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National Association of Federally-Insured Credit Unions

May 5, 2022

The Honorable Todd M. Harper, Chairman
The Honorable Kyle S. Hauptman, Vice Chairman
The Honorable Rodney E. Hood, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Permissible Interest Rate Ceiling

Dear Chairman Harper, Vice Chairman Hauptman, and Board Member Hood:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to you regarding the permissible interest rate ceiling. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 130 million consumers with personal and small business financial services products. NAFCU urges the National Credit Union Administration (NCUA) Board to immediately raise the permissible interest rate ceiling to mitigate unnecessary interest rate risks posed to federal credit unions during this critical period of economic recovery and to enable all federal credit unions to more confidently endeavor to serve the underserved and unserved in their communities. Specifically, NAFCU strongly encourages the NCUA Board to establish a floating permissible interest rate ceiling equal to a 15 percent spread over the prime rate. In the alternative, NAFCU recommends that the NCUA Board extend the 18 percent permissible interest rate ceiling for the maximum allowable period of 18 months no fewer than 90 days before its currently scheduled expiration on March 10, 2023.

General Comments

Irrespective of broader economic realities, the *Federal Credit Union Act* (FCU Act) at 12 CFR §701.21(c)(7)(i) generally prohibits federal credit unions from extending credit to members at rates exceeding 15 percent per year, inclusive of all finance charges. However, under §701.21(c)(7)(ii)(A), the NCUA Board may establish a higher permissible interest rate ceiling if, after consulting with certain congressional committees, the United States Department of the Treasury (Treasury), and other federal agencies, the NCUA Board determines (1) money market rates have risen over the preceding 6-month period; and (2) prevailing interest rate levels threaten the safety and soundness of individual federal credit unions as evidenced by adverse trends in liquidity, capital, earnings, and growth. A higher permissible interest rate ceiling established by the NCUA Board may be made effective for a maximum allowable period of 18 months.

Under §701.21(c)(7)(ii)(A), the NCUA Board may, at any time, raise the permissible interest rate ceiling or extend the expiration of a previously established permissible interest rate ceiling for a maximum allowable period of 18 months by again undertaking the same consultative and deliberative process. Notably, neither this subsection nor any other part of the FCU Act places an upper limit on a permissible interest rate ceiling's numerical value nor establishes a rubric for its calculation. In June 2021, roughly three months before the 18 percent permissible interest rate

ceiling was most recently set to expire, the NCUA Board extended its expiration through March 10, 2023. The 18 percent permissible interest rate ceiling has been continuously maintained by the NCUA Board in similar fashion for decades.

Raising the Permissible Interest Rate Ceiling

Contemporary economic conditions plainly warrant the NCUA Board's immediately raising the permissible interest rate ceiling. The first prong of §701.21(c)(7)(ii)(A)'s two-prong test, that money market rates must have risen over the preceding six months, is clearly satisfied. Monthly rate cap information released by the Federal Deposit Insurance Corporation shows the national money market rate cap has increased more than 30 percent from a trailing 6-month low of 0.06 percent as of November 15, 2021, to 0.08 percent as of April 18, 2022[1].

Though the second prong of §701.21(c)(7)(ii)(A)'s two-prong test requires more than a simple data comparison, it is no less clearly satisfied. When this subsection describes potential interest rate risks to the safety and soundness of individual federal credit unions, this subsection broadly refers to risks arising from "prevailing interest rate levels," not the singular "maximum permissible rate" described in §701.21(c)(7)(i). Said differently, §701.21(c)(7)(ii)(A) does not require that the NCUA Board determine its failure to establish a higher than 15 percent permissible interest rate ceiling or extend the expiration of a previously established permissible interest rate ceiling would threaten the safety and soundness of individual federal credit unions. Rather, the second prong of this subsection's two-prong test requires only that the NCUA Board find that broader interest rate pressures threaten individual federal credit unions' well-being as evidenced by adverse trends in liquidity, capital, earnings, and growth.

The NCUA's April 2011 Permissible Interest Rate Ceiling Letter to Credit Unions provides us significant insight into the NCUA Board's prior treatment of this low statutory bar. In that April 2011 Letter to Credit Unions, the NCUA expressly recognized that, though short-term interest rates generally remained below historical means, the NCUA Board's failing to at least extend the expiration of the 18 percent permissible interest rate ceiling in a rising-rate environment unnecessarily risked impairing the safety and soundness of individual federal credit unions. If the NCUA Board failed to act, those federal credit unions that had fairly extended risk-priced loans to members at rates between 15 and 18 percent would directly suffer reduced earnings without an offsetting reduction in credit risks. When a financial institution's overall earnings backstop is lowered, realized credit risks more quickly metastasize into adverse trends in liquidity, capital, and growth.

