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SUMMARY

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Credit unions make loans to their members, other credit unions, and corporate credit unions that provide financial services to individual credit unions. Historically, credit unions have faced statutory restrictions on their lending activities, including restricting lending activities to their members. Other lending restrictions include a 15% statutory loan interest rate ceiling, with some authority to operate above the cap under certain circumstances; a 15-year maturity limit on most loans (with some exceptions, such as residential mortgages); and an aggregate limit on an individual credit union's member business loan (MBL) activity (in the form of outstanding loan balances) and on the amount that can be loaned to any one member.

Congress passed the Federal Credit Union Act of 1934 (FCU Act; 48 Stat. 1216) to create a class of federally chartered financial institutions to "promote thrift among its members and create a source of credit for provident or productive purposes." The original concept of a credit union stemmed from small lending cooperatives that not only provided a low-cost source of credit for but also promoted thriftiness among their members. Since their inception, credit unions have been granted additional lending authorities as the marketplace has evolved. Nevertheless, the credit union system still faces more restrictions than the commercial banking system.

Credit union industry advocates argue that lifting lending restrictions to make the system more comparable with the banking system would increase borrowers' available pools of credit. Community banks, which often compete with credit unions, argue that policies such as raising the business lending cap, for example, would allow credit unions to expand beyond their congressionally mandated mission and could pose a threat to financial stability. By amending the FCU Act several times to expand permissible lending activities, Congress arguably recognizes that the credit union system has evolved into a more sophisticated financial intermediation system. In addition to various FCU Act amendments over the past several decades, Congress has recently passed various legislation that would allow credit unions to expand their lending activities. For example, P.L. 115-174 revised the MBL definition, allowing credit unions to extend loans to one-to-four family dwellings regardless of whether the dwellings are primary residences. In the 116th Congress, H.R. 1661 has been introduced and, if enacted, would amend the FCU Act to allow the National Credit Union Administration (NCUA)—the primary regulator of federally insured credit unions—the flexibility to extend loan maturities for all loans, including MBLs and student loans.

Recognizing credit unions' primary mission as meeting consumers' credit and savings needs, Congress emphasized prudential safety and soundness concerns when it established the statutory cap on MBLs and a capital supervisory framework for the credit union system. Following the 2008 financial crisis, the federal bank prudential regulators (i.e., the Federal Reserve, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation) enhanced their prudential capital requirements to increase the U.S. banking system's resilience to systemic risk events. Likewise, the NCUA initially proposed in 2014 to increase capital (net worth) requirements particularly for large credit unions (those with $500 million or more in assets); however, the proposal has been revised and delayed and is currently scheduled to become effective in January 2022. In the meantime, the NCUA has implemented and proposed rules to support expanding lending activities that would increase financial transactions volumes (economies of scale), thus increasing the array of loan product offerings for members and potential revenues for the credit union system. Likewise, Congress has been monitoring the extent to which the adoption of enhanced prudential capital requirements for the credit union system has kept pace with the bank prudential regulatory regime.

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Introduction

Credit unions are nonprofit depository financial institutions that are owned and operated entirely by their members.[1] In other words, *natural person* credit unions, also known as retail credit unions, are financial cooperatives that return profits to their memberships. For this reason, member deposits are referred to as *shares*, which may be used to provide loans to members, other credit unions, and credit union organizations; and the interest earned by members is referred to as *share dividends*, which are comparable to shareholder profit distributions. Credit unions (and banks) engage in *financial intermediation*, or facilitating transfers of funds back and forth between savers (via accepting deposits) and borrowers (via loans).

The National Credit Union Administration (NCUA), an independent federal agency, is the primary federal regulator and share deposit insurer for credit unions.[2] There are three federal bank prudential regulators: the Office of the Comptroller of the Currency (OCC) charters and supervises national depository (commercial) banks; the Federal Deposit Insurance Corporation (FDIC) provides deposit insurance by collecting insurance premiums from member banks and places the proceeds in its Deposit Insurance Fund (DIF), which are subsequently used to reimburse depositors when acting as the receiver of a failed bank; and the Federal Reserve provides lender-of-last-resort liquidity to solvent banks via its discount window. The NCUA, by comparison, serves all three functions for federally regulated credit unions. The NCUA also manages the National Credit Union Share Insurance Fund (NCUSIF), which is the federal deposit insurance fund for credit unions.

Federally Guaranteed Deposits

The NCUA insures demand deposit (noninterest bearing) accounts, interest bearing checking accounts, savings accounts, certificates of deposit, and funds in traditional and Roth Individual Retirement Accounts (IRAs) up to $250,000.[3] The NCUA provides separate coverage for deposits held in different account ownership categories, such as single accounts, joint accounts, and IRAs. For example, the funds in a deposit account and those in an IRA would be insured separately, even if the accounts belonged to the same individual. The NCUA does not insure stocks, bonds, mutual funds, money market funds, life insurance policies, annuities, municipal securities, or other nondeposits (investments) even if these products were purchased from an insured depository. In addition, the NCUA does not insure safe deposit boxes, bank theft or fraud losses, accounting error losses, and U.S. government-backed investments, such as Treasury securities and savings bonds. In short, NCUA insurance coverages apply only to deposits associated with an insolvent credit union's closure. The FDIC performs the same deposit insurance functions for the banking system.

Although scholars are unable to pinpoint the precise origin of the credit union movement, the organization of membership-owned cooperatives to raise funds for members lacking sufficient collateral or wealth necessary to qualify for bank loans dates back to colonial times.[4] During their infancy stages, credit cooperatives basically emerged as a form of microlending in financially underserved localities to provide unsecured small-dollar loans. Small group cooperatives initially

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[1] For additional information about the credit unions along with comparisons to banks, see CRS InFocus CRS In Focus IF11048, *Introduction to Bank Regulation: Credit Unions and Community Banks: A Comparison*, by Darryl E. Getter.

[2] The National Credit Union Administration (NCUA) was created by the Federal Credit Union Act of 1934 (48 Stat. 1216). P.L. 91-468, 84 Stat. 994 made the NCUA an independent agency, which is governed by a three-member board.

[3] See NCUA, *How Your Accounts Are Federally Insured*, at https://www.ncua.gov/files/press-releases-news/NCUAHowYourAcctInsured.pdf; and Federal Deposit Insurance Corporation (FDIC), *A Guide to What Is and Is Not Protected by FDIC Insurance*, at https://www.fdic.gov/deposit/covered/notinsured.html.

[4] See Erdis W. Smith, "Federal Credit Unions: Origin and Development," *Social Security Bulletin*, vol. 18, no. 11 (November 1955).

relied on pooled funds, donations, and subsidies to make loans (allocated via lotteries or auctions) until evolving into self-sufficient systems more reliant on deposits.[5] The advantage of small memberships for group credit cooperatives allow members to know each other, which facilitates peer monitoring of the lending decisions and borrowers' repayment behavior.[6] The original concept of a credit union stemmed from cooperatives formed to promote thrift among its members and to provide them with a low-cost source of credit.

Following numerous bank failures and runs during the Great Depression that resulted in an extensive contraction of credit, Congress sought to enhance cooperative organizations' ability to meet their members' credit needs.[7] Congress passed the Federal Credit Union Act of 1934 (FCU Act; 48 Stat. 1216) to create a class of federally chartered financial institutions for "promoting thrift among its members and creating a source of credit for provident or productive purposes."[8] Over time, Congress expanded credit unions' permissible activities because the original concept of a credit union arguably needed to evolve with the marketplace. According to the NCUA,

> When Congress amended the FCU Act in 1977 to add an extensive array of savings, lending and investment powers, it intended to "allow credit unions to continue to attract and retain the savings of their members by providing essential and contemporary services," and acknowledged that credit unions are entitled to "updated and more flexible authority granting them the opportunity to better serve their members in a highly-competitive and ever-changing financial environment." H.R. Rep. 95–23 at 7 (1977), *reprinted in* 1977 U.S.C.C.A.N. 105, 110. Congress acknowledged the difficulty in "regulating contemporary financial institutions within the framework of an Act that has on a continuing basis required major updating by means of regulation."[9]

Although small memberships may be more advantageous for informal microlending systems, advanced intermediation systems—such as banking and the modern credit union industry—benefit from *economies of scale*. In other words, more assets (loans), greater access to deposits, and increased transactions volumes provide greater risk diversification and lower average cost per transaction, thus reducing vulnerability to financial disruptions that would be confined to a particular small group.[10]

On April 19, 1977, P.L. 95-22 (the Mini Bill of 1977) substantially amended the FCU Act. It authorized the credit union industry to provide many financial products (e.g., loans, checking and

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[5] See Thorsten Beck, *Microfinance: A Critical Literature Survey*, Independent Evaluation Group, IEG Working Paper 2015/No. 4, 2015, at https://openknowledge.worldbank.org/bitstream/handle/10986/23546/Microfinance000al0literature0survey.pdf.

[6] For centuries, (rural) cooperative microfinance systems—particularly during their initial stages—typically relied on peer monitoring to encourage loan repayment and maintain operational self-sufficiency. For more information, see Timothy Besley and Stephen Coate, "Group Lending, Repayment Incentives, and Social Collateral," *Journal of Development Economics*, vol. 46, no. 1 (February 1995), pp. 1-18; and Prabal Roy Chowdhury, "Group Lending: Sequential Financing, Lender Monitoring and Joint Liability," *Journal of Development Economics*, vol. 77, no. 2 (August 2005), pp. 415-439.

