American Bankers Association®

Memo

May 21, 2018

To: Members of the House Financial Services Committee

From: James Ballentine, Executive Vice President, Congressional Relations & Political Affairs

Re: Views on Section 701 of H.R. 5841, the Foreign Investment Risk Review Modernization Act of 2018

We write to make you aware of concerns regarding Section 701 of H. R. 5841, the Foreign Investment Risk Review Modernization Act of 2018, which delays the effective date of the National Credit Union Administration's (NCUA) risk based capital rules.

Although this provision is an improvement on earlier proposals that would repeal the NCUA risk based capital rules outright, Congress should still reject this provision. These rules should not be delayed, both because doing so places the taxpayer-backed insurance fund at risk for losses, and because it places banks – who already have a competitive inequity because of the taxpayer subsidy provided to the credit union industry – in an unequal position in the marketplace.

The current credit union capital scheme was designed for a less complex industry than exists today, and does not adequately protect the taxpayer. The credit union industry has seen exponential growth in the recent past, with industry assets now exceeding *$1.4 trillion.* The nearly 300 credit unions with more than $1 billion in assets are each larger than 87% of the banks in this country. Congress should take seriously the rules that govern this expansive industry that, in all important respects, has graduated.

Except among credit union executives, there is nearly universal agreement NCUA's existing rules are antiquated and need modernization. As NCUA noted in a 2015 report to the House Financial Services Committee, the risk based capital rule was pursued because:

> both the [Government Accountability Office] and NCUA's Inspector General found that the existing NCUA rule on risk-based net worth failed to prevent credit union losses as a result of the financial crisis. GAO concluded that NCUA should propose "additional triggers" for prompt corrective action that "would require early and forceful regulatory action." The Inspector General noted that NCUA needs a prompt corrective action framework that will identify increasing risks on a timely basis, before losses occur.

There are current reminders of the need to implement these rules. In December, NCUA Board Member Rick Metsger noted the National Credit Union Share Insurance Fund may soon be required to increase loss reserves because of recent credit union failures due to high concentrations of certain business loans. Existing capital rules did not stop these risky concentration levels, and as Board Member Metsger noted, these recent failures are "a prime example of why we need a strong risk-based capital system" for credit unions.

More important from the perspective of our members, a delay of these rules by Congress artificially distorts market pricing and puts the tax-exempt credit union industry at a further competitive advantage over taxpaying banks. Banks have lived with capital rules that are more robust than the credit union industry for years, and are now required to meet the international standards of Basel III. Having to hold less capital than banks provides credit unions with a lower overall cost of funds that artificially distorts market pricing, and can lead to the underpricing of risk. It likewise artificially drives business away from competing industries, and compounds the competitive advantage conferred by the credit union industry's tax exempt status.

The Basel III-related provision in S. 2155, the regulatory relief package that will be voted on in the House tomorrow, does not address this competitive inequity. Section 201 of S. 2155 allows regulators to establish a leverage ratio of between 8% and 10% for community banks to be deemed in compliance with capital rules. This is not intended to reduce the amount of capital banks need, but rather serves as a regulatory relief measure for banks that can demonstrate they have significantly more regulatory capital than the Basel III standards require. While it is not a direct apples-to-apples comparison, under NCUA's old capital regimen that H.R. 5841 would now extend, credit unions would need only 7% to be considered well capitalized. In addition, the provision in S. 2155 only applies to banks under $10 billion. Larger community banks and midsize banks that actively compete with credit unions of all sizes will still have to live under Basel III even under a post-S. 2155 scenario, exacerbating the already-unlevel playing field even further.

After four years of debate over risk based capital at the NCUA and ample notice to plan for compliance, Congress should question the real purpose for seeking a delay in these rules. As all three members on the NCUA may soon be replaced, it may be that credit unions hope that more time will provide them with a backdoor way to eliminate these rules entirely. If that occurred, it would give credit unions a significant competitive advantage over banks for years to come. The Committee should reject Section 701 of H.R. 5841.