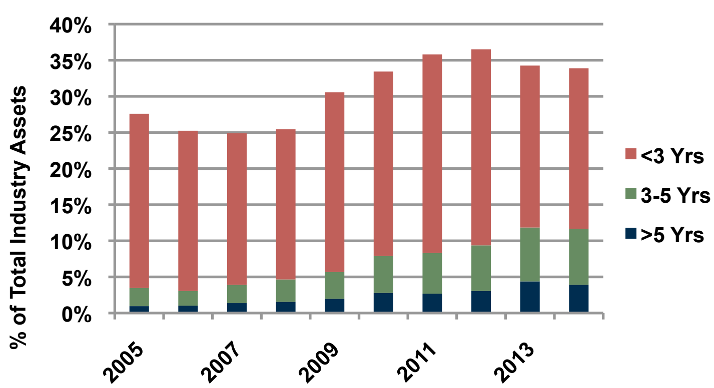
** Failures annualized through June 30*
Note: Problem CUs defined as those with a CAMEL code of 4 or 5
Source: NCUA Annual Reports

Chart 2 | Credit Union Share Trends



Source: NCUA FPR

Chart 3 | Investments by Maturity



Source: NCUA FPR

Shares

A credit union's composition of shares and deposits impacts its interest rate risk. Core deposits (regular shares, share drafts and money market accounts) can be withdrawn on demand and are immediately impacted by a change in dividend rates. In a rising rate environment, the decision of when to raise dividend rates and by how much has implications for a credit union's cost of funds, share growth and member retention. Delaying dividend rate increases or increasing them by too little may give rise to liquidity concerns as rate-sensitive members shop for more advantageous deposit rates.

Credit union shares have increased 49 percent since 2007 (Chart 2). Not surprisingly given the low rate environment, core deposits represent a growing portion of those shares. Still, the ratio of core deposits-to-total deposits in June 2014 (70.4 percent) was similar to 2003 (67.5 percent), immediately prior to the most recent era of rapidly rising interest rates.

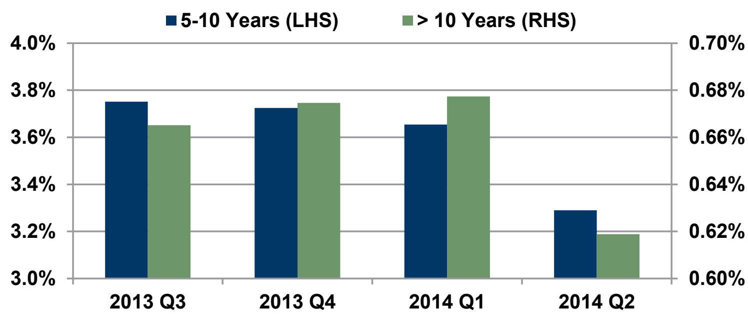
Investments

Limitations to credit unions' investment authority minimize their exposure to credit risk. However, credit unions that choose to extend the maturities of their investments may increase their exposure to interest rate risk. By locking into rates during a low-rate environment, some credit unions may experience unrealized losses if and when rates rise.

Since 2006, investments with maturities of over 3 years have increased from 3.1 percent of credit union assets to 12 percent of assets (Chart 3, on page 27). Credit unions experienced gains on these investments as interest rates fell, but there is a potential for losses if rates rise.

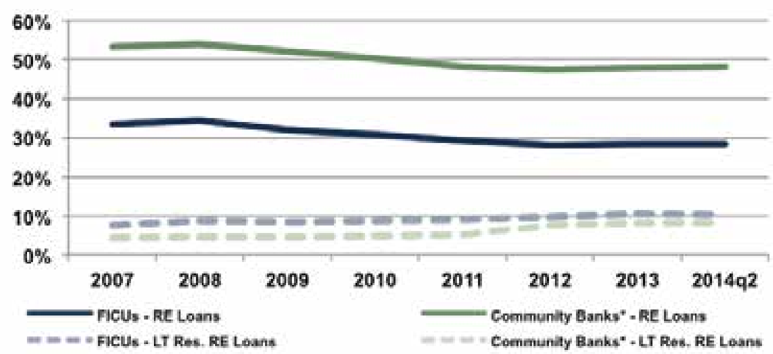
Call report data indicates that credit unions are taking clear steps to reduce their holdings of long-term investments prior to an increase in rates. In the second quarter, credit unions drastically cut their concentrations of long-term investments (Chart 4). In a recent NAFCU survey, 72.2 percent of respondents indicated that they had shortened the duration of their investment portfolio in anticipation of a rise in rates.