[7] William R. Emmons and Frank A. Schmid, "Credit Unions Make Friends—But Not with Bankers," Federal Reserve Bank of St. Louis, *The Regional Economist*, St. Louis, MO, October 2003, at http://www.stlouisfed.org/publications/re/articles/?id=406.

[8] See NCUA, "NCUA: The Federal Credit Union Act," revised April 2013, at http://www.ncua.gov/Legal/Documents/fcu_act.pdf.

[9] See NCUA, "Federal Credit Union Incidental Powers Activities," 66 *Federal Register* 40845-40859, August 6, 2011.

[10] See James A. Wilcox, *Economies of Scale and Continuing Consolidation of Credit Unions*, Federal Reserve Bank of San Francisco, November 4, 2005, at https://www.frbsf.org/economic-research/publications/economic-letter/2005/november/economies-of-scale-and-continuing-consolidation-of-credit-unions/#subhead2.

savings deposit services) similar to those offered by the commercial banking system.[11] Today, modern credit unions primarily engage in consumer and residential lending, and some originate commercial business loans for members. The lending and investment powers of the credit union industry, however, are still more restrictive than those of commercial banks.

- Credit unions can make loans only to their members, other credit unions, and credit union organizations, thus limiting who they can serve.
- A statutory interest rate cap for credit union loans exists (with exceptions that allow for sufficient earnings necessary to maintain credit availability).
- Loans made by federally insured credit unions are generally limited to 15 years (except for residential mortgages).
- Federal credit unions' investment authority is limited by statute to loans, government securities, deposits in other financial institutions, and certain other limited investments given their origins to promote thrift rather than be long-term investors.[12]
- Business lending restrictions include an aggregate limit on an individual credit union's member business loan balances and on the amount that can be loaned to one member.

If some or all of these restrictions are relaxed to allow the credit union system's lending powers to expand and become more comparable to the banking system, the prudential regulatory regimes arguably may require greater harmonization to protect against comparable financial risk exposures.[13]

This report focuses on policy developments pertaining to the credit union system. It begins with an overview of recent efforts to further expand system lending capacities. Next, it describes how the system's exposure to mortgage credit (default) risk grew after credit unions were given greater intermediation authorities in the mortgage lending space. It then discusses the system's financial distress and recovery resulting from the 2008 financial crisis, and updates the progress made to improve the system's resiliency to credit and insolvency risks. This discussion will use the balance sheet terminology defined in the box below.

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[11] See Alane K. Moysich, "An Overview of the U.S. Credit Union Industry," *FDIC Banking Review*, vol. 3, no. 1 (Fall 1990), pp. 12-25, at https://www.fdic.gov/bank/analytical/banking/br1990vol3no1full.pdf.

[12] See Stephen F. Ambrose, Jr., "The Legality of Credit Union Share Draft Accounts Under Federal Law," *Fordham Law Review*, vol. 46, no. 6 (1978).

[13] See CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by Darryl E. Getter.

Credit Union Balance Sheet Terminology

Credit union assets include consumer (e.g., automobile, credit card, installment) and mortgage loans, cash, and other financial securities that are held in their portfolios. Commercial member business loans are also assets for credit unions (discussed in more detail below). Assets generate earnings (revenues) or losses, depending upon whether share deposit members repay or default on their loans. The maturities of loans made by credit unions are generally restricted to 15 years or less with the exception of primary mortgages and other designated loans.

Credit union liabilities include the funds that they borrow (for shorter periods of time). For example, when customers (share depositors) make savings or checking share deposits into a credit union, the credit union essentially borrows those funds short-term to lend them out for longer periods of time. Liabilities are, therefore, the costs incurred by the credit unions to obtain the funds necessary to originate loans to members.

Credit union net worth is the difference between assets and liabilities, which is analogous to bank capital. Net worth consists of retained earnings, or the allotment of profits not paid to members in the form of dividends. Given that the share deposits are federally insured, credit unions are required to maintain sufficient net worth to absorb their shareholders' loan defaults. Compliance with regulatory capital requirements broadly requires asset (lending) portfolios to grow only if net worth grows proportionately. If sufficient net worth is maintained to absorb the losses, then loan defaults by borrowers are less likely to result in failure of a credit union to repay its shorter-term obligations. If, however, a credit union's net worth falls below minimum regulatory threshold levels, it would be considered undercapitalized and faces the prospect of the NCUA shutting it down. The NCUA also serves as the receiver of the insolvent institution.

Expanding Permissible Lending Activities

Congress has passed legislation, and the NCUA has implemented and proposed rules, supporting the expansion of lending activities that would increase financial transactions volumes (economies of scale). The expansion of lending activities, as discussed in this section, is likely to generate greater cash flows and revenues for the credit union system.

Field of Membership and Common Bonds

A credit union's "field of membership" is the legal definition of who is eligible to join. Federal or state governments grant credit union charters on the basis of a "common bond." There are three types of charters: a (1) single common bond (occupation or association based); (2) multiple common bond (more than one group each having a common bond of occupation or association); and (3) community-based (geographically defined) common bond. Individual credit unions are owned by their memberships.[14] Credit union members elect a board of directors from their institution's membership (one member, one vote).[15] Credit unions can make loans only to their members, other credit unions, and credit union organizations.

Field of membership restrictions may limit an intermediary's ability to collect deposits, which are used to fund loans. Common bond requirements on credit unions can be considered analogous to U.S. restrictions on interstate and branch banking, which are no longer in place.[16] By limiting

[14] A credit union that is established with an occupational or associational charter usually consists of individuals that share an affiliation (e.g., employer). A credit union that is established with a multiple common bond charter may consist of individuals with different affiliations, but merging into a single cooperative is likely to improve the financial soundness of the depository institution. A credit union that is established with a geographical charter is likely to consist of members, for example, that reside in a single state.

[15] Credit union board member positions are voluntary and unpaid; the board of directors may appoint a president or chief operating officer, who is paid and reports directly to the board.

[16] See David L. Mengle, *The Case for Interstate Branch Banking*, Federal Reserve Bank of Richmond, Economic Review, November/December 1990, at https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_review/1990/pdf/er760601.pdf.

access to supplementary sources of funds, a credit union (or bank) becomes more vulnerable to cash flow disruptions (e.g., increases in loan defaults, substantial deposit withdrawals) following adverse events—particularly those that would directly affect its field of membership. Despite field of membership restrictions, some of the larger credit unions may still be able to achieve a sufficiently large and diversified depositor base, allowing them to enjoy greater economies of scale. Nevertheless, all intermediaries of all sizes are still vulnerable to a sudden need for liquid funds following some unexpected or adverse interest rate movements or a national recession, discussed in the section entitled "Increased Exposure to Mortgage Credit Risk and Recent NCUSIF Management Initiatives." For this reason, access to more sources of depositors arguably enhances liquidity management for credit unions and banks, which typically have assets (portfolio loans) that are less liquid than their liabilities (deposits).

On December 7, 2016, the NCUA published a final rule comprehensively amending its chartering and field of membership rules to maximize access to federal credit union services to the extent permitted by law.[17] Although NCUA cannot change the three initial statutory field of membership categories, it revised certain terms such as *local community*, *rural district*, *underserved area*, and *multiple common-bond credit union*, among other things to broaden access to federal credit unions.[18] Competitors of credit unions, however, legally challenged the revisions, arguing that an associational charter may limit the ability of a credit union to add underserved areas (e.g., local urban or rural underserved areas as determined by the NCUA) to its field of membership unless it also has a multiple common-bond charter.[19]

On August 20, 2019, the D.C. Circuit Court of Appeals upheld the rule but remanded two provisions of the NCUA's revised field of membership rule.[20] One provision, to satisfy a community-based common bond charter, would have allowed a combined statistical area with fewer than 2.5 million people to qualify as a local community; arguably, this provision could have had a discriminatory impact on poor and minority urban residents. The second remanded provision would have raised the population limit for rural districts from the greater of 250,000 or 3% of the relevant state's population to 1 million people; some geographical areas arguably could have been defined to extend beyond the state borders of a credit union's headquarters. The NCUA proposed to clarify its authority to reject fields of membership applications that would want to exclude low- or moderate-income individuals.[21] On November, 7, 2019, the NCUA proposed to re-adopt the provision pertaining to the combined statistical area to clarify existing requirements and add an explicit provision to the rule to address potential discriminatory concerns.[22]

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[17] See NCUA, "Chartering and Field of Membership Manual," 81 *Federal Register* 88412-88523, December 7, 2016.

[18] By contrast, banks may define and update their *assessment areas*, the areas where they collect deposits and are subsequently evaluated on their reciprocal statutory obligations to meet credit needs—particularly the needs of their low- and moderate-income patrons. For more information, see CRS Report, *The Effectiveness of the Community Reinvestment Act*, by Darryl E. Getter.

[19] See 12 U.S.C. §1759(c)(2).

[20] See *American Bankers Association, Appellee v. National Credit Union Administration*, No. 18-5154 (United States Court of Appeals for the District of Columbia Circuit 2019), at https://www.cadc.uscourts.gov/internet/opinions.nsf/EB59CD243BABE1BD8525845C0050E450/$file/18-5154.pdf.

[21] See NCUA, "NCUA Board Member Todd M. Harper Statement on the Proposed Community Field of Membership Rule," press release, October 24, 2019, at https://www.ncua.gov/newsroom/speech/2019/ncua-board-member-todd-m-harper-statement-proposed-community-field-membership-rule.

