



Credit Union National Association

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Testimony of
O. William Cheney
President and CEO
Credit Union National Association

Before the
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
United States House of Representatives
Hearing on
“The Effect of Dodd-Frank on Small Financial Institutions and Small Businesses”
March 2, 2011



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Madam Chairman, Ranking Member Maloney, and Members of the Subcommittee, thank you very much for the opportunity to testify at today’s hearing and present the views of the credit union movement on the implementation of the Dodd-Frank Act and the regulatory burdens credit unions face. My name is Bill Cheney and I am the President and CEO of the Credit Union National Association (CUNA).¹ Prior to my current role, I served as a credit union CEO for nine years with Xerox Federal Credit Union (today known as Xceed FCU) in El Segundo, California, and as president of the California and Nevada Credit Union Leagues for four years.

Credit unions are the best way for consumers to conduct their financial services. Therefore, relieving credit unions’ regulatory burden so that they are able to serve their members in a safe and sound manner is a key objective for CUNA.

As you know, credit unions are not-for-profit financial cooperatives; the only owners of a credit union are its members, who receive the benefit of ownership through reduced fees, lower interest rates on lending products, and higher dividends on savings products. Because of this

¹ CUNA is the nation’s largest credit union advocacy organization, representing approximately 90 percent of the 7,600 state and federal credit unions in the United States and their 93 million members.

structure, the cost of a credit union's compliance with unnecessary and unduly burdensome regulations impacts its members directly. Every dollar that a credit union spends complying with an unnecessary or overly burdensome regulation is a dollar that is not used to benefit the credit union's membership.

Credit unions support reasonable safety and soundness rules as well as meaningful consumer protection laws. However, the fact is that credit unions are among the most highly regulated financial institutions in the United States, and their regulatory burdens continue to multiply with little or no apparent regard for the costs of each requirement or, more important, the cumulative impact on the institutions that must comply. These concerns are compounded by the range of upcoming regulations credit unions will face under the Dodd-Frank Act.

Combined with existing regulatory burdens, the increasing regulatory requirements pursuant to the Dodd-Frank Act and other government initiatives are among the major drivers of credit union consolidation. Some have called this a "crisis of creeping complexity" because it is not any one particular regulation, mandatory information collection, or required form which makes it impossible for smaller credit unions to continue to exist. Instead it is the steady accumulation of regulatory requirements over the years which eventually add up until a straw breaks the camel's back. Credit unions are concerned that these creeping regulatory burdens not only take up an increasing share of credit union employee and volunteer time—often necessitating mergers with larger credit unions—but also stifle innovation in credit union financial services.

Approximately 5,500 of America's credit unions today are small institutions with fewer than \$50 million in assets. Yet in 1991, there were over 12,000 credit unions under \$50 million

in assets², or approximately 5,000 more credit unions under \$50 million in 1991 than the total number of credit unions which exist today. Many of these smaller credit unions have found it untenable to continue as stand-alone operations because of the employee time required to comply with the many regulatory requirements and dictates that have accumulated over the years.

These creeping regulatory burdens range from interchange regulation, to net worth requirements, to caps on business loans to examination requirements that are constantly changing, to limitations on certain executive compensation, to the elimination of many Regulatory Flexibility Act authorities on which many credit union rely, to new reporting requirements and other government initiatives. And those are only the relatively new regulatory burdens on credit unions!

In addition to the regulatory hurdles that have a negative effect on job growth, there are also statutory constraints that keep credit unions from doing more to help their members promote job creation and economic growth. My testimony will discuss both the statutory and regulatory hurdles credit unions now face as well as two provisions of the Dodd-Frank Act we believe that the committee should insist that the new Consumer Financial Protection Bureau (the Bureau) exercise to the fullest extent possible. This testimony also discusses statutory restrictions contributing to overall regulatory burden as well as examination issues and other regulatory concerns that credit unions have.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

As CUNA said from the time that the Administration first released its proposal to restructure the financial regulatory regime, consumers of financial products, especially

² Adjusted for inflation.

consumers of products and services provided by unregulated entities, need greater protections and a consumer financial protection agency could be an effective way to achieve that protection, provided the agency does not impose duplicative or unnecessary regulatory burdens on credit unions. In order for such an agency to work, consumer protection regulation must be consolidated and streamlined; it should not add to the regulatory burden of those who have been regulated and performed well, such as credit unions.

