# COMPARING CREDIT UNIONS WITH OTHER DEPOSITORY INSTITUTIONS

UNITED STATES DEPARTMENT OF THE TREASURY

**January 2001**

The Honorable Paul S. Sarbanes
Chairman
Committee on Banking, Housing,
and Urban Affairs
U.S. Senate
Washington, D.C. 20510-6075

Dear Mr. Chairman:

I am pleased to transmit the Department of the Treasury's report on credit union regulation and taxation, and on preserving the growth and viability of small banks. We prepared this report as required by sections 401 and 403 of the Credit Union Membership Access Act of 1998.

In preparing this report, we compared the safety and soundness regulations governing credit unions with those governing all other federally insured depository institutions. We also compared the application of regulatory enforcement authority and federal consumer protection laws across credit unions and all other federally insured depository institutions. Finally, we compared the product offerings of these various institutions.

We reviewed the history of credit unions' exemption from the federal corporate income tax and estimated the potential revenue that could be raised were Congress to remove the exemption.

We also reviewed the steps taken during this Administration to promote the viability of small banks, and discuss the tax policy principles that govern any expansion of Subchapter S eligibility.

The report contains no recommendations.

Sincerely,

Lawrence H. Summers

Enclosure

[Identical letters sent to the Honorable Phil Gramm, the Honorable Max Baucus, and the Honorable Charles Grassley]

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
U.S. House of Representatives
Washington, D.C.  20515-6050

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## SUMMARY

Credit unions are depository institutions that accept deposits and make loans. As of June 30, 2000, there were 10,477 federally insured credit unions with $426.8 billion in assets. Although the average credit union is small, with only $41 million in assets, those with more than $50 million in assets hold more than 79 percent of all credit union assets, even though they account for only 15 percent of all credit unions.

As a group, credit unions have grown larger in recent years and have expanded their offerings of financial products and services. According to an industry survey, more than half of all credit unions accept loan applications through the Internet. Moreover, more than 10 percent provide stock brokerage services or sell mutual funds, albeit through a subsidiary.

Although they provide many of the same products and services as banks and thrifts, credit unions have certain distinguishing characteristics. They are member-owned cooperatives, with each member having one vote regardless of the amount of a member's deposits. Moreover, they do not issue capital stock; rather, they are non-profit entities that build capital by retaining earnings. Finally, credit unions may serve only an identifiable group of customers with a common bond (*e.g.*, the employees of a particular firm, the members of a certain organization, or the members of a specific community).

**Federal Laws and Regulations**

Despite their relatively small size and their restricted fields of membership, federally insured credit unions operate under banking statutes and rules virtually identical to those applicable to banks and thrifts. Significant differences have existed in the past, but have been gradually disappearing. Recently, most of the remaining major regulatory differences between credit unions and other depository institutions were removed.

In 1998, Congress established net worth requirements for credit unions and directed the National Credit Union Administration (NCUA) to promulgate prompt corrective action (PCA) rules and risk-based net worth requirements for credit unions. Although the NCUA's final rules mirrored those applicable to other depository institutions in most respects, a few differences can be noted. Each of these two rules contains a placeholder for the role that "regulatory capital" could play should the NCUA authorizes it. Such "capital" would be uninsured, but would be viewed as adding to the net worth available to a credit union to absorb losses. However, history shows that uninsured depositors withdraw their funds at the first sign of financial difficulty, thus rendering such funds unavailable to absorb losses and, in some cases, precipitating runs on institutions. In addition, under the PCA regulation, the NCUA waived its right to take certain

statutorily authorized actions against undercapitalized credit unions, such as requiring a new election of a credit union's board of directors.

We have identified only two other important differences. First, the NCUA's loans-to-one-borrower restriction greatly exceeds the limit applicable to other depository institutions, which is typically set at 15 percent of capital. The limit for credit unions stands at 10 percent of net worth *and 10 percent of deposits*. Second, credit unions are exempt from the Community Reinvestment Act (CRA), which requires that banks and thrifts serve all customers within their geographic area. However, the NCUA recently promulgated a regulation requiring that any credit union seeking to expand, convert to, or charter a community credit union would have to prepare a written plan for serving its entire community.

At this time, we do not believe these differences raise any particular safety and soundness or competitive equity concerns. Therefore, we offer no administrative or legislative recommendations.

**The Credit Union Tax Exemption**

Historically, cooperative depository institutions were generally exempted from the federal corporate income tax. For example, cooperative banks had always been exempt, whereas state credit unions obtained an exemption in 1917. Federal credit unions have also always enjoyed an exemption, one that stemmed from the cooperative character of federal credit unions and the desire to tax them in a manner consistent with federal thrift institutions.

In 1951, however, Congress removed the thrift tax exemption because these institutions had evolved into commercial bank competitors, and had lost their "mutuality," in the sense that the institutions' borrowers and depositors were not necessarily the same individuals. Congress determined that, under these circumstances, their tax exemption afforded them an unfair advantage over commercial banks. Although it removed the thrift exemption, Congress left intact the credit union exemption.

In directing the Treasury Department to study this issue, Congress asked us to analyze "the potential effects of the application of . . . Federal tax laws . . . on credit unions in the same manner as those laws are applied to other federally insured financial institutions." Thus, we analyzed how much revenue might be raised by removing the exemption. We estimated that between $13.7 billion and $16.2 billion would be raised over a ten-year period if all credit unions were taxed.

**Preserving Small Banks**

The Administration has, throughout its tenure, taken substantial steps to preserve the growth and viability of small banks. The Credit Availability Program (CAP), for example, was unveiled by the President shortly after taking office in 1993. In the midst of a slow economic recovery, the CAP updated certain important regulations, thereby curtailing regulatory burden on banks and improving the availability of credit, particularly to small and medium-sized businesses, farms, and low-income communities. Other initiatives included streamlining compliance with the Bank Secrecy Act, reducing regulatory burden, streamlining CRA rules, and simplifying small bank capital standards. Believing that we have taken those actions best tailored to preserving the growth and viability of small banks, we recommend no new policy initiatives at this time.

Small banks have also benefited from the tax benefits of Subchapter S status. By the end of 1999, more than 1,260 banks were operating as S corporations. These institutions represent over 15 percent of U.S. banks, but only about 2 percent of banking assets, suggesting that smaller institutions have been among the first to elect S corporation status. This strong response by smaller banks suggests that Subchapter S offers considerable advantages in terms of more favorable tax treatment and lower compliance burdens. If further policy changes are considered, they should satisfy two broad requirements. First, any additional measures to simplify the tax treatment of small banks must be crafted with a recognition that small businesses electing Subchapter S status play a vital role in the U.S. economy, and that only a small number of these firms are banks. Second, proposed modifications to Subchapter S must be evaluated with respect to potential effects on the competitive environment faced by smaller banks.

# CHAPTER 1

## INTRODUCTION

The Credit Union Membership Access Act of 1998 (CUMAA) directed the Treasury to study several depository institution issues.[1] Most of these concerned credit unions, but one addressed the viability of community banks. This report presents the results of our study with regard to sections 401 and 403 of CUMAA. A report on section 203, which required a study of credit union member business lending, will be submitted under separate cover.

Section 401 requires the Treasury to evaluate:

> the differences between credit unions and other federally insured financial institutions, including regulatory differences with respect to regulations enforced by the Office of Thrift Supervision, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Administration; and
>
> the potential effects of the application of Federal laws, including Federal tax laws, on credit unions in the same manner as those laws are applied to other federally insured financial institutions.

Under section 403, Congress directed Treasury to submit:

> recommendations for such legislative and administrative action as the Secretary deems appropriate, that would reduce and simplify the tax burden for insured depository institutions having less than $1,000,000,000 in assets; and banks having total assets of not less than $1,000,000,000 nor more than $10,000,000,000; and
>
> any other recommendations that the Secretary deems appropriate that would preserve the viability and growth of small banking institutions in the United States.

### I. Credit Union Characteristics

Like banks and thrifts, credit unions are depository institutions that accept deposits and make loans.[2] Also like banks and thrifts, their member deposits are insured by the federal government up to $100,000.[3] As of June 30, 2000, 10,477 federally insured credit unions with

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[1] Pub. L. No. 105-219, §§ 203, 401, and 403, 112 Stat. 913, 922 and 934-935 (1998) (codified at 12 U.S.C. §§ 1752a note and 1757a note).

[2] For a thorough analysis of credit unions, their business operations, and how they compare to banks and thrifts as financial service providers, *see* U.S. Dept. of the Treasury, *Credit Unions* (Wash., DC: 1997), pp. 15-27. Congress directed the Treasury to conduct this study in section 2606 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. Pub. L. No. 104-208, § 2606, 110 Stat. 3009-473 (Sept. 30, 1996) (codified at 12 U.S.C. § 1752a note).

[3] 12 U.S.C. § 1787(k)(1).

$426.8 billion in assets served 76.3 million members.[4] Thus, the average credit union asset size is $41 million. As Table 1-1 shows, the vast majority of credit unions is small and holds a relatively small share of credit union assets. About 57 percent of all credit unions hold less than $10 million in assets. Moreover, credit union assets are concentrated within the largest institutions. Credit unions with more than $50 million in assets comprise less than 15 percent of all credit unions, but they hold over 79 percent of total federally insured credit union assets.

Table 1-1: Number of Federally Insured Credit Unions and Total Assets by Size Category
(Dollars in billions; data as of June 2000)

| Asset Size Category | Number of Institutions | Percent of All Credit Unions | Total Assets | Percent of Total Assets |
|---|---|---|---|---|
| < $2 million | 2,537 | 24% | $2.2 | 0.5 |
| $2 -$10 million | 3,457 | 33% | $17.9 | 4.2 |
| $10-$50 million | 2,939 | 28% | $68.0 | 15.9 |
| > $50 million | 1,544 | 15% | $338.7 | 79.4 |
| Total | 10,477 | 100% | $426.8 | 100.0 |

Source: Sheshunoff Information Services, Inc., *BankSearch* (Austin, TX: 2000).

