United States General Accounting Office

GAO

Testimony

Before the Committee on Banking, Finance and Urban Affairs
House of Representatives

For Release on Delivery
Expected at
10:00 a.m., EDT
on Thursday
September 29, 1994

CREDIT UNIONS:

Both Industry and Insurance Fund Appear Financially Sound

Statement of Thomas J. McCool
Associate Director, Financial Institutions and Markets Issues
General Government Division

061094 / 152622

GAO/T-GGD-94-142

Credit Unions: Both Industry and Insurance Fund Appear Financially Sound

Statement by
Thomas J. McCool
Associate Director
Financial Institutions and Markets Issues
General Government Division
U.S. General Accounting Office

On the basis of data provided by the National Credit Union Administration (NCUA), the overall financial condition of federally insured credit unions appears strong. Since 1990, credit union assets have increased 46 percent and capital has increased from 7.6 percent to 9.1 percent of assets. The largest part of credit union loans remains consumer and residential real estate loans. Because the growth of member loans has not kept pace with member savings, investments have increased over the period, rising to almost 40 percent of assets. Since 1990, the maturity of deposits has remained stable, but the maturity of assets has increased.

Because the credit union industry has been generally stable over the last several years, the financial condition of the National Credit Union Share Insurance Fund (the Insurance Fund) also appears sound. GAO's analysis of the Insurance Fund's audited financial statements through fiscal year 1993 and unaudited 1994 data provided by NCUA indicate that the fund has an adequate capital base and sufficient liquid assets to handle its current operations and foreseeable exposure from troubled institutions. The fund's exposure to losses from troubled or problem credit unions has declined substantially. Much of the decline in the number of problem credit unions came about through resolutions of a significant number of them through involuntary liquidation or assisted mergers. As the need for assistance has declined, it has become easier for the Insurance Fund to maintain a stable capital base without annual premium assessments. In fact, between fiscal years 1989 and 1993, the Insurance Fund has only had to assess an insurance premium in 1 year, 1992.

GAO's 1991 report on the status of the credit union industry made 48 recommendations--24 to Congress and 24 to NCUA. Many of the recommendations to Congress have not been enacted, although some have been implemented by NCUA as a matter of policy. GAO is highlighting a number of recommendations that have not been implemented but that remain important. Among these recommendations are a number that would (1) further improve the soundness and liquidity of the Insurance Fund; (2) eliminate double-counting of insurance deposits as components of the industry's total capital; (3) dissolve the Central Liquidity Facility or, at least, limit its ability to borrow; and (4) improve the safety and soundness of the industry by establishing minimum capital requirements and limiting loan concentration.

Mr. Chairman,

It is a pleasure to appear before the Committee today to discuss credit unions; their federal regulator, the National Credit Union Administration (NCUA); and their federal insurer, the National Credit Union Share Insurance Fund (the Insurance Fund). You requested that we report on the overall financial condition of the credit union industry[1] and of the Insurance Fund. In particular, you asked us to point out any problem areas that may affect the health of the industry or the Insurance Fund.

The credit union industry has grown rapidly in recent years and now provides credit and depository services to over 64 million consumers. As of June 30, 1994, unaudited figures showed insured deposits of about $251 billion, nearly 10 percent of all federally insured deposits. Compared to banks and thrifts, credit unions came through the turbulent 1980s with few problems. At present, based on information supplied to us by NCUA, the Insurance Fund appears to be well capitalized. As a result, the likelihood of near-term taxpayer exposure appears low.

However, we believe that regular congressional oversight of federally-insured credit unions and their regulator is justified. Their importance to the economy is growing, and credit unions will continue to operate in highly competitive and rapidly changing financial markets. Also, we continue to have some concerns about the industry, its regulation, and the federal arrangements for handling major problems should they arise.

In 1991, we issued a comprehensive report entitled Credit Unions: Reforms for Ensuring Future Soundness (GAO/GGD-91-85, July 10, 1991). The report, which was mandated by the Financial Institutions Reform, Recovery and Enforcement Act of 1989, found that the industry was in a favorable financial condition. However, we identified several areas where regulatory policies and procedures needed to be improved. NCUA took steps to strengthen supervision during our review. Our report contained 48 recommendations for change, which were equally divided between legislative and regulatory issues. In its comments on our report, NCUA said it agreed with a majority of our recommendations; and NCUA has implemented many of them.

Since 1991, we and NCUA have periodically reviewed the status of these recommendations. However, we have not done a follow-up review of the industry, NCUA, or the Insurance Fund. For that reason, our remarks today are primarily based on information provided by NCUA that we have not independently verified.

---

[1]The term "credit union industry" as used in this testimony refers to federally insured natural person credit unions. It excludes privately insured natural person credit unions, corporate credit unions, and the U.S. Central Credit Union.

Our testimony today focuses four issues:

-- the condition of the industry,

-- the condition of the Insurance Fund,

-- the increase in the coverage of federal insurance, and

-- an update on the recommendations in our 1991 report that have not been fully implemented.

CONDITION OF THE FEDERALLY INSURED CREDIT UNIONS APPEARS STRONG

The credit union industry is organized in three tiers. The first tier of the structure is the traditional credit union, which is technically referred to as a natural person credit union. As of June 30, 1994, there were 12,138 federally insured credit unions. These institutions are nonprofit cooperative enterprises that are owned by their members. Their activities are comparable to those of banks and thrifts in providing credit, savings, checking, and other services directly to individuals. Our testimony today will focus on this part of the industry only.

The middle tier of the industry consists of 44 corporate credit unions, commonly referred to as corporates. Corporates are nonprofit cooperatives that are owned by their respective member credit unions, and their mission is to serve these institutions. Corporates provide liquidity loans, investment products, and such other services as share draft (i.e., check) processing.

The third tier in this structure is occupied by the U.S. Central Credit Union. It too is a nonprofit cooperative, owned by 42 of the 44 corporates, and it offers investment, credit and other services only to its owners. U.S. Central became federally insured in 1991. As you requested, our testimony scheduled for next week's hearing will cover the condition and activities of the corporates and U.S. Central.

