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Statement by

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U.S. House of Representatives

"Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"

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Chairwoman Waters, Ranking Member McHenry, and other Members of the Committee: Thank you for inviting me to discuss the state of the credit union industry and to provide an update on the operations, programs, and initiatives of the National Credit Union Administration (NCUA). As a former congressional aide who spent more than a decade working for the House Financial Services Committee, I am deeply honored to be here with you today.

After more than 20 years of working on financial services policy issues, I have come to believe that effective financial institutions regulators like the NCUA need to be:

- fair and forward-looking;
- innovative, inclusive, and independent;
- risk-focused and ready to act expeditiously when necessary; and
- engaged appropriately with all stakeholders to develop effective regulation and efficient supervision.

This regulatory philosophy is my North Star, and it is guiding the agency's response to the COVID-19 pandemic's economic fallout and positioning the NCUA for future challenges. This regulatory philosophy has also informed my priorities for the agency, including capital and liquidity, consumer financial protection, cybersecurity, diversity and inclusion, and economic equity and justice.

In my testimony today, I will first focus on the state of the credit union industry and the National Credit Union Share Insurance Fund before turning to the NCUA's response to the COVID-19 pandemic's economic fallout, with a particular emphasis on the road ahead. I will also highlight several recent rulemakings, as well as the agency's efforts to advance diversity and inclusion, improve consumer financial protection, and advance economic equity and justice. I will then conclude with several legislative requests related to vendor authority, flexibility in managing the National Credit Union Share Insurance Fund, and permanently extending the temporary enhancements of the Central Liquidity Facility.

State of the Credit Union System

Although the pandemic and its associated contraction in economic activity influenced credit union performance throughout 2020, the credit union system has remained on a solid footing.

As of December 31, 2020, there were 5,099 federally insured credit unions, 2.6 percent fewer than a year earlier, and membership increased 3.3 percent to 124.3 million.[1] The number of federal credit unions declined by 3.0 percent over the same period to 3,185, and the number of state-chartered credit unions declined 2.0 percent to 1,914. The decline in the number of credit unions mainly resulted from the long-running trend of consolidation across all depository institutions, which has remained relatively constant across all economic cycles for more than three decades.

[1] See March 4, 2021 Quarterly Credit Union Data Summary

Total assets in federally insured credit unions rose by $278 billion, or 17.7 percent, over the year ending December 31, 2020, to $1.84 trillion. Credit union shares and deposits rose by $268 billion, or 20.3 percent, to $1.59 trillion, reflecting the CARES Act's stimulus payments and the sharp economy-wide increase in personal savings. The credit union system's net worth increased by $12.1 billion, or 6.8 percent, over the year to $190.3 billion.

Strong asset growth in 2020 led to a decline in the aggregate net worth ratio from 11.37 percent to 10.32 percent. Nevertheless, the credit union system remains above the statutory well-capitalized requirement of 7 percent.

The overall liquidity position of federally insured credit unions also improved during 2020. Cash and short-term investments as a percentage of assets increased from 13.0 percent to 18.0 percent, reflecting a 69.0 percent increase in cash and short-term investments, from $201 billion as of December 31, 2019, to $340 billion as of December 31, 2020.

In recent months, economic conditions have improved and the outlook for the year ahead is generally favorable. Credit union performance, however, will continue to be shaped by the fallout from the pandemic and associated recession. The NCUA is actively monitoring economic conditions and assessing these and other risks to credit unions, their members, and the Share Insurance Fund.

Factors Affecting the Industry in 2021

Looking ahead, the top priority for the NCUA is ensuring that the credit union system and the Share Insurance Fund are prepared to weather any economic fallout related to the pandemic. To protect the Fund, the agency is actively monitoring certain segments of the system, including credit unions closely connected to the oil and gas, travel and leisure, and agricultural sectors, among others. The agency is also focusing on credit unions with elevated risks, such as those with large concentrations of commercial real estate loans relative to assets.

As during past recessions, it is likely that credit union performance will trail any improvement in the labor markets by one to two years. Accordingly, system-wide delinquency rates, which remained low through the end of 2020, could begin to rise as forbearance programs end. To prepare, credit unions will need to continue to pay careful attention to capital, asset quality, earnings, and liquidity. And, as the pandemic evolves, the NCUA will continue to adjust its supervision and examination program to address potential risks to the Share Insurance Fund and the broader system.

As more Americans receive the COVID-19 vaccine, the NCUA anticipates increased economic activity and job creation. Nonetheless, it will take time for the economy to heal completely. Although the unemployment rate has fallen sharply since last spring, the labor market recovery has been uneven. Lower-income households, which were hit harder by the recession than upper-income households, may not begin to feel the effects of the recovery for some time. For these households, high unemployment will likely continue to impede loan demand, especially for non-mortgage consumer loans, and the credit quality of loans already on the books could be affected.

As noted earlier, credit union shares and deposits surged last year, reflecting the boost to member income from economic stimulus payments as well as the economy-wide increase in personal savings. Shares likely got another substantial boost at the start of 2021, as many member households received two more rounds of federal relief payments provided under the Consolidated Appropriations Act and the American Rescue Plan Act. Even after these payments are absorbed, credit union shares could remain elevated as consumers avoid riskier investments or refrain from making purchases until the economy is on a stronger footing. This will have implications for credit union net worth ratios as well as the Share Insurance Fund's equity ratio.