At the time of its enactment, we viewed the Dodd-Frank Act's approach to consumer protection regulation as balanced. We were under no illusions during its legislative consideration that if the Dodd-Frank Act were defeated that the result would mean the end of consumer protection regulation; our view was that whether under the previous structure or under the Dodd-Frank structure, consumer protection regulation was going to continue to exist and continue to be proposed. Now that the Dodd-Frank Act is law, and the Bureau is in the process of being established, it is critically important that Congress support the activities of the Bureau that ensure credit unions – which do not have a history of widespread consumer complaints – will not be adversely impacted by unnecessary and unduly burdensome regulation. It is equally important for Congress to review and consider repeal or significant modification to Section 1075 of the Act related to regulation of debit interchange.

Regulation of Debit Interchange

For credit unions and their members, the most chilling effect of the Dodd-Frank Wall Street Reform and Consumer Protection Act will be the implementation of Section 1075 related to the regulation of interchange fees.³ Section 1075 and the Federal Reserve Board's proposed

³ See 15 U.S.C. § 1693o-2; Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722 (Dec. 28, 2010).

regulation are both flawed and will disrupt the debit interchange market that has benefited merchants, card issuers and consumers. Moreover, the impact of this disruption will be proportionately more severe for the credit union Congress sought to protect through a carve-out and the consumers that they serve. In fact, it was the inclusion of this provision that ultimately caused credit unions to oppose the Dodd-Frank Act in its entirety.

As Frank Michael, President and CEO of Allied Credit Union, testified before this Subcommittee on February 17, 2011, Section 1075 adds a new Section 920 to the Electronic Fund Transfer Act (EFTA), which requires the Board to set standards for assessing whether debit interchange transaction fees are “reasonable and proportional” to the issuers’ costs associated with a debit card transaction and to issue regulations on debit card transaction routing. When considering the costs incurred by the issuer, Congress directed the Board to distinguish between the incremental costs incurred by the issuer as a result of authorization, clearance, or settlement of a particular electronic debit transaction (which the Board is permitted to consider when issuing its rule) and other costs incurred by the issuer which are not specific to a particular electronic debit transaction but which are essential to the operation of a debit card program. The Board is also permitted to make an adjustment to the interchange transaction fees for fraud prevention costs.

Unfortunately, the Board’s interpretation of the statute is that Congress directed the Board to disregard many of the most significant costs associated with operating a debit card program. As a result, the Board has proposed a debit interchange rate that is well below the cost of operating a debit card program. The Board’s proposed rule changes the nature of the debit interchange fee from a proportional rate based on the amount of the transaction to a hard per transaction cap that does not distinguish between the type of debit transaction (PIN or Signature)

or take into consideration the risk assumed by the card-issuing credit union or bank for accepting the transaction. To make matters worse, the Board has selectively chosen to exclude clearly permissible incremental costs associated with authorizing clearing and settling a transaction. These costs include, at minimum, network fees, adjustments for fraud prevention costs, and other relevant costs.

At its most basic level, the Board's rule tells financial institutions that seek to meet the debit card demands of their customers that if they want to do this business, they must do so under a set of government-imposed restrictions that require them to do it for less than it costs them to operate the program. Even for not-for-profit credit unions, the idea of the government requiring the operation of a program at a loss is abhorrent; it flies in the face of safety and soundness and certainly is not reasonable and proportional to credit unions' cost of providing debit card programs.

While we urge Congress generally to repeal the Section 1075 or delay its implementation, if that is not possible, we urge Congress to amend Section 1075 to direct the Board to consider all costs incurred in the operation of debit card programs by all issuers, even those which were exempt from the regulation.

This is significant to credit unions, the vast majority of which are exempt from the regulation, because simply being exempt from the language of the regulation does not guarantee that these credit unions will be unaffected by the regulation. We are deeply concerned that the carve-out may be rendered essentially meaningless by the Board's proposed rule for two specific reasons. First, the carve-out relies on the operation of a two-tier debit interchange system; however, it is uncertain whether—and for how long—the various payment networks will be willing and/or able to maintain separate pricing schemes for small and large institutions because

there is no regulatory requirement for them to do so. Second, even if the payment card networks operated a two-tiered system, with the passage of time, market forces and other factors, including the routing and exclusivity provisions which apply to all issuers, will cause convergence of prices between the two tiers. Absent enforcement by the Board of the small issuer exemption intended by Congress, these conditions will render the exemption meaningless.

