2015 NAFCU REPORT *on* CREDIT UNIONS

NAFCU

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NAFCU REPORT ON CREDIT UNIONS

December 2015

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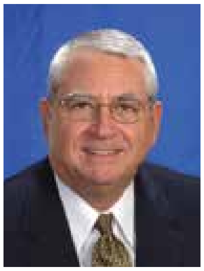
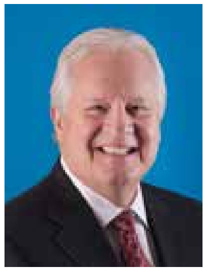
This material was prepared for a meeting on December 7, 2015 between the NAFCU Board of Directors and the Board of Governors of the Federal Reserve System.

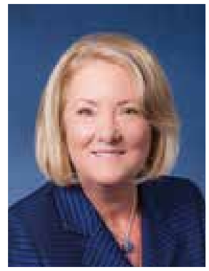
Board of Directors and President and CEO of the National Association of Federal Credit Unions



Ed Templeton
Chair
Director-at-Large
SRP
Federal Credit Union
North Augusta, SC
Asset Size: $719M
Members: 104,997
FOM: Community

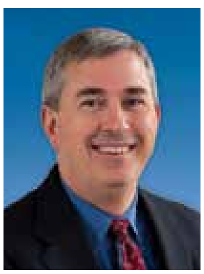


Richard Harris
Vice Chair
Region V Director
Caltech Employees
Federal Credit Union
La Canada, CA
Asset Size: $1.4B
Members: 31,368
FOM: Multi-Occupational

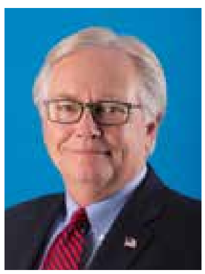


Jeanne Kucey
Treasurer
Region III Director
JetStream
Federal Credit Union
Miami Lakes, FL
Asset Size: $171M
Members: 20,647
FOM: Community

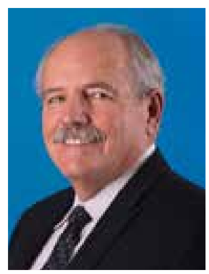
Debra Schwartz
Secretary
Director-at-Large
Mission
Federal Credit Union
San Diego, CA
Asset Size: $2.8B
Members: 182,898
FOM: Community



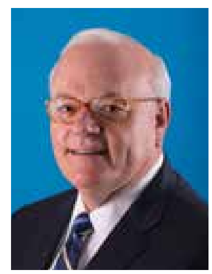
Martin Breland
Region II Director
Tower
Federal Credit Union
Laurel, MD
Asset Size: $2.8B
Members: 137,001
FOM: Multi-Occupational



Thomas W. DeWitt
Region IV Director
State Farm
Federal Credit Union
Bloomington, IL
Asset Size: $3.9B
Members: 132,776
FOM: Service



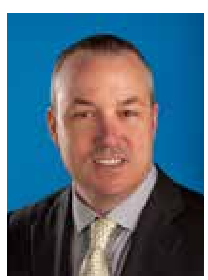
Gary Easterling
Region I Director
United
Federal Credit Union
Saint Joseph, MI
Asset Size: $1.9B
Members: 138,541
FOM: Multi-Occupational



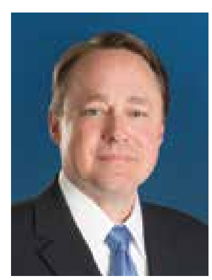
Robert L. Fisher
Director-at-Large
Grow Financial
Federal Credit Union
Tampa, FL
Asset Size: $2.1B
Members: 187,273
FOM: Multi-Occupational

Jan N. Roche
Director-at-Large
State Department
Federal Credit Union
Alexandria, VA
Asset Size: $1.7B
Members: 69,416
FOM: Multi-Occupational

Rod Taylor
Director-at-Large
Barksdale
Federal Credit Union
Barksdale AFB, LA
Asset Size: $1.2B
Members: 116,827
FOM: Multi-Occupational



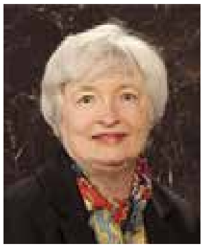
Daniel Weickenand
Director-at-Large
Orion
Federal Credit Union
Memphis, TN
Asset Size: $575M
Members: 61,660
FOM: Multi-Occupational



B. Dan Berger
President and CEO

FOM is Field of Membership.

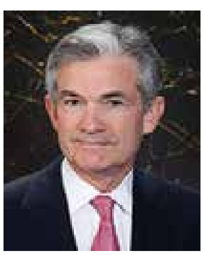
Board of Governors of the Federal Reserve System



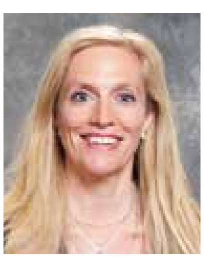
Janet Yellen, Chair of the Board of Governors. Her four-year term as Chair expires February 3, 2018, and her 14-year term as member ends January 31, 2024. She began her term on February 3, 2014. Prior to her appointment, Dr. Yellen was Vice Chair of the Board of Governors and was previously a president 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 and the Economic Policy Committee of the Organization for Economic Cooperation and Development.

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. Dr. Fischer was also a Vice Chairman of Citigroup and served as the first deputy-managing director of the International Monetary Fund.

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 to 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 also served in several staff positions for President Clinton and was a professor of Applied Economics at the Massachusetts Institute of Technology (MIT).

Abbreviations

ACH	Automated Clearing House
ATM	Automated Teller Machine
ATR	Ability to Repay
CFPB	Consumer Financial Protection Bureau
CISA	Cybersecurity Information Sharing Act
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
FS-ISAC	Financial Services Information Sharing and Analysis Center
FSSCC	Financial Services Sector Coordinating Council
GLBA	Gramm-Leach-Bliley Act
HMDA	Home Mortgage Disclosure Act
IRR	Interest Rate Risk
MBL	Member Business Loan
MSR	Mortgage Servicing Rights
NAFCU	National Association of Federal Credit Unions
NCUA	National Credit Union Administration
OMB	Office of Management and Budget
PCA	Prompt Corrective Action
QM	Qualified Mortgage
RBC	Risk-Based Capital
RBC2	Second Risk-Based Capital Proposed Rule
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 national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions. 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 roughly 800 of the nation's most innovative and dynamic federal credit unions (FCUs) and federally insured, state-chartered credit unions (FISCUs) 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. As of June 2015, 87 of the 100 largest FCUs were NAFCU members. NAFCU represents 70 percent of total FCU assets and 64 percent of all FCU member-owners.

In addition, NAFCU's Board of Directors voted earlier this year to open its membership to all FISCUs. NAFCU's membership includes 66 FISCUs.

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 2015, there were 3,856 FCUs, with assets of $620 billion and a membership base of approximately 54.1 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 and FISCUs are subsets of FICUs. As of June 2015, there were 6,159 FICUs, with assets of $1.2 trillion and a membership base of over 101 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.

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 2015, there were 13 corporate credit unions with assets of $19.2 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

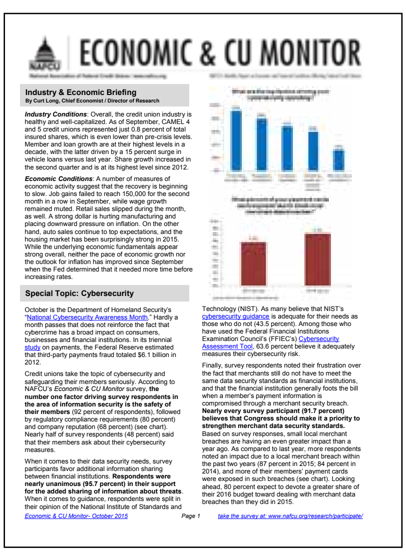
NAFCU's *CU Industry Trends Report* is a quarterly analysis of trends in the credit union industry, with key financial ratios summarized and aggregated by region and asset class.

