



## Testimony

Before the Committee on Banking, Housing, and Urban Affairs  
United States Senate

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# CREDIT UNIONS

## Proposed Reforms for Corporate Credit Union Regulation

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Mr. Chairman and Members of the Committee,

In our testimony last week, we briefly reviewed the circumstances leading to the failure of the Capital Corporate Federal Credit Union (Cap Corp), an institution that was supervised by the National Credit Union Administration (NCUA). We noted several basic weaknesses in Cap Corp's risk management system and the board of directors' oversight of that system. We also noted NCUA's repeated failures, since at least 1989, to ensure that problems identified in its own examinations of Cap Corp were addressed and resolved. Finally, we cited general weaknesses in NCUA's oversight of all 45 of the corporate credit unions and made eight remedial recommendations to the agency.

Before and since our testimony last week, we have discussed our concerns with NCUA board members and senior staff. We have received and reviewed drafts of the new regulations for corporate credit unions and we are encouraged by the staff's efforts to revise the corporate regulations. Our preliminary evaluation of those proposed regulations is based on an outline of the most recent version we have received.

In general, the outline appears to address almost all of our recommendations that are most appropriately addressed through regulation. However, it must be noted that these revised regulations are not final and must go through a number of steps before they become final. In addition, if these proposed regulations are to have the desired impact, NCUA must vigorously enforce them.

The draft regulations would generally narrow the permissible activities and financial risks that corporates can undertake, and would require corporates to build a stronger capital base, including a specific minimum leverage requirement. In particular, they include more stringent requirements for stress testing and accounting for risky and volatile investments. They also require that, when unrealized investment losses exceed one-half of primary capital, the corporate must either begin to sell these investments or submit a plan to do so. Finally, the proposed regulations require large corporates to establish an internal audit function and emphasize the responsibility of corporate board members to truly oversee corporate management, especially in the area of risk management. We strongly endorse these concepts.

I would like to note that, as a result of these new regulations, the mission of corporate credit unions may be refocused. This is because tighter limits on risk-taking, together with higher capital requirements, may tend to make the investment yields offered by corporates less competitive. This in turn could cause shrinkage in the investments that natural person credit unions--especially the larger, more sophisticated ones--make in their

corporates. This may raise issues of corporate viability, at least temporarily. Thus, it is essential that NCUA ensure an orderly transition to the new regime. This being said, we believe this change will serve the interests of the thousands of small credit unions that do not have investment expertise and that concentrate major portions of their investments in their respective corporates. All natural person credit unions are in the end responsible for the safe and sound investment of deposited funds that are not needed for loans to their members. However, if these credit unions decide to concentrate their investments in corporates--often well in excess of the insured limit--they should be assured that their money is both safe and available as needed, even if at a reduced yield.

In last week's testimony we made eight recommendations to NCUA. We believe that NCUA's proposed regulations will address, in whole or in part, four of those. The other four are concerned with improvements in NCUA's oversight of the industry, which cannot be addressed by means of a regulation. However, they too are important for enhancing the safety and soundness of the credit union industry. We recommended that NCUA:

1. Closely monitor the financial condition and risk-taking of corporate credit unions and large natural person credit unions, especially those that have been substantially affected by declines in the market value of their assets;
2. Increase the expertise of staff overseeing corporate credit unions, especially emphasizing training in investment analysis;
3. Assess the accuracy and completeness of call report data and take steps to ensure that data are accurate and useful for offsite supervision;
4. Delay implementing any policy that would allow corporates to compete with each other for membership until necessary regulatory reforms, including adequate capital standards, are established and in force.

Finally, we observe that NCUA's new regulations will only be as effective as their enforcement. This may be obvious, but our review of Cap Corp's history shows that stronger NCUA enforcement of its then existing regulations might have prevented that failure.

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We would be pleased to answer any questions you might have.

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