On the basis of data provided by NCUA, the overall financial condition of federally insured credit unions appears strong. In our 1991 report, which covered industry financial results through mid-1990, we found that the average credit union was in better condition than the average bank or thrift. From year-end 1990 through mid-1994, NCUA statistics showed continuing profitable growth. Total credit union assets in the 3-1/2-year period increased by 46 percent, to $290 billion. Total assets, loans, investments, deposits, and capital, increased each year. Net income increased continuously, but may drop in 1994. (see table I.1).

The capital of credit unions has more than kept pace with asset growth, and is now 9.1 percent of assets, compared to 7.6 percent in 1990. The industry has been profitable and earned a 1.3 percent return on assets in 1992 and again in 1993. On an annualized basis, NCUA reported that the return on assets decreased in the first half of 1994, to 1.2 percent.

As of June 30, 1994, credit union loans of $159 billion were concentrated in the consumer installment categories. Automobile and unsecured personal loans comprised 58 percent of total loans. Real-estate-based loans, including mortgages and home equity loans, were 40 percent of total loans, up from about one-third of total loans in 1990. More than $35 billion in first mortgages were held in credit union portfolios.

Loan delinquencies and losses have been lower in the past for credit unions than for most other types of lenders, and have continued to improve in the past 3-1/2 years. As of June 30, 1994, the total amount of loans delinquent over 2 months was reported at $1.5 billion, or 0.9 percent of total loans (see table I.2). In part, of course, this performance reflects the strong economy of the past 2 years.

<u>Credit Union Investments Are a Larger Part of Total Assets</u>

Credit union investments, as opposed to loans, have become a larger component of total assets in recent years. This reflects the faster growth of member savings compared to member loans. Investments at year-end 1990 were about 31 percent of total assets, and by mid-year 1994 they had risen to almost 40 percent (see table I.3). In 1993, loans grew faster than savings for the first time since 1989, and this continued in the first half of this year. If this trend continues, investments could shrink as a part of total assets.

Credit union investments are generally confined to short-and medium-term debt obligations of relatively high quality. The mix of these investments has changed in recent years. The type of investment that has grown fastest is federal agency securities, which comprised 31.4 percent of all investments as of June 30, 1994 (see table I.4). This investment category includes investments in mortgage-backed securities. In addition, the proportion of credit union funds placed in the 44 corporates for investment compared to total credit union investments has decreased since 1990, but at 26.3 percent of the total still represents a large concentration. Finally, the category referred to as "other investments," primarily in bank and thrift certificates of deposit, has also decreased since 1990.

As has been the case with many financial institutions, credit union investments were adversely affected by the sharp increase in market interest rates during the first half of 1994. This development resulted in a moderate decrease of 2.5 percent in the combined market value of credit union portfolios compared to original cost. This decrease would only result in realized losses if the securities were sold. If they are held to maturity, which is usually the case, no actual losses would result.

Credit unions report the maturities of their savings liabilities and investments in categories of (1) less than 1 year, (2) 1 to 3 years, and (3) over 3 years. At mid-1994, 94 percent of their savings liabilities were scheduled to mature (or reprice) in less than 1 year. This high percentage of short-term savings liabilities has been stable in recent years (see table I.5). By contrast, the maturities of credit union investments have been lengthening. At year-end 1990, about 70 percent of investments were scheduled to mature or reprice within 1 year, but by mid-1994, this rate had dropped to 53 percent (see table I.6). In addition, the expected average maturity of investments in mortgage-backed securities lengthened in the first half of 1994, as market interest rates rose and fewer mortgage holders are expected to refinance. This change would not be reflected in call reports because the original investment was already carried in the "over 3 year" category.

This increase in the amount of medium-to long-term fixed-rate investments, without a corresponding increase in similar-term savings liabilities, normally means that credit unions are taking more interest rate risk. If market interest rates rise, a credit union's cost of money is liable to increase faster than the yield on its investments. This is true with respect to all fixed-rate loans that credit unions make and hold, and especially for long-term fixed-rate mortgages, which now comprise about 10 percent of total credit union assets.

The industry may experience an earnings squeeze if the upward trend in market interest rates continues. One NCUA official told us that this has been typical of the earnings pattern of the industry over the years. Given the potential for rapid repricing of liabilities compared to assets, industry earnings tend to fall in a rising interest rate environment. Conversely, earnings rise when market rates decline. We do not conclude from this brief analysis that credit unions are taking unwarranted risks relative to their capital. However, this is an area that deserves regulatory attention because excessive interest rate risk exposure was a major contributor to thrift failures. NCUA should be receiving enough information to be confident it can identify and respond to problems as they arise.

GAO Is Concerned About Information Reported to NCUA

Our observation that credit unions are taking additional interest rate risk comes from a comparison of call report data that describe the maturities of credit union liabilities and investment assets for different years. However, we believe that the call reports for credit unions do not provide sufficient information to precisely measure the interest rate risks credit unions are taking. This problem was cited in our 1991 report. Although NCUA has expanded the information it requires in its periodic call reports, the problem persists.

In addition, we have a serious concern about the accuracy of some of the credit union investment data being reported to NCUA. We asked NCUA for the market and book values of each credit union's investments as reported to NCUA as of June 30, 1994. The information we received raised obvious questions of accuracy in the case of a significant number of credit unions. For example, we noticed that most credit unions, including many large ones, listed the original cost and current market value of their investments as equal. Given the recent changes in interest rates, we would be surprised if this were so.

For effective off-site supervision, a regulator must be sure that the information reported to it is accurate and reliable. For NCUA, this need becomes more critical if the riskiness and complexity of credit union investments are increasing. This appears to be the case for credit unions as they expand their mortgage and security portfolios. The NCUA officials responsible in these areas agreed that data quality needs improvement and that credit union investment portfolios are getting riskier.

