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SENATE

REPORT
104–133

CREDIT UNION REFORM AND ENHANCEMENT ACT

REPORT

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

TO ACCOMPANY

S. 883

AUGUST 9 (legislative day, JULY 10), 1995.—Ordered to be printed

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C O N T E N T S

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Mr. D'AMATO, from the Committee on Banking, Housing, and Urban Affairs, submitted the following

REPORT

[To accompany S. 883]

INTRODUCTION

On June 28, 1995, the Senate Committee on Banking, Housing, and Urban Affairs (the "Committee") marked up and ordered to be reported S. 883, the Credit Union Reform and Enhancement Act ("CURE"), a bill to strengthen the safety and soundness of federally insured credit unions and to protect the National Credit Union Share Insurance Fund ("NCUSIF") from losses due to high risk activities.

The Committee vote was unanimous to adopt S. 883 without amendment and to report it to the Senate for consideration. Nine Republicans and seven Democrats voted in favor of adopting and reporting the bill. Voting to report the bill were Chairman D'Amato and Senators Gramm, Shelby, Bond, Mack, Faircloth, Bennett, Grams, Frist, Sarbanes, Dodd, Kerry, Bryan, Boxer, Moseley-Braun and Murray. No senators opposed the bill.

PURPOSE AND SUMMARY

Over the last two decades, the credit union industry in the United States has undergone rapid change. In the early 1970s, almost 24,000 credit unions were operating in the United States.[1] These credit unions had $18 billion in total assets, 23 million members, no federal deposit insurance, asset powers limited to short-term small consumer loans, and restricted membership requirements.[2] Today, 11,991 credit unions have federal deposit insurance, total assets of $289.5 billion, more than 65 million members, the author-

[1] General Accounting Office, "Credit Unions: Reforms for Ensuring Future Soundness," July 1991, p. 2 (*hereinafter*, GAO Report).
[2] *Id.*

ity to offer a wide range of consumer and business loans and investment services, and relaxed membership requirements.[3]

As federally insured credit unions grow and evolve into more diversified financial institutions, it is important that the systems intended to ensure their safety and soundness and minimize risk to the NCUSIF change as well. In some cases, the National Credit Union Administration ("NCUA") has been able to modernize and improve these systems by regulation. In other cases, however, legislation is necessary.

The purpose of S. 883 is to strengthen the safety and soundness of the credit union system and to protect the taxpayer-backed NCUSIF from losses due to the increasingly risky activities of credit unions. Specifically, S. 883 intends: (1) to limit certain high risk investments by federally insured credit unions; (2) to ensure the prompt detection of unsafe and unsound practices; and (3) to ensure the prompt resolution of problem and failing credit unions. To achieve this purpose, S. 883 would:

- Prohibit federally insured credit unions from investing in non-federally insured credit unions. Such investments currently place federally insured credit union deposits outside the scope of federal supervision and regulation.
- Prohibit federally insured, state-chartered credit unions from engaging in high risk activities—such as direct equity investments and investments in foreign country bonds—that are not permitted under federal law, unless the NCUA determines that the activity does not pose a significant risk to the federal insurance fund or unless the activity was authorized pursuant to the laws of the chartering state and utilized by at least one credit union in that state on May 1, 1995.
- Require the NCUA to set limits on loans and investments by a corporate credit union to a single obligor and establish minimum capital requirements for corporate credit unions.
- Allow the NCUA to appoint itself as liquidating agent for a federally insured, state-chartered credit union that is insolvent or bankrupt, after prior consultation with the state regulator.
- Allow the NCUA to implement a timely conservatorship for a federally insured, state-chartered credit union by eliminating the 30-day waiting period that can be imposed upon the NCUA under current law. Prior consultation with the state regulator would, however, continue to be required.

S. 883 is the result of a bipartisan effort by the Committee to respond to discrete weaknesses in the regulation and federal insurance systems for credit unions. It is based on many months of study, public hearings, extensive meetings with the GAO, federal regulators and the affected industries, new research and a thorough review of the existing body of work in this area. S. 883 was carefully drafted to achieve a balance between strengthening the safety and soundness of the credit union system, minimizing risk to the taxpayer-backed federal insurance fund (the NCUSIF), and preserving the benefits of the current dual chartering system. S. 883 would achieve this balance in the following ways:

[3] See, National Credit Union Administration, *1994 Annual Report* (*hereinafter*, 1994 NCUA Annual Report).

First, S. 883 would grant the NCUA limited powers to minimize risk to the NCUSIF. It must be recognized that the NCUSIF is backed by the full faith and credit of the United States government and is not a self-financing industry program. The NCUA, not the state credit union supervisors, bears ultimate responsibility for protecting the NCUSIF and the nation's taxpayers from losses due to high risk activities. S. 883 would grant the NCUA the powers necessary to protect the NCUSIF from such losses. As is described more fully below, failing to give the federal regulator adequate authority over federally insured state savings associations was one of the causes of the savings and loan debacle.