It is noteworthy that our concern for the impact of Section 1075 and the Board's proposed rule is shared by several Federal financial regulators including the Chairman of the Federal Reserve Board of Governors, who said at a Senate Banking Committee hearing on February 17, 2011:

“It is possible that because merchants will reject more expensive cards from smaller institutions or because networks will not be willing to differentiate the interchange fee for issuers of different sizes, it is possible that the exemption will not be effective in the marketplace.”⁴

Federal Deposit Insurance Corporation Chairman Sheila Bair echoed Chairman Bernanke's concerns at this hearing saying:

“The likelihood of this hurting community banks and requiring them to increase the fees they charge for accounts is much greater than any tiny benefit retail customers may get.”⁵

The Chairman of the National Credit Union Administration (NCUA) has also expressed concern regarding the ineffectiveness of the small issuer exemption and has suggested that the exemption should also cover the network and exclusivity requirements. In a letter to Chairman Bernanke, Chairman Matz said:

⁴ Senate Banking Committee Hearing entitled, “Oversight of Dodd-Frank Implementation: A Progress Report by Regulators at the Half-Year Mark.” February 17, 2011.

⁵ Ibid.

“In addition to exempting small issuers from the fee limits, I believe it is important that smaller issuer be exempted from requirements related to network exclusivity and routing restrictions. Such action would be consistent with the exemption from the interchange transaction fee rulemaking, which is intended to shield small institutions from the costs of the Act... The current rule’s prohibitions against network exclusivity and merchant routing restrictions could significant increase both the fixed and variable costs for these small institutions, resulting in an inability to remain competitive with large card issuers.”⁶

There is little doubt in the minds of credit union executives and Federal financial regulators that the proposed interchange regulation will significantly reduce the amount of debit interchange income credit unions earn, despite the exemption and Congressional pledges to the contrary. The only real question is how much.

We estimate that the reduction of credit union net income would be in the range of 20-30 percent if the Board’s proposal were implemented without amendment. But for credit unions, the loss of debit interchange revenue is not just about losing money or receiving less income – it is about the impact that this reduction in revenue will have on credit union members.

Credit unions will not be able to absorb this reduction without passing costs along to their members because their safety and soundness regulator will not permit it. NCUA will expect credit unions to maintain their current net income levels and replace this lost revenue. Credit unions will have to take steps to ensure that they continue to operate in a safe and sound manner.

The implementation of this provision of the Dodd-Frank Act will absolutely hit the pocketbooks of consumers and businesses holding debit cards. As Mr. Michael testified last month, if the exemption for small issuers proved completely ineffective, the Board’s proposed 12 cent fixed fee could require credit unions to impose an annual fee in the range of \$35-\$55 per

⁶ Letter from National Credit Union Administration Chairman Debbie Matz to Federal Reserve Board of Governors Chairman Ben Bernanke. February 16, 2011. http://www.ncua.gov/news/press_releases/2011/MA11-0216MatzInterchangeRule.pdf

debit card, a fee in the range of 25-35 cents per transaction, or some combination of the two in order to maintain pre-reform revenue. These would be new fees to credit union members.

Again, these are not solely claims that credit union executives are making. The Federal financial regulators agree. Chairman Bernanke said before the Senate Banking Committee:

“It is certainly possible that some of those costs would get passed on to consumers in some – in some way, for example, a charge for a debit card or something like that.”⁷

Chairman Bair made a similar suggestion:

“If they are forced down to the 12 cent level, that is going to – to reduce the income that they get for debit cards, so I think they’re going to have to make that up somewhere, probably by raising fees that they have on transaction accounts.... That would not be helpful for consumer and that might be an unintended consequence.”⁸

The consequences of allowing the Board to proceed to finalize and implement its rule under Section 1075 are potentially devastating for small financial institutions and consumers. That is why credit unions are urging Congress to: Stop. Study. Start over. We implore Congress to intervene to stop the Board’s proposed rule from being finalized and implemented. Further study on this issue of the impact of debit interchange on small issuers and consumers is essential. Ultimately, the Board should be directed to issue a rule that includes meaningful enforcement authority for a two-tier system to protect small issuers, and to set standards for assessing interchange rates that take into consideration all of the operational costs associated with offer debit cards to consumers.

⁷ Senate Banking Committee Hearing. February 17, 2011.

⁸ Ibid.

Additional Regulatory Burden Associated with the Dodd-Frank Act

The debit interchange price setting regulations are far from the only new regulatory burden on credit unions imposed by the Dodd-Frank Act. Examples of additional new regulatory burdens imposed on credit unions by the Dodd-Frank Act include but not limited to:

- New HMDA reporting requirements under Section 1094;
- Changes to the SAFE Act registry under Section 1100;
- New Fair Credit Reporting Act requirements under Section 1088;
- Changes to the Truth in Lending Act under Section 1100A;
- Numerous new requirements regarding real estate appraisals and mortgage disclosers, including:
 - Appraisal independence requirements under Section 1472;
 - Appraisal management company requirements and automated valuation models under Section 1473;
 - Equal Credit Opportunity Act revisions concerning appraisals under Section 1474; and
 - Revisions to Real Estate Settlement Procedures Act forms under Section 1475.