Credit unions have grown larger in recent years. As of year-end 1994, 67 percent of all credit unions had less than $10 million in assets,[5] compared with 57 percent as of June 30, 2000. Of this 10 percent difference, credit unions with more than $50 million in assets account for half of this change.[6]

Although credit unions have certain characteristics in common with banks and thrifts, (*e.g.*, the intermediation function), they are clearly distinguishable from these other depository institutions in their structural and operational characteristics. Many banks or thrifts exhibit one or more of the following five characteristics; but only credit unions exhibit all five together.

First, credit unions are member-owned,[7] and each member is entitled to one vote in selecting board members and in certain other decisions.[8] Although other mutual institutions are

[4] Sheshunoff Information Services, Inc., *BankSearch* (Austin, TX: 2000). Note that this figure will overstate membership, because some people belong to more than one credit union.

[5] *Ibid.*

[6] *Ibid.*

[7] 12 U.S.C. § 1752(1) (defining a federal credit union as "a cooperative association organized . . . for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes . . . . "). Mutual thrifts are also owned by their depositors, but the other credit union characteristics do not necessarily apply to these depository institutions.

[8] 12 U.S.C. § 1760.

also member-owned, voting rights are generally allocated according to the size of the mutual member's deposits, rather than being "one member, one vote."[9]

Second, credit unions do not issue capital stock. Credit unions create capital, or net worth, by retaining earnings. Most credit unions begin with no net worth and gradually build it over time.[10]

Third, credit unions rely on volunteer, unpaid boards of directors whom the members elect from the ranks of membership.[11]

Fourth, credit unions operate as not-for-profit institutions, in contrast to shareholder-owned depository institutions. All earnings are retained as capital or returned to the members in the form of interest on share accounts, lower interest rates on loans, or otherwise used to provide products or services.

Fifth, credit unions may only accept as members those individuals identified in a credit union's articulated field of membership.[12] Generally, a field of membership may consist of a single group of individuals that share a common bond; more than one group, each of which consists of individuals sharing a common bond; or a geographical community.[13] A common bond may take one of three forms: an occupational bond applies to the employees of a firm; an associational bond applies to members of an association; and a geographical bond applies to individuals living, working, attending school, or worshiping within a particular defined community.[14]

Table 1-2 shows the number of federal credit unions and their total assets for each type of field of membership category. A multiple common bond credit union holds more than one occupational or associational common bond or a combination of both types of common bonds. (Community common bonds may not be part of a multiple common bond federal credit union.)

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[9] 12 C.F.R. § 544.1 (presenting the federal mutual charter, section 6 of which provides that "each holder of an account shall be permitted to cast one vote for each $100 . . . . "). Federal mutual institutions may set the number of votes per member anywhere from 1 to 1,000. 12 C.F.R. § 544.2(b)(4).

[10] 12 U.S.C. § 1790d(b)(2)(B)(ii) (requiring credit union prompt corrective action regulations "to recognize that credit unions (as cooperatives that do not issue capital stock) initially have no net worth, and give new credit unions reasonable time to accumulate net worth . . . . "). This contrasts with banks and thrifts, which will be chartered only if they have sufficient capital with which to begin operations. 12 C.F.R. § 5.20(h)(4)(national banks); 12 C.F.R. § 552.2-1(b)(3)(ii)(federal savings associations). Even federal mutual associations must have a minimum amount of capital with which to begin operations. 12 C.F.R. § 543.2(g)(2)(ii).

[11] *See* 12 U.S.C. § 1761. Nevertheless, federal credit unions do have the authority to permit a specified number of paid credit union employees to serve as directors. *See* NCUA, *The Federal Credit Union Bylaws*, art. VI, § 2. Also, some state chartered credit unions may have paid boards of directors.

[12] 12 U.S.C. § 1759(b). Such requirements for state credit unions vary from state to state.

[13] 12 U.S.C. § 1759(b).

[14] NCUA, *Chartering and Field of Membership Manual* (Alexandria, VA: 1999), 63 Fed. Reg. 71,998 (Dec. 30, 1998), as amended, 65 Fed. Reg. 37,065 (Jun. 13, 2000).

Note that 49 percent of federal credit unions have multiple common bonds, but they hold 71 percent of federal credit union assets. Of the institutions organized around a single common bond, most serve particular occupational groups. Occupational bonds account for 31 percent of all federal credit unions and 16 percent of federal credit union assets.

Table 1-2: Federal Credit Unions by Type of Membership*
(Dollars in billions; data as of December 31, 1999)

| | Number | Percent of all Federal Credit Unions | Total Assets ($ in billions) | Percent of all Federal Credit Union Assets |
|---|---|---|---|---|
| Single Common Bond | 3,317 | 51.3% | $71.7 | 29.3% |
| Occupational | 1,978 | 30.6% | $40.2 | 16.4% |
| Associational | 666 | 10.3% | $3.8 | 1.6% |
| Community | 649 | 10.0% | $26.4 | 10.8% |
| Other** | 24 | 0.4% | $1.3 | 0.5% |
| Multiple Common Bond | 3,149 | 48.7% | $172.6 | 70.7% |
| Total | 6,466 | 100.0% | $244.3 | 100.0% |

* Data on state chartered credit unions were not available.
** Common bonds in this category consist of atypical common bonds that have been grandfathered.
Source: National Credit Union Administration

## II. Organization of the Report

This report is divided into four chapters. Chapter 2 analyzes the differences between federally chartered credit unions and other federally chartered depository institutions generally and compares the different statutory and regulatory requirements applicable to all federally chartered depository institutions. Chapter 3 examines the revenue implications of eliminating the federal income tax exemption currently applicable to federally insured credit unions. Finally, Chapter 4 describes actions taken by this Administration to preserve the viability and growth of small banks. The report also contains an Appendix containing a detailed comparison of the statutes and regulations applicable to banks, savings associations, and credit unions.

# CHAPTER 2

## COMPARING THE DIFFERENCES BETWEEN FEDERALLY INSURED CREDIT UNIONS AND OTHER FEDERALLY INSURED DEPOSITORY INSTITUTIONS

Pursuant to section 401 of CUMAA, this chapter identifies the major statutory and regulatory differences between federally insured credit unions and other federally insured depository institutions. In preparing this chapter, Treasury drew upon its 1997 credit union study.[15] In that report, we enumerated several important characteristics that differentiate credit unions from banks and thrifts.[16] We also compiled a table comparing both the enforcement and the safety and soundness laws and regulations applicable to federally chartered depository institutions, that is, those depository institutions supervised by the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS).[17]

Given the mandate of section 401, we updated and expanded that table (see Appendix). The updated table compares rules applicable to federally insured depository institutions as implemented by all six federal depository institution regulators, including the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC). Where applicable, meaningful divergences between state and federal rules are noted. Moreover, the updated table augments the previous one by summarizing the safety and soundness rules recently implemented by the NCUA and by comparing the basic consumer protection laws and regulations across depository institutions. It also identifies the major powers enjoyed by national banks, federal savings associations, and federal credit unions.[18]

Our 1997 report included several safety and soundness recommendations.[19] Most of these have been enacted in the CUMAA, including credit union net worth requirements, risk-based net worth requirements, prompt corrective action, and updated audit standards. This chapter examines the NCUA's regulations implementing these statutory requirements.

Given the important structural and operational differences between credit unions and other depository institutions highlighted in Chapter 1, one would expect credit union rules to

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[15] Treasury, *Credit Unions, op. cit.* footnote 2.

[16] *Ibid.*, pp. 17-19.

[17] *Ibid.*, pp. pp. 131-143.

[18] State depository institution powers vary by state and will not be considered in this report. Moreover, a federally insured state bank (or its subsidiary) or savings association (or its subsidiary) may not engage in any activity impermissible for a national bank (or its subsidiary) unless the FDIC finds that it poses no significant risk to the appropriate deposit insurance fund and the institution complies with all applicable capital rules. 12 U.S.C. § 1831a(a)(1)(state banks); 12 U.S.C. § 1831e(a)(state savings associations).

[19] Treasury, *Credit Unions, op. cit.* footnote 2, p. 128.

differ in some respects from those applicable to banks and thrifts. For example, credit unions' cooperative character precludes them from issuing stock to raise capital, but also excludes them from the myriad rules governing stock issuance and the payment of dividends. On the other hand, banks and thrifts may serve any customer and need not limit their operations to pre-established fields of membership, whereas credit unions may only serve those who fall within their fields of membership. This chapter examines whether the most important statutory and regulatory requirements applicable to depository institutions differ in any significant respect for credit unions.

This chapter has been divided into three sections. Section I evaluates the recent safety and soundness rules promulgated by the NCUA pursuant to statutory mandates. Section II compares the banking statutes and regulations under which depository institutions operate. Section III summarizes our conclusions.

## I. NCUA Implementation of Mandated Safety and Soundness Rules

Treasury's 1997 report, *Credit Unions*, noted that credit unions operated under less rigorous and formal safety and soundness rules than did banks and thrifts even as "a growing number of credit unions evolve into larger and more complex financial institutions."[20] Contending that "[s]afety and soundness regulation must keep pace with expanding credit union operations,"[21] our report recommended, among other things, that credit unions be subject to statutory net worth requirements, including: a risk-based net worth requirement; prompt corrective action; and independent audit requirements for larger institutions.[22]

Congress incorporated these three recommendations into the CUMAA.[23] These requirements and the NCUA's proposed and final regulations implementing them are discussed and evaluated below.