Additionally, credit unions face a prolonged period of very low interest rates. Short-term interest rates are expected to remain low for the foreseeable future. Longer-term interest rates have increased recently and are expected to edge higher, but they will generally remain lower than pre-pandemic levels, suppressing already compressed net interest margins. It also poses risks for credit unions that rely primarily on investment income. In the year ahead, a credit union's ability to manage interest-rate risk will play a crucial role in financial performance.

State of the Share Insurance Fund

Created by Congress in 1970, the Share Insurance Fund is backed by the full faith and credit of the United States and insures the deposits of more than 124.3 million members at federally insured credit unions up to at least $250,000. As of December 31, 2020, the Share Insurance Fund insured $1.47 trillion in member deposits.[2]

Under the Federal Credit Union Act, one of the NCUA Board's primary missions is to protect the safety and soundness of the credit union system. An essential part of this responsibility is for the Board to maintain a strong and healthy Share Insurance Fund, which promotes confidence in the system of cooperative credit.

The dramatic rise in insured shares throughout last year resulted in an equity ratio for the Share Insurance Fund of 1.26 percent at the end of 2020.[3] This figure is 4 basis points higher than at the end of the second quarter of 2020, but it also represents a decline of 9 basis points from the year-end 2019 level.

If the equity ratio falls below 1.20 percent, or the NCUA Board projects it to do so within six months, then the NCUA Board is required to establish and implement a restoration plan within 90 days that would increase the equity ratio to at least the statutory minimum of 1.20 percent before the end of the eight-year period beginning upon the implementation of the plan, and such other conditions as the Board determines to be appropriate.

The Share Insurance Fund's equity ratio has steadily declined since 2014, even with fewer credit union failures causing losses to it. The primary drivers of this trend are the steady growth in insured shares and reduced investment income resulting from a persistent low interest-rate environment. Based on the current interest rate environment, even with a return to modest insured share growth levels and relatively low credit union failure losses to the Fund, the agency expects the equity ratio to continue its downward trajectory. As a result, it seems likely that the

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[2] https://www.ncua.gov/files/publications/analysis/quarterly-data-summary-2020-Q4.pdf

[3] See p. 114 of the *2020 NCUA Annual Report*

Board will need to adopt a restoration plan at some point absent a sizable change in these underlying fundamentals.

Update on the NCUA's COVID-19 Response

Throughout the COVID-19 pandemic, the NCUA has focused on three priorities:

- Protecting the health and safety of NCUA staff and contractors, so the agency can continue to perform its mission;
- Assessing the impact of COVID-19 on credit union members and operations; and
- Analyzing how the pandemic will affect the future financial condition of credit unions and the Share Insurance Fund.

Agency examiners continue to work closely with credit unions to obtain documentation and complete examination procedures offsite, so credit unions can, in turn, focus on providing services to their members.

Supervisory Priorities in 2021
Recognizing the continued challenges credit unions face due to the pandemic, the NCUA updated its supervisory priorities in January 2021 to focus its examination activities on the areas that pose the highest risk to the credit union industry and the Share Insurance Fund. Some of the agency's supervisory priorities are reviews of credit unions' efforts to:

- Maintain sufficient loss reserves;
- Comply with the Bank Secrecy Act and anti-money laundering laws and regulations;
- Implement provisions in the CARES Act applicable to credit unions and the CARES Act provisions extended through the Consolidated Appropriations Act, including the suspension of the requirement to categorize certain eligible loan modifications as troubled debt restructurings;
- Comply with consumer financial protection laws and regulations;
- Monitor and control credit risk;
- Protect information systems and strengthen cybersecurity defenses;
- Transition from the use of LIBOR; and
- Manage for the potential liquidity risk due to the economic impact of the pandemic.

As the pandemic and its economic and financial disruptions evolve, the NCUA will continue to update its policies and procedures to enhance its supervision program and to provide necessary guidance to the industry.

Over the last year, the NCUA has also established priorities to focus examination and supervisory activities on credit unions that pose the greatest risk to the credit union system. Of highest priority are credit unions experiencing significant financial or operational problems. This includes credit unions that have asked for assistance and those the NCUA determines may need assistance based on their financial and operational conditions. NCUA examiners will continue working with those credit unions to identify what assistance, if any, is needed.

Additionally, the NCUA recognizes the need to ensure our nation's financial services system is not used for illicit or terrorist financing. The agency continues to work closely with its counterparts at bank regulatory agencies to adopt the significant changes occurring under the Anti-Money Laundering Act and Corporate Transparency Act of 2020.[4] The NCUA will also rely on the Treasury Department and the Financial Crimes Enforcement Network to consult and coordinate implementation of those laws, as appropriate.

Regulatory Flexibility Measures
Throughout 2020, the NCUA provided temporary and targeted regulatory flexibility to enable federally insured credit unions to manage their operational and financial risks while meeting their members' needs and adapting to social distancing measures within their communities.

In December 2020, the NCUA Board approved an extension of the effective date of certain regulatory requirements to help federally insured credit unions remain operational and provide appropriate liquidity management flexibility to address economic conditions caused by the pandemic. Specifically, the temporary final rule:

- Raised the maximum aggregate amount of loan participations that a federally insured credit union may purchase from a single originating lender to the greater of $5,000,000 or 200 percent of the credit union's net worth;
- Suspended limitations on the eligible obligations that a federal credit union may purchase and hold; and
- Suspended the required timeframes for the occupancy or disposition of properties not being used for federal credit union business or that have been abandoned.

Each of these temporary modifications were set to expire on December 31, 2020. Due to the continued effects of COVID-19 on credit unions and their members, the Board extended these measures through December 31, 2021.