CUNA urges Congress to be very vigilant in the oversight of the implementation of these provisions. While these new or revised regulations may not change credit unions' business practices—or how they offer financial services to their members—any change in regulation will result in significant compliance costs, especially to institutions which may be too small to hire compliance specialists. The proportional cost of changes in regulation—no matter how well intentioned—is significantly higher on smaller institutions than on the big banks. We hope that Congress and the regulators are mindful of this distinction when implementing these changes.

NCUA's Executive Compensation Proposal

NCUA has recently proposed an interagency rule on executive and director incentive-based compensation—such as bonuses or commissions—as required by the Dodd-Frank Act. There is considerable misunderstanding about the nature and scope of the Dodd-Frank Act provision and the proposal. While most credit unions do not provide the kind of incentives the Act sought to address, nonetheless, credit unions are justifiably concerned about the prospect of new reporting requirements, which add one more regulatory burden on top the myriad reporting requirements already in place. This is especially true because credit union executive compensation is across the board generally much lower than that for executives at similarly-sized banks. Credit unions have another major concern that the proposal would saddle credit unions with more than \$10 billion in assets with incentive-based compensation restrictions that only apply to the largest banks, those banks with more than \$50 billion in assets.⁹

The Dodd-Frank Act does not require that the restrictions on big banks also apply to credit unions.¹⁰ Credit unions have no systemic record of engaging in the risky compensation structures like those which were problematic in other areas of the financial sector. We are encouraging NCUA to harmonize the asset classes in its proposal with those of the OCC, FDIC, and Federal Reserve Board that give favorable treatment to all but the biggest banks so as to not disadvantage credit unions relative to similarly-sized FDIC-insured institutions.

Dodd-Frank Act Provisions Designed to Reduce Regulatory Burden

⁹ See Incentive-based Compensation Arrangements (proposed Feb. 17, 2011) (“The term ‘larger covered financial institution’ for the Federal banking agencies and the SEC means those covered financial institutions with total consolidated assets of \$50 billion or more. For the NCUA, all credit unions with total consolidated assets of \$10 billion or more are larger covered financial institutions.”), available at <http://ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2011/Feb17/Item2b11-0217.pdf> (last visited Feb. 24, 2011).

¹⁰ See 12 U.S.C. § 5641 (“Enhanced compensation structure reporting.”).

The Dodd-Frank Act included two provisions (Section 1021(b)(3) and Section 1022(b)(2)(A)(ii)) which are designed to reduce regulatory burden for financial institutions, including credit unions, and we encourage the Committee to exercise considerable oversight over the Bureau's implementation of these provisions.

Section 1021(b)(3) directs the Bureau to ensure that “outdated, unnecessary, and unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens.” Section 1022(b)(2)(A)(ii) directs the Bureau in its rulemaking process to consider the impact of proposed rules on credit unions and community banks with less than \$10 billion in total assets.

It is widely expected that the Bureau will engage in a comprehensive regulatory review process; quite frankly, credit unions and others expect that at the end of this process the overall regulatory burden will have increased. However, these provisions offer credit unions a modicum of hope that the Bureau will take steps to remove unnecessary, outdated and unduly burdensome regulations from the books and that it will take into consideration the impact of its rules on credit unions. Congressional oversight of how the Bureau executes these provisions is necessary in an effort to minimize burdens for credit unions.

Among the regulations we believe deserve an immediate review by the agency are:

- Regulation Z—Truth in Lending Act;
- Regulation C—Home Mortgage Disclosure Act;
- Regulation DD—Truth in Savings Act;
- Regulation E—Electronic Funds Transfer Act;
- Regulation V—Fair Credit Reporting Act;
- SAFE Act regulations; and
- Regulations under Sections 502 through 509 of the Gramm-Leach-Bliley Act.¹¹

¹¹ 15 U.S.C. §§ 6802-6809.

Our point in seeking review is not to undermine consumer protections, which we ardently support and believe are critical. However, we believe consumers' interests will be even better served if disclosures and other regulatory requirements including those that directly affect consumers are streamlined and more readily understood.

Statutory Restrictions Contributing to Overall Regulatory Burden

Looking beyond the Dodd-Frank Act, there are a number of other statutory restrictions that impose undue regulatory burdens or limit credit unions' ability to serve members.

