Credit Union National Association
CUNA

WASHINGTON, D.C.
99 M Street SE
Suite 300
Washington, D.C. 20003-3799
Phone: 202-638-5777
Fax: 202-638-7734

October 28, 2022

Ms. Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NCUA Staff Draft 2023-2024 Budget Justification; NCUA–2022–0145

Dear Ms. Conyers-Ausbrooks:

On behalf of America's credit unions, I am writing regarding the National Credit Union Administration's (NCUA or agency) 2023 draft budget. The Credit Union National Association (CUNA) represents America's credit unions and their more than 130 million members.

We commend the agency for continuing to provide comprehensive budget information as well as rationalization of the budget and agency expenditures in the context of a well communicated strategic plan. Providing budget items in advance, holding an open briefing where stakeholders are invited to present, and soliciting written comment is good public policy and reflects the agency's commitment to government transparency.

CUNA and our member credit unions recognize that the NCUA is the only Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) agency that has embraced this level of transparency and engagement. We greatly appreciate this distinction. Please keep doing this. This process is incredibly important. As advocates, our ability to see these details and connections helps us better articulate to our member-credit unions exactly what the agency is doing and why it is doing it. Given their unique ownership structure, credit unions deserve to know how and where their members' money is being spent.

They deserve to see the link between those expenditures and their mission of improving financial well-being for all. And they deserve to weigh-in (directly or indirectly) when they perceive a significant disconnect in spending plans and priorities when compared to their core mission.

We, once again, find the NCUA's Budget Justification document to be clear, comprehensive, and well-developed. The proposed activities and expenditures described generally align with strategic initiatives that the agency has previously detailed and that CUNA has analyzed, discussed, and broadly encourages and supports.

The NCUA's proposed 2023 budget reflects an 8.1% increase in expenditures overall compared to the 2022 Board-approved budget. Although the requested Capital Budget and Share Insurance Fund Administrative Budget reflect declines, the Operating Budget (which accounts for 94% of total agency expenditures) reflects an increase of 9.6%. While an increase is unsurprising in today's economic environment, CUNA is concerned with the extent of this proposed increase, as described in detail below.

The increases are proposed against a backdrop of elevated financial pressure at the nation's credit unions—with operating expenses and funding costs rising rapidly and a variety of income sources under increasing pressure (most especially non-interest income). Net income is on track to decline by 30 basis points in 2022. Most economists believe the Federal Reserve's aggressive policy moves are likely to put the nation into recession—which would only serve to magnify these current financial challenges. These trends suggest the agency should be laser-focused on budgetary discipline, just as credit unions are in an environment where costs are increasing across the board.

<u>**Operating Budget**</u>

Employee Pay and Benefits

The proposed 9.6% increase in the Operating Budget is dominated by increases in Employee Pay and Benefits, which account for 76% of proposed expenditures within the Operating Budget. This increase totals $12.9 million (or 5.1%) in 2023.

We recognize the lack of flexibility the agency has regarding the primary drivers of increase costs related to Pay and Benefits. As noted in the Budget Justification, these are:

- Merit and locality pay increases in accordance with the agency's Collective Bargaining Agreement and merit-based pay system.
- Contributions for employee retirement to the Federal Employee Retirement System, which are set by the Office of Personnel Management (OPM).
- Contributions for employee health insurance, which are also set by OPM.

Within the category of Pay and Benefits, the proposed increase in the Operating Budget reflects 25 new positions compared to 2022 staffing levels. This includes 20 new positions and five previously authorized positions that would be made permanent.

While, as noted above, the NCUA has limited flexibility regarding the primary drivers of the increased costs associated with Pay and Benefits, the agency does have greater latitude in the number of new positions it creates and existing vacancies it fills. The first-year cost of the proposed 25 net new positions is estimated to be $4 million.

We support the addition of certain positions, such as the proposed new position for the Office of Minority and Women Inclusion to support the agency's special emphasis programs. We also agree with making permanent certain positions previously authorized, such as the position for the Office of Ethics Counsel to consolidate the regional ethics program.