In April 2021, the NCUA Board also renewed an interim final rule that temporarily modifies certain prudential requirements to help ensure federally insured credit unions remain operational and able to provide needed financial services during the COVID-19 pandemic. This interim final rule is substantively similar to the interim final rule approved by the Board in May 2020.

Specifically, the interim final rule makes two temporary changes to the NCUA's prompt corrective action regulations. The first change reduces the earnings retention requirement for federally insured credit unions classified as adequately capitalized. The second change permits an undercapitalized credit union to submit a streamlined net worth restoration plan if it becomes undercapitalized predominantly because of share growth. If a credit union becomes less than adequately capitalized for reasons other than share growth, it must still submit a net worth restoration plan under the current requirements in NCUA's regulations.

[4] Enacted into law as part of the National Defense Authorization Act for Fiscal Year 2021.

These temporary measures will remain in place until March 31, 2022. The interim final rule became effective upon publication in the *Federal Register*, and there is a 60-day public comment period currently underway.

Central Liquidity Facility

Following the statutory enhancements provided in the CARES Act and their extension in the Consolidated Appropriations Act, 2021, as well as related changes to the agency's regulations, the Central Liquidity Facility (CLF) experienced a significant increase in its membership and borrowing capacity.[5] I want to thank the Chairwoman, Ranking Member, and the Members of this Committee for supporting these enhancements last March, as well as their extension last December. And, as outlined later, I now respectfully request that these reforms be made permanent to better protect the credit union system from future liquidity events.

As of April 30, 2021, the number of regular members of the CLF, which consists of consumer credit unions, was 349, up from 283 members in April 2020. All 11 corporate credit unions became agent members in May 2020, meaning most of their member credit unions also have access to CLF liquidity. In total, 4,110 credit unions, or 81 percent of all federally insured credit unions, now have access to the CLF, either as a regular member or through their corporate credit union.

New memberships added $1.6 billion in additional total subscribed capital stock plus surplus to the CLF. Under the temporary authority granted by the CARES Act and later extended, the CLF can borrow sixteen times its total capital through the end of 2021. As of April 30, 2021, the facility's borrowing authority stood at $36.1 billion, an increase of $25.6 billion since April 2020.[6]

The NCUA encourages all credit unions to consider joining the CLF to bolster the system's access to emergency liquidity, should the need arise. And, there are several credit unions exploring joining the CLF, which would further increase capacity.

Grants and Loans to Support Members and Underserved Communities

Through its stewardship of the Community Development Revolving Loan Fund (CDRLF), the NCUA provides grants and loans to low-income-designated credit unions that use this funding to improve and expand services to members, build capacity, and stimulate local economic activity. Although relatively small in size, these grants make a big difference to low-income and minority credit unions working to provide more and better services to their members and communities.

In 2020, Congress appropriated $1.5 million for CDRLF technical grants. Congress has not provided an appropriation for the loan component since 2005. Instead, NCUA revolves loan funds to qualified credit unions to the extent possible. The urgent need grants the agency provides to low-income credit unions that experience unforeseen disruptions to their operations are funded from income generated by the CDRLF loan portfolio.

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[5] The Central Liquidity Facility provides the credit union system with a contingent source of funds to assist credit unions experiencing unusual or unexpected liquidity shortfalls during individual or system-wide liquidity events. The CLF also serves as an additional liquidity source for the Share Insurance Fund, which helps to ensure the credit union system and the fund remain strong. Member credit unions own the CLF, which is managed by the NCUA.

[6] Central Liquidity Facility Monthly Reports

It should be noted the NCUA does not use appropriated funds to administer the CDRLF. Every penny of the appropriations goes to eligible credit unions and their member-owners.

Last year, the NCUA made the strategic decision to devote almost all its CDRLF efforts to help credit unions and their members meet the significant challenges posed by the COVID-19 pandemic. Overall, the NCUA received 432 technical assistance grant and loan requests for a total of $7.6 million. The agency's funding capacity allowed the NCUA to only award $3.7 million in technical assistance grants and loans to 165 credit unions.[7]

Additionally, the NCUA awarded 149 credit unions in 42 states and the District of Columbia more than $968,000 in urgent need grants. Of these credit unions, 144 received more than $930,000 in funding to assist with their operational needs resulting from the pandemic. Five credit unions received $37,000 in urgent needs grants to repair damage to their credit unions because of a natural disaster or another unexpected event.

Demand for CDRLF grants regularly exceeds supply. During the COVID-19 pandemic, the communities served by low-income credit unions and minority depository institutions (MDIs) are disproportionally affected by the pandemic's financial and economic disruptions. As such, I have previously requested that the Congress consider increasing CDRLF appropriations. I, therefore, appreciate Chairwoman Waters' recent letter to appropriators requesting an increase in CDRLF funding in 2022 to $10 million. With more funding, the agency could increase the number of credit unions receiving grants and increase the size of the grants it makes, deepening the program's impact in underserved communities.

Working with Borrowers Affected by COVID-19

Tragically, the COVID-19 pandemic has disproportionately affected low-income communities and communities of color. Besides being at a greater risk of contracting the virus, residents of underserved areas are more likely to experience pandemic-related economic and financial disruptions, like losing their jobs or getting evicted from their homes. Job losses, in turn, have made it increasingly difficult for individuals and families to pay for essential needs like food, shelter, and medicine.

Many minority-owned businesses have also been acutely affected by the suddenness and depth of the economic shock resulting from the lockdowns that were implemented to contain the spread of the virus. Rural and underserved communities, too, have been hard hit by COVID-19, and these are the areas that MDIs and low-income-designated credit unions predominately serve.