Federal Insurance Coverage Has Increased

As a final note on the condition of the industry, I would like to comment on the increased extent of federal insurance coverage that has become available to many credit unions since 1990. Federal insurance on credit union shares (deposits) was first granted in 1970, long after it became available on bank and thrift deposits. Up to that time, credit unions were either not insured or were insured privately. In the past 2 decades, the private insurance arrangements have gradually been replaced by the Insurance Fund coverage. As of July 31, 1994, NCUA told us that there remain only 624 nonfederally insured natural person credit unions in the United States, with total assets of $8.3 billion. In contrast, there were 12,138 federally insured credit unions with $290 billion in total assets as of June 30, 1994. Probably in reaction to the failure of one private insurer, the Rhode Island Share Deposit and Indemnity Corporation on January 1, 1991, at least six states subsequently required all credit unions under their state charters to convert from private to federal insurance.

NCUA instituted a high priority program to approve federal insurance for those privately insured credit unions that applied for and were in sound enough condition to warrant coverage.

According to NCUA, the process required intensive on-site work by NCUA staff to evaluate each credit union for insurance. During 1991, 577 credit unions were approved for conversion to federal insurance.

NCUA told us that from January 1991 through July 1994, 862 credit unions with total assets of over $16 billion have converted to federal insurance. These institutions were located in 16 states, with over 100 credit unions each in Massachusetts, Florida, Tennessee, and Texas. Of these 862 credit unions, NCUA told us that only 1, with $180,000 in total assets, failed after federal insurance became effective. Therefore, the process has brought increased financial security to the accounts of thousands of people, with negligible impact thus far on the Insurance Fund.

There have also been significant changes in the insurance status of some corporates and of U.S. Central since 1991. We will be discussing these developments in our testimony next week.

THE INSURANCE FUND IS ADEQUATELY CAPITALIZED

The credit union industry has been generally profitable over the last several years; this has had a positive effect on the financial condition of the Insurance Fund. We analyzed the Insurance Fund's audited financial statements[2] over the last 5 years along with unaudited financial data on through three quarters of fiscal year 1994[3] provided by NCUA. Our analysis indicated that the Insurance Fund has an adequate capital base and sufficient liquid assets to handle its current and contingent obligations.

The Insurance Fund's exposure to losses from problem credit unions has declined substantially. The number of problem credit unions has dropped sharply from a high of 1,022 problem institutions as of September 30, 1988. Five years later, on September 30, 1993, problem credit unions had declined by 54 percent, to 474. Perhaps more significantly, the percentage of the industry's insured shares in problem credit unions had dropped sharply during this time frame, from 6.3 percent at fiscal year-end 1988 to 1.8 percent at fiscal year-end 1993. By June 30, 1994, the number of problem credit unions had declined even further to 339, which held just over 1 percent of the

---

[2]The financial statements of the Insurance Fund are audited by a public accounting firm annually.

[3]Through 1994, the Insurance Fund's fiscal year begins on October 1 and ends on September 30. In November 1993, NCUA's Board of Directors agreed to change the Insurance Fund's fiscal year to coincide with the calendar year. This change becomes effective for the 1995 fiscal year, which will commence on January 1, 1995.

industry's total insured shares. About $4.3 billion in insured shares were maintained in problem credit unions at the end of fiscal year 1993. This amount is a sharp decrease from the $10.4 billion in insured shares maintained in problem credit unions just 2 years earlier.

Much of the decline in the number of problem credit unions came about through resolutions of a significant number of these institutions through involuntary liquidations or assisted mergers. Between fiscal years 1989 and 1993, regulators commenced liquidations for 361 problem credit unions. Additionally, the Insurance Fund assisted in 232 credit union mergers during this period. Insurance Fund-assisted mergers have declined substantially over the last few years, from 81 in fiscal year 1990 to 17 in fiscal year 1993. Only 5 problem credit unions were resolved through the Insurance Fund-assisted mergers in the first 3 quarters of fiscal year 1994. Liquidations have shown a similar pattern.[4]

The Insurance Fund has also used open assistance to resolve problem credit unions without closing the institutions and liquidating their assets and obligations. It has provided assistance in the form of capital notes, cash advances, and guarantees to keep open troubled institutions it considered viable while giving credit union management time to return the institution to sound financial condition. The Insurance Fund's exposure from open assistance transactions has also declined significantly in the last few years. Since fiscal year 1991, the number of credit unions receiving some form of open assistance from the Insurance Fund has declined 70 percent, from 51 active assistance cases at fiscal year end 1991 to 15 at the end of fiscal year 1993. During this period, outstanding assistance, either in the form of cash and capital notes or guarantees, declined dramatically from approximately $215 million at fiscal year-end 1991 to about $23 million at fiscal year end 1993. This trend continued through June 30, 1994.[5]

These positive trends have meant a stable capital base for the Insurance Fund over the last several years. Since the industry

---

[4]While the number of liquidation proceedings rose sharply from 54 in fiscal year 1989 to 83 in fiscal year 1990, by fiscal year 1993 this number returned to its fiscal year 1989 level. Through the first 9 months of fiscal year 1994, regulators commenced liquidation proceedings for 25 problem credit unions.

[5]At that time, the number of active assistance cases had declined to just seven, with outstanding assistance totaling about $8.7 million.

recapitalization of the Insurance Fund in 1985, the Insurance Fund has maintained a ratio of equity to insured shares at or near the 1.25 percent minimum capital ratio established by the NCUA board. Since fiscal year 1989, the Insurance Fund's ratio of equity to insured shares dropped below the minimum threshold in only 1 year, 1991, and the Insurance Fund's fiscal year 1993 audited financial statements indicated the Insurance Fund completed 1993 operations with a 1.26-percent equity to insured share ratio. At June 30, 1994, the Insurance Fund's ratio of equity to insured shares equaled 1.28 percent.

Between fiscal years 1989 and 1993, the Insurance Fund revenues have exceeded expenses every year. In 1989, 1990, and 1993, the Insurance Fund's revenue consisted almost exclusively of interest income generated from the Insurance Fund's investment portfolio. The NCUA Board assessed an annual insurance premium during 1992 to cover insurance losses. This premium assessment totaled $165 million.[6] Through June 30, 1994, the Insurance Fund continued to report positive operating results, with unaudited financial data showing an excess of revenue over expenses of $51 million for the first 9 months of fiscal year 1994. Virtually all of the Insurance Fund's fiscal year 1994 revenue through the first 3 quarters consisted of interest income.