### A. Net Worth Requirements for Credit Unions

Prior to CUMAA, NCUA regulations did not impose any net worth requirement on credit unions. In other words, credit unions were not required to maintain a given ratio of net worth to total assets for safety and soundness purposes. Instead, credit unions were required only to add to their reserves a specified percentage of current earnings. If reserves reached a certain threshold, credit unions were no longer required to add to reserves, but no law or regulation stipulated that credit unions were required to reach that level.[24] The major differences between

[20] Treasury, *Credit Unions*, *op. cit.* footnote 2, pp. 82-83.

[21] *Ibid.*

[22] *Ibid.*

[23] Pub. L. No. 105-219, 112 Stat. 913 (Aug. 7, 1998).

[24] For example, a credit union operating for more than four years and having at least $500,000 in assets had to transfer annually 10 percent of its gross income to a reserve account until that account reached 4 percent of outstanding loans and assets. Other credit unions had to transfer the same proportion of gross income until they

the capital requirements of credit unions and those of the other depository institutions are delineated below. The Appendix contains a more detailed comparison.

In contrast, banks and thrifts are required to meet two capital requirements in order to be adequately capitalized: (1) a minimum ratio of total capital to total assets, generally 4 percent of Tier 1 capital,[25] which includes common stock and non-cumulative perpetual preferred stock;[26] and (2) a risk-based capital ratio of 8 percent capital to risk-weighted assets.[27] Half of the 8 percent risk-based capital requirement may consist of Tier 2 capital, which may include cumulative perpetual preferred stock, the allowance for loan and lease losses, and hybrid instruments that combine debt and equity features.[28]

CUMAA's net worth requirements direct federally insured credit unions to maintain at least 6 percent net worth to total assets to be considered adequately capitalized.[29] Note that this exceeds the 4 percent Tier 1 leverage ratio applicable for banks and thrifts (and is statutory, as opposed to regulatory). Congress determined that a higher ratio was appropriate because credit unions cannot quickly issue capital stock to raise their net worth as soon as a financial need arises. Instead, credit unions must rely on retained earnings to build net worth, which necessarily takes time. Moreover, Congress established a capital level two percentage points higher, a level recommended by Treasury, because one percent of a credit union's capital is dedicated to the National Credit Union Share Insurance Fund and another one percent of the typical credit union's capital is dedicated to its corporate credit union.[30]

Congress also directed the NCUA to develop risk-based net worth requirements for complex credit unions.[31] The NCUA was directed to both define what attributes cause a credit

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reached 7.5 percent. At that point, their transfer requirement declined to 5 percent until the reserve reached 10 percent. 12 U.S.C. § 1762 (repealed 1998).

[25] 12 C.F.R. § 6.4(b)(2)(iii) (OCC); 12 C.F.R. § 565.4(b)(2)(iii) (OTS); 12 C.F.R. § 325.103(b)(2)(iii) (FDIC); and 12 C.F.R. § 208(b)(2)(iii) (FRB). Savings associations must meet capital requirements as stringent as those applicable to banks. 12 U.S.C. § 1464(t)(1)(C).

[26] 12 C.F.R. part 3, app. A (OCC); 12 C.F.R. part 325, app. A (FDIC); and 12 C.F.R. part 208, app. A (FRB). In the case of savings associations, Tier 1 capital also includes certain non-withdrawable accounts and pledged deposits. 12 C.F.R. part 567 (OTS).

[27] 12 C.F.R. § 6.4(b)(2)(i) (OCC); 12 C.F.R. § 565.4(b)(2)(i) (OTS); 12 C.F.R. § 325.103(b)(2)(i) (FDIC); and 12 C.F.R. § 208(b)(2)(i) (FRB). The risk-based capital requirements for savings associations may deviate from those applicable to national banks to account for interest rate risk or other risks, but any deviations may not result in materially lower levels of capital for savings associations. 12 U.S.C. § 1464(t)(2)(C).

[28] 12 C.F.R. part 3, app. A (OCC); 12 C.F.R. part 325, app. A (FDIC); 12 C.F.R. part 208, app. A (FRB); and 12 C.F.R. part 567 (OTS).

[29] 12 U.S.C. § 1790d(c)(1)(B)(i).

[30] Treasury, *Credit Unions*, *op. cit.* footnote 2, pp. 58 and 70-71.

[31] 12 U.S.C. § 1790d(d)(1).

union to be considered complex,[32] and design a system for complex credit unions that accounts for any material risks not adequately addressed by the 6 percent leverage requirement.[33] To be adequately capitalized, a complex credit union must meet the higher of the 6 percent leverage requirement and the risk-based net worth requirement.[34]

The risk-based capital system for banks and thrifts assigns each class of assets a risk weight that varies from 0 percent to 100 percent. The 0 percent category includes assets such as cash, the 20 percent category includes assets such as securities issued by government-sponsored enterprises, the 50 percent category includes mortgage loans, and the 100 percent category consists of typical commercial loans.[35] These rules stemmed from a 12-country effort to develop internationally uniform capital standards.[36] As such, this system best serves larger, internationally active commercial banks, but it would not likely serve credit unions as well. In this case, credit unions should operate under different rules, but rules aimed at the same goal of requiring capital to account for risks not adequately covered by the leverage ratio.

### *1. NCUA's Risk-Based Net Worth Requirement*

The NCUA's risk-based capital rule applies to any credit union with more than $10 million in assets and whose risk-based net worth requirement exceeds 6 percent.[37] A credit union's risk-based requirement is the sum of eight standard components, as depicted in Table 2-1. Each of the eight components constitutes a "risk portfolio," which is a portfolio of assets, liabilities, or contingent liabilities expressed as a percentage of total assets. A risk-weighting is applied to each component, and all are summed to determine the credit union's requirement. A credit union is undercapitalized if its net worth is less than the applicable risk-based net worth requirement.

[32] *Ibid.*

[33] 12 U.S.C. § 1790d(d)(2).

[34] 12 U.S.C. § 1790d(c)(1)(B)(ii).

[35] 12 C.F.R. part 3, app. A (OCC); 12 C.F.R. part 325, app. A (FDIC); 12 C.F.R. part 208, app. A (FRB); and 12 C.F.R. part 567 (OTS).

[36] William A. Lovett, *Banking and Financial Institutions Law* (St. Paul, MN: 1997), pp. 127-128.

[37] 65 Fed. Reg. 44,950, 44,966 (Jul. 20, 2000) (to be codified at 12 C.F.R. part 702).

Table 2-1: Standard Calculation of Risk-Based Net Worth Requirement

| Risk Portfolio Component | Allocation of Risk Portfolios (as % of total assets) | Multiplying Factor |
|---|---|---|
| Long-term real estate loans[38] | 0 to 25<br>over 25 | .06<br>.14 |
| Outstanding member business loans | 0 to 12.25<br>over 12.25 | .06<br>.14 |
| Investments | 0 to 1 year<br>> 1 year to 3 years<br>> 3 years to 10 years<br>> 10 years | .03<br>.06<br>.12<br>.20 |
| Low risk assets[39] | All | .00 |
| Average-risk assets[40] | All | .06 |
| Loans sold with recourse | All | .06 |
| Unused member business loan lines of credit | All | .06 |
| Allowance for loan losses | Limited to the equivalent of 1.5% of total loans (expressed as a % of assets) | (1.00) |

Source: NCUA. *See also* 65 Fed. Reg. 44,969.

The final rule offers an alternative method of calculating the requirement, which a credit union may use if it results in a lower risk-based net worth requirement. Three of the above-mentioned “risk portfolios”–long-term real estate loans, member business loans, and investments–are weighted according to their remaining maturity. If the alternative results in any

[38] Long-term real estate loans consists of all real estate loans and lines of credit–excluding member business loans–that will not reprice or mature within five years. 65 Fed. Reg. 44,966 (to be codified at 12 C.F.R. § 702.104(a)).

[39] Low risk assets consist of cash on hand and the one percent deposit held by credit unions in the National Credit Union Share Insurance Fund. 65 Fed. Reg. 44,966 (to be codified at 12 C.F.R. § 702.104(d)).

[40] Average risk assets equals total assets minus the sum of long-term real estate loans, outstanding member business loans, investments, and low risk assets. 65 Fed. Reg. 44,966 (to be codified at 12 C.F.R. § 702.104(e)).

component generating a lower requirement, the credit union may substitute the lower determination for the standard calculation of that component.[41]

### 2. *Assessment of the NCUA's Risk-Based Net Worth Requirement*

In general, the NCUA implemented the risk-based net worth requirements as Congress intended. However, the rule contains a placeholder for the role that "regulatory capital" might play as "a criterion in evaluating net worth restoration plans" if regulatory capital is approved by the NCUA.[42] Under CUMAA, only retained earnings calculated according to generally accepted accounting principles (GAAP) may count as net worth,[43] which means that no form of uninsured regulatory capital may count as net worth. Nevertheless, the NCUA finds such capital valuable, believing that it would be available to absorb losses. Specifically, the NCUA will take regulatory capital, which may be established by NCUA regulation or authorized by state law and recognized by NCUA, into account when evaluating a credit union's net worth restoration plan.

A credit union with regulatory capital would likely be permitted to have lower net worth targets in its net worth restoration plan than a similarly situated credit union without regulatory capital, on the theory that regulatory capital would be available to absorb potential losses. However, depository institution experience with uninsured depositors shows that these account holders tend to withdraw their funds at the first sign of financial difficulty, thus rendering such funds unavailable to absorb losses and, in some cases, precipitating runs on institutions.