[22] See NCUA, "Chartering and Field of Membership," 84 *Federal Register* 59989-60001, November 7, 2019.

Member Business and Commercial Lending

Lending caps on member business (commercial) loans offered by credit unions did not exist until 1998. Congress included provisions in the Credit Union Membership Access Act of 1998 (CUMAA; P.L. 105-219) that established a commercial lending cap that limits most credit unions to lending no more than 12.25% of their assets to small businesses, among other provisions.[23] The following passages from the Senate's CUMAA report explain the rationale for establishing the member business loan (MBL) cap.[24]

- "The purpose of H.R. 1151, the CUMAA, as reported from the Committee, is to amend existing law with regard to the field of membership of federal credit unions, to preserve the integrity and purpose of federal credit unions and to enhance supervisory oversight of federally insured credit unions.... The bill significantly strengthens the prudential safeguards applicable to federally insured credit unions and makes the credit union system safer, sounder and more resilient."
- "*Section 203. Limitation on member business loans.* In new section 107A(a), the Committee has imposed substantial new restrictions on commercial business lending by insured credit unions. Those restrictions are intended to ensure that credit unions continue to fulfill their specified mission of meeting the credit and savings needs of consumers, especially persons of modest means, through an emphasis on consumer rather than business loans. The Committee action will prevent significant amounts of credit union resources from being allocated in the future to large commercial loans that may present additional safety and soundness concerns for credit unions, and that could potentially increase the risk of taxpayer losses through the National Credit Union Share Insurance Fund ('Fund')."

The CUMAA contained the following provisions:

- The *MBL* definition was codified and defined as "any loan, line of credit, or letter of credit, the proceeds of which will be used for a commercial, corporate or other business investment property or venture, or agricultural purpose," but it does not include an extension of credit that is fully secured by a lien on a one-to-four-family dwelling that is a member's primary residence.[25]
- The aggregate amount of MBLs that can be made by an individual credit union was limited to the lesser of 1.75 times the credit union's actual net worth or 1.75 times the minimum net worth amount required to be well-capitalized under the prompt corrective action supervisory framework, typically calculated to be 12.25%.[26]

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[23] For a discussion of the Supreme Court decision and congressional response to it that resulted in P.L. 105-219, see *National Credit Union Administration, Petitioner, v. First National Bank & Trust Co., et al.; AT&T Family Federal Credit Union, et al., Petitioners, v. First National Bank and Trust Co., et al.*, 118 S. Ct. 927 96-843, 96-847 (1998). See also William R. Emmons and Frank A. Schmid, "Credit Unions and the Common Bond," *Federal Reserve Bank of St. Louis Review*, September/October 1999, at http://research.stlouisfed.org/publications/review/99/09/9909we.pdf.

[24] See U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Credit Union Membership Access Act*, Report 105-193 to accompany H.R. 1151, 105th Cong., 2nd sess., May 21, 1988, pp. 1-25, at https://www.congress.gov/105/crpt/srpt193/CRPT-105srpt193.pdf.

[25] 12 U.S.C. §1757a(c)(1).

[26] At the time of the Credit Union Membership Access Act of 1998 (CUMAA), some Members of Congress were

- Three exceptions to the aggregate MBL limit were authorized for credit unions (1) that have low-income designations or participate in the Community Development Financial Institutions program;[27] (2) chartered for the purpose of making business loans (as determined by the NCUA); and (3) with a history of primarily making such loans (as determined by the NCUA).

In addition to the statute, a NCUA regulation limits the aggregate amount of a business loan that can be made to one member or group of associated members at 15% of the credit union's net worth or $100,000, whichever is greater.[28]

MBL Definition and Requirement Updates

On March 14, 2016, the NCUA implemented final MBL rules to replace the prescriptive requirements (and limitations) with a broad principles-based regulatory approach, which became effective on January 1, 2017.[29] The prescriptive approach, for example, required credit unions to request MBL origination waivers for NCUA approval, among other requirements. According to the NCUA, the prescriptive approach took significant time and resources from both credit unions and NCUA, resulting in delays in processing MBL applications.[30] The principles approach, by contrast, streamlines the MBL underwriting process by granting credit unions more flexibility and individual autonomy to best fit their members' needs. Credit unions are still expected to comply with prudential underwriting practices and commensurate net worth requirements.

To facilitate the streamlined underwriting approach, the NCUA updated various MBL exemptions, resulting in several new definitions. For example, a *commercial loan* is a business loan (1) that is fully guaranteed by a federal or state agency or provides an advance commitment to purchase in full or (2) made to a nonmember or part of a joint lending arrangement with an entity that is not a member of the credit union system.[31] Commercial loans do not count toward the MBL cap.[32]

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concerned that commercial lending, which is considered riskier than consumer lending, would increase the risk profile of the credit union system. In deliberations over the CUMAA, Members expressed concern that a cap calculated as 12.25% (1.75 multiplied by the 7% statutory requirement to be well-capitalized) of a credit union's total assets was too high if small loans (under $50,000) were not counted toward the cap, and they were also concerned that such an exemption could open up a regulatory arbitrage opportunity enabling chartered credit unions to assume more financial risk and circumvent the cap limitation in the legislation. Nevertheless, the 12.25% arguably represented a compromise between having no cap, which was the case prior to enactment of CUMAA, and allowing loans under $50,000 not to be counted toward the cap. See additional discussions in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Credit Union Membership Access Act*, report to accompany H.R. 1151, 105th Cong., 2nd sess., May 21, 1998, S.Rept. 105-193.

[27] A designated Community Development Financial Institution (CDFI) works in financial market niches that are underserved by traditional financial institutions. For more information, see the CDFI website at http://www.cdfifund.gov/what_we_do/programs_id.asp?programid=9.

[28] See 12 C.F.R. §723.4—Commercial Loan Policy, at https://www.law.cornell.edu/cfr/text/12/723.4.

[29] See NCUA, "Member Business Loans; Commercial Lending," 81 *Federal Register*, 13530-13559, March 14, 2016.

[30] In 2016, NCUA reported having over 1,000 active requests while processing 336 and 225 waivers in 2014 and 2015, respectively. See NCUA, "Member Business Loans; Commercial Lending," 81 *Federal Register*, March 14, 2016.

[31] See NCUA, "Summary of Key Changes to NCUA's Member Business Loan Final Rule: Table 2—Comparison of Member Business Loans and Commercial Loan Definitions," at https://www.ncua.gov/files/agenda-items/AG20160218Item2c.pdf.

[32] A *participation loan* is a joint lending arrangement among multiple depository institutions, discussed in more detail in the section entitled "Policy Options Related to Increasing the MBL Cap."

On May 24, 2018, Section 105 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA; P.L. 115-174) amended the statutory MBL definition (i.e., it removed the words ‘‘that is the primary residence of a member’’) to address a disparity in the treatment of certain residential real estate loans made by credit unions and banks.[33] The NCUA has since revised the MBL definition to exclude all extensions of credit that are fully secured by a lien on a one-to-four-family dwelling regardless of the borrower’s occupancy status.[34] For this reason, *non-owner* occupied real estate (e.g., rental property) loans are no longer considered MBLs and do not count toward the aggregate MBL cap.

In addition to amending the MBL definition, EGRRCPA Section 103 amended the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA; P.L. 101-73) to exempt from appraisal requirements certain federally related,[35] rural real estate transactions valued at or below $400,000 if no state-certified or state-licensed appraiser is available. The NCUA implemented this provision in a July 2019 final rule.[36] Depository institution lending typically requires appraised collateral as backing for the loans. The rise in home prices (since the $250,000 appraisal threshold was set in 1994) along with the innovation of less expensive automated appraisal valuations arguably has reduced the need for manual appraisals on less expensive homes, thereby lowering borrowers’ closing costs.[37] The NCUA also increased the appraisal threshold to $1 million for commercial real estate and qualified MBLs.[38] The $1 million commercial appraisal threshold is higher than the current $500,000 for banks.[39] The NCUA board, however, did not unanimously agree on the $1 million commercial appraisal threshold

[33] See U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Hearing on the Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act*, 116th Cong., 1st sess., October 2018, at https://www.ncua.gov/files/press-releases-news/testimony-written-chairman-mcwatters-implementation-economic-growth.pdf.

[34] See NCUA, “Commercial Lending,” 83 *Federal Register* 25881-25882, June 5, 2018, at https://www.govinfo.gov/content/pkg/FR-2018-06-05/pdf/2018-11946.pdf.

[35] 12 U.S.C. §3350(4). A *federally related transaction* is a real estate-related financial transaction that a federal-prudential-regulated financial institution engages in or contracts for, for which the agencies require a FIRREA Title XI appraisal. See OCC, Treasury; Federal Reserve System; FDIC, “Real Estate Appraisals,” 83 *Federal Register* 63110, December 7, 2018.

[36] See NCUA, “Real Estate Appraisals,” 84 *Federal Register* 35525-35538, July 24, 2019. In comparison, the final rule for banks increases the threshold level at or below $400,000 at which appraisals are not required for all residential real estate transactions secured by 1-to-4 family residential property. See Office of the Comptroller of the Currency (OCC), Treasury, Board of Governors of the Federal Reserve System (the Federal Reserve), and the Federal Deposit Insurance Corporation (FDIC), “Real Estate Appraisals,” 84 *Federal Register* 53579-53597, October 8, 2019. Banks must still obtain appraisals for exempt residential transactions, but they are not required to use licensed or certified appraisers. Under EGRRCPA, rural residential properties, which banking regulators had previously exempted from appraisal requirements, must now obtain appraisals. See FDIC, “New Appraisal Threshold for Residential Real Estate Loans,” *Financial Institutions Letter*, FIL-53-2019, September 27, 2019, at https://www.fdic.gov/news/news/financial/2019/fil19053.pdf.