Second, the limited powers granted to the NCUA are comparable to but less broad than the powers already granted to the Federal Deposit Insurance Corporation ("FDIC") over federally insured, state-chartered savings associations and banks. Under current law, for example, the FDIC can prohibit federally insured, state-chartered savings associations and banks from "engaging in any activity" that is not permitted for their federally chartered counterparts, a broader authority than is granted to the NCUA by S. 883.[4] In addition, the FDIC can place federally insured, state-chartered savings associations and banks into liquidation even prior to insolvency or bankruptcy, an authority not provided to the NCUA in this bill.[5]

Third, S. 883 would only apply to federally insured credit unions. It would not apply to state-chartered credit unions that are privately insured or uninsured. State-chartered credit unions are only subject to S. 883 if they voluntarily choose—or are required by their state legislatures—to have federal insurance. If a state credit union benefits from federal deposit insurance, it should be required to comply with the safety and soundness regulations put in place to protect the federal insurance fund and the nation's taxpayers from losses.

Fourth, S. 883 would not prohibit state-chartered credit unions from exercising any asset powers that are currently being utilized. S. 883 contains a "grandfather" clause that exempts all asset powers currently authorized pursuant to a state's laws and utilized by a credit union in that state on May 1, 1995. This "grandfather" clause was included in S. 883, because most federally insured, state-chartered credit unions currently are not utilizing asset powers that pose a significant risk to the NCUSIF.

Fifth, S. 883 would not prohibit state legislatures and regulators from granting state chartered credit unions new asset powers that are broader than those granted to federally chartered credit unions. Rather, it would prohibit federally insured, state-chartered credit unions from engaging in such asset powers, only if the NCUA Board of Directors (the "NCUA Board") determines that such powers pose "a significant risk" to the taxpayer-backed insurance fund.

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[4] *See,* 12 U.S.C. 1831a and e.

[5] *See,* 12 U.S.C. 1831o(h)(3). See also, Fax from Neil D. Levin, Superintendent of Banks, State of New York, to the Committee, May 19, 1995 (Based on its analysis of S. 883, the New York State Banking Department concluded that granting the NCUA the authority to initiate credit union liquidation or conservatorship "would be consistent with authority of [the Office of Thrift Supervision] under 12 USC 1464 and FDIC under 12 USC 1821" over federally insured, state chartered thrifts and banks and, therefore, found "no reason to object to these provisions in the proposed legislation.").

Thus, S. 883 would allow federally insured, state chartered credit unions to experiment with new powers and other innovation consistent with maintaining safety and soundness and minimizing risk to the NCUSIF.

S. 883 has received the support of the NCUA, the General Accounting Office ("GAO"), and the Treasury Department. The Chairman of the NCUA, Norman E. D'Amours, stated that S. 883 "will greatly strengthen NCUA's ability to preserve the safety and soundness of federally-insured credit unions. You have my full support for its speedy enactment." [6] The Director of the Financial Institutions and Market Issues Division of the GAO, James L. Bothwell, noted that S. 883 "would enhance the safety and soundness of federally insured credit unions and further the protection of the National Credit Union Share Insurance Fund." [7] The Assistant Secretary of the Treasury, Richard S. Carnell, expressed the Clinton Administration's strong support for the reforms contained in S. 883:

> These reforms, previously approved by the Senate in 1991, respond to potential weaknesses in the credit union system documented in the General Accounting Office's 1991 report, "Credit Unions: Reforms for Ensuring Future Safety and Soundness." The reforms would strengthen the credit union system, protect the National Credit Union Share Insurance Fund, and help credit unions continue their record of meeting Americans' financial needs safely and soundly. We urge prompt enactment of S. 883.[8]

HISTORY OF THE LEGISLATION

On June 6, 1995, the Chairman of the Committee, Senator Alfonse M. D'Amato, and the Committee's Ranking Member, Senator Paul S. Sarbanes, introduced S. 883.

On February 28 and March 8, 1995, the Committee held hearings to examine the condition of the credit union industry and the failure of Capital Corporate Federal Credit Union, the largest failure by a credit union in American history. Witnesses testifying on February 28 included Norman E. D'Amours, Chairman, NCUA; Charles A. Bowsher, Comptroller General of the United States, GAO; James R. Bell, President, U.S. Central Credit Union; Harold A. Black, Professor, University of Tennessee, Knoxville; Edward J. Fox, President and Chief Executive Officer, Mid-Atlantic Corporate Federal Credit Union; and Richard M. Johnson, President and Chief Executive Officer, WesCorp Federal Credit Union. Witnesses testifying on March 8 included Norman E. D'Amours, Chairman, NCUA; James L. Bothwell, Director, Financial Institutions and Market Issues, General Government Division, GAO; James R. Bell, President, U.S. Central Credit Union; Albert E. DePrince, Professor, Middle Tennessee State University, Nashville; Edward J. Fox, President and Chief Executive Officer, Mid-Atlantic Corporate Fed-

[6] Letter from Norman E. D'Amours, Chairman of the NCUA, to Senator Alfonse M. D'Amato, May 24, 1995.
[7] Letter from James L. Bothwell, Director, Financial Institutions and Market Issues, GAO, to Senator Alfonse M. D'Amato, May 24, 1995.
[8] Letter from Richard S. Carnell, Assistant Secretary of the Treasury, to Senator Alfonse M. D'Amato, June 26, 1995.

eral Credit Union; and Richard M. Johnson, President and Chief Executive Officer, WesCorp Federal Credit Union.

On June 28, 1995, the Committee marked up and ordered to be reported S. 883. The Committee vote was unanimous to adopt S. 883 without amendment and to report it to the Senate for consideration. Nine Republicans and seven Democrats voted in favor of adopting and reporting the bill. Voting to report the bill were Chairman D'Amato and Senators Gramm, Shelby, Bond, Mack, Faircloth, Bennett, Grams, Frist, Sarbanes, Dodd, Kerry, Bryan, Boxer, Moseley-Braun and Murray. No senators opposed the bill.