## B. Prompt Corrective Action for Credit Unions

In response to the large number of bank and thrift failures in the late 1980s and early 1990s, Congress enacted a regulatory structure known as prompt corrective action (PCA). PCA consists of a set of statutory and regulatory provisions aimed at resolving capital deficiencies before they grow into larger problems.[44] This system classifies depository institutions into five categories, according to their capital holdings: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.[45] An institution that becomes undercapitalized faces progressively more stringent regulatory restrictions and

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[41] *See* 65 Fed. Reg. 44,969 (to be codified at 12 C.F.R. § 702.107).

[42] 65 Fed. Reg. 8,607 (Feb. 18, 2000). Net worth restoration plans will be codified at 12 C.F.R. § 702.206(e). The NCUA's approach relies in part on the standards applicable to low-income credit unions, which may accept uninsured secondary capital accounts that count towards meeting net worth requirements. Although CUMAA specifically permitted these credit unions to count such capital as net worth, it did not permit its use in any form by other credit unions.

[43] 12 U.S.C. § 1790d(o)(2).

[44] 12 U.S.C. § 1831o. Regulations implementing these statutory requirements can be found at 12 C.F.R. part 6 (OCC); 12 C.F.R. part 325, subpart B (FDIC); 12 C.F.R. part 208, subpart D (FRB); and 12 C.F.R. part 565 (OTS).

[45] 12 U.S.C. § 18310(b)(1). Although created by statute, these terms are defined only in regulation. 12 C.F.R. § 6.4 (OCC); 12 C.F.R. § 565.4 (OTS); 12 C.F.R. § 325.103 (FDIC); 12 C.F.R. § 208.43 (FRB).

requirements. Depending on how undercapitalized an institution becomes, and how long the institution remains undercapitalized, the primary federal regulator may direct the institution to issue capital stock or to refrain from increasing its asset size. Regulators also have the authority to require a new election of the board of directors and to dismiss managers. Ultimately, an institution may be placed into receivership if it remains critically undercapitalized for a long period of time and shows no ability to recover.[46]

Treasury's 1997 report determined that prompt corrective action would benefit credit unions. At that time, we found that the:

> relevant statutes, regulations, and policies fall short of providing a system of prompt corrective action for credit unions. The NCUA has no regulations or even formal guidelines for taking corrective action regarding a troubled credit union, and once a credit union depletes its net worth, the NCUA's response may be to provide assistance from the Share Insurance Fund rather than to close the institution. Although this approach may sometimes turn around a troubled institution, it also has risks. In particular, regulatory forbearance may delay the actual recognition and correction of serious deficiencies. When this occurs in a general downturn with many institutions getting into difficulty, what might otherwise have produced small losses to the insurance fund could produce much larger losses. The breakdown in regulatory discipline and management discipline becomes difficult to correct. Unstructured regulatory discretion may also promote unfairly disparate treatment of similarly situated credit unions.[47]

Based on Treasury's recommendation, Congress directed the NCUA to implement a system of PCA for credit unions.[48] Recognizing the differences between credit unions and other depository institutions, Congress did not simply apply the then-existing PCA system to credit unions; rather, it adapted that system to the characteristics of credit unions.[49] For example, given that credit unions can only increase net worth through retained earnings and that credit unions are generally chartered with little or no net worth, the statute directed the NCUA to promulgate separate PCA rules for newly chartered credit unions.[50] Similarly, the legislation grants the

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[46] 12 U.S.C. § 1831o(h)(3)(C)(i) (directing the regulator to appoint a receiver for an insured depository institution has remained "critically undercapitalized on average by the calendar quarter beginning 270 days after the date on which the institution became critically undercapitalized"). Subject to certain stringent restrictions, the FDIC and the critically undercapitalized institution's federal regulator may spare the institution from receivership if it "is viable and not expected to fail." 12 U.S.C. § 1831o(h)(3)(C)(ii)(II).

[47] Treasury, *Credit Unions*, *op. cit.* footnote 2, p. 76.

[48] Pub. L. No. 105-219, § 301, 112 Stat. 913, 923-931 (codified at 12 U.S.C. § 1790d).

[49] For example, CUMAA directed the NCUA to design a system of prompt corrective action "to take into account that credit unions are not-for-profit cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consist primarily of volunteers." 12 U.S.C. § 1790d(b)(1)(B).

[50] CUMAA required the NCUA to "prescribe a system of prompt corrective action that shall apply to new credit unions in lieu of this section [which must] recognize that credit unions (as cooperatives that do not issue capital stock) initially have no net worth and give new credit unions reasonable time to accumulate net worth . . . . " 12 U.S.C. § 1790d(b)(2)(B).

NCUA more time to allow a critically undercapitalized credit union to build net worth and return to financial health than generally permitted for banks and thrifts.[51]

In addition to tailoring specific statutory PCA provisions to credit unions, the legislation directs the NCUA to develop a PCA system that is "comparable" to the PCA rules applicable to banks and thrifts.[52] According to the Senate Banking Committee report, "comparable" means "parallel in substance (though not necessarily identical in detail) and equivalent in rigor."[53]

*1. NCUA's Prompt Corrective Action Rule*

PCA consists of two primary components: (1) a framework of mandatory actions prescribed by statute together with discretionary actions developed by the NCUA; and (2) an alternative system of PCA that applies to "new" credit unions. With regard to the first component, CUMAA mandated a set of required actions, corresponding to five statutory net worth categories. Those actions that would trigger conservatorship or liquidation are prescribed in CUMAA. Discretionary actions were left for the NCUA to devise, provided they are "comparable" to those devised by the federal banking agencies for banks and thrifts.

New credit unions are those that have been in operation less than ten years and have $10 million or less in assets.[54] Pursuant to CUMAA, the NCUA devised a completely different system of PCA for these institutions, taking into account the fact that new credit unions begin with no net worth and can only build it slowly over time. The final rule expanded the net worth categories from five to six and delineated how long it would normally take a new credit union to work its way from uncapitalized, on the day it is chartered, to higher levels of net worth. For example, the NCUA anticipates that it would require five years to accumulate 2 percent net worth and about 10 years to become adequately capitalized, with at least 6 percent net worth.

The NCUA promulgated its final PCA rule on February 18, 2000,[55] and it became effective on August 7, 2000.

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[51] For example, the NCUA may, under certain conditions, decide not to liquidate a critically undercapitalized credit union, but it must revisit that decision every six months. 12 U.S.C. § 1790d(i)(2). In contrast, the other federal depository institution regulators must revisit such a decision every three months. 12 U.S.C. § 1831o(h)(3)(B). The NCUA must generally liquidate a credit union that has remained critically undercapitalized on average during the calendar quarter beginning 18 months after the date on which the credit union initially became critically undercapitalized. 12 U.S.C. § 1790d(i)(3)(A). For the other federal regulators, the comparable time period is nine months. 12 U.S.C. § 1831o(h)(3)(C)(i).

[52] 12 U.S.C. § 1790d(b)(1)(A)(ii).

[53] S. REP. NO. 193, 105th Cong., 2nd Sess. p. 12 (1998).

[54] 12 U.S.C. § 1790d(o)(4).

[55] 65 Fed. Reg. 8,560 (Feb. 18, 2000).

### 2. *Assessment of the NCUA's Prompt Corrective Action Rule*

As with its approach to devising a risk-based net worth requirement, the NCUA has generally implemented its PCA rule as Congress intended, including the congressional mandate that PCA for credit unions be "comparable" to PCA for banks and thrifts. To the extent there are differences, for the most part they derive from the structural distinction between credit unions and other depository institutions.

We found, however, that the rule differs unnecessarily from the bank and thrift PCA rule in two respects. First, the NCUA has decided explicitly to forego its right to take certain discretionary actions against undercapitalized credit unions. For example, the NCUA has decided not to use its authority to require a new election of an undercapitalized credit union's board of directors, although it will retain its authority to do so in the case of a significantly or critically undercapitalized institution. With regard to an undercapitalized credit union, the NCUA believes that a wholesale election of the board of directors may be an overreaction when a credit union's net worth falls below six percent. Although this may be true in many, or nearly all such situations, there may well be exceptions. Treasury believes that it would have been more appropriate for the NCUA to articulate its perspective in the preamble and in guidance, while at the same time retaining the authority.

Second, as with the proposed risk-based net worth rule, the final PCA rule contains a placeholder for the role that "regulatory capital" could play in the PCA system if the NCUA authorizes it. As noted previously, only GAAP calculated retained earnings count as net worth.[56] Recognizing this, the NCUA states in the preamble that "the final rule is revised to establish as a criterion in evaluating net worth restoration plans the type and amount of any forms of regulatory capital as may be established by NCUA . . . ."[57] The prospect of new forms of regulatory capital raises concerns, as mentioned in the discussion of the NCUA's proposed risk-based net worth requirement rule.

## C. Independent Audits

All federally insured banks and thrifts must complete annual reports on their financial condition and management.[58] Moreover, all banks and thrifts with at least $500 million in assets must establish an independent audit committee and obtain an annual independent audit of its financial statements by an independent public accountant in accordance with generally accepted accounting standards.[59] Furthermore, the OTS requires any savings association with an unsatisfactory supervisory rating (3, 4, or 5) to obtain an independent audit.[60]

[56] 12 U.S.C. § 1790d(o)(2).

[57] 65 Fed. Reg. 8,560, 8,564 (Feb. 18, 2000).

[58] 12 U.S.C. § 1831m(a).

[59] 12 C.F.R. part 363, implementing 12 U.S.C. § 1831m(d) and (g)(1).

[60] 12 C.F.R. § 562.4(b)(1).