[37] For more information on developments that have reduced appraisal costs and appraiser shortages, see Comment Letter from Pete Mills, senior vice president Residential Policy & Member Engagement Mortgage Bankers Association, *Real Estate Appraisals [RIN: 1557-AE57; 3064-AE87; 7100-AF30]*, OCC, FDIC, the Federal Reserve, February 5, 2019; and Mortgage Bankers Association, *The State of Automated Valuation Models in the Age of Big Data*, January 2019. For more on the use of collateral to secure loans, see U.S. Treasury, OCC, *OCC Comptroller’s Handbook*, section on “Asset-Based Lending,” January 27, 2017, at https://www.occ.treas.gov/publications/publications-by-type/comptrollers-handbook/asset-based-lending/pub-ch-asset-based-lending.pdf; and CRS Report R45878, *Small Business Credit Markets and Selected Policy Issues*, by Darryl E. Getter.

[38] See NCUA, “Real Estate Appraisals,” 83 *Federal Register* 49857-49869, October 3, 2018.

[39] See OCC, Treasury, the Federal Reserve, and FDIC, “Real Estate Appraisals,” 83 *Federal Register* 15019-15036, April 9, 2018.

because, despite the system's low exposure to commercial real estate risks, the banking system still has more expertise evaluating and managing commercial lending risks than does the credit union system.[40]

Policy Options Related to an MBL Cap Increase

The credit union industry has generally supported efforts to increase or eliminate the MBL cap.[41] At the end of 2018, the NCUA reported that the credit union system originated 4.7% in MBLs relative to its assets.[42] If MBL capacity were increased, some larger credit unions could become more competitive with small community banks as well as with some midsize and regional banks.[43] Credit unions that currently enjoy a presence in the commercial lending market, have a sufficiently large asset base, or already operating close to the existing statutory limit would be more likely to increase their presence in the commercial market if the cap were raised.

In addition, the credit union *system* as a whole can support increased member business lending by increasing its use of *participation loans*. Financial institutions use loan participations to provide credit jointly. The loan originator, that often structures the loan participation arrangement, typically retains the largest share of the loan and sells smaller portions to other institutions.[44] This practice allows the originator to maintain control of the customer relationship (including the loan servicing) and overcome funding limitations. In addition, all of the institutions involved in the participation loan use their individual portions of the loan to diversify their asset (loan) portfolios, which can be a cost-effective financial risk management tool. The credit union system could, therefore, become a more prominent competitor in the commercial lending market with the banking system, which also uses participation lending arrangements to diversify risks. Nevertheless, because all lending entails exposure to financial risks, having multiple credit unions involved in participations would still pose risk to the NCUSIF.[45]

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[40] See NCUA, "NCUA Board Member Todd M. Harper Statement on the Final Rule—Real Estate Appraisals," press release, July 2019, at https://www.ncua.gov/newsroom/speech/2019/ncua-board-member-todd-m-harper-statement-final-rule-real-estate-appraisals.

[41] See National Association of Federally-Insured Credit Unions, "Member Business Lending," at https://www.nafcu.org/mbl; and Credit Union National Association, "Member Business Lending," at https://www.cuna.org/Advocacy/Priorities/Member-Business-Lending/.

[42] See NCUA, *2018 Annual Report*, at https://www.ncua.gov/files/annual-reports/annual-report-2018.pdf. According to NCUA, by the end of September 2015, 36% of credit unions offered MBLs, up from 19% at the end of 2004. See NCUA, "Member Business Loans; Commercial Lending," 81 *Federal Register*, March 14, 2016. In 2013, approximately 85% of MBLs were secured by real estate, with some credit unions heavily concentrated in agricultural loans. See NCUA, "Overall Trends," December 31, 2013, at http://www.ncua.gov/legal/documents/reports/ft20131231.pdf.

[43] Smaller credit unions—with assets under $10 million—would be unlikely to substantially increase their presence in the commercial lending market because it would not be cost effective for them to invest in the necessary underwriting systems given the low volume of commercial lending that they would feasibly be able to do. MBLs are perhaps the most complex lending activity for credit unions and would require significant resources that many smaller credit unions would find cost prohibitive. (For example, church or faith-based organizations that are open for very limited hours during the week, with an all-volunteer management and staff, are likely to fall into this small asset-size category.) See the testimony of the Honorable Debbie Matz, chairman of the NCUA in U.S. Congress, House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit, *H.R. 1418: The Small Business Lending Enhancement Act of 2011*, 112th Cong., 1st sess., October 12, 2011, pp. 11-12, at http://financialservices.house.gov/UploadedFiles/101211matz.pdf.

[44] Although credit unions often enter into participations together (and banks often enter into participations together), loan originators can sell loan portions to any financial entity. This activity should not be confused with a securitization because the loan portions are sold directly to specific entities rather than restructured into new public offerings.

[45] Since 2007, the number of credit unions purchasing loan participations increased 15%, and the dollar value of loan

From an economics perspective, a lending cap imposes an arbitrary limit that may be too high for some credit unions and too low for others, thus resulting in MBL shortages in the latter situations. For those credit unions that provide very few or no MBLs, a cap is irrelevant. Credit unions facing an active MBL market must abruptly cease this type of lending when activity volume reaches the cap, which some may argue is set "too low," given that they can no longer satisfy their memberships' financial needs. Hence, a lending cap is arguably a blunt instrument to the extent that it imposes the same requirement on all institutions without taking into account differences in asset size and market purview.

Alternatively, a policy tool with a greater focus on the costs to originate MBLs—specifically subjecting the net income derived from MBL activities to a type of tax—would impose financial costs on credit unions without directly capping their lending ability.[46] For example, the unrelated business income tax (UBIT) for tax-exempt organizations could be applied to MBLs.[47] At the entity level, credit unions are exempt from federal income tax because they are not-for-profit financial cooperatives. If, for example, a credit union were to provide financial services (e.g., check-cashing) to nonmembers, any revenue generated from those activities would be subject to UBIT. Likewise, implementing the UBIT for MBLs would allow costs to grow in proportion to the amount of MBL activity while minimizing an abrupt discontinuation of the activity for those credit unions nearing an established policy cap.

Another policy option, also with similarities to a tax, would be to adopt capitalization requirements comparable to those implemented for the banking system. The CUMAA established the MBL cap and a capital-based supervisory framework as tools to enhance prudential safety and soundness, ultimately providing more protection for the share deposit insurance fund. Enhanced capitalization (net worth) requirements arguably could substitute for an MBL cap.[48] In short, policy tools operating via cost disincentives rather than quantity restrictions may still allow the credit union system to restrain MBL activity but with more flexibility for certain circumstances.

Greater Flexibility in Lending Terms

As previously discussed, the credit union system has evolved to a formal intermediation system that provides a range of financial services; however, it still has not acquired all of the lending powers comparable to those of banks. In addition, some of the system's current lending authorities are temporary and must be regularly renewed. This section reviews some of the

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participations on credit unions' balance sheets grew by more than 40%. The NCUA also reported that participation loan charge-offs increased by more than 160% during the same period that credit unions increased their participation loan purchases. The NCUA has since provided more participation loan rules to mitigate risks to the NCUSIF while still attempting to maintain the viability of this diversification tool for individual credit unions. See "NCUA Board Approves New Rule for Loan Participations," *Board Action Bulletin*, June 20, 2013, at http://www.ncua.gov/about/Documents/Agenda%20Items/BAB20130620.pdf.

[46] Using market-based incentives to affect MBL costs and, thus, determining the optimal distribution is analogous to the use of environmental (e.g., carbon) taxes to manage pollution emissions. For example, see Valerie Reppelin-Hill, *Taxes and Tradable Permits as Instruments for Controlling Pollution: Theory and Practice*, International Monetary Fund, WP/00/13, Washington, DC, January 2000, at http://www.imf.org/external/pubs/ft/wp/2000/wp0013.pdf.

[47] See "Statement for the Record on behalf of the American Bankers Association before the Oversight Subcommittee of the Committee on Ways and Means, United States House of Representatives, July 25, 2012," at http://www.aba.com/Advocacy/Testimonies/Documents/72512StatementUBITCU.pdf.

[48] The Community Bank Leverage Ratio framework is briefly discussed in the section entitled, "The Risk-Based Capital Rule." For more information, see FDIC, "Community Bank Leverage Ratio Framework," *FIL-66-2019*, November 4, 2019, at https://www.fdic.gov/news/news/financial/2019/fil19066.html.

temporary or limited lending authorities that the credit union industry and some policymakers argue could be enhanced.

Interest Rate Ceilings and Temporary Exemptions

The FCU Act sets an annual 12% interest rate ceiling (or cap) for loans made by federally chartered credit unions and federally insured state-chartered credit unions. The statutory loan interest rate ceiling was raised to 15% per annum after the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA; P.L. 96-221) was passed. The DIDMCA also authorized the NCUA to set a ceiling above the 15% cap for up to an 18-month period after consulting with Congress, the U.S. Department of the Treasury, and other federal financial agencies.[49]

The credit union interest rate ceiling is currently set at 18%. According to NCUA notices, its interest rate ceiling is an annual percentage rate (APR) rather than a pure interest rate.[50] The APR represents the *total* annual borrowing costs of a loan expressed as a percentage, meaning that it is calculated using *both* interest rates and origination fees.[51] The text-box below explains more about how to calculate and interpret the APR.