Chart 4 | Investments by Maturity, as % of Total Industry Assets



Source: NCUA FPR

Chart 5 | Real Estate Loans, as % of Total Assets

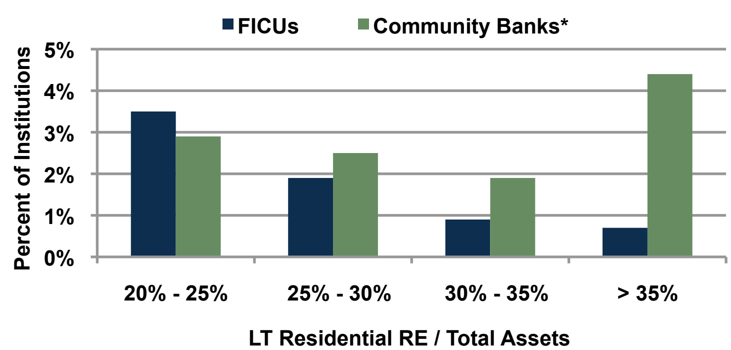


** Banks and thrifts with under $1 billion in assets*
Source: NCUA, FDIC

Real Estate Loans

A high concentration of real estate loans, particularly those which will not reprice or mature for a number of years, could expose an institution to greater interest rate risk. As rates rise, cost of funds generally increases. A large amount of fixed-rate loans could create a situation where interest income does not rise to the same degree, compressing net interest margin for a time.

Chart 6 | Long-Term Residential Real Estate Loan Concentrations



** Banks and thrifts with under $1 billion in assets*
Source: NCUA, FDIC

Comparing credit unions with community banks, credit unions have a much lower concentration of real estate loans (Chart 5). While they have a slightly higher concentration of long-term residential real estate loans (those that will not refinance, reprice or mature within the next five years), the margin has shrunk in recent years.

Ultimately, broad averages can only say so much about the breadth of exposure within the industry. Focusing on those institutions with high concentrations of long-term real estate loans provides a clearer picture of the how many institutions may be at risk. A comparison between credit unions and community banks reveals that there are far more community banks with high concentrations of long-term residential loans (Chart 6).

Net Long-Term Assets

While there is no single ratio to approximate the exposure to interest rate risk within the industry, the net long-term assets ratio is a relatively comprehensive measure, inclusive of long-term investments, long-term residential real estate loans, business loans, fixed assets and the Share Insurance Fund capitalization deposit. NCUA has recently pointed to this measure as evidence that the industry's interest rate risk exposure is on the rise .

Using this measure as a benchmark and investigating the last era of rising rates, it is unclear that elevated levels of net long-term assets had the type of impact on net interest margin that NCUA has warned against. Table 1 shows a comparison between credit unions with net long-term asset ratios above 50 percent (roughly twice the industry average at the time) versus those below 50 percent immediately prior to the last period of rising interest rates.

Table 1 | Average Change in Net Interest Margin (in bp), 2004Q2-2007Q1

Asset Class	FICUs with Net Long-Term Asset Ratio < .5 as of 2004Q2	FICUs with Net Long-Term Asset Ratio > .5 as of 2004Q2
Under $10M	+58	+34
$10M – $50M	+19	-2
$50M – $100M	-6	-12
$100M – $250M	-18	-17
$250M – $500M	-27	-35
Over $500M	-28	-28

Source: NCUA 5300 call report data

Overall, net interest margins declined for all credit union asset peer groups above $50 million during the period, as the effective federal funds rate increased more than 400 basis points. However, it was only for those credit unions under $50 million that net interest margins were noticeably better for those credit unions with lower net long-term asset ratios. For credit unions over $50 million, the benefit of a lower concentration of net long-term assets appears to be minimal.