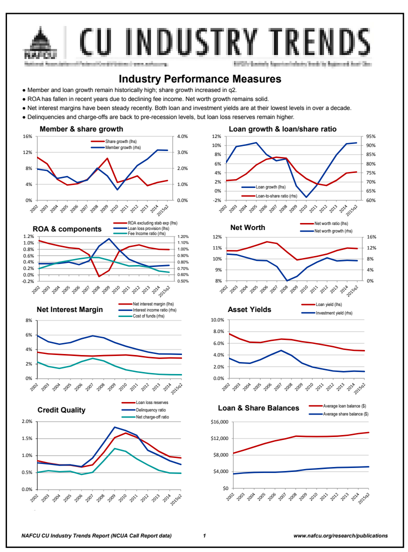
NAFCU Report on Credit Unions

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 2015.

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

NAFCU commissioned a special study in 2014 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.


ECONOMIC & CU MONITOR
Industry & Economic Briefing
Special Topic: Cybersecurity


CU INDUSTRY TRENDS
Industry Performance Measures


Economic Benefits of the Credit Union Tax Exemption to Consumers, Businesses, and the U.S. Economy
February 2014
Robert M. Feinberg, Ph.D.
Professor of Economics
American University
Washington, DC
Douglas Meade, Ph.D.
Director of Research
Interindustry Economic Research Fund, Inc.
College Park, MD
Prepared on behalf of the National Association of Federal Credit Unions
www.nafcu.org/research

KEY FINDINGS

Credit union trends

- The credit union industry overall is healthy and well capitalized. The net worth ratio is up to 11 percent, and asset quality is at pre-crisis levels. Nevertheless, small credit unions continue to struggle with diminished margins due to an increasing regulatory burden.
- Loan growth is near its highest point in a decade, and survey respondents are reporting stronger demand for all major loan types as compared to a year ago.
- The secondary mortgage market is a critical tool for credit unions in managing balance sheet risk. Credit unions tend to utilize Fannie Mae and Freddie Mac more heavily than banks.

Credit union service to members and use of Federal Reserve services

- Electronic services continue to expand throughout the industry, both in terms of the range of services provided and the number of credit unions offering them to their members.
- A majority of credit unions offer internet banking and a growing number offer mobile banking.
- As compared to last year, survey respondents indicated a shift in transaction service intermediaries from corporate credit unions to the Federal Reserve.

Legislative issues facing credit unions

- Preserving the credit union tax exemption remains the top legislative priority at 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.
- The cap on interchange rules impacts all credit unions. In light of increasing costs due to data breaches, the one cent adjustment for fraud costs is too low.
- Regulation D limitations should reflect the reality of new technology and consumer habits.
- 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 NCUA should withdraw its risk-based capital rule prior to the 2019 implementation date.

Emerging Challenges and the Future of Credit Unions

- Margins are shrinking across the industry, partly as a result of declining fee income. Small credit unions are particularly vulnerable, and their consolidation rate has increased in recent years.
- There is a disparity within the industry's dual chartering system with regard to field of membership rules. NCUA should act to make the federal charter more competitive with state charters.
- The growth of online lenders highlights the need for regulatory relief for financial institutions and a level playing field with non-traditional lenders.

CREDIT UNION TRENDS

General Financial Conditions

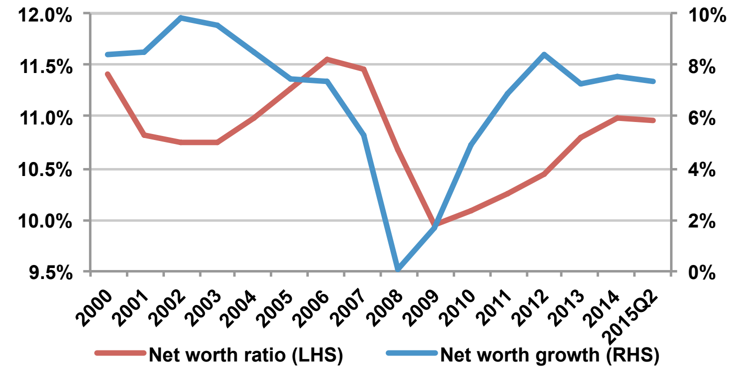
Credit unions are conservatively run, well-capitalized institutions, which enabled them to emerge from the Great Recession more quickly than other financial institutions. FICUs' net worth ratio has risen steadily since 2009 (Chart 1), and as of June 2015, year-over-year growth in net worth (7.4 percent) far exceeded asset growth (5.9 percent). Throughout the recession, credit unions had a lower failure rate than banks. From 2008 through 2014, there were 507 bank failures compared to only 144 credit union failures[2]. As of June 2015, NCUA reported that there were 251 problem credit unions with a CAMEL rating of 4 or 5. These credit unions constitute 1.1 percent of industry shares, which is down from a peak of 5.7 percent in 2009 and only slightly higher than the pre-recession figure of 1 percent in 2007.

The industry experienced a spike in share growth during the financial crisis (Chart 2), but that has moderated in subsequent years. Since 2010, share growth has generally been below the long-run trend of roughly 6 percent. However, as of June 2015 year-over-year share growth increased to 4.9 percent, up from just 3.4 percent in June 2014.

The extended period of low interest rates has resulted in a shift in liabilities as members have opted out of share certificates and into core deposits (share drafts, regular shares and money market shares). From December 2007 to June 2015, the percent of credit union shares in core deposits increased from 55.5 percent to 71.7 percent. This has resulted in a lower cost of funds for credit unions, but that trend is likely to be reversed when interest rates increase.

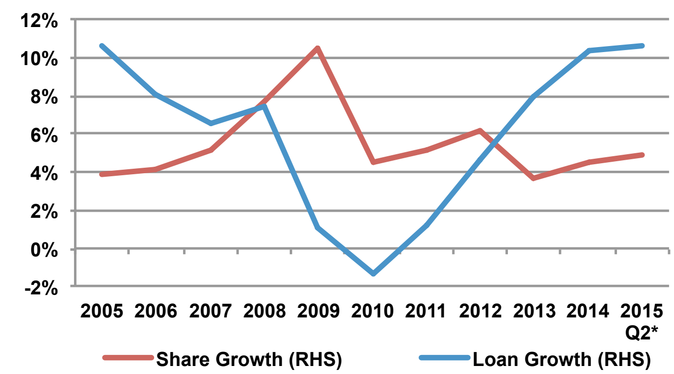
Credit unions are a critical source of credit and their market share for first mortgage, vehicle and revolving loans has increased significantly since 2007 (Chart 3). Loan balances overall continue to surge, increasing 10.6 percent year

Chart 1 | FICU Net Worth Ratio



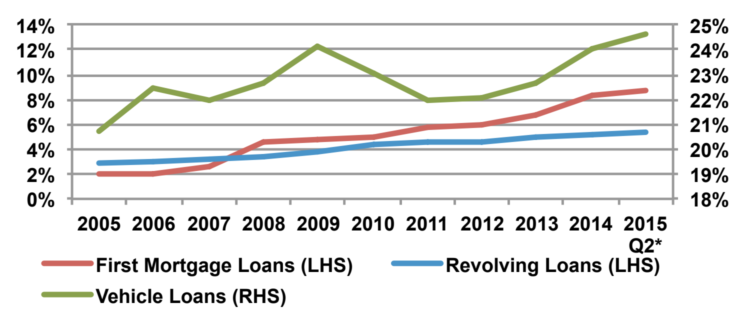
Source: NCUA Financial Performance Report (FPR)

Chart 2 | FICU Loan and Share Growth



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

Chart 3 | FICU Market Share



** First mortgage loan figures reflect loan originations, revolving and vehicle loan figures show loans outstanding*

Sources: NCUA FPR, Mortgage Bankers Association, Federal Reserve G.19 - Consumer Credit

[2] As of December 2007, there were 8,534 banks in existence compared to 8,101 FICUs.