As cooperative, member-owned financial institutions that reinvest their earnings, many credit unions have a long history of assisting their member-owners in times of need. Throughout the COVID-19 pandemic, the NCUA has encouraged credit unions to work with members experiencing hardship by extending the terms of repayment, or otherwise restructuring their members' debt obligations.

[7] In 2020, the NCUA received 417 grant applications requesting $3.9 million in funding. The agency awarded approximately $1.6 million in technical assistance and minority depository institution mentoring grants to 156 credit unions. The NCUA also approved $2.25 million in loans to nine credit unions.

When prudent, credit unions may ease terms for new loans to members, as doing so may help consumer and business members deal with any impact on their financial well-being due to COVID-19. The NCUA has also instructed its examiners to refrain from criticizing a credit union's efforts to provide prudent relief for members, when conducted in a reasonable manner with proper controls and management oversight.

During the pandemic, millions of credit union members have also received government stimulus checks. Although lawmakers intended for consumers to spend this funding on necessities like food, shelter, utilities, and medical care, in some instances some financial institutions, including some credit unions, have instead used these stimulus payments to cover overdraft fees, outstanding debts, and other liabilities.

Financially stressed American consumers deserve better treatment. And, many federally insured credit unions have already voluntarily decided to protect their members' relief payments from collection, garnishment, and the right of offset. In doing so, these credit unions are demonstrating the cooperative philosophy at the heart of the credit union movement.

A small number, however, may choose a different course. Credit unions that withhold the stimulus money meant for daily living expenses for their members should fear the reputational risk they will face by failing to accommodate the needs of their members during tough times. To protect consumers and help families struggling during the pandemic downturn, I encourage Congress to continue working to protect the latest round of stimulus payments from garnishment and offset.

Recent Rulemakings

I would now like to turn to several recent rulemakings and actions taken by the NCUA Board since last November. These matters include updating the credit union rating system, increasing the amount of capital within the system to absorb losses, and facilitating the ability of credit unions to work with borrowers experiencing financial trouble. Additional information about the Board's regulatory actions can be found on the NCUA's public website.[8]

Adding Interest Rate Sensitivity or "S" to the CAMEL Rating System
In January 2021, the NCUA Board unanimously approved a proposed rule that would add the "S" (Sensitivity to Market Risk) component to the existing CAMEL rating system, thus updating the rating system from CAMEL to CAMELS, and redefine the "L" (Liquidity Risk) component in the rating system. This proposal would enhance clarity and allow the NCUA, state supervisory authorities, and federally insured credit unions to better distinguish between liquidity risk and sensitivity to market risk. The amendment would also enhance consistency between the regulation of credit unions and other financial institutions.

The estimated implementation of this proposal is approximately one year, or as early as the first quarter of 2022. The comment period on this proposed rule closed on May 10, 2021.

[8] Information on the Board's actions can be found at https://www.ncua.gov/about/ncua-board/board-meetings-agendas-results

Final Rules on Subordinated Debt
In December 2020, the Board unanimously approved a final rule that amends various parts of the NCUA's regulations to permit low-income-designated credit unions, complex credit unions, and new credit unions to issue subordinated debt for purposes of regulatory capital treatment. One month later, the Board unanimously approved a final rule that amends the NCUA's corporate credit union regulation by making clear that corporate credit unions may purchase subordinated debt instruments issued by consumer credit unions and specifies the capital treatment of these instruments for corporate credit unions that purchase them.

Together, these two rules have the potential to increase capital within the credit union system and better protect the Share Insurance Fund — and taxpayers — from losses. Both rules become effective on January 1, 2022.

Joint-Ownership Share Account Final Rule
In February 2021, the Board unanimously approved a final rule amending the NCUA's regulation governing the requirements for a share account to be separately insured as a joint account. The final rule provides federally insured credit unions with an alternative method to satisfy the membership card or account signature card requirement.

The change is especially important given the challenges posed by COVID-19 and the resulting economic uncertainty. If the pandemic's economic fallout contributes to the failure of a federally insured credit union, the changes would facilitate the prompt payment of share insurance on joint accounts. The final rule went into effect on March 26, 2021.

Proposed Rule on the Capitalization of Interest
In November 2020, the Board unanimously approved a proposed rule that removes the prohibition on the capitalization of interest in connection with loan workouts and modifications.

For members experiencing financial hardship, a prudently underwritten and appropriately managed loan modification, consistent with safe-and-sound lending practices and consumer financial protection laws, is generally in the long-term best interest of both the member and the credit union. Such modifications may allow borrowers to remain in their homes, as well as help to minimize the costs of default and foreclosure for the credit union.

Specifically, the proposed rule would establish documentation requirements to ensure that the addition of unpaid interest to the principal balance of a mortgage loan does not hinder the member's ability to become current on the loan. The proposed change would apply to workouts of all types of member loans, including commercial and business loans. The proposal also contains important consumer financial protection guardrails, such as assessing a member's ability to repay, providing disclosures on the cost of the loan modification, ensuring that any workouts result in affordable and sustainable payments, and limiting the number of loan modifications.

The Board determined that the current prohibition on authorizing additional advances to finance unpaid interest might, in some cases, hamper a federally insured credit union's good-faith efforts to engage in loan workouts with members facing difficulty because of the economic disruption that the COVID-19 event has caused. Advancing interest may avert the need for alternative actions that would be more harmful to members.

The comment period on this proposal closed February 2, 2021. The agency is reviewing the comments received.