There are many variables to consider in terms of credit unions' exposure to a rise in interest rates. Certainly, credit unions with less exposure will be better positioned to deal with a variety of potential interest rate environments. However, if the last period of rising rates is any guide, it would appear that the net long-term assets ratio is either an insufficient measure of interest rate risk exposure, or that credit unions with high net long-term assets ratios are far more resilient during a period of rising rates than NCUA is suggesting.

CONCLUSION: NEW CHALLENGES, NEW OPPORTUNITIES

The financial services industry has undergone a seismic shift in recent years, and credit unions are no exception. Credit unions are growing and offer a wider array of products and services. Today's credit union must deal with a stifling regulatory environment and frequent, costly merchant data breaches. Despite these changes, credit unions remain prudent lenders who exist to serve their members.

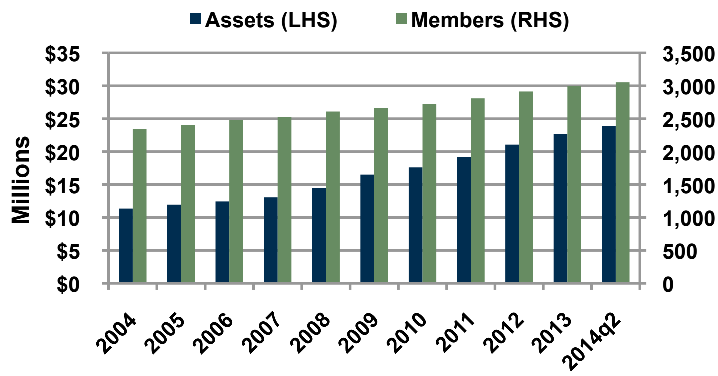
More and more households are coming to realize the value that credit unions provide in the financial services arena. Over the last decade, the median credit union has increased nearly 30 percent in membership and doubled in asset size, with no signs of slowing down (Chart 1). Credit unions make up a small but important source of credit for borrowers. According to Federal Reserve data[4] , credit unions' share of outstanding credit card loans has risen from 2.8 percent in 2004 to 5.2 percent today. And data from the Mortgage Bankers' Association[5] indicates that credit unions' share of mortgage loan originations increased from 2 percent in 2004 to 8 percent as of June 2014.

Credit unions operate in a dynamic marketplace, one in which they must sort through the rush of new technologies in order to meet the growing demands of members. Just in the last three years, the number of credit unions offering business loans and real estate loans grew to 31 percent and 71.1 percent, respectively (Chart 2). Those credit unions represent 83.9 percent of total industry assets in the case of business lenders and 98.9 percent of industry assets in the case of real estate lenders. Credit unions have expanded their offerings of services like international remittances and free bill pay, and a growing number of credit unions are offering the same menu of online options as large commercial banks.

According to the U.S. House of Representatives Financial Services Committee, the Dodd-Frank Act has already resulted in 24 million annual labor hours of compliance, with more rules on the way. While credit unions did not cause the financial crisis, they are subject to many of the same rules as the largest banks.

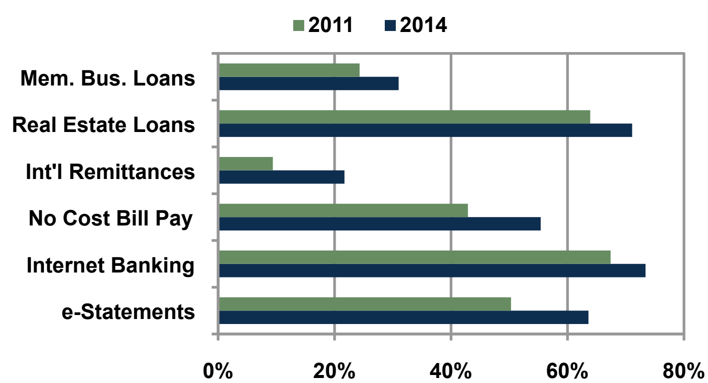
The Federal Reserve Bank of Kansas City's 2014 *Survey of Community Depository Institutions* indicated that over 80 percent of credit unions consider regulatory compliance requirements

