

June 27, 2019

The Honorable Rodney E. Hood
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

The Honorable J. Mark McWatters
Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

The Honorable Todd M. Harper
Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

The Honorable James Hagen
Inspector General
National Credit Union Administration
P.O. Box 25705
Alexandria, Virginia 22313

Dear Chairman Hood, Board Members McWatters and Harper, and Inspector General Hagen:

This week, the credit union industry celebrated a significant milestone: the 85th anniversary of the Federal Credit Union Act. As the agency and industry reflect on that history, it is similarly worth reflecting on the mission, purpose, and ideals lawmakers had when, at the height of the Depression, President Franklin Roosevelt signed this legislation in 1934. Congress intended the industry to do good, through mandates to operate “not-for-profit” and to serve people of “small means.”¹ Congress also intended the industry to operate in a safe and sound way, ensuring depositors and the taxpayer are protected from undue risks, and that lending be focused on “provident or productive purposes.”²

We call on the NCUA and the NCUA Office of Inspector General to conduct a top-to-bottom assessment of whether the credit union industry is living up to these ideals. According to new research by respected analyst Karen Shaw Petrou and her firm, Federal Financial Analytics, notwithstanding the industry’s higher purpose, modern credit unions may be a contributing factor to the *widening* of economic inequality. The report details how credit unions are increasingly using their tax advantage and regulatory supports to expand membership with higher-income customers, make high-risk loans without adequate capital, and even buy up taxpaying community banks.

Federal Financial Analytics’ report identifies several troubling issues that merit further investigation by NCUA’s Inspector General, and action by the NCUA Board. Although the full analytical assessment should be reviewed in detail, we have highlighted a few of the findings here:

- **NCUA needs to impose mission-related requirements:** Petrou notes that modern credit union regulation is often premised on profit maximization, not mission compliance (i.e., serving people of small means). The modern regulatory framework highlights the “small means” mission in rhetorical terms, yet has redesigned the credit-union business model into one often indistinguishable from banks – *without* the comparable Community Reinvestment Act requirements or a documented showing of serving low- and moderate-income households.

¹ See 12 U.S.C. 1751 at Preamble.

² *Id.* at 1752.

With no mandate of any significance to serve lower income households, Petrou finds that credit unions appear to lend disproportionately to higher-income households. NCUA's changes to common bond requirements undermine "the ability of credit unions to focus on provident and productive lending, instead converting business objectives to profit maximization." Petrou also notes that credit union promotion of "toy loans," such as loans for private aircraft, as well as wealth-management services and multi-million dollar commercial real estate loans not only furthers economic inequality, but also poses safety-and-soundness risks, especially at this point in the U.S. business and financial cycle.

- **NCUA regulation and supervision is substandard and poses increasing risks to the credit union system:** Petrou details how NCUA capital requirements and other safety-and-soundness rules are considerably more relaxed than those applicable to banks and should be strengthened. (Importantly, just last week, NCUA proposed to delay its risk-based capital rule—which applies only to the largest credit unions—until 2022, even though every single bank in the country has been subject to Basel III for many years.) Credit unions with access to "secondary" capital fail at a rate 362 percent greater than other institutions, according to the paper (yet NCUA also announced last week it is prepared to allow credit unions to tap the debt markets and allow profit-seeking investors to invest in credit unions). Moreover, as the NCUA Inspector General has repeatedly found, the lack of a timely and aggressive supervisory approach has led to concentration risks and credit union failures, most recently visible during the taxi medallion crisis.³ Significant evidence of what Petrou calls "charter arbitrage" and "regulatory capture" raises parallels to the 1980s Savings & Loan crisis, which of course ended very badly. Given these historic parallels, recent examples of regulatory problems and potential risks posed by an increasingly suspect approach to regulatory capital requirements, Petrou raises concerns that should be taken seriously by all.
- **NCUA's definition of "low-income" is misleading, but carries consequences in the marketplace:** "Low income" designated credit unions are given additional tools by Congress, including the ability to accept non-member deposits from any source, outside capital, and additional business lending authority. However, Petrou points out that NCUA's definition of "low-income" is far more expansive than that used by other federal agencies, allowing some of the wealthiest communities in the world, like Greenwich, CT, to be considered "low-income." Coupled with the lack of documented accountability that low-income people are actually served in those communities, Petrou observes that the broad definition of "low-income" undermines the incentive the additional authorities provide to, in fact, serve low-income communities.

³ See, e.g., NCUA Office of Inspector General (OIG), "Material Loss Review of Melrose Credit Union, LOMTO Federal Credit Union, and Bay Ridge Federal Credit Union," Report IG-19-06, (March 29, 2019), available at <https://www.ncua.gov/files/audit-reports/oig-material-loss-review-march-2019.pdf>.

- **The “provident or productive” mandate is all but ignored by NCUA regulation:** The ideals of the industry find support in statute – by law, credit unions are supposed to be a “source of credit for provident or productive purposes.”⁴ However, as Petrou notes, not all lending is provident, as the taxi medallion crisis, where credit unions pushed risky loans on borrowers who could not understand the terms, demonstrates with tragic consequences. From her perspective, NCUA analysis of business lending through the lens of what makes *credit unions* more “productive” misses the point—multimillion-dollar commercial real estate loans do not help small means consumers start businesses that lead to long-term wealth generation. This misdirected focus is troubling and needs reexamination.
- **Credit union acquisitions of banks show a changed mission:** The paper argues that the trend of credit unions buying banks suggests that the prior mission differentiation between banks and credit unions is not material. Petrou also notes that the acquisition of small banks by credit unions provides clear evidence of the limited membership constraints provided by the common bond.

No question, there are examples of credit unions that do an excellent job serving small means consumers, and would continue to make the Federal Credit Union Act’s original drafters proud. However, Petrou’s paper suggests that NCUA should be concerned that despite the unprecedented public subsidies and exemption from important bank-like regulations, many credit unions, particularly those of a larger nature, are simply falling short of achieving the mission intended 85 years ago.

This report should serve as a wake-up call to the agency that this \$1.5 trillion-dollar industry cannot be trusted to meet its statutory mission to serve low- and moderate-income households without appropriate oversight. The report is attached here. We strongly encourage you to read it as it raises important policy questions as to whether today’s credit union industry is meeting the mission Congress intended. We believe that any fair reading of this paper suggests that it is not.

Sincerely,

A handwritten signature in black ink that reads "BOB NIENOW". The letters are bold and slightly slanted, with a stylized flourish at the end of the last name.

⁴ 12 U.S.C. 1751.