BACKGROUND

The Credit Union System

Credit unions are cooperative not-for-profit associations in which members, who are the owners, deposit funds and obtain credit. Credit union members must have a "common bond," such as working for the same employer, which is specifically defined in the credit union's charter. As of June 30, 1994, there were 12,446 credit unions, with total assets of $295.8 billion and with more than 65 million members.[9] While the credit union industry is quite large in the aggregate, a majority of the credit unions are relatively small and many are managed primarily by volunteers.

History of the Credit Union System

From their introduction into the United States in the early 20th century, credit unions have played a special role in the U.S. financial system, promoting thrift among their members and providing services to those members that were denied to them by larger depository institutions. One of the stated purposes of the Federal Credit Union Act, passed in 1934 to provide federal charters for credit unions, was "to make more available to people of small means credit for provident purposes." [10]

Structure of the Credit Union System

The credit union industry can best be visualized as a triangle. 12,446 natural person credit unions form the base of the industry structure. Natural person credit unions primarily serve individuals, who are their member-owners. These natural person credit unions are in turn the member-owners of 44 corporate credit unions. These corporate credit unions provide liquidity and investment services to other credit unions. The corporate credit unions, in turn, are the members-owners of a single, very large corporate credit union—U.S. Central Credit Union—into which they can invest all or a portion of their assets and from which they can borrow to meet liquidity needs.

Credit unions, like banks and thrifts, are chartered by both the federal government and by state governments. As of December 31, 1994, 7,497 credit unions were federally chartered and federally insured, and 4,494 credit unions were state chartered and federally

[9] Callahan and Associates, *1995 Credit Union Directory*, October 1, 1994, p. 1.
[10] Federal Credit Union Act, 48 Stat. 1216 (codified as 12 U.S.C. 1751 et seq).

insured.[11] As of that date, only 617 state-chartered credit unions were not federally insured but were, instead, insured by private, cooperative entities.[12] Thus, more than 95% of all credit unions (11,991 of 12,608) are federally insured.

The National Credit Union Administration

All federally insured credit unions—whether federally chartered or state charted—are regulated and supervised by the NCUA. The NCUA is an independent federal agency administered by a three-member board. Board members are appointed to 6-year terms with the advice and consent of the United States Senate. The NCUA administers the NCUSIF, which was established in 1970 to provide federal share (deposit) insurance for credit unions. To protect the insurance fund, the NCUA has both general rulemaking authority and enforcement powers to address unsafe or unsound conditions and violations of laws or regulations. The NCUA's authority includes cease and desist powers, civil money penalty authority, removal and prohibition authority and the power to terminate federal insurance.

THE NEED FOR LEGISLATION

Earlier this year Capital Corporate Federal Credit Union of Lanham, Maryland ("Cap Corp") failed—the largest credit union failure in United States history. Cap Corp had invested nearly 70 percent of its $1.5 billion in assets in a form of derivative instrument called a collateralized mortgage obligation ("CMO"). These highly interest rate sensitive instruments experienced significant losses in value as interest rates rose in 1994. The losses became so severe that the NCUA took over Cap Corp's operation by placing it into conservatorship on January 31, 1995 and ultimately placed it into liquidation.[13]

On April 13, 1995 the NCUA announced that the remaining assets, liabilities, and field of membership of Cap Corp had been acquired by Mid-Atlantic Corporate Federal Credit Union of Harrisburg, Pennsylvania. Before its acquisition, Cap Corp had experienced investment losses of $61 million, all of which were absorbed by Cap Corp's capital. As a result, the NCUSIF itself did not incur losses due to Cap Corp's failure.[14]

The failure of Cap Corp raised serious questions about the adequacy of the NCUA's regulation and supervision of corporate credit unions. A corporate credit union is a specialized form of credit union which accepts deposits only from other credit unions and credit union organizations rather than individuals. As of December 31, 1994, there were 45 corporate credit unions, including U.S. Central.[15] Corporate credit unions were created in the 1970's principally to serve as a source of liquidity for their member credit unions during periods when deposits were low. Over the years, however, they also evolved into sources of investment and payment services for their member credit unions.

[11] 1994 NCUA Annual Report, pp. 40–41.
[12] Data compiled by the NCUA from various sources.
[13] *Id.*
[14] *Id.*
[15] *Id.*

Due to increasing concern about the corporate credit union system, the NCUA Chairman, Norman E. D'Amours, appointed in early 1994 a Corporate Credit Union Study Committee, made up of five independent financial experts, to conduct a thorough review of the regulation of corporate credit unions. That committee's report, which was released on July 26, 1994, provided a careful and critical evaluation of the investment behavior and risk-taking of the corporate credit union system.[16] The report made the following findings:

- "Corporate credit unions . . . are assuming more risk in their investment practices and in their portfolios than in the past."[17]
- Corporate credit union "investment activities are becoming more complex and will continue to become increasingly complex in the future."[18]
- "Primary capital levels [for corporate credit unions] are, on average, inadequate."[19]
- "Credit analysis procedures [utilized by corporate credit unions] have not kept pace with the increased volume of funds flowing into the system."[20]
- Corporate credit unions "use derivative instruments to hedge interest rate risk and create synthetic securities for other corporates and natural person credit unions."[21]

The GAO, in an extensive 1991 report on the credit union industry, also raised particular concerns about the condition of the corporate credit union system. The 1991 GAO report stated:

> Changes are needed to augment NCUA's currently incomplete regulatory and supervisory authority over all corporates and provide for more carefully defined asset and liability powers and higher capital requirements.[22]

Prompted by the failure of Cap Corp, the Committee held hearings on February 28 and March 8, 1995 to examine the condition of the corporate credit union system and the performance of the NCUA. In testimony presented to the Committee, both the NCUA Chairman, Norman E. D'Amours, and the Comptroller General of the GAO, Charles Bowsher, confirmed the findings of the reports issued by their agencies.