Cybersecurity Efforts in Response to COVID-19

On the issue of cybersecurity, it is well-known that bad actors continue their attempts to undermine the very integrity of our interconnected financial system through fraud and cyberattacks. To compete, credit unions must be able to safely and securely use technology to deliver member services and to adopt financial innovations to ensure the industry's long-term success. However, each of us — the NCUA, state supervisory authorities, vendors, and credit unions — must work together to promote innovation with an emphasis on security and equity.

The pandemic has prompted a heightened cybersecurity stance for the agency and the industry, with an emphasis on credit union service continuity, remote workers' security and compliance, and flexibility regarding agency supervision and examination processes. The NCUA has seen increasing fraudulent activity, such as phishing, identity theft, and credential acquisition; ransomware; and cyber-enabled fraud methods within the credit union system. Emerging cyber-attacks are a persistent threat to the financial sector, and the likelihood of these threats adversely affecting credit unions and consumers is rising because of advances in financial technology and increases in the use of remote workforces and mobile technology for financial transactions.

The NCUA continues to promote cybersecurity best practices in credit unions, and reviews of credit union information systems and assurance programs remain a supervisory priority for the agency. Building upon its industry outreach efforts in 2020, the NCUA will continue to provide guidance and resources to assist credit unions with strengthening their cyber defenses throughout the year. As part of its 2021 CDRLF grant initiative, the agency is again funding cybersecurity grants.

The NCUA is also examining ways to strengthen cybersecurity reviews during regular examinations of credit unions. In 2020, the agency began piloting the Information Technology Risk Examination for Credit Unions (InTREx-CU). InTREx-CU harmonizes the IT and cybersecurity examination procedures shared by the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System, and many state financial regulators, thereby generating a consistent approach across all community-based financial institutions. In 2021, the NCUA will continue to integrate this tool into our cybersecurity reviews.

Diversity, Equity, and Inclusion

The NCUA has a long-standing commitment to diversity, equity, and inclusion, and these important values are reflected in the agency's policies and practices.

Numerous studies have demonstrated that organizations that prioritize the creation of a more diverse and inclusive workplace experience greater staff motivation, improved customer service, and higher employee retention, all of which lead to greater efficiencies and better financial performance. Thus, these principles are vital for the continued health and success of the credit union system.

NCUA's Workforce Diversity

With respect to its workforce, the NCUA continues to exceed the Civilian Labor Force in the Black/African American, Asian/Pacific Islander, and Multiracial groups. In 2020, 41.5 percent of new hires at the NCUA were people of color, and gender diversity among the agency's executives increased to 50.0 percent. Additionally, 15.4 percent and 4.2 percent of the NCUA's workforce identify as having disabilities and targeted disabilities, respectively. These figures exceed the federal employment goals established in Section 501 of the Rehabilitation Act of 1973.

The NCUA also works to advance the agency's mission and create a greater sense of belonging within its workforce through its seven employee resource groups. After establishing the program in 2018, the NCUA has 269 employees, or 23.4 percent, of the workforce, participating in one or more of these employee resource groups. This is more than twice the benchmark participation rate for successful programs.

Additionally, in May 2020, the agency launched its Culture, Diversity, and Inclusion Council. Comprised of 18 employees across the agency's business lines, in both supervisory and non-supervisory roles, the council's mission is to identify and advance a positive, high-performing organizational culture that will allow the NCUA to achieve its mission; support the agency's strategic goal of attracting, engaging, and retaining a highly skilled, diverse workforce by cultivating an inclusive environment; and assist and advise leadership on the implementation of strategic diversity and inclusion priorities.

In 2020, the council conducted an agency-wide culture and climate survey, which a majority (59 percent) of the NCUA's staff responded to. These survey results were combined with results from subsequent focus groups to assess employee perceptions of the NCUA's culture. The council is now analyzing the results and developing recommendations to address the issues identified in the survey.

Under any circumstances, these achievements would be commendable, but during a time of unprecedented change and uncertainty caused by the pandemic, they are a testament to the dedication of the NCUA's leadership and staff.

Supplier Diversity

The NCUA also understands the importance of developing and maintaining a base of suppliers and contractors where a diverse group of businesses is well-represented.

In 2020, 33.2 percent of the agency's reportable contracting dollars were awarded to minority- and women-owned businesses, a decrease of 9.8 percentage points from 43.0 percent in 2019.[9] Most of the decline was seen in technology purchasing, where the minority- and women-owned business contract spend was 33.3 percent in 2020 compared to 44.8 percent in 2019.

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[9] See p. 20, OMWI Report to Congress 2020

Despite this decline, 2020 was a relatively strong year for the NCUA's supplier diversity performance. And, the agency's performance continues to demonstrate the positive impact of intentional and consistent inclusion of proven, qualified, and responsive minority- and women-owned businesses in the competitive procurement process.

Assessing Diversity Policies and Practices of Regulated Entities
The NCUA's voluntary Credit Union Diversity Self-Assessment tool assists credit unions in implementing the diversity standards set forth in the *Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies*. Credit unions are encouraged to annually use and submit the self-assessment to the NCUA.

In 2020, 188 federally insured credit unions, 115 federal and 73 state-chartered, submitted self-assessments, an increase of 59.3 percent over 2019. Submitting credit unions varied in the number of employees and asset size. Of those credit unions submitting results, 104 had more than 100 employees, representing 15.1 percent of the credit unions in this category. The aggregate number of employees working at these credit unions represented 13.6 percent of employees at all federally insured credit unions. Asset sizes for the responding credit unions ranged from just above $1 million to more than $15 billion, with 142 of the 188 credit unions, or 75.5 percent, reporting $100 million or more in assets.