Credit unions have traditionally followed much different audit procedures. First, a credit union's volunteer board of directors must appoint a supervisory committee from among the credit union's membership.[61] The supervisory committee must then conduct, or hire a competent party to conduct, an annual audit of the credit union. The supervisory committee must also verify that the institution's financial statements accurately and fairly represent the institution's financial condition and that management practices and procedures sufficiently protect member assets.[62] NCUA regulations require that a credit union's financial statements provide full and fair disclosure of all assets, liabilities, and member equity.[63]

In our 1997 report, we noted that with the "rise of large, financially complex credit unions, the audit becomes increasingly more difficult for unpaid volunteers to carry out personally."[64] At that time, the NCUA required that supervisory committee audits be performed by "persons having adequate technical training and proficiency as an auditor commensurate with the level of sophistication and complexity of the credit union under audit," but did not require that even the largest, most complex credit union hire a professional accountant.[65]

Therefore, we recommended that the NCUA require each large federally insured credit union to obtain an annual audit from an independent certified public accountant, in a manner comparable to that required by the FDIC.[66]

CUMAA modified the audit requirements as recommended in our report. First, all financial reports and statements required to be filed with the NCUA must be uniform and consistent with GAAP, although credit unions with less than $10 million in assets are exempt.[67] The NCUA may substitute its own accounting principles for GAAP, provided that (1) GAAP is found to be inappropriate for credit unions, and (2) the substitute principles are "no less stringent" than GAAP.[68]

Like banks and thrifts, all insured credit unions with at least $500 million in assets must now obtain an annual independent audit of their financial statements, performed in accordance with GAAP by an independent certified public accountant or public accountant licensed to

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[61] 12 U.S.C. § 1761b(5).

[62] 12 C.F.R. part 715, implementing 12 U.S.C. § 1761d.

[63] 12 C.F.R. § 702.3.

[64] Treasury, *Credit Unions, op. cit.* footnote 2, p. 80.

[65] *See* 12 C.F.R. § 701.12(c)(2)(i) (superseded).

[66] Treasury, *Credit Unions, op. cit.* footnote 2, p. 80.

[67] 12 U.S.C. § 1782(a)(6)(C)(i) and (iii).

[68] *Ibid.*, § 1782(a)(6)(C)(ii)

perform these services by the appropriate jurisdiction.[69] Certain audit requirements also apply to insured credit unions with more than $10 million in assets, but less than $500 million, that voluntarily choose to be audited by an independent auditor who is compensated for the service.[70]

## II. Depository Institution Rules Compared

This section compares the basic statutory and regulatory rules applied to depository institutions across four broad categories: institution powers, safety and soundness, regulatory enforcement authority, and consumer protection. The Appendix contains a detailed table summarizing these findings.

### A. Institution Powers

In general, federal credit unions have more limited powers than national banks and federal savings associations. Most notably, federal credit unions face stricter limitations on their commercial lending and securities activities. In addition, a usury ceiling prevents them from charging more than 18 percent on any loan, and the term of many types of loans may not extend beyond 12 years. At the same time, however, federal credit unions have ample authority to offer most other consumer products and services, whether directly or through an affiliate. Table 2-2 identifies the major products and services available from credit unions and shows the proportion of credit unions offering such products and services by asset size.

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[69] 12 U.S.C. § 1782(a)(6)(D)(i).

[70] 12 U.S.C. § 1782(a)(6)(D)(ii).

Table 2-2: Credit Union Products and Services by Asset Size
(Percent of credit unions; data as of December 31, 1999)

| Asset Size (in millions) | | | | | |
|---|---|---|---|---|---|
| | $1-2m | $5-10m | $50-100m | Over $500m | All Credit Unions |
| Loans: | | | | | |
| Unsecured | 98.4 | 99.7 | 100.0 | 100.0 | 98.8 |
| First Mortgage | 8.6 | 33.9 | 84.6 | 100.0 | 41.2 |
| Guaranteed Student | 3.7 | 14.5 | 35.7 | 52.3 | 18.4 |
| Used Auto | 96.4 | 99.0 | 100.0 | 100.0 | 96.1 |
| New Auto | 96.4 | 99.2 | 100.0 | 100.0 | 95.3 |
| Auto Leasing | 1.9 | 8.0 | 27.8 | 45.2 | 11.6 |
| Plane/Boat/RV | 71.6 | 88.4 | 94.5 | 97.7 | 80.6 |
| Credit Cards | 3.6 | 45.1 | 92.0 | 97.7 | 46.3 |
| Member Services: | | | | | |
| Stock/Bond Brokerage* | 0.3 | 3.5 | 32.7 | 73.8 | 10.8 |
| Mutual Funds* | 0.4 | 2.5 | 32.6 | 78.6 | 10.3 |
| Safe Deposit Boxes | 0.0 | 2.9 | 49.0 | 66.7 | 14.5 |
| Loan Application Through Audio Response | 2.1 | 5.4 | 36.4 | 66.3 | 12.8 |
| Loan Application Through a PC | 0.8 | 12.2 | 67.4 | 80.2 | 23.4 |
| Loan Application Through the Internet | 0.0 | 48.3 | 72.5 | 78.9 | 62.6 |
| ATM Cards | 2.8 | 53.4 | 94.1 | 100.0 | 49.1 |
| Deposit Accounts/Services: | | | | | |
| CDs | 38.3 | 75.5 | 94.7 | 97.7 | 66.6 |
| Traditional IRAs | 18.5 | 61.6 | 93.2 | 98.8 | 56.1 |
| Business Checking | 5.9 | 37.8 | 58.2 | 48.3 | 31.9 |
| Personal Checking | 13.8 | 74.8 | 96.1 | 100.0 | 60.7 |

Source: Credit Union National Association, *Credit Union Services Profile 1999.* (Data consists of responses from 68 percent of the 11,012 credit unions in existence at the end of 1999).
* Institutions may not provide these services themselves, but may offer them if another entity actually provides the services.

One of the most apparent differences between federal credit unions and other federally chartered depository institutions stems from the restrictions federal credit unions have regarding their customer base. Whereas banks and savings associations may offer products and services to anyone, federal credit unions may serve only their members.[71] In addition, federal credit unions may accept only individuals as members, although community credit unions may also serve qualified businesses.[72] Despite these restrictions, a federal credit union may extend its offerings to non-members through an affiliate known as a credit union service organization (CUSO).

[71] 12 U.S.C. § 1759.

[72] 63 Fed. Reg. 71,998, 72,037 (Dec. 30, 1998).

CUSOs may be owned as a subsidiary or jointly with other depository institutions, including banks and thrifts.[73]

Below we compare the activities in which federal credit unions may engage to those in which national banks and federal savings associations may engage. A more complete comparison is provided in the Appendix.

*1. Deposits and Trust Accounts*

Like national banks and federal savings associations, federal credit unions may offer checking and savings accounts, although the Federal Credit Union Act (FCUA) refers to them as share accounts.[74] Unlike banks and savings associations, however, credit unions may pay interest on business checking accounts. Whereas federal credit unions may only offer trust accounts through a CUSO, national banks and federal savings associations may offer them directly.

*2. Customer Services*

Generally, federal credit unions may provide the same financial products and services as national banks and federal savings associations, including travel and foreign exchange services, insurance, securities brokerage, investment advice, and real estate brokerage. However, while national banks may offer these directly, federal credit union customers may only obtain these from a CUSO. A federal savings association may not offer these products directly, unless registered as a broker/dealer or investment advisor.

*3. Derivatives*

Federal credit unions have very limited authority to purchase or sell derivatives, even for the purpose of hedging risk,[75] unlike national banks and federal savings associations. Also in contrast to other federally chartered depository institutions, a federal credit union may not directly securitize its assets through its own trust. Furthermore, neither federal savings associations nor federal credit unions may underwrite securities, whereas national banks, through financial subsidiaries, may underwrite any security under certain conditions.

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[73] Federal credit unions may only invest up to one percent of their total paid in and unimpaired capital and surplus in CUSOs. 12 U.S.C. § 1757(7)(I).

[74] Federal credit unions are member-owned cooperatives. 12 U.S.C. § 1752(1). Therefore, the FCUA refers to member deposits as member shares, whether the share represents a demand deposit, time deposit, or certificate of deposit. 12 U.S.C. § 1752(5).

[75] Federal credit union may use derivatives to manage the risk of loss through a decrease in value of its commitments to originate real estate loans at specified interest rates by entering into long put positions on securities issued by the Government National Mortgage Association, the Federal National Mortgage Corporation, and the Federal Home Loan Mortgage Corporation. 12 C.F.R. § 701.21(i)(2).

*4. Lending*

Federal credit unions may offer residential mortgage loans, but such loans may not extend beyond 40 years, and any second mortgage may not extend beyond 20 years. In addition, national banks and federal savings associations must obtain a certified appraisal of such properties only when the loan amount exceeds $250,000,[76] whereas federal credit unions must generally obtain a certified appraisal if the loan exceeds $100,000.[77] Similarly, federal credit unions must obtain a certified appraisal for any business loan in excess of $50,000,[78] while other federally chartered depository institutions need only obtain such appraisals for loans in excess of $1 million.[79]

Federal credit unions may not make unsecured residential construction loans, whereas national banks and federal savings associations face only limited restrictions on such lending. On the other hand, federal credit unions may make other types of unsecured loans without specific additional limitations.

Federal credit unions' member business (commercial) lending may not exceed the lesser of 1.75 times net worth or 12.25 percent of total assets, unless the credit union is either chartered to make such loans, has a history of concentrating on making such loans, is a low income credit union, or participates in the Community Development Financial Institutions program. In contrast, national banks face no specific restrictions on this type of lending, and federal savings associations' commercial loans may not exceed 20 percent of their total assets.

*5. Investments*

NCUA regulations limit a federal credit union's investments to those specifically listed in the Act, such as government and agency securities, which may be purchased without limitation. Aside from the issuances of certain government sponsored enterprises, federal credit unions may not invest in residential mortgage-backed securities, such as strips; residual interests in collateral mortgage obligations or real estate mortgage investment conduits; or commercial mortgages and related securities. Moreover, unlike national banks and federal savings associations, federal credit unions may not invest in securities backed by non-residential assets, such as credit cards or automobiles, unless issued by certain government sponsored enterprises. Furthermore, subject to certain restrictions, national banks and federal savings associations may invest in corporate debt securities, but federal credit unions lack such authority.