Testimony at the Committee's hearings raised concerns that taxpayers could be forced to bail out credit unions that may be speculating in high risk derivative instruments. Like Cap Corp, many credit unions, both corporate and natural person, have substantial investments in CMOs and have experienced losses in the market value of these investments due to rising interest rates. Corporate credit unions have particularly high levels of CMO holdings and have incurred significant decreases in the value of these holdings. As of December 31, 1994, 25 of the 45 corporate credit unions, with

[16] Black, DePrince, Ford, Kudlinski, Schweitzer, "Corporate Credit Union Network Investments: Risks and Risk Management," 1994.
[17] *Id.*, p. i.
[18] *Id.*
[19] *Id.*, p. ii.
[20] *Id.*, p. iii.
[21] *Id.*, p. iv.
[22] GAO Report, p. 139.

total assets of $54.6 billion, held CMOs valued at $9.5 billion.[23] Almost 20% of corporate credit union assets were invested in CMOs. Of the 25 corporate credit unions holding CMOs, eight have 20% or more of their total assets invested in CMOs.[24] As of February 22, 1995, those corporate credit unions had unrealized losses in their investment portfolios of $742 million, a figure equal to more than 63 percent of their primary capital.[25] Natural person credit unions, which primarily serve individuals, also have invested in CMOs. As of December 31, 1994, 1,179 of the 11,991 natural person credit unions, with total assets of $113.6 billion, held CMOs valued at $6.7 billion, or 5.9% of assets.[26] Of those credit unions, 15 have 30% or more of their assets invested in CMOs.[27]

The low capital levels of corporate credit unions have heightened concerns about the health of the corporate credit union system. As of December 31, 1994, only eight of the 45 corporate credit unions had capital that was greater than four percent of their total assets, and, including Cap Corp, 11 corporate credit unions had capital of less than 2.5%.[28] As of that date, U.S. Central Credit Union, which provides services to other corporate credit unions, had a capital level of 1.1%. As of December 31, 1994, U.S. Central Credit Union had total assets of almost $19 billion and an unrecognized loss on investments equal to 33.7% of equity capital.[29] U.S. Central Credit Union is the largest credit union in the United States and is federally insured.

The NCUA announced at the Committee's hearings that it was in the process of developing a new set of regulations that would raise capital requirements, tighten investment authority, and raise management standards for corporate credit unions. The stated objective was to return corporate credit unions to their original mission of serving as liquidity centers and safe havens for their members' funds. NCUA had previously established a new Office of Corporate Credit Unions, hired additional corporate examiner staff, and expanded training for corporate examiners.[30] The NCUA issued its new corporate credit union regulations on April 13, 1995, and they were published in the Federal Register on April 26, 1995. The comment period ends on August 25, 1995. The NCUA had indicated, based on its review of the comments already received, that a second proposal will be issued in the fall of 1995.[31]

Although the new regulations address many of the problems relating to corporate credit unions that were identified by the NCUA and the GAO, there are a small number of matters that require legislative action. S. 883 would make those changes, some of which would apply to natural person credit unions as well as corporate credit unions.

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[23] Data compiled by the NCUA from various sources, including call reports.
[24] *Id.*
[25] *Id.*
[26] *Id.*
[27] *Id.*
[28] Knecht, "New Credit Union Rules Planned," *Wall Street Journal,* June 20, 1995, p. C1.
[29] *Id.*
[30] Testimony of Norman E. D'Amours, Chairman, NCUA, before the Committee on Banking, Housing and Urban Affairs, United States Senate, September 22, 1994.
[31] NCUA Press Release, July 14, 1995.

PURPOSE AND SCOPE

S. 883 responds to several discrete weaknesses in the credit union system. S. 883 would address those weaknesses in the least intrusive manner consistent with its purpose of strengthening the safety and soundness of the credit union system and minimizing risk to the taxpayer-backed NCUSIF.

Insured Credit Union Investments in Other Credit Unions

Federally insured credit unions invest a significant portion of their assets in corporate credit unions. As of December 31, 1994, federally insured credit unions had invested $24 billion in corporate credit unions, an amount equal to 33.65% of total investments of $101.5 billion and over eight percent of total assets of $289.5 billion.[32]

Five of the 43 corporate credit unions are state-chartered and uninsured and, therefore, outside the authority of the NCUA. The Federal Credit Union Act explicitly authorizes federally insured credit unions to invest in any corporate credit union, regardless of whether that corporate credit union has federal or private insurance. As a result, federally insured credit unions can and do invest in uninsured corporate credit unions.