[49] See "Attachment 1. Supplemental Information and Interest Rate Statistics," NCUA, at https://www.ncua.gov/files/press-releases-news/AG20170223Item2b.pdf.

[50] See NCUA, *Permissible Interest Rate Ceiling*, letter no. 11-FCU-04, April 2011, at https://www.ncua.gov/files/letters-federal-credit-unions/LFCU2011-04.pdf.

[51] See Board of Governors of the Federal Reserve System, "Determination of Finance Charge and Annual Percentage Rate ('APR')," *Regulation Z: Truth in Lending*, at http://www.federalreserve.gov/boarddocs/caletters/2008/0805/08-05_attachment1.pdf.

APR Computation and Interpretation

The annual percentage rate (APR), representing the total annual borrowing costs of a loan expressed as a percentage, is calculated using both interest rates and origination fees.[52] A general formula to calculate the APR is

APR = [(INTFEES)/(LNAMT)]*(365/DAYSOUT)*100, where

INTFEES = Total interest and fees the borrower pays;

LNAMT = Loan amount or total borrowings; and

DAYSOUT = Number of days that the loan is outstanding (term length).

The formula shows that the APR rises with increases in interest and fees (INTFEES) paid by the borrower. Furthermore, the APR is inversely related to (1) the loan amount (LNAMT) and (2) the length of time the loan will be outstanding (DAYSOUT). If interest and fees are held constant, a loan expected to be repaid in 30 days or less (in a single balloon payment) would have a higher APR than a larger loan, in which the repayment of principal and total charges occur over a longer period of time in multiple installment payments. Thus, the interpretation of the APR for loans originated for less than 365 days has been debated.[53] An APR based on a term length of *one year* or greater accurately reflects the *annual* cost of credit. By contrast, the APR for a loan that is expected to be repaid in *less than 365 days*, is likely to be large. (For example, payday loans with term lengths of 30 days or less are likely to have triple digit APRs because the interest and fees would be due very shortly after origination.)

For this reason, APR comparisons are more useful when the loans' maturity lengths are identical.[54] APR comparisons of loans with different maturities, such as APR comparisons of a 30-day payday loan to a 365-day maturity loan, would be misleading. Although the longer-term loan's APR will mathematically be lower, the borrower's interest and fees may actually be higher. Hence, when maturity lengths differ, APR comparisons are more likely to capture differences in loan amounts or maturities instead of capturing solely the differences in borrowing costs.

In December 1980, the NCUA board raised the ceiling to 21%. In May 1987, the board reduced the rate ceiling and has since maintained it at 18%.[55] When setting the interest rate above 15%, the NCUA must (1) review money market interest rate trends and (2) assess how prevailing interest rate movements (volatility) might threaten credit unions' safety and soundness in terms of the ability to sustain their lending activities, the effect on their *net-interest income* (earnings), and the effect on their liquidity.[56] In July 2018, for example, the board expressed concern that a ceiling below 18% could result in lower net interest income, considered to be the key driver of credit union earnings, thus reducing credit union profitability and limiting borrowers' access to credit.[57] On January 23, 2020, the board retained the current 18% rate ceiling for federally insured

[52] See Board of Governors of the Federal Reserve System, "Determination of Finance Charge and Annual Percentage Rate ('APR')," in *Regulation Z: Truth in Lending*, at http://www.federalreserve.gov/boarddocs/caletters/2008/0805/08-05_attachment1.pdf.

[53] See Randy Mitchelson, "Why APR Can Be Misleading," *Daily Dollar*, October 1, 2009, at http://dailydollarnewsletter.com/2009/10/01/why-apr-can-be-misleading/.

[54] See Robert DeYoung et al., *Reframing the Debate About Payday Lending*, Federal Reserve Bank of New York, Liberty Street Economics, October 19, 2015, at https://libertystreeteconomics.newyorkfed.org/2015/10/reframing-the-debate-about-payday-lending.html; and American Financial Services Association Education Foundation, *Personal Loans 101: Understanding APR*, at http://afsaef.org/Portals/0/Resources/Understanding_APR1.pdf.

[55] See "Attachment 1. Supplemental Information and Interest Rate Statistics," NCUA, at https://www.ncua.gov/files/press-releases-news/AG20170223Item2b.pdf.

[56] Net interest income is the difference between interest received from assets (e.g., the rates charged borrowers for loans) and interest paid on liabilities (i.e., what the financial institution must pay to acquire the funds to be lent). The NCUA has computed average term spreads (differences) by observing movements of the yield curve over the 1982 to 2007 period, finding it to be approximately 168 basis points (1.68%). See "Attachment 1. Supplemental Information and Interest Rate Statistics," NCUA, at https://www.ncua.gov/files/press-releases-news/AG20170223Item2b.pdf.

[57] See Letter from Larry Fazio—Director, Office of Examination and Insurance, NCUA Board, July 18, 2018, at https://www.ncua.gov/files/agenda-items/AG20180802Item2a.pdf; and U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Hearing on the Implementation of the Economic Growth, Regulatory Relief, and Consumer Protection Act*, 116th Cong., 1st sess., October 2, 2018, at https://www.ncua.gov/files/press-releases-news/

credit union loans, from March 11, 2020, through September 10, 2021, after (1) observing rising money market rates over the preceding six-month period; (2) observing adverse liquidity, capital, earnings, and growth trends; and (3) consulting with the relevant federal agencies.[58]

The Military Lending Act of 2006 (MLA; P.L. 109-364) was passed to protect active duty military personnel and their eligible family members from predatory lending.[59] The MLA limits the Military Annual Percentage Rate (MAPR) to 36% for small-dollar loans and credit products, such as credit cards, deposit advances, overdraft lines of credits, and certain types of installment loans.[60] The MLA, however, does not apply to mortgages, automobile loans, and secured loans. A credit union borrower typically receives an APR below the MAPR ceiling for covered transactions. Hence, the credit union interest rate ceiling is currently below the federal MLA cap on consumer loans offered to military personnel.

The NCUA, however, permits the credit union system to make payday alternative loans (PALs) to its membership with certain restrictions.[61] Under the existing permissible framework, PAL amounts may range from $200 to $1,000; they must have fully amortizing payments; the term length must range from 46 days to 180 days; and the application fee must be $20 or less.[62] If the borrower cannot repay the initial PAL, a credit union may allow for a rollover into a new PAL of the same initial maturity as long as no additional fees are charged or no additional credit is extended. No more than three PALs can be made to a single borrower in a rolling six-month period. This specific loan product, referred to as a PALs I, requires a one-month membership before it can be offered.

The PALs program has a 28% ceiling, meaning that it is exempt from the 18% interest rate ceiling that covers other loan originations made by federally insured credit unions and from the 36% MAPR ceiling.[63] The MAPR ceiling includes the origination fees, but the NCUA PALs ceiling excludes the $20 origination fee. The PAL loan APR when including the $20 origination fee, in many cases, exceeds the 36% MAPR ceiling.[64] To avoid lending reductions by credit unions to military service customers, the NCUA requested and was granted a PAL exemption from the

testimony-written-chairman-mcwatters-implementation-economic-growth.pdf.

[58] See NCUA "Continuation of Federal Credit Union Loan Interest Rate Ceiling," at https://www.ncua.gov/files/agenda-items/AG20200123Item5a.pdf.

[59] See Military One Source, "Expanded Credit Protections for Service members and Their Families," at https://www.militaryonesource.mil/financial-legal/personal-finance/borrowing/expanded-credit-protections-for-service-members-and-their-families.

[60] See FDIC, *Chapter 5-13.1. Lending—Military Lending Act*, Consumer Compliance Examination Manual, 2016, at https://www.fdic.gov/regulations/compliance/manual/5/v-13.1.pdf. For more background on the MLA implementation, see CRS Report R44868, *Short-Term, Small-Dollar Lending: Policy Issues and Implications*, by Darryl E. Getter.

[61] The effect of small-dollar lending, particularly whether borrowers' financial situations would be made worse off by using expensive credit or having limited access to credit, is widely debated. See CRS Report R44868, *Short-Term, Small-Dollar Lending: Policy Issues and Implications*, by Darryl E. Getter.

[62] See NCUA, "Short-Term, Small Amount Loans," 75 *Federal Register* 58285-58290, September 24, 2010.

[63] Because payday alternative loans (PALs) typically have longer maturities than a payday loan (typically a two-week loan), PALs have lower APRs.

[64] For more information, see NCUA, *Complying with Recent Changes to the Military Lending Act Regulation*, April 2016, pp. 7-8, at https://www.ncua.gov/files/regulatory-alerts/RA2016-04-Enclosure-Complying-with-Changes-Military-Lending.pdf. The APR is inversely related to (1) the length of time the loan will be outstanding and (2) the loan amount. For this reason, short-term, small-dollar loans (e.g., often for less than one year and with low initial principal amounts—often less than $1,000) generally have higher APRs than relatively longer-term large loans. For more information about calculating APRs, see previous textbox, "APR Computation and Interpretation" and the Appendix of CRS Report R44868, *Short-Term, Small-Dollar Lending: Policy Issues and Implications*, by Darryl E. Getter.

MAPR so that the PAL application fee is not included in the APR computation.[65] The higher PAL ceiling also does not include an initial origination fee of up to $20 in the APR calculation.