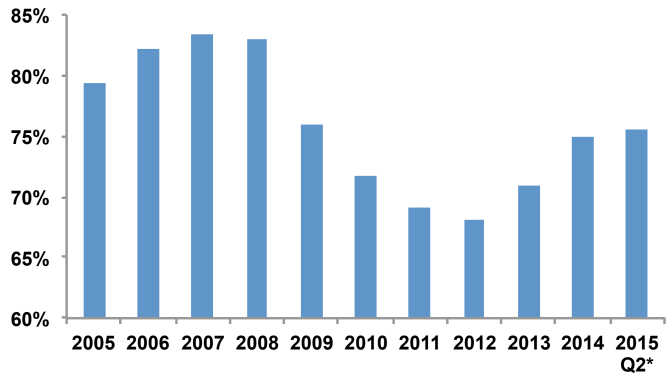
over year as of June 2015. Vehicle loan balances grew by 15.4 percent year over year in June and accounted for 45.9 percent of overall loan growth during that time.

As a result of weak loan growth and the surge in share growth during the recession, the industry's loan-to-share ratio dropped by over 150 basis points from 2007 to 2012 (Chart 4). Since declining to 68.1 percent in 2012, however, the ratio has climbed to 75.5 percent. Nevertheless, there remains a substantial amount of balance sheet liquidity within the industry when compared to pre-crisis levels.

FICUs' June 2015 annualized ROA (0.81 percent) is unchanged from a year prior (Chart 5). In general, ROA has recovered since the recession thanks to reductions in provision for loan and lease loss expense, but declining fee income in recent years presents a challenge for the industry as it seeks to maintain a viable operating margin. The Federal Reserve's cap on interchange fees, as mandated by the Dodd-Frank Act, as well as the potential for future CFPB regulations related to overdraft fees[3] could place further downward pressure on the bottom lines of all credit unions.

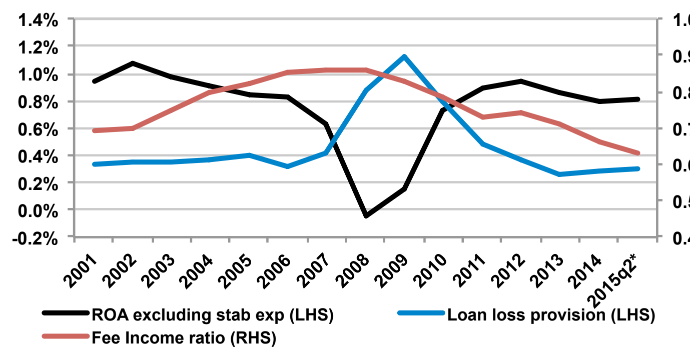
By and large, credit unions did not participate in the type of lending activities that precipitated the financial crisis, and yet, FICUs experienced some deterioration in their overall asset quality as a result of the recent financial turmoil. However, asset quality has improved since 2009 and returned to pre-crisis levels. The delinquency ratio for the credit union industry as of June 2015 was 0.74 percent, which is an 11 basis point improvement over a year ago. This compares to a delinquency ratio of 1.69 percent for all banks and 1.24 percent for community banks (Chart 6). The net charge-off ratio for credit unions is down to 0.46 percent, which is three basis points lower than a year ago.

Chart 4 | FICU Loan-to-Share Ratio



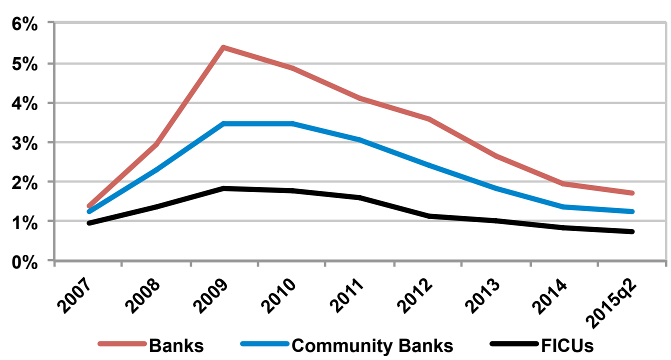
Source: NCUA FPR

Chart 5 | ROA



Source: NCUA FPR

Chart 6 | Delinquency Ratios



Source: NCUA FPR, FDIC Quarterly Banking Profile

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[3] See "Overdraft," page 25.

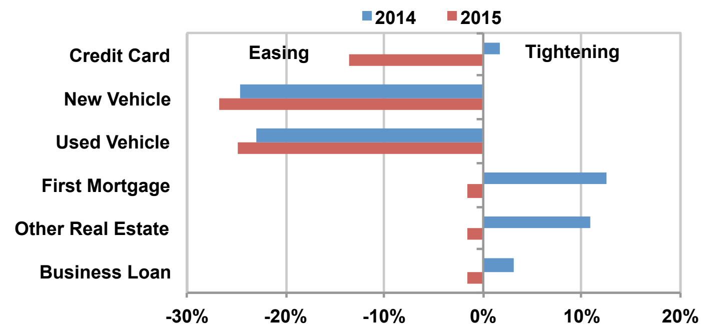
Lending Standards

NAFCU's annual *Federal Reserve Meeting Survey* includes questions on lending standards, and a comparison between 2014 and 2015 shows that standards have been eased across the board (Chart 7). For credit card, first mortgage, other real estate and member business lending, this is a stark change from a year ago, when a net majority of respondents were tightening standards.

In those instances where respondents tightened lending standards, the most commonly cited reasons were a reduced tolerance for risk (72.1 percent "somewhat" or "very important") and rising delinquencies and charge-offs (62.5 percent). The same factors were most common among respondents who eased lending standards, with 88.9 percent citing an increased tolerance for risk, which was followed by improving delinquencies and charge-offs (75 percent).

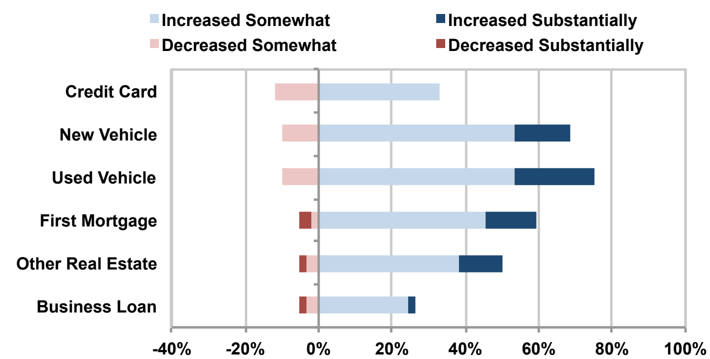
Year-over-year loan growth is at its highest point in a decade, and survey respondents indicated broad-based increases in loan demand over the past year. The strongest increases were seen in vehicle loan demand, followed by first mortgage and other real estate loan demand (Chart 8). Demand for credit card and business loans improved, as well. At the same time, the creditworthiness of applicants has improved for most loan types (Chart 9). For real estate loans in particular, very few respondents indicated a deterioration in applicant quality over the past year. Meanwhile, a substantial majority saw improvement in the quality of vehicle and business loan applicants. For credit card applicants, respondents were roughly split between those who saw improvement versus those who viewed applicants as being of lower quality than in 2014.

Chart 7 | Net Percentage Tightening Loan Standards



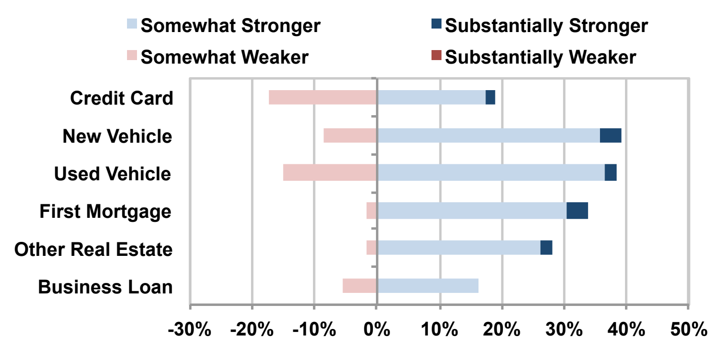
Source: NAFCU 2015 Federal Reserve Survey

Chart 8 | Change in Loan Demand (last 12 months)



Source: NAFCU 2015 Federal Reserve Survey

Chart 9 | Change in Applicant Creditworthiness (last 12 months)



Source: NAFCU 2015 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 2015 *Federal Reserve Meeting 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.