The NCUA also paid particular attention in April 2011 to the potential harms to low-income credit unions and the important need to preserve access to affordable, high-quality credit for members with low incomes and below-average credit scores. Appropriately risk-priced loans made available to low-income members and members with low credit scores by credit unions were then, and remain today, typically much less expensive than loans available through banks and non-

[1] Federal Deposit Insurance Corporation, *National Rates and Rate Caps* (2022), https://www.fdic.gov/resources/bankers/national-rates/index.html (last visited May 5, 2022).

depository lenders. By effectively reducing the permissible interest rate ceiling, the NCUA Board would have materially impaired credit unions' ability to reach and serve the underserved and unserved in their communities. Between December 2008 and November 2015, the prime rate did not waiver at 3.25 percent, and the federal funds rate rarely ventured above 0.2 percent.

In June 2021, when the NCUA Board most recently extended the expiration of the 18 percent permissible interest rate ceiling, the federal funds rate rested below 0.1 percent, as did each of the 1-month, 3-month, 6-month and 1-year Treasury rates. Between the beginning of 2022 and today, the federal funds rate has more than tripled to 0.33 percent[2]. At the same time, the 1-month Treasury rate has increased nearly 10 times, from 0.05 percent to higher than 0.44 percent[3]. The 3-month Treasury rate has risen sharply from 0.07 percent to higher than 0.95 percent. The 6-month Treasury rate, which began the year near 0.21 percent, has spiked more than 120 basis points to roughly 1.46 percent. The 1-year Treasury rate has, as should be expected, ballooned even more, up more than 170 basis points from 0.39 percent to as high as 2.15 percent. While each of the aforementioned five short-term interest rates has been higher in absolute terms in the last three years, to find similarly rapid increases in any of the five rates, one would have to look back at least a decade and, in most cases, nearly three decades.

In its March 2022 meeting, the Federal Reserve System's (Federal Reserve) Federal Open Market Committee (FOMC) announced that it would begin reducing its balance sheet. The prime rate quickly increased 25 basis points to 3.5 percent, its first move since plummeting 100 basis points in March 2020. Compounding matters is that the Federal Reserve's FOMC voted at its May 2022 meeting to further tighten the United State money supply with a goal of pushing rates 50 basis points higher still. Shortly thereafter, Federal Reserve Chair Jerome Powell explained there is broad consensus on the committee that additional 50 basis point hikes should "remain on the table" for its next two meetings.

Against this backdrop of rapidly rising key interest rates, thousands of individual federal credit unions across the country face a wide range of material risks to their well-being. However, few contemporary risks, if any, are as dire as the elevated and accelerating risks to federal credit unions' earnings. After all, federal credit unions' earnings underpin federal credit unions' liquidity, capital, and growth and are not, like big banks' earnings, meted out mostly to a handful of institutional investors headquartered in a few major cities. A federal credit union's earnings, by statutory design, are reinvested in the federal credit union's community. Federal credit unions' earnings help member-owners become more financially secure, support important affordable and free financial services, and fund federal credit unions' outreach to their communities' underserved and unserved, some of whom enjoy access to no other in-community financial institution.

From the outset of the COVID-19 pandemic, federal credit unions across the country began to experience extraordinary share growth. Almost immediately and for nearly two years, broadly

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[2] Federal Reserve Bank of New York, *Effective Federal Funds Rate* (2022), https://www.newyorkfed.org/markets/reference-rates/effr (last visited May 5, 2022).
[3] The Wall Street Journal, *Bonds and Rates* (2022), https://www.wsj.com/market-data/bonds (last visited May 5, 2022).

reduced consumer and small business spending and various forms of federal and state stimulus payments swelled share accounts. In a matter of weeks, some federal credit unions experienced such dramatic share growth that they saw their net worth ratios fall into lower prompt corrective action (PCA) regulatory tiers. On May 21, 2020, the NCUA Board recognized the awesome severity and scope of the issue when it approved an interim final rule amending the NCUA's PCA regulations to effectively waive the earnings retention requirement for any adequately capitalized credit union and to permit many less than adequately capitalized credit unions to submit a streamlined net worth restoration plan. Though most federal credit unions' rate of share growth has abated somewhat recently, prior share growth has, by and large, proved durable. As a direct result, the NCUA Board recently proposed increasing the Office of National Examinations and Supervision (ONES) net worth threshold from $10 billion to $15 billion.