Investments in such uninsured credit unions pose a significant risk to the NCUSIF and the safety and soundness of the credit union system. Since uninsured credit unions are outside the full supervisory and regulatory authority of the NCUA, they can engage in broader and potentially riskier activities than federally insured corporate credit unions. Moreover, if an uninsured corporate credit union were to fail, the deposits of its member natural person credit unions would not be insured. The failure of one of these uninsured corporate credit unions, therefore, could result in significant losses being passed on to federally insured credit unions and a domino-like failure of these federally insured credit unions.

The GAO's 1991 report on the credit union system raised serious concerns about the incomplete regulation and supervision of corporate credit unions:

> NCUA has incomplete regulatory and supervisory power over some [corporate credit unions] because of their charter and share insurance status. Because of (1) the high concentration of credit union assets in their respective corporates, (2) the low GAAP net worth of the corporate network in relation to its assets, and (3) the fact that more than 90 percent of the aggregate credit union deposits in corporates are not federally insured, the safety and soundness of the entire industry clearly requires that special attention be paid to the safe and sound operation of the corporates and U.S. Central.[33]

The GAO concluded that "NCUA authority to regulate and supervise corporates is incomplete, and NCUA does not fully use what

[32] National Credit Union Administration, "1994 Yearend Statistics for Federally Insured Credit Unions," p. 104.
[33] GAO Report, p. 138.

authority it does have."[34] Based on its analysis, the GAO recommended that federally insured credit unions be prohibited from investing in non-federally insured credit unions.

S. 883 follows this recommendation. It would prohibit federally insured credit unions from investing in non-federally insured credit unions. It would force all corporate credit unions with federally insured credit union deposits to obtain federal insurance, and, therefore, would bring all investments in corporate credit unions under the jurisdiction of the NCUA. Thus, S. 883 would reduce the potential for inappropriately risky investing that could pose an enormous risk to the NCUSIF.

Activities of Insured State-Chartered Credit Unions

The Committee is concerned that the existence of federal deposit insurance may, in some cases, give states an incentive to gamble at federal expense. The Federal Credit Union Act limits the asset powers of federally-chartered credit unions, but these limits do not apply to federally insured, state-chartered credit unions.[35] As a result, 39 states currently grant state-chartered credit unions broader and potentially riskier asset powers than those granted to federally chartered credit unions. None of these states, however, insure these riskier activities; they continue to rely primarily on the NCUSIF. One important lesson of the savings and loan debacle was that federally insured, state-chartered institutions can, with broad and potentially risky powers granted by state legislatures and regulators, present enormous risks to a federal insurance fund. S. 883 would limit the ability of federally insured, state-chartered credit unions to engage in certain high risk activities that are not permitted under federal law.

The Federal Credit Union Act limits the asset powers of federally chartered credit unions. It authorizes federal credit unions to make investments in several general categories:

- Obligations of the United States, and specified government-sponsored enterprises, any instrument issued by or fully guaranteed by any agency of the United States, or issued by a wholly owned government corporation;
- Shares or deposits of any corporate credit union authorized by the credit union's board;
- Investments in organizations providing services associated with the routine operation of credit unions; subject to a limit of one percent of total paid-in and unimpaired capital;
- Shares of federally insured credit unions;
- Banks or institutions the accounts of which are insured by the FDIC, or any national bank or specified other entities operating in accordance with the laws of the state in which the credit union does business; and
- Obligations of or issued by any state or political subdivision, subject to a limit of no more than ten percent of total paid-in and unimpaired capital and surplus with any one issuer (exclusive of general obligations).[36]

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[34] *Id.*, pp. 162–163.

[35] While the NCUA can require a state credit union to reserve for its more risky investments, the GAO has noted that additional improvements are needed. GAO Report, p. 77.

[36] 12 U.S.C. 1757(7) and (8).

These limits do not apply to federally insured, state-chartered credit unions, however, which comprise over a third (37%) of all federally insured credit unions. Data developed by the NCUA shows that 39 states currently grant state-chartered credit unions broader and potentially riskier investment powers than those granted to federally chartered credit unions The following are a few examples of investments permitted under state laws:

- Six states permit credit unions they charter to invest in foreign country bonds.
- Eight states grant state credit unions the authority to invest in corporate stocks and/or bonds.
- Two states allow their state credit unions to make any investments legal for savings banks or for trust funds in those states, and one state allows its state credit unions to make any investment legal for state banks.
- Five states allow credit unions to invest without limit in their respective state and/or local municipal bonds.

An important lesson from the savings and loan debacle was that such broad state powers can present enormous risks to a federal insurance fund.[37] In its 1993 report to Congress, entitled "Origins and Causes of the S&L Debacle: A Blueprint for Reform," the National Commission on Financial Institution Reform, Recovery and Enforcement found that: [38]

> Losses were greatest in Texas, California, and Florida where investment powers for state-chartered S&Ls were most generous, and supervision and examination most lax. The situation was most out of control in Texas, which became a breeding ground for imprudent and abusive practices. The S&Ls it chartered were allowed to engage in high-risk activities virtually without limit, and supervision and examination were essentially nonexistent for several

[37] The Committee has previously recognized the risk posed by such investments and the need for legislative action to address those risks:

> In the savings and loan crisis, risky State activities created big losses for the Federal deposit insurance system. States that gave their thrifts the most extensive powers, California and Texas, experienced the highest and most costly rates of thrift failure. Cleaning up failed State thrifts in these two states alone cost the Federal government fully 70 percent of its clean-up expenditures in 1987 and 1988. Congress addressed this problem in FIRREA by generally limiting State-chartered thrifts to activities permitted for federally chartered thrifts. The Committee believes there is a need for similar limits on State-chartered banks. . . .