	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
FRB Discount Window				
<$250 million	15.4%	7.7%	7.7%	11.5%
>$250 million	15.6%	21.9%	75.0%	0%
Central Liquidity Facility				
<$250 million	0%	0%	0%	3.8%
>$250 million	0%	3.1%	3.1%	3.1%
FHLBs				
<$250 million	15.4%	3.8%	3.8%	3.8%
>$250 million	43.8%	50.0%	59.4%	25.0%
Corporate CUs				
<$250 million	15.4%	38.5%	34.6%	3.8%
>$250 million	9.4%	25.0%	18.8%	3.1%
Banks				
<$250 million	7.7%	0%	0%	0%
>$250 million	9.4%	3.1%	15.6%	0%

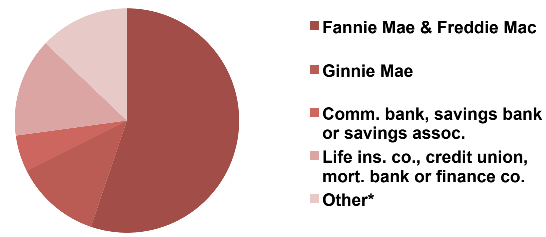
Source: NAFCU 2015 Federal Reserve Survey

Secondary Mortgage Market

The secondary mortgage market is vital to many small financial institutions with mortgage loan portfolios, both as a source of liquidity and as a tool to manage interest rate and concentration risks. Through June 2015, credit unions sold 37 percent of first mortgage real estate loans originated. This is up from 2014 when 34 percent of real estate originations were sold, and in line with historical averages. Credit unions that participated in NAFCU's 2015 *Federal Reserve Meeting Survey* indicated that, on average, 64.6 percent of their outstanding first mortgage loans qualify to be sold on the secondary market (up from 59 percent in last year's survey).

Based on data released under the Home Mortgage Disclosure Act (HMDA), credit unions tend to utilize Fannie Mae and Freddie Mac more heavily relative to banks and thrifts (Charts 11 and 12). More 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 (12.5 percent of respondents in 2015, compared to 5.5 percent in 2014), and more respondents are planning to increase sales of conforming jumbo loans in the next 12 months (25 percent of respondents in 2015, compared to 10.7 percent in 2014).

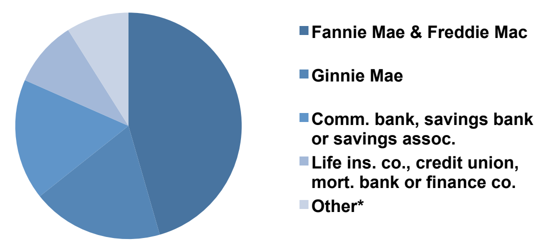
Chart 11 | Credit Union Mortgage Sales by Purchaser Type



** "Other" includes private securitization, affiliate institution or other type of purchaser*

Source: 2014 HMDA data

Chart 12 | Bank & Thrift Mortgage Sales by Purchaser Type



** "Other" includes private securitization, affiliate institution or other type of purchaser*

Source: 2014 HMDA data

CREDIT UNION SERVICE TO MEMBERS AND USE OF FEDERAL RESERVE SERVICES

In keeping with their mission to serve their members, credit unions are committed to offering superior service and modern financial products. This is evident in the growth in the number of institutions offering mobile and other electronic banking services.

Electronic Financial Services

Account balance inquiry is the most common online service offered by FICUs, with 77 percent reporting that they currently offer this service (Table 1). This is up from last year's 75.8 percent. The electronic services that saw the largest increase in usage were remote deposit capture (23.3 percent, up from 15.2 percent last year) and mobile payments (14.8 percent, up from 8.9 percent)

More credit unions are offering mobile banking services to their members (47 percent, up from 40.3 percent last year; Table 2). The shares of credit unions that offer ATM and internet banking services also increased from 72.1 percent to 73.1 percent and from 73.4 percent to 74.9 percent, respectively.

Through shared branching and tens of thousands of free ATMs across the country, including some at key retail locations, credit union members have access and convenience that surpasses other financial institutions. The institutions that provide these services hold nearly 99 percent of the total assets held by all FICUs.

Table 1 | Financial Services Offered Electronically by Credit Unions

Online Service Offered	Provided in 2014	Provided in 2015
Account Aggregation	10.9%	11.8%
Account Balance Inquiry	75.8%	77.0%
Bill Payment	59.6%	61.3%
Download Account History	64.5%	66.1%
Electronic Cash	3.8%	3.9%
Electronic Signature Services	10.4%	13.7%
e-Statements	63.6%	66.3%
External Account Transfers	17.6%	20.1%
Internet Access Services	15.4%	16.4%
Loan Payments	68.0%	69.5%
Member Application	32.1%	34.1%
Merchandise Purchase	5.6%	5.6%
Merchant Processing Services	4.7%	5.2%
Mobile Payments	8.9%	14.8%
New Loans	45.3%	47.3%
New Share Account	21.6%	23.4%
Remote Deposit Capture	15.2%	23.3%
Share Account Transfers	73.0%	74.4%
Share Draft Orders	59.4%	60.4%
View Account History	74.1%	75.4%

Source: NCUA June 2014 & 2015 Call Reports

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

Electronic Service	Percentage of # of Institutions		Percentage of Assets	
	2014	2015	2014	2015
Audio Response/Phone-Based	58.4%	59.0%	96.4%	96.5%
Automatic Teller Machine (ATM)	72.1%	73.1%	98.6%	98.7%
Home Banking via Internet Website	73.4%	74.9%	98.9%	99.2%
Mobile Banking	5.8%	6.1%	31.4%	33.9%
Kiosk	40.3%	47.0%	90.5%	93.7%
Other	4.4%	4.7%	5.1%	5.7%

Source: NCUA June 2014 & 2015 Call Reports

Federal Reserve Services

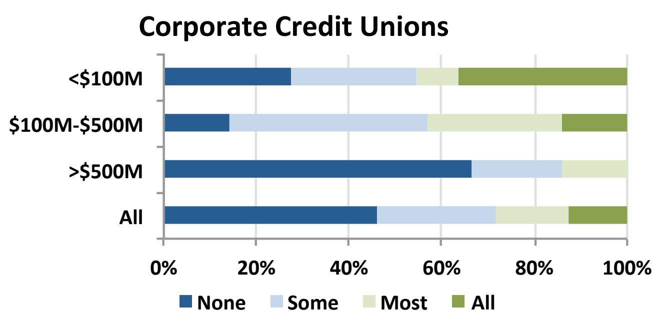
In NAFCU's 2015 *Federal Reserve Meeting Survey*, participants were asked to indicate their use of intermediaries for transaction services (Table 3). The share of respondents that use the Federal Reserve for at least some of their transaction services increased from 80.1 percent last year to 89.7 percent. The usage of corporate credit union services fell substantially, from 79.4 percent in 2014 to just 53.8 percent in 2015.

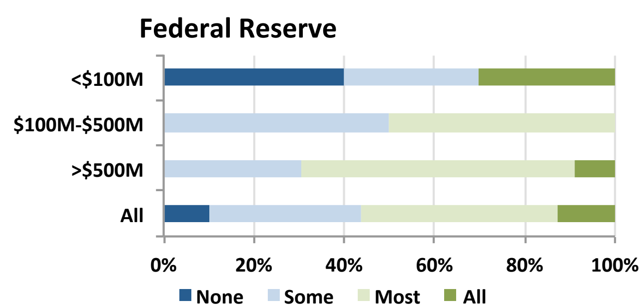
Table 3 | Which Intermediaries Does Your Credit Union Use for Transaction Services?

