CREDIT UNION TIMES

OPINION

It is Time to Modernize Credit Union Capital Standards

Among the several essential reforms contained in The Credit Union Regulatory Improvements Act, perhaps none is more essential than the provision to modernize credit union capital standards. You've probably heard a variety of reasons as to why it's so important. I'd like to distill those reasons down to three major points: 1) fairness, 2) safety, and 3) better service to credit union members.

• **Modernizing capital standards is fair.** The current leverage requirement (net worth to total assets) for a credit union to be classified as adequately capitalized is 6%. The parallel standard for banks is 4%. This "one size fits all" standard for credit unions ties-up excess capital that could be better used to serve credit union members and their communities, penalizes those credit unions with low-risk balance sheets, and places all credit unions at a competitive disadvantage compared with banks. CURIA would correct this imbalance by changing credit union leverage requirements to be consistent with those applied to banks.

CURIA also instructs NCUA to develop risk-based net worth requirements to work in tandem with the lower leverage requirements. These requirements will be consistent with the risk-based capital standards applicable to banks, and will provide credit unions the ability to manage their compliance through adjustments to their assets and activities, something the current Prompt Corrective Action (PCA) rules provide only for credit unions categorized as "complex" (about 8% of all federally-insured credit unions). A risk-based capital system provides a substantially more realistic — and fair — view of each credit union's safety and soundness.

• **Modernizing capital standards is safe.** Credit unions as a group are the best capitalized of all federally-insured depository institutions. Their average net worth ratio as of September 2005 was 11.15%, and they have maintained approximately this level of capitalization since 1996. Obviously, this is significantly greater than the levels provide for under current PCA requirements. Credit unions are so well capitalized because of their conservative nature that is inherent in a member-owned structure and the fact that credit unions build capital through accumulating retained earnings.

Capital is hard-won and precious to credit unions. For this reason, it's extremely unlikely that the reasonable and modest adjustments proposed in CURIA will lead to significantly lower capital levels. In addition, the reform proposal includes recommended adjustments to the supervisory review process to address various forms of risk, including market sensitivity (i.e., interest rates). In other words, NCUA will not abandon its responsibility to continue to analyze each credit union's capital position in relation to its overall risk.

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Some opponents of reform have suggested that lowering capital requirements for credit unions could lead to a repeat of the Savings and Loan debacle of the 1980s. For a host of reasons the comparison is inaccurate — thrifts of the 1980s are not the credit unions of 2006. Not only are today's regulatory, economic, and public policy environments very different from that of 25 years ago, but today's credit unions are prohibited from making the types of high-yield, risky investments — or engaging in extensive commercial real estate lending (up to 40% of assets) — that contributed to the failure of many S&Ls.

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Indeed, credit unions are the most heavily regulated of all financial institutions, operating within limitations on business lending, loan interest rates, loan maturities, investments, and a host of other restrictions that don't apply to other financial institutions.

• **Modernizing capital standards allows credit unions to better serve their members**. What does it mean to "better serve" credit union members? Obviously, that answer can vary by credit union, but it includes activities or projects such as adding new products, providing more convenient services, building branches in underserved areas, replacing outdated technology, and investing in community development. All of these activities have one thing in common — they represent significant expenditures.

It's conservatively estimated that U.S. credit unions hold over $30 billion in capital in excess of the current "well capitalized" requirements under PCA. In my home state of California, credit unions are estimated to hold over $3 billion of this "surplus" capital. Imagine if well-managed credit unions were empowered to utilize some of that capital to invest in activities or projects to better serve their members and communities. These funds could be loaned out to help members grow their businesses, or to buy new homes. Modernizing capital standards would enhance the ability of credit unions to continue to fulfill their mission of serving all of America's consumers, including those of low and modest means. That is better service.