While the volume of self-assessment responses received has steadily increased, the NCUA recognizes the need for higher industry response rates. The NCUA's leadership team will, therefore, continue encouraging more credit unions to participate.

Modernization of the NCUA's Examination Systems

Under the agency's Enterprise Solution Modernization Program, the NCUA is developing new technology to replace several existing systems that are at the end of their service lives.

The NCUA's current examination system, AIRES, is a custom-built, 25-year-old system based on outdated technology. Given the age of AIRES and the importance of an electronic examination system to the mission of the agency, priority was given to the development of its replacement, the Modern Examination and Risk Identification Tool, or MERIT. To successfully deploy this new system, it was also necessary to stand up the technology architecture, infrastructure, and security posture needed for a full modernization. MERIT and its related systems will be continually improved in the operations and maintenance phase of MERIT's lifecycle.

In addition to better and more robust financial analytics, MERIT provides numerous improvements over the legacy AIRES examination system, including better controlled access to examination data across the organization and greater efficiency in reporting.

Simultaneous to MERIT's development, the NCUA has been exploring the concept of virtual examinations of credit unions. By identifying and adopting alternative methods to remotely analyze much of the financial and operational condition of a credit union, with equivalent or improved effectiveness relative to current examinations, it may be possible to significantly reduce the frequency and scope of onsite examinations.

The pandemic and off-site operational posture resulted in the implementation of virtual processes during 2020 to continue the agency's supervision of the credit union industry. This unplanned need provided an incubator and learning environment to identify effective and ineffective strategies for remote or virtual examinations. Based on the lessons learned, the agency is studying longer-term strategies to institutionalize the lessons learned during the pandemic for future changes within the virtual examination program. The full implementation of MERIT in the coming months will also facilitate the ability of the agency to conduct more of its supervisory efforts remotely in the future.

Consumer Financial Protection

Equally vital to the members of credit unions is consumer financial protection and fair and equitable access to credit. To that end, the NCUA is working to strengthen its consumer financial protection program to ensure that all consumers receive the same level of protection, regardless of their financial provider of choice. The agency can do more to protect consumers' interests and ensure that the credit union system lives up to its commitment to serve members.

Specifically, the agency is developing a proposal to enhance consumer compliance examination procedures for the largest credit unions that are not primarily examined for consumer financial protection by the Consumer Financial Protection Bureau (CFPB), performing targeted consumer compliance examination procedures in every federal credit union exam, and developing consumer compliance training materials for examiners and credit unions. The agency is also placing an increased emphasis on fair lending compliance.

Regarding discrete consumer financial protection issues, the NCUA continues to focus on compliance with the forbearance provisions of the CARES Act and efforts to help consumers who are experiencing financial difficulties due to the pandemic. Whether it entails reworking an existing loan due to financial stress or delaying payments, the agency expects credit unions to work with their members as forbearance agreements and roll off and foreclosure moratoriums expire. Further, the agency has encouraged credit unions to be proactive and prepare for how they will handle the financial strains their members will experience as the pandemic's economic fallout continues.

The NCUA can also do more to improve the financial capability and personal finance knowledge of the member-owners of credit unions. Financial education plays a key role in helping consumers better understand how to save, earn, borrow, invest, and protect money wisely. Additionally, consumers who have a strong foundation in personal finance are essential to a healthy credit union system.

During the final months of 2020 and into the first quarter of 2021, the NCUA worked in partnership with other federal agencies to raise awareness of the importance of financial education. The agency cohosted webinars with the CFPB, Internal Revenue Service, and the FDIC on such topics as financial readiness for servicemembers, veterans and their families; the

Earned Income Tax Credit and Voluntary Income Tax Assistance program; and access to federally insured accounts at banks and credit unions for young people.

Going forward, the NCUA will continue to collaborate with other federal agencies and stakeholders to raise awareness of consumer financial protection laws and regulations and the importance of financial literacy. The agency's consumer website, MyCreditUnion.gov, is a resource that supports credit unions and their efforts to provide financial education to their members, and we are evaluating ways to improve this website.

Economic Equity and Justice

Last year's nationwide Black Lives Matter demonstrations heightened public awareness of economic equity and justice. The NCUA and credit unions each have important roles to play in advancing this important goal.

Research conducted after the last economic downturn found that credit unions that leaned in and increased lending within underserved communities recovered more quickly than those that did not. Research has also shown that there are three primary ways to close the wealth gap. One is to open and regularly fund a retirement account; another way is to own a home; and the third way is to start a business.

Given the cooperative philosophy at the heart of the credit union movement, credit unions have a moral obligation to step up and help minority-owned businesses and communities recover and start anew in the months ahead. Through these efforts, credit unions can help ease the financial impact of COVID-19 and systemic racism on communities of color, and the result will be a more vibrant economic outcome for everyone in society.

The NCUA is working to address these issues as part of its Advancing Communities through Credit, Education, Stability and Support, or ACCESS, Initiative and through its CDRLF technical assistance grants and other efforts. As part of the ACCESS initiative, a working group at the NCUA is examining ways to modernize the chartering process to help ensure that groups that want to form new federal credit unions can do so in an efficient manner.

The NCUA will administer approximately $1.5 million in CDRLF grants this year to qualified low-income-designated credit unions, subject to the availability of funds. Grants will be awarded in three categories:

- Underserved Outreach (maximum award of $50,000);
- Minority Depository Institution Mentoring (maximum award of $25,000); and
- Digital Services and Cybersecurity (maximum award of $7,000).