The majority of the Insurance Fund's expenses between fiscal years 1989 and 1993 were attributable to recorded losses for problem credit unions considered likely to liquidate or merge. These losses comprised over 70 percent of the Insurance Fund's expenses in fiscal years 1989 through 1992. Losses peaked at about 80 percent of total expenses in fiscal year 1991. In that year, the Insurance Fund's reserves for estimated losses from liquidation and merger activity rose 78 percent over the previous year's reserves. Without the premium assessment NCUA charged in 1992, the Insurance Fund would have posted net losses in fiscal years 1991 and 1992. In fiscal year 1993, insurance losses declined to 58 percent of its total expenses, reflecting a reduction in NCUA's estimate of losses likely from liquidations or mergers. The first 3 quarters of fiscal year 1994 continued these positive results as insurance losses declined to about 45 percent of total expenses.

The Insurance Fund's positive operating results between fiscal years 1989 and 1993 have enabled it to substantially increase its

[6]The timing of the assessment was such that fiscal year 1991 fund revenue also showed a substantial, though less significant, increase from the previous 2 years. As a result, premium income comprised about 20 percent and 45 percent of the Insurance Fund's total revenue in fiscal years 1991 and 1992, respectively, with interest income comprising virtually all of the Insurance Fund's other revenue.

insurance fund balance. The Insurance Fund balance increased from $403 million to $605 million between fiscal years 1989 and 1993. Unaudited financial data as of June 30, 1994, showed the Insurance Fund balance at $656 million. The other component of the Insurance Fund's equity, consisting of the 1-percent of insured shares that credit unions must deposit with the Insurance Fund has also increased significantly between September 30, 1989, and June 30, 1994. During this period, this deposit increased 52 percent, from about $1.6 billion as of September 30, 1989, to nearly $2.4 billion as of June 30, 1994. This increase is the result of annual adjustments based on insured credit unions' level of insured shares and reflects the significant growth in the level of credit unions' insured shares over this period.

Cash not used for the Insurance Fund's operations is invested in Treasury securities. Between fiscal years 1989 and 1993, the Insurance Fund's investments in Treasury securities, excluding overnight funds, increased from $1.3 billion to $2.6 billion. The Insurance Fund's cash and investments, which totaled approximately $2.8 billion at September 30, 1993, represented about 95 percent of its $2.9 billion in total assets at fiscal year-end 1993. These liquid assets were sufficient to fund the Insurance Fund's direct liabilities of $99 million plus its contingent liabilities, including guarantee assistance to credit unions and guarantees of any loans made by the Central Liquidity Facility (CLF) or by other credit unions, of $166 million at September 30, 1993. Consequently, at September 30, 1993, the Insurance Fund had sufficient liquid assets to cover its direct and contingent obligations. Unaudited financial data through June 30, 1994, indicated that the Insurance Fund continued to maintain a significant ratio of liquid assets to recorded direct and identified contingent liabilities. Thus, the Insurance Fund's financial statements indicate that the Insurance Fund has sufficient resources to handle current obligations and near-term identifiable exposure.

MANY GAO RECOMMENDATIONS HAVE NOT BEEN IMPLEMENTED

Our 1991 report contained 48 recommendations for reforming the credit union industry and NCUA practices. We made 24 recommendations to Congress and 24 to NCUA.

After issuing a report, we periodically follow up on the status of open recommendations. We have regularly interviewed senior staff at NCUA since 1992 about the recommendations. In preparing this testimony, we asked NCUA to describe the present status of each recommendation and advise us of cases where their views have changed from those they expressed in response to our report. Attachment II summarizes their reply. In a few cases we added clarifying comments. We did not include in the table 8 recommendations in our report that applied to corporates. Our testimony scheduled for next week's hearing will cover these recommendations.

Congress has considered action on several of our legislative recommendations but has not passed them into law. In some cases, NCUA has taken action that has largely achieved the results we sought. Based on our review of these actions, we believe that several of the original recommendations continue to merit congressional consideration.

First, we continue to recommend that Congress hold periodic oversight hearings at which NCUA would report on the condition of the industry and the Insurance Fund. Credit unions have not only become major participants in the nation's financial system, but they, like all other depository institutions, are operating in a highly competitive and fast-changing market. Moreover, recent developments in the credit union industry may lead to significant organizational change, especially for corporate credit unions.

The other areas in which we made recommendations to Congress that we still consider important include

-- the Insurance Fund financing arrangements,

-- accounting for the 1-percent the Insurance Fund deposit, and

-- improvements in safety and soundness.

Aspects of Insurance Fund Financing Arrangements Need to be Changed

As we noted, the Insurance Fund has achieved the minimum level required by NCUA. The Insurance Fund has experienced low and decreasing insurance losses, and has a high degree of liquidity. However, we believe that several aspects of the existing statutory arrangements need to be changed to avoid unnecessary taxpayer exposure. Correcting these conditions would require simultaneous congressional action in three related areas. In the first area, we continue to believe that several changes should be made in the Insurance Fund as recommended in our 1991 report:

-- NCUA should have authority to increase the Insurance Fund equity ratio and premiums and lose its authority to set an equity ratio below the statutory minimum,

-- Insurance Fund liquidity, referred to in our report as assets available to handle future credit union failures, should be an additional criterion for determining the necessary level of insurance premiums and the adequacy of the Insurance Fund,

-- in a liquidation, the Insurance Fund's position as creditor should be made superior to that of uninsured deposits,

-- credit union failures should be resolved at least cost to the Insurance Fund, and

-- the insurance and NCUA supervisory functions should report separately to the NCUA Board.

In the second area, we recommended that NCUA be given expanded authority to borrow from the Treasury on behalf of the Insurance Fund. The present $100 million limit, set in 1970, is too small to ensure that the Insurance Fund will have adequate access to capital during an emergency.

Third, we recommended that the CLF be dissolved. The need for temporary liquidity for credit unions can now be met from other sources, such as the private sector, the Federal Reserve, or the Insurance Fund. In the past year, the CLF staff has been reduced from four full time employees to one part-time. CLF has no loans outstanding, so dissolution should cause few transitional problems. In its original response to this recommendation, NCUA stated that adequate provision for backup liquidity needed to be ensured before abolishing the CLF. NCUA has since changed this position and now believes that the CLF needs to be maintained.