On October 1, 2019, the NCUA broadened the PALs framework to allow credit unions to offer additional short-term, small-dollar products.[66] A new PALs II product may have an amount up to $2000 and have fully amortizing payments over a 1-to-12-month term. Furthermore, there is no minimum membership length requirement to be eligible for a PALs II, which may allow borrowers to quickly consolidate multiple non-credit union payday loans into one PALs loan. Credit unions may not charge any overdraft or insufficient funds fees for any PALs II drawn against a member's account, which may reduce the likelihood of creating a negative balance in the account while still allowing credit unions to make sufficient (as opposed to maximum) profit in this line of business.

Loan Maturity Length and Exemption Caps

When the FCU Act was initially passed, credit unions were allowed to make loans not to exceed two years. Congress has since increased system-originated loan maturity lengths.

- On September 22, 1959, Section 8 of P.L. 86-354 amended the FCU Act to increase credit union loan maturities for up to five years.[67]
- On July 5, 1968, Section 1 of P.L. 90-375 amended the FCU Act to allow credit unions to make unsecured loans with maturities not to exceed five years and secured loans with maturities not to exceed 10 years.[68]
- The Mini Bill of 1977 allowed loan maturities not to exceed 12 years. It also allowed credit unions to make residential real estate loans with maturities up to 30 years; home improvement loans and mobile home loans (for principal residence) were allowed for up to 15 years.
- The Garn-St. Germain Depository Institutions Act of 1982 (Garn-St. Germain Act; P.L. 97-320, 96 Stat. 1469) permitted mortgage loan refinancing, and extended the maturity limit to 15 years for all second mortgages.
- The Competitive Equality Banking Act of 1987 (CEBA; P.L. 100-86) amended the FCU Act to authorize the NCUA to allow second-mortgage, home-improvement, and mobile home loans beyond 15 years.[69] On October 1989, the NCUA finalized the rule to extend the maturity limit to 20 years.[70]
- On October 13, 2006, Section 502 of P.L. 109-351 amended the FCU Act to set a 15-year maximum maturity on credit union loans, with some exceptions. For example, residential one-to-four family mortgages may exceed the 15-year maturity term as long as the property is the borrower's primary residence.

In the 116th Congress, H.R. 1661 was introduced on March 8, 2019, and referred to the House Committee on Financial Services. H.R. 1661, if enacted, would amend Section 107(5) of the FCU

[65] See NCUA, "Metsger Asks CFPB to Exempt Payday Alternative Loans in Proposed Rule," October, 5, 2016, at https://www.ncua.gov/newsroom/Pages/news-2016-oct-metsger-asks-exempt-payday-alternative-loans.aspx.

[66] See NCUA, "Payday Alternative Loans," 84 *Federal Register* 51942-51952, October 1, 2019.

[67] 73 Stat. 628 at https://www.govinfo.gov/content/pkg/STATUTE-73/pdf/STATUTE-73-Pg628.pdf#page=2.

[68] 82 Stat. 284 at https://uscode.house.gov/statutes/pl/90/375.pdf.

[69] Title VII—Credit Union Amendments, Section 702.

[70] NCUA, "15 Year Loans," 54 *Federal Register* 43277-43278, October 24, 1989.

Act to allow NCUA the flexibility to extend maturities for all loans, including MBLs and student loans.

Developments in the Credit Union System's Prudential Risk Management

Congress created the NCUSIF in 1970 to be the insurance fund for all federally regulated credit unions.[71] The NCUA manages the NCUSIF, which is completely funded by insured credit unions. The NCUSIF's primary income source is the premiums collected from credit unions,[72] which pay the fund's operating expenses, cover losses, and build reserves. Premiums were originally set at one-twelfth of 1% of the total amount of member share accounts, but P.L. 98-369 required each federally insured credit union to maintain a fund deposit equal to 1% of its insured share accounts.[73] Examination fees and any penalties NCUA collects from insured institutions are also deposited into the NCUSIF. Fund portions not applied to current operations can be invested in government securities, and the earnings also generate fund income. The NCUSIF's reserves consist of the 1% deposit, plus the fund's accumulated insurance premiums, fees, and interest earnings.

Prudential safety and soundness regulation, which includes holding sufficient capital reserves, may reduce the financial institutions' insolvency (failure) risk and promote public confidence in the financial system. Although higher capital requirements may not prevent adverse financial risk events from occurring, more capital enhances the financial firms' ability to absorb greater losses associated with potential loan defaults. The enhanced absorption capacity may strengthen public confidence in the soundness of these financial institutions and increase their ability to function during periods of financial stress. For this reason, the NCUA has proposed enhanced net worth (capitalization) requirements for credit unions, which is intended to increase the credit union system's resilience to insolvency risk and to minimize possible losses to the NCUSIF and ultimately to taxpayers. These prudential issues are discussed in this section.

Increased Exposure to Mortgage Credit Risk and Recent NCUSIF Management Initiatives

Credit unions were granted the authority to increase their participation in the mortgage market during the late 1970s and 1980s.[74] In light of the savings and loan (S&L) crisis, discussed in the text box below, the credit union system was also granted more powers to mitigate interest rate risk stemming from exposure to mortgage market risk. The following list highlights some of these authorities:

- After the Mini Bill of 1977 was passed, the NCUA adopted regulations on August 7, 1978, permitting credit unions to sell mortgage loans in the secondary market—specifically to Fannie Mae, Freddie Mac, and Ginnie Mae (government-sponsored enterprises, or GSEs) as well as to federal, state, and local housing

[71] An insurance fund provides deposit insurance to protect members' accounts in the event of a credit union failure.

[72] These arrangements are similar to those of the FDIC's Deposit Insurance Fund (DIF).

[73] July 18, 1984, 98 Stat. 494. The 1% is carried on each individual institution's books as an asset.

[74] See Alane K. Moysich, "An Overview of the U.S. Credit Union Industry," *FDIC Banking Review*, vol. 3, no. 1 (fall 1990), pp. 12-25, at https://www.fdic.gov/bank/analytical/banking/br1990vol3no1full.pdf.

authorities.[75] On August 16, 1978, federal credit unions were also granted the authority to sell their members' federally guaranteed student loans.[76]

- The Garn-St. Germain Act, as mentioned, eliminated limits on the size and maturity of first lien mortgages, permitted refinancing of mortgage loans, and extended the maturity limit to 15 years for all second mortgages. The CEBA amended the FCU Act to authorize the NCUA to allow second-mortgage, home-improvement, and mobile home loans beyond 15 years.
- The Garn-St. Germain Act also amended the FCU Act to allow credit unions to issue and sell securities, which are guaranteed pursuant to Section 306(g) of the National Housing Act.[77] In other words, federal credit unions were given the authority to participate in activities that would allow them to securitize assets.
- In 1988, the NCUA allowed credit unions to invest in mortgage-backed securities (MBS).[78] Rather than hold, for example, 30-year mortgages, the ability to hold MBS of shorter (e.g., 10 year) maturities reduces asset duration risk (discussed in the text box below).
- In 1989, credit unions were allowed to use financial derivatives to purchase insurance against declines in GSE-issued MBS values that would occur after a rise in interest rates, thus protecting the overall value of their asset (loan) portfolios.[79] (NCUA noted that the credit union system had experienced a 48% increase in real estate lending in 1987.)

Consequently, as credit unions and other financial intermediaries increased their participation in the mortgage market, they also grew more susceptible to the financial risks linked to this market.[80] Rising interest rates was a major risk factor in the S&L crisis during the 1980s, whereas rising mortgage defaults or credit risk was a major factor in the financial crisis that occurred in 2008. Because of the greater exposure to mortgage credit risk, the credit union system along with numerous financial entities in 2008 experienced distress after a sharp rise in the percentage of seriously delinquent mortgage loans in the United States.[81]

[75] See NCUA, "Sale of Eligible Obligations," *1978 Annual Report of the National Credit Union Administration*, September 1979, at https://www.ncua.gov/files/annual-reports/AR1978.pdf.

[76] NCUA, "Sale of Eligible Obligations."

[77] See NCUA, Office of General Counsel, "Authority to Issue and Sell Securities," at https://www.ncua.gov/files/legal-opinions/asset-securitization-authority.pdf.

[78] See NCUA, Letter No. 96, March 1988,

at https://www.ncua.gov/files/letters-credit-unions/LCU1988-96.pdf.

[79] See NCUA, "Loans to Members and Lines of Credit to Members," 53 *Federal Register* 19748-19752, May 31, 1988. The final rule specifically discusses the use of purchasing financial *put options*, which would allow credit unions to sell any MBS holdings to a counterparty at their initial prices prior to an interest rate increase.

[80] See CRS Report R40417, *Macroprudential Oversight: Monitoring Systemic Risk in the Financial System*, by Darryl E. Getter.

[81] See John Weinberg, *The Great Recession and Its Aftermath*, Federal Reserve Bank of Richmond, November 22, 2013, at https://www.federalreservehistory.org/essays/great_recession_and_its_aftermath.

The Savings and Loan (S&L) Crisis

Financial institutions were generally provided with more tools to manage their interest rate risk exposures following the S&L crisis of the 1980s. Similar to credit unions, S&Ls were nonprofit, member-owned financial institutions specializing in taking savings deposits to facilitate residential home mortgage lending. Between 1980 and 1983, 4853 S&Ls, which were holding portfolios consisting primarily of traditional fixed-rate mortgages, failed after the short-term interest rates paid to depositors rose to historic levels.[82] Regulation Q interest rate ceilings, which stemmed from the Banking Acts of 1933 and 1935, imposed interest rate ceilings on time and savings deposits. Depositors were subsequently incentivized to withdraw funds from accounts with interest rate restrictions and deposit them in unregulated accounts, such as money market mutual funds. Many S&Ls became insolvent when they were unable to maintain enough depositors to fund loans after deposit rates soared (with accelerating inflation).