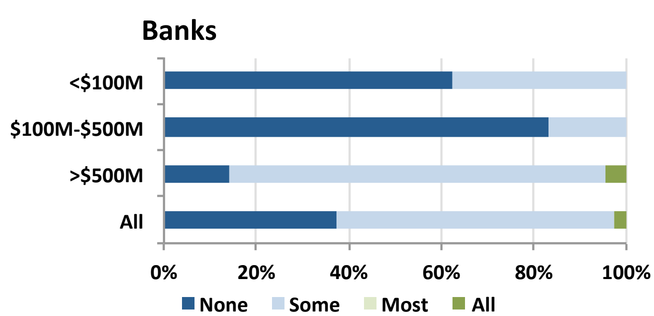
	Corporate Credit Unions		Banks		Federal Reserve		Outside Vendors	
	2014	2015	2014	2015	2014	2015	2014	2015
None	20.6%	46.2%	37.5%	37.1%	20.0%	10.3%	35.7%	40.5%
Some	26.5%	25.6%	54.2%	60.0%	36.7%	33.3%	64.3%	51.4%
Most	38.2%	15.4%	8.3%	0%	36.7%	43.6%	0%	5.4%
All	14.7%	12.8%	0%	2.9%	6.7%	12.8%	0%	2.7%

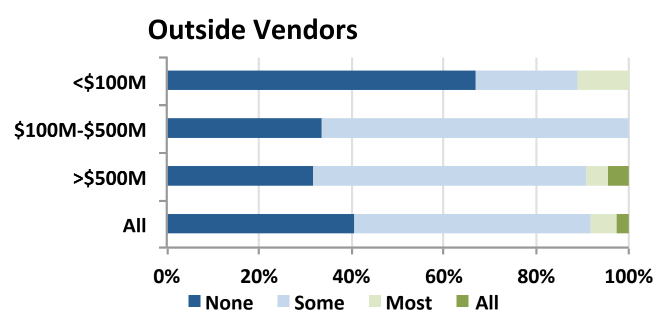
Source: NAFCU 2014 & 2015 Federal Reserve Meeting Surveys

Chart 1 | Use of Intermediaries by Asset Class









Responses by asset class suggest that credit unions under $500 million 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 the Federal Reserve and other banks for some or all of their transaction services. Credit unions over $100 million also utilize outside vendors at higher rates than the smaller credit unions.

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

Federal Reserve Service	2015 Respondent Usage				Average Rating: 1 to 5 (5=excellent)	
	Total	Declining	Same	Increasing	2014	2015
FedLine Advantage	81.6%	5.3%	55.3%	21.1%	3.9	3.9
Educational Seminars	75.6%	0%	48.8%	26.8%	3.7	3.8
Paper Check Clearing	73.0%	0%	62.2%	10.8%	4.0	3.5
ACH Originations	71.8%	0%	46.2%	25.6%	4.0	3.8
Customer Help Services	70.0%	2.5%	37.5%	30.0%	4.0	4.0
Account Services	69.2%	0%	48.7%	20.5%	4.0	3.7
National Settlement Service	68.4%	2.6%	57.9%	7.9%	4.0	3.6
FedTransaction Analyzer Service	65.8%	0%	44.7%	21.1%	3.6	3.4
FedMail	65.8%	0%	47.4%	18.4%	3.9	3.4
Presentment Point Services	64.9%	2.7%	54.1%	8.1%	3.9	3.5
ACH Receipts	63.2%	0%	50.0%	13.2%	4.0	3.8
Coin and Currency Orders	60.5%	0%	57.9%	2.6%	3.9	3.9
FedLine Web Services	47.4%	2.6%	44.7%	0%	4.2	3.8
ACH Risk Management Services	41.0%	10.3%	25.6%	5.1%	3.6	3.4
FedGlobal ACH Payments	35.9%	0%	30.8%	5.1%	4.0	3.3
Coin and Currency Deposit	34.2%	0%	29.0%	5.3%	3.8	3.8
FedImage Services	34.2%	0%	29.0%	5.3%	4.2	3.5
Foreign Check Services	32.4%	0%	32.4%	0%	3.8	3.8
Fed Discount Window	31.6%	2.6%	23.7%	5.3%	3.8	3.6
FedLine Direct	29.0%	0%	21.1%	7.9%	3.8	3.8
Fedwire Funds Service	29.0%	0%	23.7%	5.3%	4.0	3.8
FedLine Command	26.3%	0%	23.7%	2.6%	3.3	3.8
Check 21 Enabled Service	24.3%	0%	18.9%	5.4%	4.1	3.8
Fedwire Securities Service	23.7%	0%	10.5%	13.2%	3.8	3.8
FedComplete Package	18.4%	0%	18.4%	0%	3.8	3.6
FedPayments Reporter Service	16.2%	0%	16.2%	0%	3.5	3.5

Source: NAFCU 2014 & 2015 Federal Reserve Meeting Survey

NAFCU's 2015 *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 FedLine Advantage (81.6 percent), followed by educational seminars (75.6 percent), paper check clearing (73 percent), Automated Clearinghouse (ACH) originations (71.8 percent) and customer help services (70 percent). The least-used services were FedPayments Reporter Service (16.2 percent) and FedComplete Package (18.4 percent).

The services in which the greatest number of respondents noted a decline in usage versus last year were ACH Risk Management Services (10.3 percent) and FedLine Advantage (5.3 percent). The services with the most respondents seeing an increase in usage were customer help services (30.0 percent), educational seminars (26.8 percent) and ACH originations (25.6 percent). A net majority of respondents indicated that they were increasing usage for 21 of the services, while only two services (Presentment Point Services and the Fed Discount Window) saw declining usage among a net majority 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 (Table 4). 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 customer help services (4.0 rating), FedLine Advantage (3.9 rating) and coin and currency orders (3.9 rating). FedGlobal ACH Payments received the lowest rating (3.3 rating).

Sixteen of the services received a lower average rating than in 2014, while only two received a higher rating (Chart 2). The services that saw the largest decline in their average ratings were FedGlobal ACH Payments (-0.7), FedImage Services, (-0.7), paper check clearing (-0.5) and FedMail (-0.5). The services with improved ratings were FedLine Command (+0.5) and educational seminars (+0.1).

Survey participants were asked to review the overall competitiveness of Federal Reserve service pricing. A wide majority (70 percent) felt that the Federal Reserve services were either "competitively" or "very competitively" priced (Chart 3). This is an increase from 2014, when 68.9 percent rated Federal Reserve service pricing as either "competitive" or "very competitive." None of the participants rated the Federal Reserve services as "not competitively" priced. The specific service identified as "most competitively-priced" was ACH transactions, while the service viewed as "least-competitively priced" was wire processing.

Chart 2 | Change in Rating of Fed Services

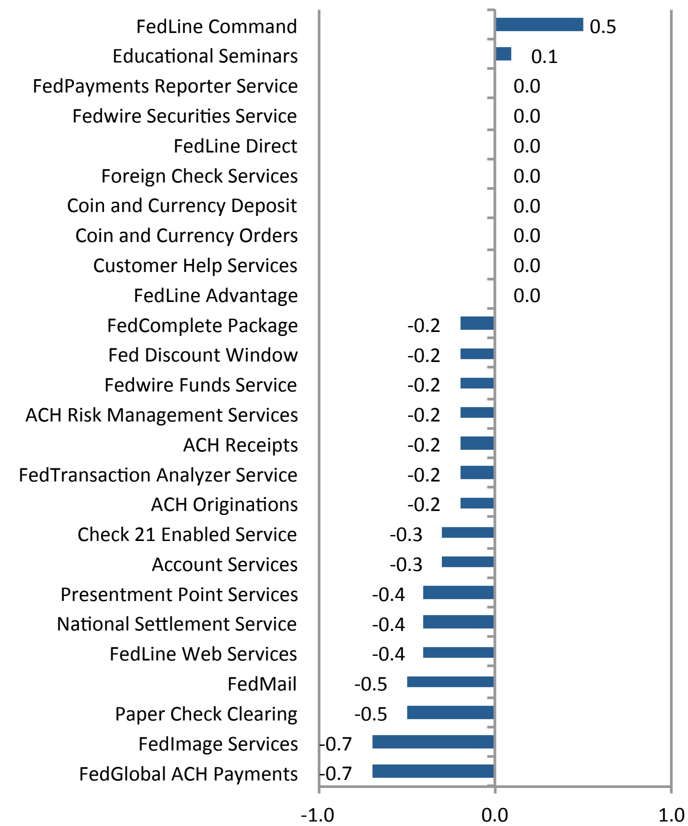
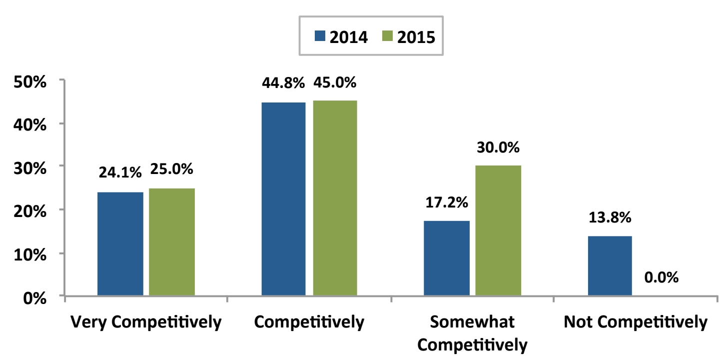