However, whether or not the CLF is maintained, there is one provision in the law that we believe should be changed. As the law now stands, the NCUA board can, through CLF, borrow money outside the industry's own resources and lend it to the Insurance Fund. Unlike other CLF borrowings, this particular transaction would not require any current review or approval by either the Treasury or Congress. The amount that could be borrowed is a multiple of the CLF ownership shares subscribed to by its member credit unions. At June 30, 1994, this borrowing authority was over $16 billion. The probability is very low that the Insurance Fund would ever need this much money to support insurance losses or assistance programs. We believe that a statutory provision for emergency the Insurance Fund borrowing from Treasury would be a far better arrangement.

<u>Accounting Method for the 1-Percent Insurance Fund Deposit Needs to be Changed</u>

In our 1991 credit, we were concerned about how federally insured credit unions accounted for the insurance deposits they make into the Insurance Fund. These include deposits made in 1985 to recapitalize the Insurance Fund and subsequent deposits based on growth in their insured shares. The amount of the 1985 deposit was equal to 1 percent of each credit union's insured shares. Both NCUA and credit unions essentially treat these deposits as capital--NCUA by directly recording the deposit as a capital contribution in the Insurance Fund's financial statements, and the credit unions by recording the deposit as an asset rather than as an expense. We remain concerned that this method of accounting counts the deposit as capital twice and thus overstates the aggregate level of capital within the credit union system. We continue to believe that credit unions should expense the deposit over a reasonable period. The period should be determined by NCUA.

Recommendations for Improvements in Safety and Soundness Not Yet Addressed

In addition to the above changes that primarily relate to financing of the Insurance Fund, Congress has not acted on several recommendations designed to improve the safety and soundness of credit unions and their corporates. Briefly, we believe the following recommendations are most important for Congress to enact:

-- Require NCUA to establish minimum capital standards for credit unions no less stringent than those applicable to other insured depository institutions.

-- Require all corporates to be federally insured. While the five nonfederally insured corporates have agreed to follow NCUA regulations, NCUA lacks enforcement powers over them. For that reason, the substantial funds invested in these corporates by federally insured credit unions may represent an unacceptable risk to the Insurance Fund.

-- Prohibit borrowing for the purpose of growth. Because credit unions are cooperatives, we do not believe they should normally be permitted to borrow for growth. NCUA should be authorized to make exceptions to this restriction.

-- Limit the loans to, or investments in, single obligors to 1-percent of assets. This limit would result in a degree of asset diversification similar to that of banks and thrifts.

-- -- -- -- --

Mr. Chairman, this concludes our statement. We would be glad to respond to any questions.

CREDIT UNION FINANCIAL DATA

Table I.1: Key Data on Federally Insured Credit Unions

Dollars in billions

Year	Total assets	Deposits (savings)	GAAP capital[a]	GAAP capital to assets	Investments[b]	Loans[b]	Net income	Return on assets
Dec. 1990	$198.2	$180.0	$15.0	7.6%	$61.9	$125.9	$1.7	0.86%
Dec. 1991	227.1	205.8	17.4	7.7%	83.6	131.7	2.1	0.92%
Dec. 1992	258.3	232.9	21.0	8.1%	107.4	137.5	3.3	1.30%
Dec. 1993	277.0	246.8	24.9	9.0%	112.7	150.2	3.7	1.30%
June 1994	289.7	257.8	26.3	9.1%	115.2	159.4	3.4[c]	1.20%[c]
Increase since Dec. 1990	$91.5	$77.8	$10.9	N/A	$53.3	$33.5	N/A	N/A
Percent increase since Dec. 1990	46.2%	43.2%	72.7%	N/A	86.1%	26.6%	N/A	N/A

[a]Generally Accepted Accounting Principles (GAAP) capital is the sum of regular, investment valuation, and other reserves, undivided earnings, and net income. It does not include allowances for loan or investment losses, and shares.
[b]These asset categories are net of their allowances for losses, respectively.
[c]Annualized by NCUA.

Source: Data calculated from credit union financial and statistical reports provided by NCUA.

Table I.2: Delinquent Loans as a Percent of Total Loans, 1990-1994

Dollars in billions

	Percent of total loans				
Year	2-6 months delinquent	6-12 months delinquent	Over 12 months delinquent	Total delinquent[a]	Dollar amount delinquent
Dec. 1990	1.0%	0.4%	0.3%	1.7%	$2.2
Dec. 1991	1.0	0.4	0.3	1.6	2.1
Dec. 1992	0.8	0.3	0.2	1.3	1.7
Dec. 1993	0.7	0.2	0.1	1.1	1.6
June 1994	0.6	0.2	0.1	0.9	1.5

[a]Components may not add to total because of rounding.

Source: Data calculated from credit union financial and statistical reports provided by NCUA.

ATTACHMENT I

Table I.3: Loans and Investments Compared to Total Assets, 1990-1994

Year	Loans/assets	Investments/assets
Dec. 1990	63.5%	31.2%
Dec. 1991	58.0%	36.8%
Dec. 1992	53.2%	41.6%
Dec. 1993	54.2%	40.7%
June 1994	55.0%	39.8%

Note: Loans and Investments are net of their respective allowances for losses.

Source: GAO calculations from NCUA-provided financial and statistical data.

Table I.4: Change in Mix of Total Investments

	Investment type as percent of total investments					
Date	U.S. government obligations	Federal agency securities	Mutual funds	Corporate credit unions	All others[a]	Total[b]
Dec. 1990	11.1%	17.7%	2.0%	35.2%	34.1%	100%
Dec. 1991	12.8%	19.9%	3.0%	33.9%	30.4%	100%
Dec. 1992	15.7%	23.4%	3.7%	32.1%	25.1%	100%
Dec. 1993	16.4%	28.0%	3.7%	28.1%	23.9%	100%
June 1994	17.2%	31.4%	2.8%	26.2%	22.2%	100%

Note: Total Investments includes allowance for investment losses because from the data provided we cannot determine the allocation to each category.