While we may be unsure as to when federal credit union share growth will revert to historical means, we are able to confidently measure, nearly in real-time, important consumer borrowing trends. In March 2022, the National Association of Realtors reported overall existing-home sales fell roughly 2.7 percent to mark the lowest seasonally-adjusted annualized rate since June 2020[4]. Like many facets of the COVID-19 pandemic, regional economic experiences varied greatly. Sales in the West held steady, but sales in the Midwest fell 4.5 percent. The Northeast slid 2.9 percent and the South 3 percent. Total vehicle sales reported by the Federal Reserve Bank of St. Louis's Federal Reserve Economic Data (FRED) system show that, while total vehicle sales staged a strong, year-long recovery beginning in April 2020, total vehicle sales remain extremely volatile and far below long-term trend lines[5].

Today, the interplay of durable, elevated share levels and fewer, more volatile core lending opportunities places significant downward pressure on federal credit unions' net interest margins and, in turn, federal credit unions' earnings. The natural outcome of the Federal Reserve's FOMC aggressively combatting inflationary trends, will be that federal credit unions will face even greater

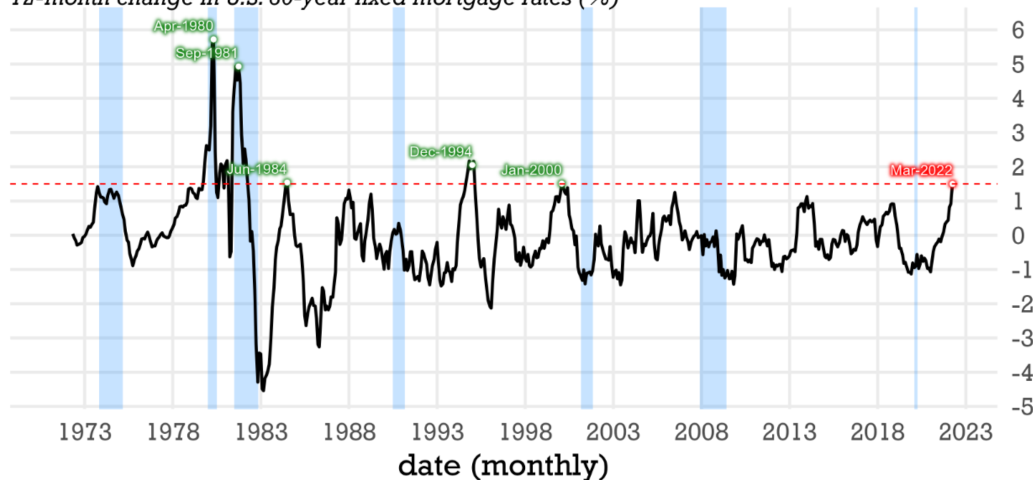
[4] National Association of Realtors, *Existing-home Sales Slip 2.7% in March* (2022), https://www.nar.realtor/newsroom/existing-home-sales-slip-2-7-in-march (last visited May 5, 2022).
[5] Federal Reserve Bank of St. Louis, *Total Vehicle Sales* (2022), https://fred.stlouisfed.org/series/TOTALSA (last visited May 5, 2022).

portfolio pressures in the months and years immediately ahead. If, in April 2011, failing to maintain the 18 percent permissible interest rate ceiling would have unnecessarily risked impairing the safety and soundness of federal credit unions and reducing affordable access to high-quality credit, failing to establish a higher permissible interest rate ceiling now – when every meaningful prevailing interest rate is higher and rapidly rising – risks even more.

Floating Permissible Interest Rate Ceiling

NAFCU continues to strongly encourage the NCUA Board to establish a floating permissible interest rate ceiling equal to a 15 percent spread above the prime rate. It is clear from the continued maintenance of the 18 percent permissible interest rate ceiling that every NCUA Board, for decades, has recognized the inherent defects of an arbitrarily low permissible interest rate ceiling. The NCUA has also long endeavored to educate federal credit unions on risk mitigation options and best practices. However, the adoption or maintenance of any fixed permissible interest rate ceiling leaves the credit union system unnecessarily exposed to all too obvious interest rate risks.

Key interest rates can climb rapidly, sometimes seemingly overnight, and far faster than the NCUA Board can reasonably be expected to act. For example, in March 2022, U.S. mortgage rates posted a year-over-year increase of 150 basis points. Though U.S. mortgage rates experienced similar volatility a handful of times between the oil-price shocks of 1979 and the final frothy days of the dot-com bubble, the likes of the March 2022 data have not been seen since some of us worried about the bite of the Y2K bug.