The Garn-St. Germain Act granted financial institutions more tools to manage their interest rate risks.[83] For example, the ability to sell loans allows financial institutions to dampen their balance sheet losses should an interest rate spike reduce the value of portfolio assets. In addition to hedging against a potential decline in asset values, various interest rate derivatives may also be used to manage the mismatch between asset and liability maturities, specifically the risk that arises when their asset portfolio duration (i.e., the length of time it takes borrowers to repay their longer-term loans) exceeds their liabilities duration (i.e., the length of time financial institutions must repay their short-term borrowings).

According to the NCUA chairman, *corporate credit unions* faced increasing liquidity pressures during 2008 after a significant portion of their MBSs—following a deterioration of the underlying real estate collateral—lost value and were subsequently downgraded below investment grade.[84] Corporate credit unions operate as wholesale credit unions, meaning that they provide financing, investment, and clearing services for the retail credit unions that interface directly with customers. The corporates accept deposits from, as well as provide liquidity and correspondent lending services to, retail credit unions. This reduces the costs that smaller institutions would bear individually to perform various financial transactions for members.[85] Given that retail credit unions are cooperative owners of corporate credit unions, they are also federally insured by the NCUSIF. The NCUA placed two corporate credit unions into conservatorship in March 2009 and three additional corporates in September 2010. The five corporates under conservatorship at the time had represented approximately 70% of the entire corporate system's assets and 98.6% of the investment losses within the system.[86]

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[82] See Alane K. Moysich, "Chapter 4: The Savings and Loan Crisis and Its Relationship to Banking," Federal Deposit Insurance Corporation, *History of the 80s: An Examination of the Banking Crises of the 1980s and Early 1990s*, Washington, DC, December 1997, at http://www.fdic.gov/bank/historical/history/167_188.pdf. A chronology and bibliography of the S&L crisis is provided at http://www.fdic.gov/bank/historical/s&l/. See also Paul Calem, "The New Bank Deposit Markets: Goodbye to Regulation Q," *Business Review*, Federal Reserve Bank of Philadelphia, Philadelphia, PA, November/December 1985, at http://www.philadelphiafed.org/research-and-data/publications/business-review/1985/brnd85pc.pdf; Alton Gilbert, "Will the Removal of Regulation Q Raise Mortgage Interest Rates?" *Federal Reserve Bank of St. Louis Review*, St. Louis, MO, December 1981, at http://research.stlouisfed.org/publications/review/81/12/Removal_Dec1981.pdf; and Charlotte E. Ruebling, "The Administration of Regulation Q," *Federal Reserve Bank of St. Louis Review*, St. Louis, MO, February 1970, at http://research.stlouisfed.org/publications/review/70/02/Administration_Feb1970.pdf.

[83] See Gillian Garcia et al., "The Garn-St Germain Depository Institutions Act of 1982," *Economic Perspectives*, vol. 7 (March/April 1983), at https://www.chicagofed.org/publications/economic-perspectives/1983/march-april-garcia.

[84] See Statement of Deborah Matz, chairman, NCUA, "The State of the Credit Union Industry," p. 3, at http://www.ncua.gov/News/Documents/SP20101209Matz.pdf, which was given in U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, 111th Cong., 2nd sess., December 9, 2010.

[85] See Robert McGarvey, "How Many Corporate Credit Unions Will Be Standing by Year End?" *Credit Union Times*, March 2, 2011, at http://www.cutimes.com/2011/03/02/how-many-corporate-credit-unions-will-be-standing?page=3.

[86] See Statement of Deborah Matz, chairman, NCUA, "The State of the Credit Union Industry," p. 3, at http://www.ncua.gov/News/Documents/SP20101209Matz.pdf, which was given in U.S. Congress, Senate Committee

The share equity ratio—the ratio of total funds in the NCUSIF relative to the estimated amount of share deposits held by credit unions—is an indicator that represents the adequacy of reserves available to protect share depositors and maintain public confidence.[87] The NCUA annually determines the *normal operating level* for the share equity ratio, which statutorily must fall between 1.2% and 1.5%.[88] The 2006 equity ratio was 1.30% and fell below the statutory minimum to 1.18% by August 2010. The NCUA board may assess a premium when the ratio falls between 1.2% and the declared operating level; however, it is required to assess a premium if the equity ratio falls below 1.2%. Similarly, the NCUA board may declare a dividend if, at the end of the calendar year, the equity level exceeds the normal operating level; it is required to do so if the equity ratio exceeds 1.5%.

Rather than deplete the NCUSIF, Congress in May 2009 established a Temporary Corporate Credit Union Stabilization Fund (TCCUSF) to accrue and recover losses from the corporates.[89] The TCCUSF borrowed from Treasury to help cover conservatorship costs, and the NCUA also raised assessments on all federally insured credit unions, including those that did not avail themselves of corporate credit union services.[90] The premium assessment reflected a plan to restore the NCUSIF equity ratio to 1.3%, which happened by December 2011.

After achieving a positive net position of $1.9 billion as of May 2017, the NCUA, in July 2017, proposed closing the TCCUSF and providing credit unions with a Share Insurance Fund distribution in 2018, estimated to be between $600 million and $800 million.[91] The TCCUSF officially closed on October 1, 2017; its assets and obligations were transferred to the NCUSIF.[92] The NCUA reduced the share equity ratio from 1.39, which had previously been set in September 2017, to 1.38,[93] administering an equity distribution (rebate) of $160.1 million to member institutions.[94]

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on Banking, Housing, and Urban Affairs, 111th Cong., 2nd sess., December 9, 2010.

[87] Similarly, the designated reserve ratio (DRR) is the ratio of total funds in the FDIC's DIF relative to the estimated amount of insured bank deposits.

[88] FCU Act (12 U.S.C. 1782(h)(4)). For comparison, the Dodd-Frank Act requires the DRR to be a minimum of 1.35% of total insured deposits. See P.L. 111-203, §334.

[89] Helping Families Save Their Homes Act of 2009 (P.L. 111-22, 123 Stat. 1632, Division A).

[90] In January 2011, the authority to assess premiums on the credit union system to repay Temporary Corporate Credit Union Stabilization Fund (TCCUSF) advances was clarified by P.L. 111-382, the National Credit Union Authority Clarification Act. See "NCUA 2013 Financial Statement Audits for Temporary Corporate Credit Union Stabilization Fund," at http://www.ncua.gov/about/Leadership/CO/OIG/Documents/2013-FSA(OIG-14-05)-TCCUSF.pdf; and "NCUA Board Gets TCCUSF Report, OKs Joint Agency Appraisal Rule," at http://www.nafcu.org/News/2014_News/March/NCUA_Board_gets_TCCUSF_report__OKs_joint_agency_appraisal_rule/.

[91] See NCUA, "Agency Proposed to Close Stabilization Fund in 2017," press release, July 20, 2017, https://www.ncua.gov/newsroom/news/2017/board-proposes-closing-stabilization-fund-and-providing-distribution-2018.

[92] See NCUA, "Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level, 82 *Federal Register* 46298-46309, October 4, 2017.

[93] See NCUA Board Action Memorandum, at https://www.ncua.gov/files/agenda-items/AG20181213Item4a.pdf; and NCUA, "Board Lowers Share Insurance Fund Normal Operating Level to 1.38 Percent," press release, December 12, 2018, at https://www.ncua.gov/newsroom/press-release/2018/board-lowers-share-insurance-fund-normal-operating-level-138-percent. See NCUA, "Stabilization Fund to Close Oct 1; Credit Unions Could Expect a Distribution in 2018," press release, September 28, 2017, at https://www.ncua.gov/newsroom/news/2017/stabilization-fund-close-oct-1-credit-unions-could-expect-distribution-2018.

[94] See NCUA, "Board Approves Share Insurance Equity Distribution in 2019," press release, March 7, 2019, at https://www.ncua.gov/newsroom/press-release/2019/board-approves-share-insurance-equity-distribution-2019; and NCUA, "Requirements for Insurance; National Credit Union Share Insurance Fund Equity Distributions," 83 *Federal*

The Risk-Based Capital Rule

On January 23, 2014, the NCUA announced increases in capital requirements for a subset of natural person credit unions designated as *complex*.[95] NCUA initially defined a complex credit union to have at least $50 million in assets.[96] On January 27, 2015, the NCUA revised the initial proposed rule, amending the definition as having at least $100 million in assets.[97] On October 29, 2015, the NCUA finalized the risk-based capital rule.[98] Some of the rule's specific requirements included the following:

- A new asset *risk-weighting* system was introduced that would apply to *complex* credit unions, which would be more consistent with the methodology used for U.S. federally insured banking institutions.[99]
- A new risk-based capital ratio (defined using the narrower risk-based capital measure in the numerator and total risk-weighted assets, which are computed using the new risk-weighting system, in the denominator) of 10% would be required for complex credit unions to be *well-capitalized* under the prompt corrective action supervisory framework.[100] The risk-based capital ratio was designed to be more consistent with the capital adequacy requirements commonly applied to depository (banking) institutions worldwide.[101] Compliance of complex credit unions with the risk-based capital ratio requirements as well as the existing statutory 7% net-worth asset ratio would have been effective by January 1, 2019, to avoid NCUA supervisory enforcement actions.
- Non-complex credit unions with assets below $100 million would not have been required to comply with the new risk-weighting system, and they would no

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Register 7954-7964, February 23, 2018.