[a]Includes commercial banks, S&Ls and mutual savings banks, deposits in and loans to customers, the Insurance Fund insurance deposits, and other investments.

[b]Percent may not total 100 percent due to rounding.

Source: Data calculated from credit union financial and statistical reports provided by NCUA.

Table I.5: Average Maturity of Total Savings

Dollars in billions

	Less than 1 year		1 to 3 years		More than 3 years		Total	
Date	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Dec. 1990	$167.5	93.0	$10.7	6.0	$1.8	1.0	$180.0	100.0
Dec. 1991	193.8	94.2	9.8	4.8	2.2	1.1	205.8	100.0
Dec. 1992	220.8	94.8	9.6	4.1	2.5	1.1	232.9	100.0
Dec. 1993	232.6	94.3	10.6	4.3	3.6	1.4	246.8	100.0
June 1994	242.4	94.0	11.3	4.4	4.1	1.6	257.8	100.0

Note 1: Percentages may not total to 100 percent due to rounding.

Note 2: Savings include share drafts, regular shares, money market shares, share certificate/certificate of deposits, IRA/Keough and Retirement Accounts, all other shares and member deposits, and nonmember deposits.

Source: Data calculated from credit union financial and statistical reports provided by NCUA.

ATTACHMENT I

Table I.6: Average Maturity of Total Investments

Dollars in billions

	Less than 1 year		1 to 3 years		More than 3 years		Total	
Date	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Dec. 1990	$43.5	70.3	$10.5	16.9	$8.0	12.9	$62.0	100.0
Dec. 1991	55.3	66.1	18.0	21.5	10.4	12.4	83.7	100.0
Dec. 1992	65.3	60.8	28.4	26.5	13.7	12.8	107.4	100.0
Dec. 1993	63.9	56.7	32.2	28.6	16.6	14.7	112.7	100.0
June 1994	61.2	53.1	35.0	30.3	19.2	16.7	115.4	100.0

Note 1: Percentages may not total to 100 percent due to rounding.

Note 2: Total Investments include allowance for investment losses.

Source: Data calculated from credit union financial and statistical reports provided by NCUA.

GAO RECOMMENDATIONS[1]

Recommendation	NCUA action/response and GAO Comment
1. Chapter 2, NCUA recommendation - Require that credit unions with assets greater than $50 million file financial and statistical reports quarterly.	Completed. NCUA required quarterly reports from these credit unions, beginning March 31, 1993.
2. Chapter 2, NCUA Recommendation - Expand the information required from credit unions with assets greater than $50 million on the financial and statistical reports in the areas of asset quality, interest rate sensitivity, management, and common bond.	Financial and Statistical Report for credit unions with assets over $50 million has been expanded. *Comment: GAO believes that information regarding interest rate sensitivity is not sufficient for adequate assessment. Projected reporting requirements for 1995 may improve information in this regard.*
3. Chapter 2, Congressional Recommendation - Hold annual oversight hearings at which the NCUA Board testifies.	NCUA has expressed no objection.
4. Chapter 3, NCUA Recommendation - NCUA should assess its real estate regulation and strengthen it to help insure the sound underwriting of loans and their suitability for sale in the secondary market.	In July 1991, NCUA issued real estate lending guidelines. In April 1994, additional guidelines were issued. *Comment: The 1994 guidelines permit, depending upon a credit union's condition, the origination of mortgage loans that do not conform to secondary market standards.*
5. Chapter 3, NCUA Recommendation - NCUA should restrict the exclusions from its commercial lending limit set forth in 1987 to help insure that credit unions are not used as vehicles for underwriting large commercial ventures.	In January 1992, the member business loan rule was revised with the intention of reducing risk.

[1]GAO's characterization of NCUA's response and description of actions taken is based on information provided by NCUA that GAO has not independently verified.

Recommendation	NCUA action/response and GAO Comment
6. Chapter 3, NCUA Recommendation - NCUA should issue a regulation applicable to all insured credit unions requiring them to adequately disclose that dividends on shares and other accounts cannot be guaranteed in advance but are dependent on earnings.	In 1993, NCUA, as authorized by the Truth in Savings Act, promulgated rules in this area. Most credit unions must begin compliance on January 1, 1995.
7. Chapter 3, Congressional Recommendation - Require NCUA to establish minimum capital levels for credit unions no less stringent than those applicable to other insured depository institutions.	NCUA's original response indicated its agreement that "minimum capital standards would bring up the bottom of the industry." *Comment: Specific minimum standards have not been established.*
8. Chapter 3, Congressional Recommendation - Limit the amount that can be loaned or invested in a single obligor, other than investments in direct or guaranteed obligations of the U.S. Government or in the credit union's corporate, to not more than <u>one percent</u> of the credit union's total assets. Presently permitted limits with respect to credit union service organizations should be provided for in repurchase agreement transactions.	NCUA has not changed its original response that a <u>five</u> percent of assets limitation on exposure to single obligors would be satisfactory. *Comment: GAO believes the five percent limit permits excessive exposures.*
9. Chapter 3, Congressional Recommendation - Congress should amend the Federal Credit Union Act to tighten the regulation concerning commercial lending and include an overall limit.	NCUA believes that its "current business loan regulations are sufficient to address the risks of commercial lending in credit unions."
10. Chapter 3, Congressional Recommendation - Modify the borrowing authority to specify that credit unions may not borrow for the purpose of growth, unless prior approval of NCUA is obtained.	NCUA has no objection, but believes it should have "the flexibility to define 'borrowing for growth.'"
11. Chapter 3, Congressional Recommendation - Congress should amend the Federal Credit Union Act to require all insured credit unions to obtain NCUA permission before opening a new branch.	NCUA opposes "the recommendation for further restrictions in this area."