Chart 3 | Overall Competitiveness of Federal Reserve Service Pricing



LEGISLATIVE ISSUES FACING CREDIT UNIONS

Preserving the Credit Union Tax Exemption

Preserving credit unions' federal income tax exemption remains NAFCU's top legislative priority. No member of Congress has proposed eliminating the credit union tax exemption and recent working groups in the Senate Finance Committee have not proposed changes to the credit union tax status. A NAFCU study on the benefit of the tax exemption, 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 today face a regulatory environment which has produced a mounting compliance burden. 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 recent 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 1,280 credit unions have disappeared since the passage of the Dodd-Frank Act in 2010, and over 96 percent 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.

Dixies Federal Credit Union President and CEO Scott Eagerton testifies on behalf of NAFCU before a House Small Business Subcommittee on the impact of Dodd-Frank

NAFCU has issued a comprehensive five-point plan to address the regulatory relief efforts that are essential to the credit union industry's ability to serve its members. While a more comprehensive package of relief is being considered in the Senate in the form of S. 1484, the Financial Regulatory Improvement Act of 2015, the House has been tackling regulatory relief in a piece-meal approach, advancing a number of smaller measures providing targeted relief on issues ranging from privacy notices to mortgage requirements.

Data Security

Data security breaches represent a significant and growing problem for both consumers and businesses. Financial institutions such as credit unions bear much of the burden of reestablishing member safety following a data breach.

Despite the fact that they are rarely the source of data breaches, credit unions are 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

State Department Federal Credit Union President and CEO Jan Roche explained the need for a national data security standard during a House Small Business Committee hearing legislation introduced by Senators Tom Carper (D-DE) and Roy Blunt (R-MO), the Data Security Act of 2015 (S. 961), and a similarly named House bill, H.R. 2205, introduced by Representatives Randy Neugebauer and John Carney that would create a national standard of data protection for those who handle sensitive financial information. 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 address the ongoing issue of data breaches. The issue of data security is also one of the provisions of NAFCU's five-point plan on regulatory relief.

Cyber Security

Cyber security is a critical issue for credit unions, as some institutions have faced denial of service attacks, in addition to other cybercrimes that threaten to compromise the financial information of their members, especially with the growth of online commerce and banking. 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 percent of responding credit unions had been contacted by their members with questions about cyber security.

NAFCU President and CEO Dan Berger testifies before the House Small Business Committee on data and cyber security issues

NAFCU is pleased to be an active participant in various industry and government cyber security initiatives. NAFCU is a member of the Payments Security Task Force, a diverse group of participants in the payments industry that is driving a discussion relative to systems security. NAFCU also supports many of the ongoing efforts at the Financial Services Sector Coordinating Council (FSSCC) and the Financial Services Information Sharing and Analysis Center (FS-ISAC). These organizations work closely with partners throughout the government creating unique information sharing relationships that allow threat information to be distributed in a timely manner. Earlier this year, NAFCU also participated in President Barack Obama's White House Summit on Cybersecurity and Consumer Protection at Stanford University which featured leaders from across the country—industry, tech companies, law enforcement, consumer and privacy advocates, law professors who specialize in this field, and students — to collaborate and explore partnerships that will help develop the best ways to bolster 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. NAFCU supports efforts in Congress, such as S. 754, the Cybersecurity Information Sharing Act (CISA), to strengthen our nation's cyber security.

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.1188) and the Small Business Lending Enhancement Act (S. 2028) has been introduced in both chambers; in the House by Reps. Ed Royce (R-CA) and Greg Meeks (D-NY), and in the Senate by Sens. Rand Paul (R-KY) and Sheldon Whitehouse (D-RI).

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 and Senate to exempt certain residential real estate loans from counting against the business lending cap (H.R. 4226/S. 1440, the Credit Union Residential Loan Parity Act) and to exempt loans made to veterans from counting against the cap (H.R. 1133).

Capital Issues

The NCUA Board issued their second risk-based capital proposed rule (RBC2) for credit unions on January 15, 2015, which amends their first proposal issued nearly a year prior. The NCUA Board finalized the rule on October 15, 2015. While NAFCU does support the concept of risk-based capital for credit unions, we believe that effective implementation of such a system must include legislative changes. On June 15, 2015, Reps. Stephen Fincher (R-TN), Denny Heck (D-WA) and Bill Posey (R-FL) introduced the Credit Union Risk-Based Capital Study Act of 2015 (H.R. 2769). This NAFCU-backed legislation will stop NCUA from moving forward with their second risk-based capital proposal until completing and delivering to Congress a thorough study addressing NCUA's legal authority, the proposal's impact on credit union lending, capital requirements for credit unions compared to other financial institutions and more. The agency would also have to submit proposed legislative changes to bring about capital reform for credit unions. This bipartisan bill overwhelmingly passed the House Financial Services Committee in late September.

In addition to a legislative solution to risk-based capital, NAFCU is also seeking access to supplemental capital for credit unions. Reps. Pete King (R-N.Y.) and Brad Sherman (D-Calif.) introduced the Capital Access for Small Businesses and Jobs Act, H.R. 989. 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

Patriot Federal Credit Union President and CEO Peggy Bosma-LaMascus testifies before the House Financial Services Committee on the need for regulatory relief for credit unions

Credit unions are stymied by regulatory burden. While smaller credit unions continue to disappear due to the growing burden, all credit unions are finding the current environment challenging. For example, credit unions worked diligently for nearly two years to implement the almost 1,900-page Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) regulation, which went into effect on October 3, 2015, at a significant cost to their staffing and resources. The CFPB's mortgage rulemakings, however, are only part of a growing regulatory drain on credit union resources. While the CFPB's rules 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, credit unions are constantly looking for ways to provide innovative products and services to their members, but are often dismayed by the threat of regulatory overreach. Ultimately, regulators must work to strike a balance between industry safety and market growth.

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. Earlier this year, NAFCU became a member of the Federal Reserve's two newly created task forces: the Faster Payments Task Force and the Secure Payments Task Force. NAFCU has appreciated the Federal Reserve's efforts thus far in gathering input from industry stakeholders on what payment solutions could be adopted to help both financial services providers and their customers increase the speed and security of sending and receiving money. NAFCU and our members appreciate the Federal Reserve's recognition of the industry-wide movement toward the adoption of faster payment technologies with its approval of enhancements to its same-day automated clearing house (ACH) service. However, NAFCU continues to believe that it is best for the industry to lead the way to innovate and improve the U.S. payment systems 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. The implementation of a new faster payment system must include a mechanism for adequate cost-recovery for even the smallest financial institutions. Additionally, since a faster payment system runs the risk of increased incidents of fraud going undetected, any new system must emphasize focus on payment security and the protection of sensitive personal and financial data, which are essential to combating dynamic and persistent cyber threats. 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 believes that the cap on debit interchange fees is too low and fails to adequately compensate credit unions for the cost of administering debit card programs. NAFCU's *Federal Reserve Meeting Survey* (survey) indicated that approximately 22 percent 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

NAFCU believes that the restriction on “convenience transfers” under Regulation D 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

NAFCU believes that the Federal Reserve Board should closely analyze and update 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 since two days is insufficient time to determine if a check could be counterfeit or there are insufficient funds to cover the check. 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 the risk of fraud committed upon the credit union or the credit union member. Approximately 62 percent 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

All credit unions, regardless of size, are subject to the CFPB's rule-making authority, and those with more than $10 billion in assets are also subject to the CFPB's examination and enforcement authority. 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.