Comprehensive Deposit Insurance Reform and Taxpayer Protection Act of 1991, Report of the Committee on Banking, Housing, and Urban Affairs, United States Senate, October 1, 1991, p. 50. The Federal Deposit Insurance Corporation Improvement Act ("FIDICIA") generally limited state-chartered banks to activities permitted federally-chartered banks. *See,* FIDICIA, Section 303, 105 Stat. 2349–2350 (1991) (codified as 12 U.S.C. 1831a). As noted, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") generally limited state-chartered thrifts to activities permitted for federally chartered thrifts. *See,* FIRREA, Section 222, 103 Stat. 269–270 (1989) (codified as 12 U.S.C. 1831e).

[38] The National Commission on Financial Institution Reform, Recovery and Enforcement was established by Subtitle F of Title XXV of the Comprehensive Crime Control Act of 1990, Public Law 101–647. The Commission was instructed to examine the causes of the problems in the savings and loan industry that led to the enactment of FIRREA. Members of the Commission were appointed by the President, the Speaker of the House of Representatives, and the President Pro Tempore of the United States Senate. In July 1993, the Commission submitted its report to the President and Congress of the United States.

> years. It was no accident that over 40 percent of all taxpayer losses came from Texas S&Ls.[39]

The Commission concluded that the "acquisition of substantial new asset powers" by state-chartered institutions and the "relaxation of regulatory and supervisory standards" by state and federal regulators were "factors precipitating the collapse" of the savings and loan industry.[40] Based on its analysis, the Commission made the following recommendation:

> Make all federally insured depository institutions subject to federal rules, regulations, and examination. These should supersede state rules, regulations and examinations—upon a finding that the latter threaten the safety and soundness of the insurance program.[41]

The Commission also recommended that no full-faith-and-credit guarantees should be given without legislation . . . designating a single federal authority as the accountable regulator."[42]

S. 883 follows the Commission's recommendation, but is less restrictive. S. 883 would prohibit federally insured, state-chartered credit unions from exercising new asset powers of a type, or in an amount, not permitted for federally chartered credit unions, unless the NCUA Board determines that "the exercise of the asset power would pose no significant risk" to the NCUSIF or unless the power was authorized pursuant to the laws of the chartering state and being utilized by at least one credit union on May 1, 1995. Thus, S. 883 would not prohibit any asset powers that were being utilized by a federally insured, state-chartered credit union on May 1, 1995. This broad "grandfather" clause was included in S. 883, because most federally insured, state-chartered credit unions currently are not utilizing asset powers that pose a significant risk to the NCUSIF. Thus, S. 883 would set up a tripwire against future high risk activities, allowing the NCUA to prevent losses from such activities—instead of reacting to those losses.

The FDIC's authority over state-chartered savings associations and banks is significantly broader than the authority granted to the NCUA by S. 883. Federally insured, state-chartered savings associations and banks are prohibited from engaging in any type of activity that is not permissible for their federally chartered counterparts, unless (1) the FDIC "has determined that the activity would pose no significant risk to the appropriate deposit insurance fund," and (2) the state-chartered savings association or bank "is, and continues to be, in compliance with applicable capital standards prescribed by the appropriate Federal banking agency."[43] Under S. 883, however, federally insured, state-chartered credit unions would only be required to obtain prior NCUA approval for new asset powers first authorized or utilized after May 1, 1995.

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[39] National Commission on Financial Institution Reform, Recovery and Enforcement, "Origins and Causes of the S&L Debacle: A Blueprint for Reform," July 1993, p. 4.

[40] *Id.*, p. 7.

[41] *Id.*, p. 13.

[42] *Id.*, p. 10. In its 1991 report, the GAO also recommended that the "NCUA should be authorized and required to compel a state credit union to follow the federal regulations in any area in which the powers go beyond those permitted federal credit unions and are considered to constitute a safety and soundness risk." GAO Report, p. 87.

[43] *See*, 12 U.S.C. 1831a and e.

Limits on Loan to a Single Obligor and Minimum Capital Requirements for Corporate Credit Unions'

There are no concentration limits and minimum capital requirements for corporate credit unions. The Federal Credit Union Act does not set either loan or investment concentration limits or minimum capital requirements for corporate credit unions. While the NCUA has the authority to set such standards by regulation, it only recently issued such rules for public comment. Such standards would strengthen the safety and soundness of the credit union system and minimize risk to the NCUSIF. S. 883 would require the NCUA to set and maintain such standards

The 1991 GAO report raised concerns about the lack of such standards:

> We are concerned about the high and potentially high concentrations of investments that may be made in single obligors other than credit union organizations and the U.S. government. The combination of the relatively low capital of corporates and the large investments they make can result in risk exposures to single obligors that are many times the corporate's GAAP net worth.[44]

The GAO recommended that "Congress should require NCUA to establish a program to promptly increase the capital of corporates and establish minimum capital standards."[45]

S. 883 is similar to this recommendation, but less intrusive. S. 883 would require the NCUA to establish limits on loans or investments to a single obligor and set minimum capital requirements, but it would allow the NCUA to determine what those standards should be. The NCUA has already taken steps to put such standards in place. On April 13, 1995, the NCUA Board approved for comment a proposed rule that would set limits on loans and investments by a corporate credit union to a single obligor and minimum capital standards for corporate credit unions.