Further, we understand the potential need to increase the number of special examiners and supervisory specialists at the regional office level, particularly given the recent increase in the threshold for supervision by the Office of National Examinations and Supervision (ONES), which results in credit unions continuing to be supervised by their regional office until they reach $15 billion in assets. However, we urge the agency to further evaluate whether a net increase of 10 specialist examiners at the regional office level is necessary, even in light of the ONES threshold increase. It is important that credit unions be afforded sufficient ability to manage their own operations. An approach that is overly focused on examiners' use of judgement in lieu of that of credit unions' can stifle credit unions' ability to ultimately serve their members. Further, as discussed in detail below, we are concerned with the proposed increase of eight new regional consumer compliance specialists. Overall, if the agency is able to eliminate even one of these 25 new positions, credit unions will benefit. Again, we recognize the crucial work of the NCUA's roughly 1,200 employees, including the critical work of specialist and generalist examiners alike. However, if efficiencies can be achieved, either through a reduction or consolidation of current positions or a reduction in the number of new positions established, we believe the agency has the duty to pursue such cost-savings.

In rationalizing the proposal to add staff, the agency has suggested that growth in large, complex credit unions is a key driver. However, large institutions are not necessarily complex. In fact, using the NCUA's measures of complexity, it appears that more than half of credit unions with $1 billion or more in total assets are not complex. Furthermore, recent growth in the number of $1 billion credit unions should be evaluated in the context of (1) inflation over the past several years and (2) the source of recent asset growth. In fact, massive federal fiscal support caused credit union savings balances (*i.e.*, assets) to increase dramatically over the course of the COVID crisis. One could reasonably argue that the growth in savings balances reduced (rather than increased) complexity and risk exposure to the National Credit Union Share Insurance Fund (NCUSIF or Fund). Regardless, we are concerned that the agency has failed to clearly articulate its rationale for the proposed staff increases.

Travel Expenses

Travel expenses, which account for 6.6% of Operating Budget expenditures are proposed to increase by $5.0 million or 27.5%. The Budget Justification notes that the proposed increase in travel expenses does not represent a typical annual travel adjustment because the 2022 budget was lower due to restricted travel during the pandemic. The 2023 budget assumes that travel will return to approximately 75% of its pre-pandemic levels.

As referenced in the Budget Justification, we urge the agency to continue to seek to contain travel costs by use of offsite examination procedures and virtual options for training. As was evidenced over the past two years, cost savings in the area of travel is certainly possible, and does not generally result in any increase in risk to the credit union system. This is particularly true in the area of remote examination; while there was a learning curve for some credit unions and examiners alike, credit unions and the agency established systems and procedures that ultimately resulted in very effective offsite examination. Further, though the agency has resumed on-site operations generally, we ask it to assess when fully-remote examinations may be appropriate; it is our understanding that some State Supervisory Authorities allow for 100% remote examinations for some state chartered credit unions.

Contracted Services; Administrative Expenses; and Rent, Communications, and Utilities

The remaining broad expense items—which account for approximately 17% of the Operating Budget—are each proposed to increase in 2023. Specifically, the budgets for contracted services, administrative expenses, and rent, communications, and utilities are proposed to increase by 30.3%, 10.8% and 21.8%, respectively. We urge the agency to examine where it can achieve cost savings in each of these categories. For example, the NCUA should thoroughly evaluate its lease plans for the Southern Region office in Austin, TX, which is one of the most expensive real estate markets in the country.

The Budget Justification is comprehensive from the standpoint of overall agency operations. At the same time, for some items, we ask the agency to provide greater detail. For example, a short narrative on the requested budget relative to current-year projected expenditures would be helpful. More detail about the proposed expenditures for each of the new staff positions proposed would also be helpful. We appreciate the agency hearing our previous concerns and providing additional detail in the Budget Justification regarding the duties to be performed by new positions. However, we ask the NCUA to go even further, providing much more detail regarding the specifics of these duties and the need for these duties to be performed.

CUNA believes that the efficiency of the NCUA's operation is essential to responsibly using credit union members' resources as the NCUA seeks to become a world class regulator. We believe there is immense capacity for the NCUA to reduce its footprint, right-size the organization and become a more nimble, stronger, more efficient, and more effective regulator.

Consumer-Focused Examinations

As we have raised previously, we continue to have significant concern around any expansion in consumer protection examination activity. Our members believe altering the agency's risk-focused examination process and substantially increasing consumer examination-related expenditures is simply not warranted.