CFPB Director Richard Cordray addresses the audience at NAFCU's Congressional Caucus

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 finalized 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 final rule imposing requirements on credit unions to assess and verify a borrower's ability to repay a mortgage loan before extending the loan went into effect in January 2014. 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 NAFCU members have withdrawn entirely from the non-qualified mortgage market out of concern for their ability to sell those loans on the secondary market, as well as the legal and regulatory risks associated with extending these loans. 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.

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 percent 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 DTI 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.

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 statements, 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 have nonetheless greatly increased for all credit unions.

Reputation Risk

NAFCU has serious concerns about the CFPB's 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 March 24, 2015, the CFPB issued its Final Policy Statement announcing that consumers will have the ability to include narratives when filing a complaint on the CFPB's consumer complaint database. Only those narratives from consumers who opt-in and give their consent to use their narratives will be published. 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. On June 25, 2015, the CFPB published over 7,700 Consumer Complaint Narratives.

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 them to 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.

In June 2015, the CFPB issued its first monthly Complaint Snapshot Report. The CFPB states that each month, the report will spotlight a particular product and geographic location. The analytics, though, are not based on an industry-wide collection of data. Instead, the monthly snapshot only provides an insular view of market-data based only on complaint information that the CFPB receives. NAFCU is concerned that the CFPB is incorrectly characterizing a number of narratives submitted online as a statistically relevant "trends and analyses" that can be used to inform the public and the marketplace. According to the CFPB's June snapshot, the most-complained-about financial product or service was debt collection, with 7,400 consumers lodging complaints through the CFPB. However, the CFPB has no method to verify the accuracy of a complaint submitted, thus, it is not statistically proper to draw conclusions about how financial institutions address debt collection issues. The Bureau improperly draws conclusions about financial products and services, which paints an overly negative picture of the financial industry that is misleading to consumers.

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.

Not only does the regulatory burden imposed by the Remittance Rule add to the growing compliance costs faced by credit unions, but it has ultimately led to a 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, 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 finalized amendments to Regulation C in October 2015 that make several substantive changes to the reporting requirements under the Home Mortgage Disclosure Act (HMDA). The final rule, among other things, expands 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 have taken this opportunity to collect significantly more data than Dodd-Frank expressly requires. In addition to expanded data collection, the final rule changes the scope of Regulation C's coverage to include most closed-end loans, open-end lines of credit and reverse mortgages secured by dwellings. Under this expansion, reporting will be required on all HELOCs.

NAFCU believes that the Bureau should limit the changes to the HMDA dataset to those mandated by Dodd-Frank. While credit unions support HMDA requirements that further the goal of ensuring fair lending and anti-discriminatory practices, NAFCU is concerned that some of the additional reporting requirements will not achieve these goals and may only serve to impose significant additional compliance and reporting burdens. Moreover, mandating HELOC reporting will exacerbate compliance costs since credit unions will need to make costly modifications to their systems in order to collect data on these newly covered transactions.

Privacy

The CFPB finalized amendments to Regulation P in October 2014 that allowed credit unions, under certain conditions, to post their annual privacy notices online rather than delivering them individually. To utilize this method of delivering privacy notices, a credit union is required to, among other things, 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 final rule constituted an important step towards 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 alternative delivery method allows consumers to be informed regarding their credit union's privacy policy without being inundated with redundant information.

Overdraft

For the past two years, the CFPB has consistently placed overdraft on its rulemaking agenda. However, the timeframe for the release of a proposal continues to be delayed. In the meantime, the CFPB has released two studies of overdraft markets and conducted several high profile information collections. Most notably, the CFPB issued an order in November 2014 to several financial services' core processors that required they provide the Bureau with anonymized data related to overdraft services. In September 2015, the Bureau requested approval from the Office of Management and Budget (OMB) to conduct "a national web survey of 8,000 individuals as part of its study of ATM/debit card overdraft disclosure forms." All of these efforts indicate the Bureau is progressing toward a rulemaking in 2016.

NAFCU believes the CFPB's continued pursuit of data on overdraft programs constitutes extraordinary regulatory overreach. Credit unions are focused on providing value to their members by offering responsible overdraft protection. In fact, NAFCU's June 2015 *Economic & CU Monitor* survey found that every respondent offered an alternative to overdraft or courtesy pay programs, with overdraft lines of credit and linked savings or money market accounts being the most popular (84.4 percent each). Additionally, 97 percent of respondents reverse overdraft charges on a case-by-case basis.

National Credit Union Administration

Capital and risk control are key concerns of the National Credit Union Administration (NCUA). Over the past several years, NCUA has finalized rules on stress testing, derivatives, and Credit Union Service Organizations (CUSOs). Most recently, the agency finalized a "risk-based" capital rule that fundamentally changes its Prompt Corrective Action (PCA) system by replacing NCUA's current risk-based net worth (RBNW) requirements with new requirements for federally insured credit unions over $100 million in assets. Further, the agency's supervisory focus for the past several years has prioritized a credit union's management of interest rate risk (IRR).

Risk-Based Capital

SRP Federal Credit Union President and CEO Ed Templeton told the Senate Banking Committee that NCUA's cost-benefit analysis on their risk-based capital rule falls short

On October 15, 2015, the NCUA Board finalized a rule regarding risk-based capital (RBC) for credit unions. The rule makes a number of revisions to NCUA's capital adequacy rules. Most notably the final rule establishes a new method for computing NCUA's risk-based requirement that would include a risk-based capital (RBC) ratio measure for federally insured "natural person" credit unions with over $100 million in assets. The rule sets forth ten categories of risk-weights for various types of assets based on the risk associated with particular investments. For example, cash would be assigned a zero percent risk weight while riskier assets such as mortgage servicing and CUSO activities would have substantially higher risk-weights.

NAFCU supports an RBC system for credit unions that would reflect lower capital requirements for lower-risk credit unions and higher capital requirements for higher-risk credit unions. However, we continue to believe that Congress needs to make statutory changes to the *Federal Credit Union Act* (FCU Act) in order to achieve a fair system. Such a system should move away from the static net-worth ratio to a system where NCUA joins the other banking regulators in having greater flexibility in establishing capital standards for institutions. NAFCU also believes that capital reform must include access to supplemental capital for all credit unions.

NCUA, however, has chosen to proceed with a rulemaking that fails to achieve an appropriate risk-based system for credit unions. Further, NCUA has failed to consider the true impact this rulemaking would have on the entire credit union industry. Although NCUA estimates that only 16 credit unions will be downgraded if the final rule were in place today, NAFCU believes that the impact of this rule will be much greater. NAFCU believes that NCUA cannot look at the impact of the rule in a vacuum and merely consider how many credit unions would be downgraded or forced to hold more capital. Instead, NAFCU believes the true impact of the rule can only be measured by examining how it will impact the long term growth and strategic planning of all credit unions.

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 directs 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.

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

Fannie Mae and Freddie Mac Guarantee Fees

Earlier this year, the FHFA released the results of its internal report on guarantee fees (g-fees) charged by Fannie Mae and Freddie Mac. As a result of the review, which began in June 2014, the FHFA concluded the structure of g-fees should remain largely unchanged.

NAFCU appreciates the FHFA's thorough study of the market and believes that FHFA should continue to keep guarantee fees at their current level. Any changes to guarantee fees could potentially cause disruption to the national housing market that is still recovering. 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 percent 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.

EMERGING CHALLENGES AND THE FUTURE OF CREDIT UNIONS

As an industry, credit unions weathered their greatest challenge in recent times – the Great Recession – far better than other financial institutions[4]. Whether viewed from the standpoint of capital levels, CAMEL ratings or asset quality, the industry is, on average, as safe and sound as it was prior the crisis, and membership growth rates speak to the healthy and dynamic role that the industry plays. However, a number of troubling issues remain. Under the current regulatory environment, fee income has shrunk considerably, which impacts the safety and soundness of the entire industry, particularly so for small credit unions. Additionally, differences in charter types when it comes to fields of membership as well as the emergence of non-traditional lenders present challenges for credit unions going forward.