NCUA Liquidation and Conservatorhip Authority for Federally Insured, State-Chartered Credit Unions.

Under current law, the FDIC has full authority to place federally insured, state-chartered banks, and savings associations into conservatorship and liquidation. Such powers are necessary to protect a federal insurance fund from losses. S. 883 would grant the NCUA comparable conservatorship and liquidation authority over federally insured, state-chartered credit unions. The authority granted to the NCUA, however, is less broad than the comparable authority already granted to the FDIC.

The need for regulators to act quickly to seize control of failed financial institutions is well documented. During the savings and loan crisis, for example, institutions attempted to avoid insolvency and bankruptcy by making increasingly risky investments as losses from previous high-risk investments mounted. S. 883 would grant the NCUA the authority to close a federally insured, state-chartered credit union that is insolvent or bankrupt, after prior con-

[44] GAO Report, p. 153.
[45] *Id.*, p. 164.

sultation with the state regulator. This amendment protects the taxpayer-backed NCUSIF, which would ultimately be responsible for any losses resulting from such a liquidation.

Because the health of a federally insured depository institution can deteriorate rapidly, the federal insurance regulator must have the power to act quickly to limit losses to the federal insurance fund. Even briefs delays in the implementation of Cap Corp's conservatorship, for example, could have resulted in millions of dollars of additional losses. Under current federal law, however, the NCUA can be forced to wait up to 30 days before placing a federally insured, state-chartered credit union into conservatorship, if the state regulator opposes the conservatorship.[46] S. 883 would eliminate the 30-day waiting period and simply require the NCUA to carry out prior consultation with the state regulator. Thus, S. 883 would increase the NCUA's ability to institute a timely conservatorship.

It is important to note that S. 883 would grant the NCUA authority less broad than the authority already granted to the FDIC over federally, insured, state-chartered thrifts and banks. The FDIC, for example, has the authority to place a federally insured, state-chartered bank or savings association into liquidation even prior to insolvency, when its capital drops below two percent.[47]

SECTION-BY-SECTION ANALYSIS OF S. 883, THE "CREDIT UNION REFORM AND ENHANCEMENT ACT"

Section 1. Short Title

Section 1 provides that S. 883 may be cited as the "Credit Union Reform and Enhancement Act."

Section 2. Insured Credit Union Investments in Other Credit Unions

Section 2(a) amends section 107(7) of the Federal Credit Union Act by eliminating subparagraph (G), which allows federally chartered credit unions to invest in uninsured corporate credit unions, and redesignating subparagraphs (H) through (K) as subparagraphs (G) through (J), respectively.

Section 2(b) amends Section 205 of the Federal Credit Union Act by adding a new subsection (j), prohibiting federally insured credit unions from investing in non-federally insured credit unions. Under subsection (j), an insured credit union may invest in shares, deposits, notes, or other instruments of another credit union only if such other credit union is also insured pursuant to Title II of the Federal Credit Union Act.

Section 3. Activities of Insured State-Chartered Credit Unions

Section 3 amends Section 205 of the Federal Credit Union Act by adding a new subsection (k). Subsection (k)(1) prohibits a federally insured, state-chartered credit union from exercising asset powers of a type, or in an amount, not authorized for federally chartered credit unions, unless the asset power was authorized pursuant to the laws of the state in which the credit union is chartered and

[46] *See*, 12 U.S.C. 1786(h)(2)(B).
[47] *See*, 12 U.S.C. 1831o(h)(3).

being utilized by at least one credit union in that state on May 1, 1995 or unless the NCUA Board determines that the exercise of the asset power would pose no significant risk to the NCUSIF. Subsection (k)(2) notes that nothing in subsection (k)(1) shall restrict or limit the general rulemaking authority of the NCUA. Subsection (k)(3) defines "asset powers" as any item or activity properly reflected on the asset side of the financial statements of a credit union and gives the NCUA authority to more specifically define "asset powers" by regulation of the NCUA Board.

Section 4. Corporate Credit Unions

Section 4(a)(1) amends Section 120(a) of the Federal Credit Union Act by removing an outdated reference to "central credit union", an institution that once performed functions similar to corporate credit unions, and replacing it with "corporate credit union". Section 4(a)(2) amends Section 120(a) by adding to the end a requirement that the NCUA Board pass regulations establishing limits on loans and investments by a corporate credit union to a single obligor and minimum capital requirements for corporate credit unions.

Section 4(b) amends section 101 of the Federal Credit Union Act by adding a new paragraph defining the term "corporate credit union" as having the meaning given to that term under the rules or regulations of the NCUA Board.

Section 5. Authority of the NCUA Board to Place Federally Insured, State-Chartered Credit Unions into Liquidation

Section 5 amends Section 207(a)(1) of the Federal Credit Union Act by adding a new subparagraph (B). This new subparagraph (B) grants the NCUA Board the authority to appoint itself as liquidating agent for a federally insured, state-chartered credit union that the NCUA Board determines is insolvent or bankrupt. The Board must consult with the appropriate state credit union supervisory authority prior to appointing itself as liquidating agent.

Section 6. Consultation for Conservatorships of Federally Insured, State-Chartered Credit Unions

Section 6 amends Section 206(h)(2) of the Federal Credit Union Act by eliminating the current requirement that the NCUA Board wait up to 30 days before placing a federally insured, state-chartered credit union into conservatorship. Under the new Section 206(h)(2) the NCUA would need only to carry out " prior consultation" with the appropriate state credit union supervisory authority.