Recommendation	NCUA action/response and GAO Comment
12. Chapter 3, Congressional Recommendation - Require insured credit unions above a minimum size to obtain annual independent certified public accountant audits and to make annual management reports on internal controls and compliance with laws and regulations.	The NCUA Chairman proposes "to require opinion audits by independent licensed certified public accountants for all federally insured credit unions greater than $50 million in assets and make it mandatory that a management letter accompany each audit report."
13. Chapter 3, Congressional Recommendation - Congress should amend the Federal Credit Union Act to provide NCUA with the authority and require that it 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 a safety and soundness risk.	In 1991, NCUA concurred with this recommendation, and no change in NCUA's position has been indicated.
14. Chapter 4, NCUA Recommendation - Clarify the purposes, unique values, and requirements for use of each of its off-site monitoring tools. It should determine the appropriate recipients of the tools and distribute them accordingly, within each region.	NCUA reports that specific off-site monitoring tools are now discussed in the Examiner's Guide as part of a "Surveillance System." The Guide does not prescribe specifics for distributing or using the monitoring tools or reports. Also, specific action is left to the discretion of regional management, according to NCUA.
15. Chapter 4, NCUA Recommendation - Require documentation at the regional office level of examiners' reviews of all credit union call reports.	The revised Examiner's Guide, issued in March 1994, instructs examiners about their duty to collect and review Call Report data and resolve any questions with officials of the respective credit union. NCUA does not believe that "additional documentation at the regional office level will provide any greater level of assurance that the information is accurate."
16. Chapter 4, NCUA Recommendation - NCUA should invoke its statutory authority to refuse to accept state supervisors' examinations when a state regulatory authority lacks adequate independence from the credit union industry.	The NCUA Chairman agrees with this recommendation, but believes NCUA "would need statutory authority to assess an operating fee to perform these additional examinations."

Recommendation	NCUA action/response and GAO Comment
17. Chapter 4, NCUA Recommendation - NCUA should examine all the Insurance Fund-insured credit unions in such states [when a state regulatory authority lacks adequate independence from the credit union industry].	The NCUA Chairman agrees with this recommendation, but believes NCUA "would need statutory authority to assess an operating fee to perform these additional examinations."
18. Chapter 4, NCUA Recommendation - NCUA should establish a policy goal for examination frequency of state credit unions.	In 1991, NCUA indicated it "will develop a policy statement establishing examination frequency goals for state credit unions." *Comment: There is no indication that this has been done, although NCUA "reserves the right to perform an insurance review or examination of any FISCU [federally insured state chartered credit union] on an examination cycle that exceeds 18 months."*
19. Chapter 4, NCUA Recommendation - Require all credit unions to submit copies of their supervisory committee audit reports to NCUA upon completion.	In 1991 NCUA opposed this recommendation. No change in NCUA's position has been indicated.
20. Chapter 4, NCUA Recommendation - Ask the Inspector General to conduct a review focusing on NCUA's handling of problem credit unions since mid-1990, specifically its use of enforcement powers, and submit a report to the NCUA Board.	By December 31, 1994, NCUA's Inspector General is scheduled to issue a report on the handling of problem credit unions for the last two years. The report will not specifically address the use of enforcement powers, but NCUA plans to request the Inspector General to study this issue.
21. Chapter 5, Congressional Recommendation - Amend the Federal Credit Union Act to authorize NCUA to provide assistance in resolving a failing credit union only when it is less costly than liquidation or essential to provide adequate depository services in the community.	NCUA indicates that its policy has been and still is to resolve failing credit unions at least cost. NCUA has not indicated whether it agrees that congressional action is desirable.

Recommendation	NCUA action/response and GAO Comment
22. Chapter 5, Congressional Recommendation - Require NCUA to maintain documentation supporting its resolution decisions, including the statistical and economic assumptions made.	NCUA agreed and agrees with this recommendation. NCUA states that its policy is to document its resolutions, and that it made several improvements to address deficiencies noted by GAO.
23. Chapter 5, NCUA Recommendation - Require that waivers and special charges be authorized by the Director, Examination and Insurance and the General Counsel, as well as the Regional Director, and that policy guidance concerning the use of these provisions be developed, and that their use be monitored.	NCUA revised its policy guidance regarding reserve charges and waivers in 1993. NCUA has not modified its processing procedures to require Examination and Insurance and/or General Counsel concurrence for reserve waivers and charges except when combined with Sec. 208 assistance in excess of $200,000, which requires Examination and Insurance concurrence. The NCUA Board is comfortable with the existing concurrence provisions.
24. Chapter 5, NCUA Recommendation - Adhere to criteria for assisting credit unions.	NCUA reported changes in its procedures for processing assistance requests in 1993. In addition, it issued supplemental guidance to aid in the consistency of documentation for approvals. NCUA believes these guidelines and quality controls at regional and headquarters levels ensure compliance with its existing assistance policy.
25. Chapter 6, Congressional Recommendation - Amend the Federal Credit Union Act to confine insured credit union investments in corporates and U.S. Central to those that have obtained deposit insurance from the Insurance Fund.	Effective March 1, 1992, NCUA regulations were changed to permit federal credit unions to invest only in those corporates that fully comply with NCUA's corporate regulations, whether or not the corporate was federally insured. NCUA continues to support congressional action that would confine all federally insured credit union investments in corporates to those corporates having federal insurance. There are five state chartered corporates that do not have federal insurance.

Recommendation	NCUA action/response and GAO Comment
26. Chapter 7, Congressional Recommendation - Congress should require that credit unions expense the one percent deposit over a reasonable period of time, to be determined by NCUA. Congress should at the same time specify that the assets represented by a failed credit union's insurance deposit should be first available to the Insurance Fund. This should be coordinated with and consistent with any legislation to recapitalize the Bank Insurance Fund, so as to avoid placing credit unions at a competitive disadvantage.	NCUA continues to oppose a requirement that the one percent insurance deposit be expensed. NCUA does not oppose legislation that would, in the case of a failed credit union, make the insurance deposit available first to the Insurance Fund.
27. Chapter 7, Congressional Recommendation- Congress should establish an available assets ratio for the Insurance Fund. (The ratio would compare the liquid assets of the Insurance Fund and contingent liabilities as a measure of the adequacy of the Insurance Fund.)	NCUA continues to agree with this recommendation, and is exploring the possibility of implementing an available asset ratio by regulation.
28. Chapter 7, Congressional Recommendation - Congress should authorize NCUA to raise the basic the Insurance Fund equity ratio, available assets ratio, and premiums and delete its ability to set a normal operating level below the statutory minimum.	NCUA originally agreed with this recommendation, and no change in this position has been indicated.