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[76] 12 C.F.R. § 34.43(a)(1) (national banks); 564.3(a)(1) (federal savings associations).

[77] 12 C.F.R. § 722.3(a)(1).

[78] *Ibid.*

[79] 12 C.F.R. § 34.43(a)(5)(i) (national banks); 12 C.F.R. § 564.3(a)(5)(i) (federal savings associations).

## B. Safety and Soundness Rules

As the table in the Appendix shows, credit unions face nearly the same safety and soundness rules as other depository institutions, with one notable exception: the NCUA's loans-to-one-borrower regulation. Currently, a credit union may lend to one borrower up to 10 percent of its "unimpaired capital and surplus,"[80] which the NCUA defines as retained earnings *plus* deposits (or shares). Relying on the FCUA, which refers to shares as "equity,"[81] NCUA regulations permit any federal credit union to lend to any borrower an amount up to 10 percent of the institution's capital plus 10 percent of the institution's deposits.[82] This greatly exceeds the limits on other depository institutions, which is typically 15 percent of capital.[83]

## C. Regulatory Enforcement Authority

When comparing enforcement authority across federal depository institution regulators, few differences are found. As the Appendix shows, credit unions in fact operate under almost identical enforcement rules as banks and thrifts. For example, the NCUA may issue cease-and-desist orders and impose civil money penalties under the same rules as the other federal depository institution regulators.

## D. Consumer Protection

Credit unions are also subject to the same consumer protection rules as other depository institutions. The Truth in Lending Act, the Truth in Savings Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, and the Expedited Funds Availability Act, for example, apply uniformly to all depository institutions. However, the Community Reinvestment Act (CRA)[84] applies to all depository institutions except credit unions.[85]

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[80] 12 U.S.C. § 1757(5)(A)(x); 12 C.F.R. § 701.21(c)(5).

[81] 12 U.S.C. § 1757(6).

[82] 12 C.F.R. § 701.21(c)(5).

[83] 12 U.S.C. § 84 (national banks); 12 U.S.C. § 1464(u) (federal savings associations). The following example illustrates how much greater the limit on loans to one borrower is for credit unions than for other depository institutions. Assume that a federal credit union and a national bank each have $100 million in assets and $8 million in net worth (8 percent). The national bank's lending limit is 15 percent of $8 million–or $1.2 million. By contrast, a federal credit union's statutory lending limit is keyed to the sum of its deposits and its net worth, a sum roughly equaling the credit union's total assets. Thus, the credit union's lending limit is 10 percent of approximately $100 million–or $10 million. The credit union therefore has a lending limit over eight times larger than that of the bank. Treasury, *Credit Unions, op. cit.* footnote 2, p. 65.

[84] Pub. L. No. 95-128, 91 Stat. 1111, 1147-48, title VIII (Oct. 12, 1977) (codified at 12 U.S.C. § 2900 *et seq.*).

[85] 12 U.S.C. § 2902(2) (referring to the definition of "insured depository institution" in 12 U.S.C. § 1813(c)(2), which includes only those banks and thrifts insured by the FDIC).

The CRA established an obligation on the part of federally insured depository institutions to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods and individuals, consistent with safe and sound banking practices. An inadequate record under CRA may be grounds for denying or conditioning an application, for example, to merge with or acquire another depository institution, or to open or close a branch.

Although the CRA does not apply to credit unions, the NCUA recently promulgated a regulation requiring that any credit union seeking to expand, convert to, or charter a community credit union would have to prepare a written plan for serving its entire community.[86] Existing community credit unions would be expected to develop a plan, which would have to be in place by December 31, 2001.

## III. Conclusion

Federal credit unions generally operate within the same legal framework as other federally insured depository institutions. Most differences between credit unions and other depository institutions derive from the structure of credit unions. We found this to be most likely in the case of safety and soundness rules, where credit union operations interact directly with the operation of the rules. With regard to enforcement and consumer protection rules, few differences exist. Credit unions have fewer powers available to them than do banks and thrifts, but, through CUSOs, credit unions may provide their members with a panoply of sophisticated financial services and products that rivals the offerings of banks and thrifts.

[86] 65 Fed. Reg. 64,512 (Oct. 27, 2000).

# CHAPTER 3

## THE POTENTIAL REVENUE EFFECTS OF APPLYING FEDERAL TAX LAWS TO CREDIT UNIONS

Section 401 of the Credit Union Membership Access Act requires the Treasury to study and report on "the potential effects of the application of federal laws, including federal tax laws, on credit unions in the same manner as those laws are applied to other federally insured financial institutions."[87] Under current law, credit unions are exempt from federal income taxation, unlike all other federally insured depository institutions.[88]

In general, depository institutions are taxed under varying rules depending on the structure of the institution. The revenue model applied below assumes that, in the absence of an exemption, the appropriate rules for taxing credit unions are those applicable to mutual thrifts (*i.e.*, mutual savings associations, mutual savings banks, cooperative banks, and domestic building and loan associations). Mutual thrifts are the federally insured depository institutions most similar in structure to credit unions, because like credit unions, mutual thrifts generally do not have corporate stock, are not-for-profit entities, and are owned by their depositors, or members, rather than by shareholders.

This chapter is organized as follows. Section I describes corporate taxation generally. Section II describes the manner in which depository institutions are taxed specifically. Section III relates the history of the federal income tax exemption for credit unions. Section IV explains the model used to estimate the revenue effect of taxing credit unions like mutual thrifts. Because a critical assumption underlying our revenue estimates is the forecasted growth rate for credit unions, two series of revenue projections, using both higher and lower growth rates, are presented.

### I. Taxation of Corporations

Corporations are generally taxed under one of two sections of the Internal Revenue Code: Subchapter C (rendering the corporation a "C" corporation)[89] and Subchapter S (rendering the corporation an "S" corporation).[90]

Most corporations, including depository institutions, are C corporations.[91] Under Subchapter C, income is taxed at both the corporate level and at the shareholder level.

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[87] Pub. L. No. 105-219, 112 Stat. 913, 934-935 (Aug. 7, 1998).

[88] 26 U.S.C. § 501(c)(14).

[89] 26 U.S.C. §§ 11,301-305.

[90] 26 U.S.C. §§ 1361-1379.

[91] Internal Revenue Service, Statistics of Income Division, *1997 Corporation Source Book,* Publication 1053 (March 2000).

Distributions of corporate income, in the form of dividends, which have already been taxed at the corporate level constitute taxable income at the individual level to stockholders. At the corporate level, such entities are generally taxed at a 35 percent tax rate on taxable income. To compute taxable income, a C corporation deducts its business expenses, such as employee compensation, depreciation, and interest paid. However, a deduction is not allowed for dividends paid. When deductions exceed income, the corporation has a net operating loss for the taxable year. Carryover rules permit corporations to use the net operating loss to offset taxable income in preceding or succeeding taxable years. In general, a corporation can carry a net operating loss back two years and forward 20 years.[92]

Some corporations may elect to be taxed under Subchapter S. Eligibility criteria include, among other things, a requirement that an S corporation have no more than 75 shareholders and that it not use the reserve method of accounting for bad debts. Unlike C corporations, the income of S corporations is allocated for tax purposes to shareholders and then taxed at their applicable rates; the entity itself does not pay federal income tax. Prior to 1997, depository institutions were ineligible to elect S corporation status.

## II. Tax Treatment of Depository Institutions

### A. General Provisions

In addition to the rules applicable to corporations generally, special rules apply to depository institutions.[93] These special rules reflect the fact that the income of depository institutions is primarily derived from taking deposits and making loans. Thus, depository institutions, unlike taxpayers generally, are allowed a bad debt deduction for securities that become worthless.[94] Similarly, sales or exchanges of debt obligations held by a depository institution result in ordinary income or loss, rather than capital gain or loss.[95] Depository institutions are also subject to a special *pro rata* allocation rule for purposes of determining the amount of interest expense that is nondeductible as an expense relating to tax-exempt interest income. With very limited exceptions, a depository institution is not allowed a deduction for interest expense allocable to tax-exempt obligations acquired after August 7, 1986.[96]

Special rules also apply to small depository institutions (those with assets of $500 million or less). In general, taxpayers are required to use a specific charge-off method to account for bad debts. Under this method, a deduction for a bad debt is allowed only when a loan becomes

[92] C corporations are also subject to the alternative minimum tax (AMT), which applies only if their minimum tax exceeds their regular tax liability. 26 U.S.C. § 55.

[93] 26 U.S.C. § 585.

[94] 26 U.S.C. § 582.

[95] 26 U.S.C. § 1221.

[96] 26 U.S.C. § 265.

wholly or partially worthless. Depository institutions (other than small depository institutions) are required to use this method.[97] Small depository institutions, however, are permitted to use either the specific charge-off method or the reserve method of accounting for bad debts. Under the reserve method, a depository institution establishes a reserve for bad debts, charges actual losses against the reserve, and is allowed a deduction for annual additions to restore the reserve to its proper balance. The reserve method thus allows loss deductions to be taken before the year in which the loss actually occurs and can be viewed as equivalent to an interest-free loan from the government to the taxpayer in an amount equal to the reserve balance multiplied by the tax rate.[98]

A taxable depository institution that grows too large no longer qualifies for the reserve method and must use the specific charge-off method of accounting for bad debts. To prevent the duplication of deductions, first as a reserve addition and then when the loan is specifically charged off, the institution must recapture its existing bad debt reserve (*i.e.*, include the amount of the reserve in income) unless it elects to use the "cut-off" method.[99] A depository institution that voluntarily changes its method of accounting to the specific charge-off method (*e.g.*, so that it can become an S corporation) must also recapture its existing bad debt reserve.[100]

### B. Tax Treatment of Mutual Thrifts

The tax treatment of a depository institution depends, in part, on whether the institution is a stock or a mutual company. In a stock company, the shareholders and the depositors are not necessarily the same individuals. The equity of the corporation is derived from amounts paid by shareholders to purchase stock from the corporation and from earnings retained by the corporation, rather than distributed to shareholders. In general, the corporation's net income is taxed at the corporate level, whether it is retained or distributed to shareholders. Income that is distributed to shareholders as dividends is also taxed at the shareholder level.