REGULATORY IMPACT STATEMENT

While the regulatory impact of the provisions of S. 883 would depend upon future actions taken by individual states and the NCUA, it is anticipated that the regulatory impact would be minimal.

Section 2(a) and (b) of S. 883 would prohibit federally insured credit unions from investing in non-federally insured credit unions. If non-federally insured credit unions want to receive investments from federally insured credit unions, such non-federally insured credit unions would need to apply and be approved for federal share insurance.

Section 3 of S. 883 would prohibit federally insured, state-chartered credit unions from exercising new asset powers that the NCUA Board determines pose a significant risk to the NCUSIF. The NCUA currently has generally rulemaking authority to prohibit federally insured, state-chartered credit unions from exercising asset powers that pose a significant risk to the NCUSIF. Under S. 883, if a federally insured, state-chartered credit union wants to exercise a new asset power of a type, or in an amount, not permitted for federally chartered credit unions, it would have to forward the relevant state law or regulation to the NCUA for its review and approval. While the regulatory impact of S. 883 would depend upon the number of new asset powers granted by the states to state-chartered credit unions, it is anticipated that the regulatory impact would be minimal, because state laws pertaining to asset powers are fairly settled and significant and frequent changes are not anticipated.

Section 4 of S. 883 would require the NCUA to establish limits for corporate credit unions on loans and investments to a single obligor and minimum capital requirements for corporate credit unions. The NCUA already has issued for comment a proposed rule that should meet these requirements, so this section of S. 883 would have minimal regulatory impact on the NCUA. While a corporate credit union with high concentrations and low capital may face higher regulatory burdens than a corporate credit union with low concentrations and high capital, the nature and extent of any burden on corporate credit unions would depend upon the final standards established by the NCUA.

Section 5 of S. 883 would grant the NCUA Board the authority to appoint itself liquidating agent for a federally insured, state-chartered credit union that the NCUA Board determines is insolvent or bankrupt, after prior consultation with the appropriate state credit union regulator. Because the NCUA normally works closely with the appropriate state credit union regulator on such matters, the regulatory impact would be minimal.

Section 6 of S. 883 would eliminate the 30-day waiting period that can be imposed upon the NCUA prior to placing a federally insured, state-chartered credit union into conservatorship. No additional regulatory costs would accrue as a result of the implementation of the provision. Rather, the implementation of this section would result in savings to the insurance fund in those cases where the NCUA is able to implement a timely conservatorship and, thereby, prevent additional losses that would have accrued during a 30-day waiting period.

COST OF THE LEGISLATION

The Committee has requested a cost estimate of this legislation under the provisions of section 403 of the Congressional Budget Act of 1974. The cost estimate of the Congressional Budget Office follows.

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 10, 1995.

Hon. ALFONSE M. D'AMATO,
Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, DC

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 883, the Credit Union Reform and Enhancement Act, as ordered reported by the Senate Committee on Banking, Housing, and Urban Affairs on June 28, 1995. CBO estimates that enacting S. 883 could reduce spending for insurance losses in failed credit unions, but we expect such savings would be minimal. Because such spending is related to maintaining the deposit insurance commitment, which is exempt from pay-as-you-go calculations under the Budget Enforcement Act of 1990, pay-as-you-go procedures would not apply to the bill. Enacting S. 883 would have no significant effect on the budgets of state or local governments.

Section 2 would restrict the ability of federally insured credit unions to make investments in corporate credit unions that are not federally insured. All investments in corporate credit unions would be subject to the jurisdiction of the National Credit Union Administration (NCUA). The bill also would codify the existing authority of NCUA to limit loans that credit unions can make to a single borrower and to require minimum capital standards for credit unions. We expect that these changes would reduce risk to the National Credit Union Share Insurance Fund (NCUSIF), thereby helping to avoid future failures that would result in losses to the fund.

Section 3 would limit the powers of state-chartered credit unions, particularly in the area of so-called non-conforming investments, to those allowable to federally chartered credit unions. The provision would authorize NCUA to limit investment activities unless it believes that the investments pose no significant risk to NCUSIF, or unless the power was authorized pursuant to the laws of the chartering state and used by at least one credit union. The effect of this provision would be to require a state credit union to follow federal regulations in any area in which its powers go beyond those permitted federal credit unions and are considered to pose a risk to safety and soundness.

Section 5 would allow NCUA, after consulting with the state regulator, to liquidate a federally insured, state-chartered credit union, whereas now NCUA must wait until the state regulator closes the institution and appoints NCUA as the liquidator. Along with Section 6, which increases NCUA's ability to institute timely conservatorship, these provisions would allow NCUA to act quickly to limit losses to NCUSIF.

CBO estimates that NCUSIF will spend less than $30 million annually over the next several years to resolve failed credit unions. Estimating the amount of savings attributable to enactment of S. 883 is very difficult. Nonetheless, we expect that any such savings would be only a small fraction of these losses. Based on information from NCUA, we do not expect any significant change in its workload as a result of enactment of the legislation.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Mary Maginniss.

Sincerely,

JUNE E. O'NEILL, *Director.*

CHANGES IN EXISTING LAW

In the opinion of the Committee, it is necessary to dispense with the requirement of subsection 12 of rule XXVI of the Standing Rules of the Senate in order to expedite the business of the Senate.