Recommendation	NCUA action/response and GAO Comment
29. Chapter 7, Congressional Recommendation - Congress should provide for additional NCUA borrowing from Treasury on behalf of the Insurance Fund.	NCUA originally agreed with this recommendation. NCUA now states that additional borrowing authority may not be needed, as long as the Central Liquidity Facility (CLF) and the Insurance Fund are maintained with their current borrowing authorities. *Comment: GAO believes that the current authority of the NCUA Board to borrow over $16 billion on behalf of the CLF from any source, and to lend the proceeds to the Insurance Fund, without concurrent review by the Congress or the Executive, needs to be curtailed. A statutory provision for emergency the Insurance Fund borrowing from the Treasury would be a more customary and far preferable arrangement. GAO strongly recommends that this be done, whether as we have also recommended, the CLF is dissolved.*
30. Chapter 7, Congressional Recommendation - Congress should amend the Federal Credit Union Act to place the Insurance Fund in a second position to general creditors, but provide that this position would rank ahead of uninsured shares.	NCUA originally agreed with this recommendation, and no change in NCUA's position has been indicated.
31. Chapter 7, NCUA Recommendation - NCUA should reduce the lag time in adjusting the Insurance Fund's financing.	Completed. In 1995, the Insurance Fund changes to a calendar fiscal year. Lag time will be reduced from 7 months to 3 months.
32. Chapter 7, NCUA Recommendation - NCUA should place the Insurance Fund on a calendar year basis.	Completed. See 31 above.
33. Chapter 7, NCUA Recommendation - Immediately establish separate supervision and insurance offices that report directly to the NCUA Board.	NCUA originally opposed this recommendation, and no change in NCUA's position has been indicated.

Recommendation	NCUA action/response and GAO Comment
34. Chapter 8, Congressional Recommendation - Require NCUA, in consultation with Congress and the credit union industry, to identify specific unsafe and unsound practices and conditions that merit enforcement action, as well as the appropriate action, and promulgate these requirements by regulation.	NCUA originally opposed this recommendation, and no change in NCUA's position has been indicated.
35. Chapter 8, Congressional Recommendation - Require NCUA to take enforcement action when unsafe and unsound conditions or practices, as specified in the recommended regulation, are identified.	NCUA originally opposed this recommendation, and no change in NCUA's position has been indicated.
36. Chapter 8, Congressional Recommendation - Provide for a five member NCUA Board, with two members, ex officio, the Chairman of the Federal Reserve Board and the Secretary of the Treasury.	NCUA originally opposed this recommendation, and no change in NCUA's position has been indicated. *Comment: In responding to a draft of the GAO report, the Federal Reserve Chairman stated he believed it would be inappropriate for him to hold an ex officio position on the NCUA Board. The Assistant Secretary of the Treasury suggested as an alternative to GAO's proposal that "one of the two [NCUA] Board positions not occupied by the Chairman be filled with the Treasury Departments' top banking regulator."*
37. Chapter 8, Congressional Recommendation - The CLF, as established by Title III of the Federal Credit Union Act, should be dissolved.	NCUA originally expressed the need for careful review prior to any final legislation. At present, NCUA believes that the CLF needs to be continued as a source of liquidity for credit unions. However, NCUA states that this function "should continue to be viewed separately from the liquidity needs of the Insurance Fund for insurance activities." See *GAO's comment on recommendation 29 above.*

Recommendation	NCUA action/response and GAO Comment
38. Chapter 8, Congressional Recommendation - Congress should remove the power of federal credit unions to borrow from Farm Credit Banks as provided for in the Federal Credit Act.	NCUA continues to have no objection to this recommendation.
39. Chapter 8, Congressional Recommendation - Recommend that Congress amend the Community Development Credit Union Revolving Fund Transfer Act to designate an entity other than NCUA as administrator of the Insurance Fund.	Originally NCUA had no objection to this recommendation, but strongly disagrees with that position now, stating that "transferring administrative responsibilities for [the Community Development Credit Union Revolving Loan] Fund to another agency would merely create additional bureaucracy and substantially diminish the effective and expeditious use of the Revolving Loan Program."
40. Chapter 9, Congressional Recommendation - If credit unions are to remain distinct from other depository institutions because, in part, of their common bond membership . . . Congress should consider stating this general intent in legislation and setting forth guidelines on the limits of occupational, associational, and community common bonds, as well as the purpose and limits of multiple group charters.	NCUA originally had no objection to this recommendation. NCUA's guidelines regarding federal credit union fields of membership were revised in July 1994. *Comment: To the extent that these new guidelines loosen the restrictions on defining the acceptable fields of membership, GAO believes they may tend to erode the distinctions between credit unions and other types of depository institutions. Moreover, these guidelines do not apply to state chartered federally insured credit unions.*

Ordering Information

The first copy of each GAO report and testimony is free. Additional copies are $2 each. Orders should be sent to the following address, accompanied by a check or money order made out to the Superintendent of Documents, when necessary. Orders for 100 or more copies to be mailed to a single address are discounted 25 percent.

Orders by mail:

U.S. General Accounting Office
P.O. Box 6015
Gaithersburg, MD 20884-6015

or visit:

Room 1100
700 4th St. NW (corner of 4th and G Sts. NW)
U.S. General Accounting Office
Washington, DC

Orders may also be placed by calling (202) 512-6000 or by using fax number (301) 258-4066.

Each day, GAO issues a list of newly available reports and testimony. To receive facsimile copies of the daily list or any list from the past 30 days, please call (301) 258-4097 using a touchtone phone. A recorded menu will provide information on how to obtain these lists.

PRINTED ON RECYCLED PAPER

United States
General Accounting Office
Washington, D.C. 20548-0001

Bulk Mail
Postage & Fees Paid
GAO
Permit No. G100

Official Business
Penalty for Private Use $300

Address Correction Requested