When the NCUA Board approved the Derivatives Final Rule in May 2021, it expressly acknowledged its continued, intentional shift to principles-based regulation. At the heart of the NCUA Board's reasoning in the Derivatives Final Rule is a simple principle: federal credit unions

capable of prudently utilizing tailored interest rate risk management tools should be permitted to use such tools to protect their balance sheets and help reduce overall risks to the credit union system. And while NAFCU is strongly supportive of the Derivatives Final Rule, not every federal credit union directly benefits from its increased regulatory flexibility because not every federal credit union has the requisite resources to prudently utilize mathematically complex financial derivatives. In contrast, a floating permissible interest rate ceiling is an interest rate risk mitigation tool available to federal credit unions of all sizes and resource levels. Federal credit unions with even the most modest resources already track the prime rate, and the basic arithmetic required for a federal credit union to utilize a floating permissible interest rate ceiling does not even require the back of an envelope.

As highlighted above, when §701.21(c)(7)(ii)(A)'s two-prong test is satisfied – as it so plainly is today, the NCUA Board is bound by no statutory upper limit on a permissible interest rate ceiling's value nor any requirement that a permissible interest rate ceiling be represented by a fixed value. More pointedly, the NCUA Board's own prior actions highlight the NCUA Board's broad discretion to establish a floating permissible interest rate ceiling and the propriety of exercising such discretion.

In October 2010, the NCUA Board formally recognized for the first time that the 18 percent permissible interest rate ceiling unnecessarily constrains federal credit unions' capacity to prudently serve their communities. Today, when a federal credit union extends a payday alternative loan (PAL), the federal credit union may, under either the October 2010 PALs Final Rule or the September 2019 PALs II Final Rule, utilize risk-based pricing up to a maximum interest rate that floats 10 percent above the otherwise permissible interest rate ceiling. Plainly, the NCUA recognizes that when federal credit unions are not arbitrarily constrained in their risk-based pricing, federal credit unions cannot only more fully serve their present members but more serve and enrich their broader communities.

This is the type of interest rate pragmatism that the NCUA Board should apply to the permissible interest rate ceiling generally. In some economic environments, such as the present, a fixed permissible interest rate ceiling gives rise to risks for which no federal credit union has an adequate mitigation tool. A floating permissible interest rate ceiling equal to a 15 percent spread above the prime rate would preserve the spirit of §701.21(c)(7)(i)'s general prohibition against federal credit unions extending credit at excessive rates, enable thousands of federal credit unions across the country to more confidently extend credit to more members, and ensure that credit unions remain all Americans' best financial services partners in every interest rate environment and through every interval of the natural economic cycle.

Maintaining the Permissible Interest Rate Ceiling

Absent the NCUA Board raising the permissible interest rate ceiling, the NCUA Board should extend the 18 percent permissible interest rate ceiling for the maximum allowable period of 18 months no fewer than 90 days before its currently schedule expiration on March 10, 2023. As described more fully above, §701.21(c)(7)(ii)(A)'s two-prong test is plainly satisfied. Failing to at least maintain the 18 percent permissible interest rate ceiling would compound the myriad risks

federal credit unions and their members face in the economic aftermath of the COVID-19 pandemic. Share levels remain stubbornly high, key components of consumer borrowing vacillate wildly far below long-term trend lines, and key interest rates are rising as rarely before seen. If the NCUA Board fails to at least maintain the 18 percent permissible interest rate ceiling, the thousands of credit unions reporting at least some lines of credit in excess of 15 percent would find their net interest margins and earnings needlessly suppressed without an offsetting reduction in credit risks. The NCUA Board should, as it has throughout the COVID-19 pandemic, strive to support the credit union system by avoiding unnecessary regulatory and economic uncertainty.

Conclusion

NAFCU always appreciates the opportunity to share our views and the views of our members on this perennially important issue. NAFCU urges the NCUA Board to support federal credit unions' role in the ongoing, all-important economic recovery by immediately raising the permissible interest rate ceiling. Specifically, NAFCU strongly encourages the NCUA to immediately establish a floating permissible interest rate ceiling equal to a 15 percent spread over prime. At a minimum, the NCUA Board should timely extend the 18 percent permissible interest rate ceiling for the maximum allowable period of 18 months to avoid even more severe regulatory and economic uncertainty.

If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2212 or akossachev@nafcu.org or Dale Baker, NAFCU Regulatory Affairs Counsel, at (703) 842-2803 or dbaker@nafcu.org.

Sincerely,

Ann C. Kossachev
Vice President of Regulatory Affairs

cc: Mr. Larry Fazio, Executive Director
Mr. Frank Kressman, General Counsel
Mr. Eugene Schied, Chief Financial Office