The application period runs May 3 through June 26. These grants make a tremendous difference to small, low-income and minority credit unions working to provide more and better services to their members and communities or seeking to bolster their own capacity.

The NCUA continues its efforts to preserve and grow the number of MDI credit unions. By the end of 2020, 520 federally insured credit unions had self-certified as MDIs. These credit unions served 4.3 million members, held more than $51.1 billion in assets, and represented 10.2 percent of all federally insured credit unions.

The agency assists these vital institutions by:

- Offering technical assistance grants and training sessions;
- Facilitating mentor relationships between smaller MDI credit unions and larger MDI credit unions;
- Negotiating financial support to sustain MDIs;
- Delivering guidance to groups establishing new MDIs; and
- Approving new charter conversions and field-of-membership expansions to facilitate new opportunities for growth.

In 2021, the agency will continue to provide targeted training to MDIs on such topics as financial statement analysis and credit union board responsibilities. Additionally, the agency will host a series of forums with MDI credit unions beginning in the summer. These forums will take place virtually and focus on gaining a greater understanding of the evolving needs of MDI credit unions and how the agency can improve its MDI preservation program.

By enhancing support for small, low-income, and MDI credit unions, enforcing fair lending laws, and advancing initiatives to close the wealth gap, the NCUA can address the disparities created by centuries of systemic discrimination and exacerbated by the pandemic. The agency can also ensure that the cooperative nature of the credit union system lives up to its mission of meeting the credit and savings needs of consumers, including those of modest means.

Legislative Requests

To ensure the NCUA has the tools it needs to respond to the ongoing pandemic and any future periods of economic and financial stress, I would like to close by briefly highlighting three additional areas where legislative action would aid the agency in fulfilling its statutory mission. In the coming weeks, the agency will provide the House Financial Services Committee with more detailed information on each of these requests.

Vendor Authority

The NCUA requests the Congress consider legislation to provide the agency examination and enforcement authority over third-party vendors, including credit union service organizations (CUSOs).

The NCUA was granted some authority in 1998 to deal with the Y2K changeover, but that authority unfortunately expired in 2002. Since then, the NCUA's Inspector General, the

Financial Stability Oversight Council, and the Government Accountability Office have all requested this authority be restored.[10]

Currently, the NCUA may only examine CUSOs and third-party vendors with their permission, and vendors, at times, decline these requests. Further, vendors can reject the NCUA's recommendations to implement appropriate corrective actions to mitigate identified risks. For example, in the past, several vendors refused to implement the NCUA's recommendations to improve network security and safeguard sensitive member information due to cost concerns. This stands in stark contrast to the authority of our counterparts on the Federal Financial Institutions Examination Council.

Increasingly, activities that are fundamental to the credit union mission, such as loan origination, lending services, Bank Secrecy Act/Anti-money laundering compliance, and financial management, are being outsourced to entities that are outside of NCUA's regulatory oversight. In addition, credit unions are increasingly using third-party vendors to provide technological services, including information security, and mobile and online banking. Member data are also being stored on vendors' servers. The pandemic, which has accelerated the industry's movement to digital services, has only increased credit union reliance on third-party vendors.

While there are many advantages to using these service providers, the concentration of credit union services within CUSOs and third-party vendors presents safety and soundness and compliance risk for the credit union industry. For example, the top five credit union core processor vendors provide services to approximately 87 percent of total credit union system assets. The top five CUSOs provide services to nearly 96 percent of total credit union system assets. A failure of even one of these vendors represents a significant potential risk to the Share Insurance Fund and the potential for losses from these organizations are not hypothetical. Between 2008 and 2015, CUSOs contributed to more than $300 million in losses to the Share Insurance Fund alone.[11]

The continued transfer of operations to CUSOs and other third parties diminishes the ability of NCUA to accurately assess all the risks present in the credit union system and determine if current CUSO or third-party vendor risk-mitigation strategies are adequate. This leaves thousands of credit unions, millions of credit union members, and billions of dollars in assets potentially exposed to unnecessary risks.

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[10] Please see the following: U.S. Government Accountability Office, GGD-99-91 "Enhancing Oversight of Internet Banking" (July 1999) https://www.gao.gov/assets/ggd-99-91.pdf. Office of Inspector General, OIG-20-07, "Audit of the NCUA's Examination and Oversight Authority over Credit Union Service Organizations and Vendors" www.ncua.gov/files/audit-reports/oig-audit-cusos-vendors-2020.pdf. Annual Reports of the Financial Stability Oversight Council 2015, 2016, 2017, 2018, available at https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/financial-stability-oversight-council/studies-and-reports/annual-reports/fsoc-annual-reports-archive. See U.S. Government Accountability Office, GAO-04-91, "Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management" (October 2003) https://www.gao.gov/products/gao-04-91

[11] Office of Inspector General, OIG-20-07, "Audit of the NCUA's Examination and Oversight Authority over Credit Union Service Organizations and Vendors" www.ncua.gov/files/audit-reports/oig-audit-cusos-vendors-2020.pdf (See page 14)

As such, the NCUA requests the comparable authority as our FFIEC counterparts to examine third-party vendors. I look forward to working with the House Financial Services Committee on legislation to close this growing regulatory blind spot.