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[97] Under Treasury regulations, banks and other corporations subject to federal or state regulatory supervision may treat debts as worthless for tax purposes when they are treated as worthless for regulatory purposes. This often allows the losses to be recognized earlier than would be the case under generally applicable standards. For supporting analysis, *see* Dept. of the Treasury, *Report to The Congress on The Tax Treatment of Bad Debts by Financial Institutions* (Wash., DC: 1991).

[98] For a discussion of when reserves may lower taxes for financial institutions, *see* Treasury, *The Tax Treatment of Bad Debts, op. cit.* footnote 101.

[99] The recapture is generally spread over four years. In the first year, 10 percent of the reserve is recaptured unless the taxpayer chooses to recapture a higher percentage. The reserve remaining after the first year is recaptured 2/9ths in the second year, 3/9ths in the third year, and 4/9ths in the fourth year.

[100] The recapture after a voluntary change is also generally spread over four years, but 25 percent of the reserve is recaptured in each year.

In contrast, mutual corporations are owned by their depositors, and the equity of a mutual corporation is derived solely from retained earnings.[101] Because depositors are the owners, payments to depositors can include both interest and an equity return to depositors in their role as owners. While depository institutions are generally permitted to deduct interest paid on deposits, mutual thrifts are also allowed a deduction for amounts paid or credited to their depositors as dividends on their accounts, including amounts that represent an equity return, if such amounts may be withdrawn on demand subject only to customary notice of intention to withdraw.[102] These dividends, whether representing interest or a return on equity, are thus taxed only at the depositor level. In effect, mutual thrifts, unlike other taxable depository institutions, are taxed only on retained earnings, and not on earnings distributed to owners.

## III. The History of Credit Unions' Tax Treatment

The first credit unions that appeared in the United States at the beginning of the previous century were state chartered. When the federal income tax was first enacted, state chartered credit unions were not specifically exempt. In 1917, however, an administrative ruling by the U.S. Attorney General exempted these credit unions from federal income taxation. The Attorney General ruled that the credit unions closely resembled cooperative banks and similar institutions that Congress had expressly exempted from taxation in 1913 and 1916.[103]

Congress first established a federal charter for credit unions in 1934.[104] However, that Act did not exempt federal credit unions from the federal taxation of their income, although they were exempt under the previous administrative ruling. A statutory exemption was not provided until 1937.[105] Two reasons were given for granting this exemption: (1) that taxing credit unions on their shares, much as banks are taxed on their capital shares, "places a disproportionate and excessive burden on the credit unions" because credit union shares function as deposits; and (2) that "credit unions are mutual or cooperative organizations operated entirely by and for their members . . . ."[106] Thus, the tax exemption was based primarily on the organizational form of credit unions and ensured consistent treatment with federal thrift institutions, including mutual savings banks.

In 1951, thrift institutions lost their tax exemption, but the credit union exemption was retained.[107] The Senate report to the Revenue Act of 1951 stated that mutual savings banks and

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[101] As of June 30, 2000, there were 730 mutual savings institutions with $141 billion in assets. Federal Deposit Insurance Corporation, *FDIC Quarterly Banking Profile Graph Book* (Wash., DC: second quarter 2000), p. 45.

[102] 26 U.S.C. § 591.

[103] *See* General Accounting Office, *Credit Unions: Reforms for Ensuring Future Soundness* (Wash, DC: 1991) (providing a brief history of the tax exemption for credit unions).

[104] Federal Credit Union Act, Pub. L. No. 467, c. 750, 48 Stat. 1216 (Jun. 26, 1934).

[105] Pub. L. No. 416, c. 3, § 4, 51 Stat. 4 (Dec. 6, 1937).

[106] H.R. REP. NO. 1579, 75th Cong., 1st Sess. p. 2.

[107] Revenue Act of 1951, Pub. L. No. 183, § 313, 65 Stat. 490 (Oct. 18, 1951).

savings and loan associations were losing their tax exemption because they had evolved into commercial bank competitors. In addition, thrifts had evolved from mutual organizations to ones that operated in a similar manner to banks. Finally, the exemption had given thrifts a competitive advantage over taxable commercial banks and life insurance companies.

> At the present time, mutual savings banks are in active competition with commercial banks and life insurance companies for the public savings, and they compete with many types of taxable institutions in the security and real estate markets. As a result your committee believes that the continuance of the tax-free treatment now accorded mutual savings banks would be discriminatory.[108]

> In the early days of [savings and loan associations], the transactions of the associations were confined to members, and no one could participate in the benefits they afforded without becoming a shareholder . . . The fact that the members were both the borrowers and the lenders was the essence of the "mutuality" of these organizations. Although many of the old forms have been preserved to the present day, few of the associations have retained the substance of their earlier mutuality . . . More and more, investing members are becoming simply depositors, while borrowing members find dealing with a savings and loan association only technically different from dealing with other mortgage lending institutions in which the lending group is distinct from the borrowing group . . . The grounds on which your committee's bill taxes savings and loan associations on their retained earnings . . . are the same as those on which mutual savings banks are taxed under the bill.[109]

## IV. Estimating the Revenue Effects of Taxing Credit Unions

### A. General Issues

To evaluate the effect on federal revenues of applying the present tax rules for mutual thrifts to credit unions, we developed a model to forecast taxable credit union income for fiscal years 2000 through 2009. The model is based upon a number of income and balance sheet items available from the Call Reports database. These are then forecast into the future, with their growth a function of certain macroeconomic aggregates and the size, measured in assets, of each institution. Assumptions concerning the behavior of relevant macroeconomic aggregates are taken from the Administration's fiscal year 2000 budget forecast.[110]

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[108] S. REP. NO. 781, 82[d] Cong. 1[st] Sess. 25.

[109] *Ibid.*, pp. 27-28.

[110] The model forecasts credit union tax revenues in two steps. First, the total assets for the entire credit union industry are projected into the future based on the Administration's forecast for the fiscal year 2000 Budget from February 1999. Based on this forecast, projected annual growth rates are generated and then adjusted to take into account historical differences in the growth of small and large credit unions. Because larger credit unions with assets in excess of $10 million have been growing faster than smaller credit unions, the growth rate for large credit unions is adjusted upwards and the one for small credit unions downward. Second, to reflect the variation in income growth rates in the model, the previous year's net charge-offs are increased by the asset growth rate and then randomly adjusted to allow the net charge-off growth rate to be positive or negative.

Credit union consolidation is also addressed. Between 1992 and 1997, the number of credit unions declined by an average of 2.7 percent. Our model assumes that trends observed over this time period continue through 2009, and makes appropriate adjustment to the composition of the industry with respect to asset base, income and other measures.

The exact response of credit unions to imposition of a corporate tax is unclear. Our model therefore considers two alternate scenarios: A higher growth rate assumes that credit unions can absorb the corporate income tax without any effect on asset growth. A lower growth rate assumes that credit unions will pay the tax out of their retained earnings on a dollar-for-dollar basis, thereby reducing their available capital and opportunity for growth.[111] The two alternative rates thus serve as an upper and lower bound on the model's estimation of credit union asset growth in the absence of a tax exemption.

Credit unions are assumed to modify their behavior to lower their taxable income without lowering their "true" income in order to reduce their tax liability. For example, credit unions are assumed to alter their investment portfolios to hold more tax-exempt securities in order to lower their tax liability.

### B. Estimating the Revenue Derived from Taxing Credit Unions

The estimated revenue raised by applying the federal corporate income tax to credit unions, subject to a high and low asset growth rate, as shown in Tables 3-1 and 3-2, respectively.

Under the high growth rate assumption, we estimated that taxing credit unions would raise $6.8 billion over a five-year period (fiscal years 2000 through 2004) and $16.2 billion over a ten-year period (fiscal years 2000 through 2009). The vast majority of the revenue raised would come from larger credit unions. For example, Table 3-1 suggests that credit unions with at least $100 million in assets would account for more than 75 percent of the revenue, while comprising just over 10 percent of the number of credit unions.

The estimated tax revenue from large credit unions increases relatively more than for small credit unions over time, primarily because credit unions with at least $10 million in assets have higher growth rates. This differential growth rate reflects historical patterns. As a result, over time the income and assets of large credit unions, as well as their number, increase faster than those of small credit unions. Moreover, consolidation results in there being fewer small credit unions over time. Finally, the total tax liability estimated includes the alternative minimum tax which, because of exemptions for small corporations, generally would affect only larger credit unions.

Similarly, the tables illustrate the revenue effects of exempting smaller credit unions from the imposition of any federal corporate income tax. For example, credit unions with less than

[111] The assumption of efficient operation implies that credit unions may not obtain the funds necessary to pay federal income taxes on a given book of business simply by lowering their operating expenses. Instead, paying taxes would result in lower after-tax earnings, which would lower the rate at which credit unions retained earnings. Lower retained earnings, in turn, means that credit unions' net worth would grow more slowly, and hence credit unions could experience somewhat lower overall growth.

$10 million in assets account for 2 percent of the revenue, although they comprise roughly 50 percent of all credit unions. Using the tables, the revenue effects of other potential thresholds may be determined.