Chart 1 | Median Credit Union Size



Source: NCUA FPR

Chart 2 | Products & Services



Source: NCUA Credit Union Profile

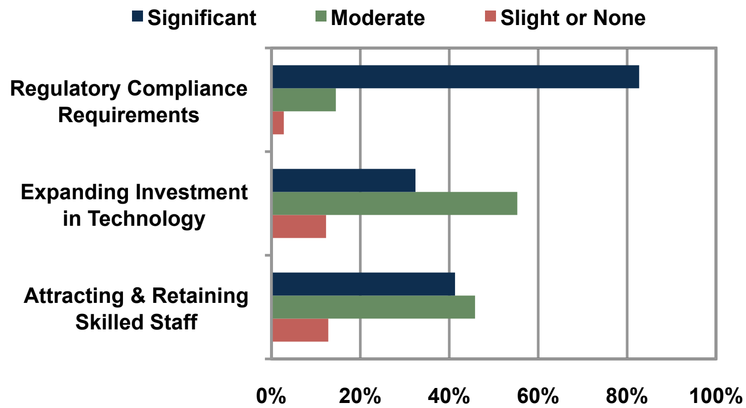
[4]Consumer Credit – G.19 Release, www.federalreserve.gov/releases/g19/
[5]Quarterly Originations Estimates, www.mbaa.org/researchandforecasts/forecastsandcommentary

to be a significant challenge over the next three years (Chart 3). At the same time, most credit unions lack the resources to hire additional compliance staff. A 2013 survey in NAFCU's *Economic & CU Monitor* found that 70.2 percent of respondents had non-compliance personnel taking on compliance-related duties.

Another challenge for today's credit union is in the area of data security. High-profile merchant data breaches have garnered headlines over the last few years, but as community lenders, credit unions are impacted by smaller local breaches as well. Until a legislative solution is in place, credit unions and other card issuers will be left footing the bill. According to an October 2014 NAFCU survey, 84.4 percent of respondents had been impacted by a merchant data breach during the past two years. Respondents reported that one in five (20.6 percent) member payment cards were exposed in large merchant breaches, while 6.9 percent were exposed in local breaches.

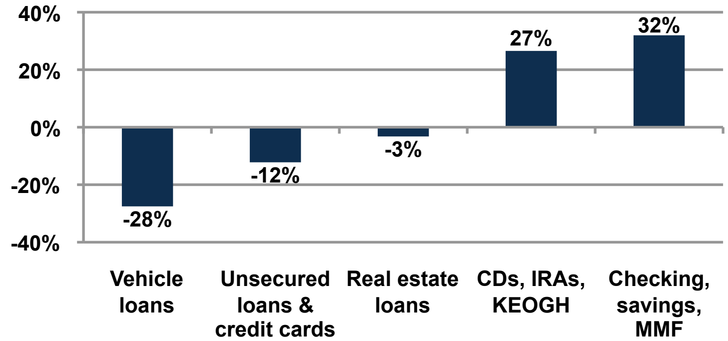
While credit unions are faced with a host of new challenges, they remain true to their mission of serving their 98 million member-owners. Credit unions' dedication to low fees and quality service has not gone unnoticed. Bank Transfer Day, a social media-driven movement that started in November 2011 and continues to grow, speaks to the dissatisfaction consumers are feeling toward large commercial banks and the increasing profile of credit unions. And credit unions continue to offer superior saving and loan rates to banks (Chart 4). A NAFCU-commissioned study estimated the benefits to credit union members at $4.6 to $7.1 billion annually for the period 2005-2013. Preserving the credit union tax exemption is key to these benefits and must be maintained going forward.

Chart 3 | Organizational Challenges



Source: Federal Reserve Bank of Kansas City

Chart 4 | Credit Unions vs. Banks, Interest Rate Differences (2005-2013 avg)



Source: Datatrac

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The National Association of Federal Credit Unions is a direct membership association committed to representing, assisting, educating and informing its member credit unions and their key audiences.

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