National Credit Union Share Insurance Fund Improvements

Three enduring lessons of the financial crisis in 2008 are the critical importance of well-funded deposit insurance systems to maintain financial stability during times of stress; the need for flexibility to properly prepare for and navigate through future crises; and the establishment of appropriate incentives for financial institutions to mitigate risk.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) made several changes to the Federal Deposit Insurance Act to increase the authority to manage the Deposit Insurance Fund. One provision increased the Deposit Insurance Fund's minimum reserve ratio from 1.15 percent to 1.35 percent.[12] Another provision removed the 1.50 percent upper limit on its designated reserve ratio and eliminated the requirement that dividends be provided from the Deposit Insurance Fund when the reserve ratio is between 1.35 percent and 1.50 percent.[13] The Dodd-Frank Act also granted discretion in determining whether to suspend or limit the declaration or payment of dividends.[14]

Congress did not make similar statutory changes to the Federal Credit Union Act's provisions governing the Share Insurance Fund following the financial crisis more than a decade ago. As a result, under current law, the NCUA does not have the appropriate flexibility necessary to manage the Share Insurance Fund in a manner consistent with the growing size and complexity of the credit union industry, as well as with broader national financial stability goals.

To address these concerns, the NCUA seeks changes to the statutory provisions contained in the Federal Credit Union Act to enable the NCUA Board to proactively manage the Share Insurance Fund. In particular, the agency requests the following legislative changes:

- Increase the Share Insurance Fund's capacity by removing the 1.50 percent statutory ceiling on its capitalization;
- Remove the limitation on assessing premiums when the equity ratio exceeds 1.30 percent, granting the NCUA Board discretion on the assessment of premiums; and
- Institute a risk-based premium system.

These recommended changes, if enacted, would allow the NCUA Board to build, over time, enough retained earnings capacity in the Share Insurance Fund to effectively manage a significant insurance loss without impairing credit unions' contributed capital deposits in the Share Insurance Fund. Moreover, these changes would generally bring the NCUA's statutory authority over the Share Insurance Fund more in line with the statutory authority over the operations of the Deposit Insurance Fund.

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[12] Pub. L. No. 111–203, 334(a), 124 Stat. 1376, 1539 (codified at 12 U.S.C. § 1817(b)(3)(B)); *see also* 75 FR 79286 (Dec. 20, 2010) available at https://www.fdic.gov/regulations/laws/federal/2010/10finaldec20.pdf.

[13] *Id.*

[14] *Id.*

Central Liquidity Facility
The CARES Act contained a provision that provided the NCUA with an important tool to ensure continued liquidity of the system as it responded to the COVID-19 pandemic. This provision, which was reauthorized in the Consolidated Appropriations Act, is set to expire on December 31, 2021. The NCUA respectfully requests that Congress make the enhancements to the NCUA's Central Liquidity Facility granted in the CARES Act permanent for the stability of the credit union system moving forward.

Before the CARES Act was enacted into law, the CLF had the authority to borrow provided its obligations did not exceed twelve times the subscribed capital stock and surplus of the CLF (that is, the sum of its retained earnings and capital stock). The CARES Act temporarily increased the multiplier from 12 to 16, meaning that, for every $1 of capital and surplus, the CLF can now borrow $16. Because a credit union that joins the CLF pays in only half of the subscribed capital stock subscription amount, the CLF can now borrow $32 for each new dollar of paid in capital it raises.

Second, the CARES Act temporarily relaxes the requirements on agent membership, making such membership more affordable for corporate credit unions. An agent member is no longer required to buy capital stock for all its member credit unions, it may buy CLF capital stock for a chosen subset of the credit unions it serves.

Third, the CARES Act changed the definition of "liquidity needs" to include the needs of any credit union, not only consumer credit unions. This new definition broadens access by allowing the CLF to meet the liquidity needs of corporate credit unions.

Lastly, the CARES Act provides more clarity about the purposes for which the NCUA Board can approve liquidity-need requests by removing the phrase "the Board shall not approve an application for credit the intent of which is to expand credit union portfolios." The NCUA Board now has more flexibility and discretion to approve applications for CLF members that have made a reasonable effort to first utilize primary sources of funding. This change increases the transparency and efficiency of the loan-approval process by removing doubt about whether a credit union's portfolio may expand if it borrows from the CLF to meet liquidity needs.

The growth in the number of CLF's members and its borrowing authority is a testament to our nation's credit unions coming together in a time of crisis to strengthen the national system of cooperative credit. However, it is important that these temporary enhancements to the CLF are made permanent.

We know from experience that any time there are economic contractions, we can expect credit unions' liquidity needs to rise. Those liquidity needs may spike after the current expiration date of these statutory changes, or they may increase during a future economic crisis. Permanence would provide regulatory certainty for federally insured credit unions during the current crisis and bolster the credit union system's ability to respond to future emergencies.

Conclusion

In conclusion, the NCUA appreciates the continued support of the House Financial Services Committee for the credit union system and its members, as well as the goals, priorities, initiatives, and employees of the NCUA.

Unquestionably, 2020 was an unusual year in which the many participants within the credit union system rose to numerous challenges. In that regard, I would like to express my deep gratitude and appreciation to the NCUA's 1,141 employees and my fellow Board members, including former Chairman Rodney E. Hood, who led the agency throughout much of the crisis. The NCUA staff and Board are fundamental to the agency's effectiveness. None of us could have anticipated the extraordinary circumstances we found ourselves in this past year, yet the NCUA team has exhibited tremendous resilience in responding to the pandemic.

As we continue to smartly and safely navigate through the pandemic-induced economic crisis and plan for the future, the NCUA will stay focused on addressing the needs and best interests of credit union members, while also ensuring the safety and soundness of the credit unions and protecting the Share Insurance Fund from losses. By staying focused on these issues, we can together ensure that the cooperative philosophy at the heart of the credit union movement achieves its full potential and address long-standing issues of economic equity and justice.

I look forward to working with all of you in support of these endeavors. Thank you.