Credit Union Net Worth Restrictions

If there has been one lesson learned from the recent financial crisis, it is that, for financial institutions, capital is king. Financial regulators in the United States and around the globe have been looking for ways to increase capital requirements for banks and other financial institutions in order to ensure that this country never again experiences failures like those that were caused by the recent economic crisis. It is in everyone's best interests that all financial institutions—including credit unions—have access to the capital-building tools necessary to meet and sustain reasonable capital standards.

Credit unions are the only depository institutions in this country that do not have the legal authority to supplement their capital by issuing capital instruments. This despite the fact that credit unions are the only depository institutions in the United States that must meet specific capital levels set by statute—not only by regulation— or face asset restrictions and other

sanctions that limit growth. The Federal Credit Union Act requires credit unions to have 7% net worth to be considered well-capitalized and 6% net worth to be adequately capitalized.¹²

Over the last two years, as many banks have failed and depositors have sought the safety and stability of credit unions, some credit unions have had to turn away members' deposits or ask members to withdraw funds in order for the credit unions to retain their net worth ratios or increase them. Credit unions exist to serve members, not to turn them away.

We urge Congress to permit the use of supplemental capital instruments to boost credit unions' net worth and permit them to continue to serve their members fully. We ask that the Subcommittee, in conjunction with the Committee on Financial Services, give serious consideration to the need for improvements in the regulation of credit union capital and the ability to supplement capital in a manner that is consistent with safety and soundness.

Member Business Lending Cap

Since they were first established in the United States over one hundred years ago, credit unions have been providing business loans to their members. They want to lend more to their members who own small businesses, but they are restricted in the amount they can lend by a statutory cap imposed in 1998. In the last Congress, when the Administration proposed spending \$30 billion of taxpayer money to encourage community banks to lend to small businesses, credit unions encouraged Congress to pass legislation to increase the credit union member business lending cap from its current level, 12.25% of total assets to 27.5% of total assets. The legislation was developed by the Treasury Department and Treasury Secretary Timothy Geithner strongly endorsed it. Also, the National Credit Union Administration Board,

¹² 12 U.S.C. § 1790d; 12 C.F.R. part 702.

the federal regulator for credit unions, supports increased authority and has testified that any risk associated with additional credit union business loans is manageable and that the cap is not needed for safety and soundness reasons.

Bipartisan legislation to increase the member business lending cap (H.R. 3380 and S. 2919) was introduced in both chambers in 111th Congress. Madam Chairman, we appreciate your having cosponsored this legislation. We estimate that if this legislation becomes law, credit unions could lend an additional \$10 billion to their small business owning-members within the first year of implementation, helping to create over 100,000 new jobs. This proposal is economic stimulus that does not cost the taxpayers a dime, and would not increase the size of government. It is a commonsense proposal that Congress should swiftly enact.

Recommendations

While we have discussed a number of concerns in this testimony, these just begin to scratch the surface of regulatory hurdles and burdens that prevent credit unions from serving their members even better. As the Dodd-Frank Act is implemented, we encourage Congress to consider the following statutory changes:

- Repeal or significantly reform Section 1075 related to debit interchange regulation so that the intent of Congress that small issuers be exempt from the regulation is realized.
- Provide for regular inflationary adjustments to the various thresholds in the Dodd-Frank Act, including but not limited to the thresholds in Section 1025, 1026 and 1075.
- Require federal financial regulators and the Bureau to report to Congress annually on steps they have taken in the previous year to reduce the regulatory burden on the institutions they supervise.
- Direct the Bureau to conduct a study and present recommendations on statutory and regulatory improvements to reduce regulatory burdens on financial institutions, consistent with the requirement under the Dodd-Frank Act that the

Bureau identify and address unnecessary, outdated and unduly burdensome requirements.

Further, we encourage Congress to play a critical role in helping credit unions do even more to help boost the economy and create jobs by supporting the following recommendations beyond the scope of the Dodd-Frank Act:

- Eliminate or increase the statutory cap on credit union business lending.
- Amend the statutory capital restrictions to allow credit unions to strengthen their net worth with supplemental capital.

Conclusion

Madame Chairman, credit unions appreciate your recognition of the significant costs to our communities and the economy in general associated with the growing regulatory burden faced by credit unions and the prospect of even more regulation under the Dodd-Frank Act. While CUNA supported many of the goals of the Dodd-Frank Act, we are concerned that growing regulatory burdens will divert credit unions from serving their members. We appreciate your review of the implementation of this legislation and its implications for credit unions and their members. And, we look forward to working with you on this issue.

Thank you very much for the opportunity to testify at today's hearing. I am happy to answer any questions that the Members of the Subcommittee may have.