Fee Income

Two areas where credit unions have seen a decline in fee income are debit interchange and overdraft fees. As mandated by the Dodd-Frank Act, the Federal Reserve capped debit interchange rates in 2011 for institutions over $10 billion. However, even exempt institutions have seen a decline in their interchange rates since the rule went into effect[5]. According to NAFCU's 2015 *Federal Reserve Meeting Survey*, credit unions that are exempt from the rule have continued to see a decline in their per transaction debit interchange rate over the past 12 months. By a wide margin, more respondents indicated that their rate had declined over the past year (41.5 percent) versus those that had seen an increase (14.6 percent).

Table 1 | Fee Income Ratio by Asset Class

Asset Class	Fee Income Ratio			
	2012	2015 Q2	Difference	Difference as % of 2015 Q2 ROA
$0 - $50M	72.8 bp	66.7 bp	-6.1 bp	-25.1 %
$50M - $100M	88.1 bp	80.9 bp	-7.2 bp	-18.7 %
$100M - $250M	95.2 bp	83.5 bp	-11.7 bp	-22.0 %
$250M - $500M	93.5 bp	82.0 bp	-11.5 bp	-17.7 %
Over $500M	66.7 bp	56.1 bp	-10.6 bp	- 11.4 %

Source: NCUA 5300 Call Reports

In 2010 the Federal Reserve's rule requiring opt-in for overdraft protection programs related to ATM and one-time debit transactions went into effect. Credit unions tend to minimize overdraft fees for their members by ordering transactions either chronologically or from low to high, reversing charges and offering overdraft alternatives, such as linked accounts and overdraft lines of credit[6]. Nevertheless, the CFPB is continuing to look into this issue and may potentially issue further regulation related to overdraft.

Fee income has been in decline across the industry, but it has greater implications for the smallest credit unions. Fee income as a percent of average assets declined across all asset classes between 2012 and the second quarter of 2015 (Table 1). While the drop was relatively less for smaller credit unions, it represents a greater share of the bottom line for those credit unions since they are operating with thinner margins. For credit unions with under $50 million in assets, the 6.1 basis point decline in fee income over that period represents one-quarter of their June 2015 ROA.

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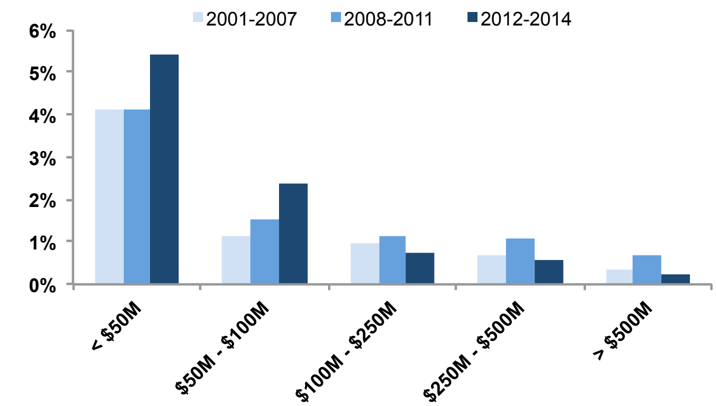
[4] See "General Financial Conditions," page 8.
[5] See "2013 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions," Federal Reserve Board of Governors.
[6] See "Overdraft," page 25.

The decline in fee income coincides with an increase in merger activity within the industry. From 2001 to 2011, the industry lost an average of 3.4 percent of credit unions due to merger. Since that time, however, an average of 4.1 percent of credit unions have been merged out of existence each year. When viewed across asset classes, it becomes clear that the increased rate of consolidation has been concentrated among smaller credit unions (Chart 1). Larger credit unions saw an increase in merger activity during the financial crisis, but that has since subsided. For credit unions with assets under $100 million, on the other hand, consolidation has accelerated in recent years.

Chart 1 | CU Annual Merger Rate by Asset Class



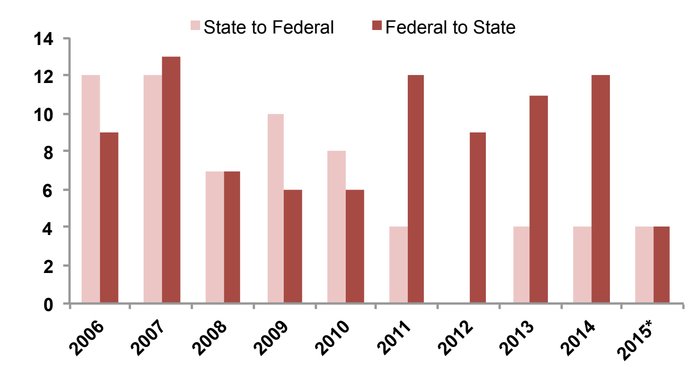
Source: NCUA "Credit Union Chartering Events" (Data Query 2)

There are numerous reasons why a credit union opts to merge, and fee income is not the primary cause for each and every merger in recent years. However, the outsized impact of fee income reductions to the bottom lines of small credit unions is something that should be considered by regulators looking forward. Most credit unions do not have access to supplemental capital. As such, regulations that diminish fee income, and thereby earnings, have significant safety and soundness implications for the industry and represent a growing challenge for credit unions.

Dual Chartering System

Another emerging issue for credit unions is the strength of the industry's dual chartering system. As the NCUA Board has noted numerous times, the credit union industry's dual chartering system works best when the state and federal charters keep pace with each other. Several states, however, have been much more progressive in modernizing their field of membership (FOM) rules to recognize today's dynamic and ubiquitous marketplace. As a result, the industry has seen multiple credit unions convert to state charters over the last several years because of their inability to grow under the federal charter (Chart 2). For example, one of the largest community credit unions in Connecticut converted to a state charter in 2015 because it wanted to expand its FOM beyond its community base, but was precluded from doing so under NCUA's current FOM rules. This trend underscores the need for comprehensive legislative and regulatory FOM modernization. While NAFCU acknowledges that legislation is necessary to relax aspects of the *Federal Credit Union Act's* limitations on chartering, NCUA has the statutory authority to provide some relief today that make the federal charter more competitive.

Chart 2 | CU Conversions by Charter Type



** Through June, annualized*
Source: NCUA "Credit Union Chartering Events" (Data Query 2)

Online Marketplace Lenders

Although credit unions continue to focus on their members, the increasing complexity of the regulatory environment after the passage of the Dodd-Frank Act, is taking a toll on the credit union industry's ability to grow and expand access to credit. While credit unions are seeing their lending opportunities curtailed by increasing regulatory burden from financial regulators, non-traditional financial actors are benefitting from this environment because they are not covered by the new financial regulations. For example, there is a growing online marketplace lending industry that increasingly uses investment capital and data-driven online platforms to lend to small businesses and consumers, while not being subject to consumer protection laws or business lending caps.

The online market is largely a proliferation of peer-to-peer lenders, hedge funds, and other non-depository entities that are not subject to consumer protection laws such as the Truth in Lending Act (TILA). Additionally, some online lenders originate loans across the country but choose to underwrite the loans in a state with the least onerous consumer protection laws such as a state that does not have a usury cap. Consumers may enter into an online loan without receiving the same level of disclosure about the terms and fees of the loan that they receive from a credit union or bank. As such, online lenders are often able to operate more quickly and with fewer compliance costs since they are not required to follow the same disclosure practices and underwriting standards of traditional depository institutions.

The growth of online marketplace lenders proves the need for regulators to modernize existing regulations on traditional financial institutions in order to facilitate greater access to credit. At the same time, financial regulators must promulgate rules that require online market lenders to meet basic consumer protection requirements such as the protections of TILA, underwriting standards for loans, and applicable state usury laws.

The Future

Despite these and other challenges, credit unions are well-positioned for success in the future. Member growth is at its highest level in two decades, which speaks to the industry's growing footprint in the financial services marketplace. As the economy continues to heal, there will be more opportunities for credit unions to distinguish themselves from other lenders and to prove the value of their member-owned cooperative model to customers.

NOTES

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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