[95] See NCUA, "NCUA Board Advances Greater Protection and Modern Regulation," press release, January 23, 2014, at https://www.ncua.gov/newsroom/news/2014/ncua-board-advances-greater-protection-and-modern-regulation.

[96] The Credit Union Membership Access Act of 1998 (CUMAA; P.L. 105-219) required the NCUA to develop the definition of a *complex* credit union. The Regulatory Flexibility Act (RFA; P.L. 96-354) requires federal agencies to consider the impact of their proposed and final rules on small entities. Consequently, the NCUA currently defines a complex credit union as a natural person credit union with at least $50 million in assets. This definition became effective on February 19, 2013, reflecting an increase from the 2003 definition that used the asset threshold of at least $10 million. See National Credit Union Administration, "Prompt Corrective Action, Requirements for Insurance, and Promulgation of NCUA Rules and Regulations," 78 *Federal Register* 4032-4038, January 18, 2013.

[97] See NCUA, "Part II: Risk-Based Capital; Proposed Rule," 80 *Federal Register* 17, January 27, 2015.

[98] See NCUA, "Risk-Based Capital," 80 *Federal Register* 66626-66723, October 29, 2015, at http://www.gpo.gov/fdsys/pkg/FR-2015-10-29/pdf/2015-26790.pdf.

[99] See "Summary of the Risk Weights" in the NCUA final rule, which includes an NCUA and FDIC risk weights comparison. The Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency adopted the risk-weighting-assets system on July 2, 2013; the Federal Deposit Insurance Corporation adopted it on July 9, 2013. See "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule," at https://www.govinfo.gov/content/pkg/FR-2013-10-11/pdf/2013-21653.pdf. The risk-based capital measure primarily accounts for credit (default) and concentration risk; NCUA will address interest rate risk via alternative regulations and supervisory processes.

[100] Under the prompt corrective action supervisory framework, regulators examine whether credit unions and banks meet the requirements to be considered well-capitalized, adequately capitalized, under-capitalized, significantly undercapitalized, and critically undercapitalized. The level of scrutiny, restrictions, and penalties imposed by regulators increases as the financial health of a depository institution deteriorates.

[101] See CRS Report R42744, *U.S. Implementation of the Basel Capital Regulatory Framework*, by Darryl E. Getter.

longer be required to risk-weight their assets. Instead, non-complex credit unions must comply with the existing statutory 7% net-worth asset ratio.[102]

- Credit unions with a concentration in commercial lending in excess of 50% of their total assets would be required to hold higher amounts of net worth to abate the higher levels of concentration risk.[103]

On December 17, 2019, the NCUA issued a final rule to move the effective date to January 1, 2022.[104] The NCUA also amended the complex credit union's definition by increasing the asset threshold level from $100 million to $500 million. Nevertheless, the delays have prompted some Members of Congress to monitor the implementation progress of the risk-based capital rule for credit unions.[105]

Complex Credit Union Leverage Ratio

On July 22, 2021, the NCUA released a proposed rule that would allow eligible complex credit unions to opt into a complex credit union leverage ratio (CCULR) framework, which is comparable to the optional Community Bank Leverage Ratio framework.[106] Under the CBLR framework, banks with less than $10 billion in average total consolidated assets that meet certain risk-profile criteria may elect to maintain a leverage ratio of greater than 9% to satisfy both the risk-based and leverage capital requirements to be well-capitalized.[107] Likewise, rather than calculate risk-based capital requirements, the CCULR framework would require complex credit unions to meet a minimum net worth ratio initially established at 9% by January 1, 2022, that would gradually increase to 10% by January 1, 2024. The comment period ended on October 15, 2021.

[102] Credit unions' statutory net worth requirements may be found at Illustration 17-A—Statutory Net Worth Category Classification on the NCUA website, at http://www.ncua.gov/Legal/GuidesEtc/ExaminerGuide/chapter17.pdf.

[103] A risk weight of 150% will be applied to commercial loans should the total amount exceed 50% of total assets. For more information on NCUA risk weights, see "Risk-Based Capital Proposal Comparison: 2015 Revised Proposal Changes Compared to 2014 Original Proposal," at http://www.ncua.gov/Legal/Documents/RBC/RBC-Proposal-Comparison.pdf.

[104] See NCUA, "Delay of Effective Date of the Risk-Based Capital Rules," 84 *Federal Register* 68781-68787, December 17, 2019.

[105] See Senate Banking Committee, "Brown to NCUA: Unacceptable to Extend Delay on Capital Rules," press release, June 24, 2019, at https://www.banking.senate.gov/newsroom/minority/brown-to-ncua-unacceptable-to-extend-delay-on-capital-rules.

[106] See NCUA, "NCUA Board Proposes Complex Credit Union Leverage Ratio," July 22, 2021, at https://www.ncua.gov/newsroom/press-release/2021/ncua-board-proposes-complex-credit-union-leverage-ratio; and NCUA, "Capital Adequacy: The Complex Credit Union Leverage Ratio; Risk-Based Capital," 86 *Federal Register* 45824-45854, August 16, 2021.

[107] See FDIC, "Community Bank Leverage Ratio Framework, *FIL-66-2019*, November 4, 2019, at https://www.fdic.gov/news/news/financial/2019/fil19066.html; and CRS Report R45989, *Community Bank Leverage Ratio (CBLR): Background and Analysis of Bank Data*, by David W. Perkins. In addition, the NCUA issued a final rule in April 2018 that amended its regulations regarding capital planning and stress testing for federally insured credit unions with $10 billion or more in assets. See, NCUA, "Capital Planning and Supervisory Stress Testing," 83 *Federal Register* 17901-17910, April 25, 2018. Because of Section 4012 of the Coronavirus Aid, Relief, and Economic Security Act (P.L. 116-136), the CBLR was temporarily lowered to 8%. The initial CBLR at greater than 9% will be phased in and fully re-established effective on January 1, 2022. See Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Department of the Treasury, FDIC, "Agencies Announce Changes to the Community Bank Leverage Ratio," April 6, 2020, at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm.

Supplemental Capital

Because credit unions do not issue common stock equity, they do not have access to capital sources beyond retained earnings. If alternative sources of capital, referred to as supplemental capital, were to be used in addition to net worth, then credit unions would be able to increase their lending while remaining in compliance with their safety and soundness net worth requirements. The proposal discussed below to adopt *supplemental capital* requirements would enhance the credit union system's lending capacity and introduce a new prudential risk management tool.

An NCUA working group has developed three general sources of supplemental capital, all of which would be repaid after reimbursement of the NCUSIF following liquidation of an insolvent credit union.[108] Credit unions could raise

- *voluntary patronage capital* (VPC) if (noninstitutional) members were to purchase "equity shares" in the organization.[109] VPC equity shares would pay dividends; however, a VPC investor would not obtain any additional voting rights, and no investment would be allowed to exceed 5% of a credit union's net worth.
- *mandatory membership capital* (MMC) if a member pays what may be conceptually analogous to a membership fee. MMC capital would still be considered equity for the credit union but, unlike VPC, it would not accrue any dividends.
- *subordinate debt* (SD) from external and institutional investors. SD investors would have no voting rights or involvement in a credit union's managerial affairs. SD would function as a hybrid debt-equity instrument, meaning the investor would simply be a creditor with no equity share in the credit union while it is solvent and would not be repaid principal or interest should the credit union become insolvent. SD investors must make a minimum five-year investment with no option for early redemption.

A credit union's net worth is defined in statute; therefore, congressional legislative action would be required to permit other forms of supplemental capital to count toward their net worth prudential requirements.

[108] See National Association of State Credit Union Supervisors, "Q&A on Supplemental Capital for Credit Unions," press release, http://www.nascus.org/Regulatory/1-09-Q&A-Supplemental-Capital.php; and the Executive Summary, "NCUA Supplemental Capital White Paper prepared by the Supplemental Capital Working Group," April, 12, 2010, at http://www.ncua.gov/Legal/GuidesEtc/Documents/Publications/20100412SupCapital.pdf.

[109] In discussions of supplemental capital, the term *equity shares* is used to help distinguish from *share deposits*, which is the term generally used in discussions about credit unions' deposits.

Conclusion

Credit union industry advocates argue that lifting lending restrictions to make the system more comparable with the banking system would increase borrowers' available pools of credit. Community banks, which often compete with credit unions, argue that policies such as raising the business lending cap, for example, would allow credit unions to expand beyond their congressionally mandated mission and could pose a threat to financial stability. By amending the FCU Act several times to expand permissible lending activities, Congress arguably had recognized that the credit union system has evolved into a more sophisticated financial intermediation system. Congress has also emphasized prudential safety and soundness concerns. Following the 2008 financial crisis, the federal bank prudential regulators implemented prudential requirements to enhance the U.S. banking system's resiliency to systemic risk events. The NCUA initially proposed in 2014 to increase capital requirements particularly for large credit unions (those with $500 million or more in assets); however, the proposal has been revised, delayed, and is currently scheduled to become effective in January 2022. In the meantime, the NCUA has implemented and proposed rules to support expanding lending activities that would increase financial transactions volumes (economies of scale), thus possibly generating greater cash flows and profitability for the credit union system. The adoption of enhanced prudential net worth requirements for the credit union system, however, arguably may facilitate mitigating the financial risks that typically accompany increases in lending.

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