There are three key reasons we strongly object to these impulses:

1. First, as its mission statement makes clear, the NCUA exists chiefly to ensure the safety and soundness of the credit union system. Its examination program should remain focused on that primary objective.

2. Second, the NCUA uncovers and cites occasional individual instances of credit union behaviors and member interactions it deems concerning. This suggests the agency already has—through the risk-focused examination process and consumer complaint hotline—the requisite resources and tools in place to investigate, uncover, and evaluate any deficiencies in an individual credit union's consumer compliance program. Proposed increases in expenditures—especially expansion of staff in this area—should be accompanied by a rationale for such action with an eye on a narrow, non-expansive scope of supervision.
3. Third, credit unions are the original consumer financial protectors. The unique credit union member-ownership structure and not-for-profit status establishes powerful incentives that discourage anti-consumer behavior. These underlying characteristics set credit unions apart and encourage strong pro-social and pro-consumer behaviors. They provide a clear and powerful deterrent to anti-consumer behaviors.

   Unlike banks, credit unions most assuredly put "people before profits." The credit union movement's collective focus on financially healthy members and healthy communities has historically, consistently been easily observable. Within credit unions, the absence of outside owners demanding a market rate of return on the invested capital clearly and powerfully encourages desirable behaviors and clearly and powerfully discourages undesirable behaviors.

NCUA examiners are keenly focused on any hint of anti-consumerism and they take their jobs very seriously. Credit union members need no significant additional investment of NCUA resources to protect them from the institutions they own. Rules, regulations, *and* examinations should be tailored so they are not overly burdensome on credit unions. Consumers lose when one-size-fits-all rules and burdensome examinations force credit unions to pull back safe and affordable options from the market, pushing consumers into the arms of unregulated entities engaged in the very activity that the NCUA hopes to curtail.

Consequently, an overwhelming majority of CUNA members reflect strong resistance to additional and superfluous NCUA consumer protection oversight.

We also caution the NCUA against drawing parallels between itself and bank regulators in terms of resource allocation or examination priorities. Ultimately, each federal banking agency is tasked with overseeing significantly different entities with markedly different organizational structures, product offerings, and risk profiles. The fact that a regulator of for-profit banks identifies a systemic need for the industry it regulates does not mean that other regulators—especially the regulator of not-for-profit cooperatives—ought to follow suit.

Further, CUNA and our League partners are willing and able to aid the NCUA in ensuring credit unions are aware of any potential consumer compliance concerns being raised with the agency. This can be achieved through our regular communications, webinars, and trainings with credit union representatives, or potentially through a dedicated alert communication. As you are aware, CUNA and state Leagues have always been strong partners with the NCUA in educating credit unions regarding examination and compliance issues, as we all have the same vested interest in the financial health and well-being of Americans.

Extended Examination Cycle

Efforts by the NCUA to extend the examination cycle for certain credit unions have been positive, particularly for credit unions for which a 12-month cycle was clearly unnecessary.

More can be—and in our view—should be done on this front. The state and federal policy responses to the COVID-crisis resulted in unusually strong deposit inflows from federal fiscal stabilization/stimulus efforts increasing the number of $1 billion plus credit unions by a total of 85 in the 30 months ending June 2022. At the institution level, those increases generally occurred against a backdrop of substantial growth in low-risk investments and little increase in risk profiles—which have not changed significantly since that time.

We therefore again urge the NCUA to extend the credit union asset threshold for the 18-month examination cycle from $1 billion to $3 billion.

National Credit Union Share Insurance Fund

The NCUSIF remains strong. The Fund's equity ratio stands at 1.26% and is projected by agency staff to climb to 1.30% by year-end. This is, of course, despite a massive fiscal stimulus that led to an enormous surge in insured shares over the past two years.

Given the overall health of credit unions, the health of the Fund and its historically favorable performance, we strongly object to any suggestion that the NCUA may need to charge a premium in the near future and/or that statutory changes to the NCUSIF funding guidelines are needed.

Every dollar spent over-insuring the Fund is a dollar that is not being used to the benefit of credit union members. We believe any changes to the NCUSIF are unwarranted and counterproductive. Credit union members need their credit unions in the market working to improve their financial well-being and advancing the communities they serve. Please do not take money out of credit union members' accounts to over-insure a Fund that historically has performed exceedingly well.

System Liquidity Trends and the Need for Continued Access to the CLF

The combination of historically weak savings growth and historically strong loan growth has led to an obvious decline in liquidity profiles at natural person credit unions.

Large savings outflows/disintermediation: COVID-19 caused the fastest two-year savings growth rates in history in 2020 and 2021. However, CUNA economists forecast a 2022 savings growth of 3.5%, which would be among the slowest rates of the past forty years: a remarkable reversal. Further, with an inflation rate over 7.0%, real (inflation adjusted) savings growth will be negative for the year. This weak growth is due in part to members spending down the excess savings built up during the worst of the COVID shutdowns. More recently, members with larger deposits are likely finding interest rates at internet banks, money market mutual funds, and even on U.S. Treasury bills attractive: cross- and dis-intermediation.

Historically strong loan demand: Credit union lending has been on a tear so far this year, and the 18% increase in outstanding loans CUNA economists expect by the end of the year will be the strongest calendar year growth in over 35 years. This is due to a surge in pent up consumer demand as the effects of COVID recede, coupled with the higher prices of products members are financing (*e.g.*, Case-Shiller data shows home prices are up 16% for the year ending July 2022 and the U.S. Bureau of Labor Statistics reports car prices are up 15% over the same period). Of course, slowing prepayments on mortgage loans due to higher interest rates are also playing a role.

These trends are an obvious reminder that stress on agency resources (and on the proposed budget) could grow over the budget horizon. They also underline the absolute need for credit union access to liquidity generally *and* access to the Central Liquidity Facility (CLF) specifically. Absent extension of the temporary CLF enhancements, which are set to expire at year-end, the over 3,600 credit unions that currently have access to the CLF through their corporate credit union will lose this critical emergency liquidity source. We commend agency leadership for its efforts to maintain this access and welcome any further engagement to extend CLF enhancements.

Improving the Quality of the Examination and Supervision Process

As noted above, we have serious concerns about the agency's budget and proposed increases in staffing. We often also hear about the uneven quality of examinations. In many cases examination teams are praised and viewed as helpful and willing to listen. At the other end of the spectrum, we also hear concerns around inconsistency between teams and (in some cases) poor communication and even combative interactions.

These concerns are especially relevant in the context of proposals to boost staffing and the resulting increase in inexperienced examiners.

With this in mind, CUNA again suggests the agency give credit unions a more obvious role in the process of improving examinations. Specifically, we urge the NCUA to develop and conduct ongoing, confidential examination staff satisfaction surveys—distributed to credit unions after each examination. Of course, these surveys should be distributed, processed, and compiled outside the purview of the agency staff, and by an outside third party with each examiner's (or examination team's) average rating shared with the regions to assist in filling education and training gaps to improve the overall examination process.

Climate-Related Financial Risks

As outlined in the NCUA's 2021-2026 Draft Strategic Plan, Climate-Related Financial Risk is rising. As noted in CUNA's budget hearing testimony last year, credit unions have significant concern about any agency activities on this front. One year on, these concerns remain elevated.

Credit unions need additional tools to address these risks. Continued, significant field of membership reform is one of the fundamental ways to help institutions accomplish this. The ability to diversify fields of membership by industry and geographically can clearly help many credit unions lower exposure to climate-related risks. In a similar vein, portfolio diversification also can be a powerful tool—and we believe our work centered on removing the member business lending cap is paramount to achieving this goal. CUNA applauds the NCUA's support of efforts related to the cap, and we look forward to working with the agency to explore what additional steps might be taken.

While the agency is yet to provide details of its contemplated actions on this front, we urge the NCUA to collaborate thoroughly with the industry before any concrete steps are taken. Industry leaders have significant concerns around the possibility that the agency is considering actions that are widely seen as "meddling" and/or "mandates." CUNA would, of course, strongly resist any regulatory initiatives that might take on these characteristics.

Conclusion

On behalf of CUNA and our more than 130 million members, thank you for the opportunity to share our concerns regarding the agency's 2022-2023 draft budget. Please let me know if you would like any additional information regarding these comments or to discuss them further.

Thank you,

Jason Stverak
Deputy Chief Advocacy Officer for Federal Government Affairs