Table 3-1: Estimated Tax Revenue of Applying Mutual Thrift Tax Rules to Credit Unions: High Growth Rate Assumption
(Dollar figures are in millions)

| Asset Size Category | Fiscal Years 2000 - 2004 | | | Fiscal Years 2000 - 2009 | | |
|---|---|---|---|---|---|---|
| | Estimated Tax | | Estimated Percentage of Average Number of Institutions | Estimated Tax | | Estimated Percentage of Average Number of Institutions |
| | Amount | Percentage | | Amount | Percentage | |
| Less than $5 million | $49 | 1% | 38% | $86 | 1% | 35% |
| $5 - 10 million | $89 | 1% | 15% | $163 | 1% | 14% |
| $10 - 20 million | $186 | 3% | 12% | $329 | 2% | 12% |
| $20 - 50 million | $630 | 9% | 17% | $1,281 | 8% | 17% |
| $50 - 100 million | $696 | 10% | 8% | $1,569 | 10% | 10% |
| $100 - $500 million | $2,474 | 36% | 9% | $5,559 | 34% | 11% |
| Greater than $500 million | $2,688 | 40% | 2% | $7,211 | 45% | 2% |
| Total | $6,811 | 100% | 100% | $16,200 | 100% | 100% |

Source: Treasury estimates using Credit Union Call Report data obtained from Sheshunoff Information Services *One Source*. *See* text for information about the model and underlying assumption used to generate these estimates.

Revenue estimates using the lower growth rate are shown in Table 3-2. In this case, credit union tax revenues are estimated to be $6.1 billion between fiscal years 2000 and 2004, or approximately 10 percent less than with the higher growth rate. For fiscal years 2000 to 2009 the estimated tax revenue would be approximately $13.7 billion, or 15 percent less than when using the higher growth forecast. The tax revenue gap between the high and low growth scenarios widens over time because the growth rate for large credit unions, which has a disproportionate effect on overall industry growth rates, is approximately one-third less than under the high growth rate scenario. As with the high growth rate estimate, the vast majority of revenue raised comes from larger credit unions.

Table 3-2: Estimated Tax Revenue of Applying Mutual Thrift Tax Rules to Credit Unions: Low Growth Rate Assumption
(Dollar figures are in millions)

| Asset Size Category | Fiscal Years 2000 - 2004 | | | Fiscal Years 2000 - 2009 | | |
|---|---|---|---|---|---|---|
| | Estimated Tax | | Estimated Percentage of Average Number of Institutions | Estimated Tax | | Estimated Percentage of Average Number of Institutions |
| | Amount | Percentage | | Amount | Percentage | |
| Less than $5 million | $49 | 1% | 39% | $89 | 1% | 36% |
| $5 - 10 million | $90 | 2% | 15% | $165 | 1% | 14% |
| $10 - 20 million | $209 | 3% | 14% | $387 | 3% | 13% |
| $20 - 50 million | $609 | 10% | 16% | $1,262 | 9% | 17% |
| $50 - 100 million | $662 | 11% | 8% | $1,418 | 10% | 9% |
| $100 - $500 million | $2,236 | 37% | 8% | $4,989 | 36% | 9% |
| Greater than $500 million | $2,222 | 37% | 2% | $5,410 | 39% | 2% |
| Total | $6,078 | 100% | 100% | $13,719 | 100% | 100% |

Source: Treasury estimates using Credit Union Call Report data obtained from Sheshunoff Information Services *One Source*. *See* text for information about the model and underlying assumption used to generate these estimates.

## V. Conclusion

In laws enacted in 1913 and 1916, Congress expressly exempted mutual thrifts from federal corporate income tax. Congress extended that exemption to credit unions in 1937, although an administrative ruling in 1917 gave credit unions an effective exemption from taxation. In 1951, Congress decided that mutual thrifts had evolved into direct competitors with banks and removed the tax exemption in order to provide greater competitive equity between banks and mutual thrifts.

If Congress decided to remove credit unions' tax exemption, credit unions would receive the same treatment under the federal corporate income tax code as do mutual thrifts. We estimate that removing the exemption would raise between $6.1 billion and $6.8 billion over five years, and between $13.7 billion and $16.2 billion over ten years.

# CHAPTER 4

## PRESERVING THE GROWTH AND VIABILITY OF SMALL BANKS

Section 403 of the Credit Union Membership Access Act directed the Treasury Department to submit a report to Congress containing:

- recommendations, as the Secretary deems appropriate, that would reduce and simplify the tax burden (1) on insured depository institutions with less than $1 billion in assets and (2) on banks with assets equal to or in excess of $1 billion, but not greater than $10 billion; and

- any other recommendations that the Secretary deems appropriate that would preserve the growth and viability of small banks.[112]

The Administration has, throughout its tenure, taken meaningful steps to preserve the growth and viability of small banks. Its first efforts came during the first weeks of the Administration and additional efforts continue to this day. Many of these actions have reduced the regulatory costs and improved the quality of bank regulation. We believe that we have taken those actions best tailored to furthering these aims. Thus, we recommend no new policy initiatives in this area at this time.

We highlight below some of the ways in which the Administration has implemented policies that promote the growth and viability of small banks, and then address issues surrounding the taxation of small depository institutions under Subchapter S of the Internal Revenue Code.

### I. Administration Accomplishments

#### A. The Credit Availability Program

On March 10, 1993, shortly after taking office, the President unveiled the Credit Availability Program (CAP), which created a better climate for bank lending. At that time, the country was in the midst of a slow economic recovery, and the CAP improved the availability of credit, particularly to small- and medium-sized businesses, farms, and low-income communities. Largely in place within 90 days of the President's announcement, the CAP addressed: (1) real estate lending and appraisals; (2) appeals of examination decisions and complaint handling; and (3) examination processes and procedures.

At that time, some were concerned that costly formal appraisals may have been rendering otherwise sound loans uneconomical. Three significant changes resulted. First, the bank regulatory agencies increased from $100,000 to $250,000 the threshold level at or below which certified or licensed appraisals would not be required for a real estate-related transaction. They identified additional circumstances, particularly for small business lending, in which appraisals

[112] Pub. L. No. 105-219, 112 Stat. 913, 935 (Aug. 7, 1998).

are not required. Finally, they permitted renewals and refinancings without an appraisal if there had been no deterioration in market conditions.

The agencies also revamped their appeals processes to ensure that bankers had a fair and prompt review of examination disagreements. The OCC and the OTS have each created an Office of Ombudsman, which manages the appeals process. The OCC has also revamped its procedures for handling the nearly 15,000 general complaints it receives annually. For example, it has established a toll-free number and improved its complaint tracking system.

Third, the regulators have begun to coordinate many of their interactions with the industry. For example, they have determined that examinations will be conducted by the primary federal regulator. Moreover, the OCC and the FDIC share examination schedules to better coordinate the supervision of holding companies with both national and state-chartered banks, and coordinate enforcement actions.

### B. Streamlining Compliance with the Bank Secrecy Act

Treasury and the federal banking regulators promulgate regulations to implement the Bank Secrecy Act, which Congress passed to combat money laundering. Proper enforcement requires adequate recordkeeping on the part of financial institutions to support federal prosecutions of money launderers. Working with a Bank Secrecy Act Advisory Group, composed of 30 representatives of financial institutions and federal and state regulatory and enforcement officials, Treasury pared down the amount of required recordkeeping. Treasury eliminated the requirement that institutions record and retain for five years special records of all cash purchases of travelers checks, bank checks, and cashier’s checks over $3,000. Proposed regulations that would have required mandatory electronic filing of currency transaction reports (CTRs), and would have established a mandatory system to “aggregate” cash transactions, were withdrawn. Treasury also streamlined by 30 percent the CTR, a form long criticized as too cumbersome by bankers.

### C. A-to-Z Review of Regulations

Pursuant to a Presidential directive, each regulatory agency within the government undertook a line-by-line review of its regulations with the goal of eliminating redundant and unnecessary requirements, streamlining procedures, and rewriting rules to be more easily understood. The OCC and OTS have both completed this review and are in the process of putting their regulations into plain English.

There are concrete examples of the burden-reducing benefits resulting from this intense review. The OCC and OTS reduced, by six times, the number of lending limit calculations institutions must perform, requiring quarterly, rather than daily, analyses. The OCC has also reduced some of its fees and its national bank assessment rate, which covers the cost of examination and supervision. For example, the fee for establishing a shared automated teller machine has been reduced from $1,500 to zero, corporate application fees have been reduced by 50 percent, and the national bank assessment rate has been reduced by six percent.

## D. Refocusing Supervision

Our nation's thousands of depository institutions vary greatly in size, complexity, and financial strength. Yet, regulations often ignore these differences by treating all institutions alike, and relying on generally applicable procedures. This provides institutions with little regulatory incentive to reduce risk or increase their capacity to manage risk. It also creates needless regulatory burden and costs when rules are inappropriate, irrelevant, or even counterproductive as applied in certain instances.

The OCC and OTS have been working diligently to make appropriate differentiations in their regulations. For example, both bureaus have streamlined the examinations process for smaller, well-capitalized, well-managed institutions. Materials requested for noncomplex small national bank examinations have been reduced by nearly 600 percent, from some 200 items (or more at the examiner's discretion) to 35 standardized items. Moreover, the streamlined nature of such examinations is evidenced from the OCC small bank examination handbook, which has been reduced from 1,216 pages to just over 30 pages. In addition, small, well-capitalized, well-managed savings associations need no longer automatically obtain a costly annual independent audit.

The difficulty of supervising a diverse banking industry has also led regulators to focus on eliminating and streamlining procedures. The Administration has worked to refocus supervision on results instead, and to thereby provide institutions with the incentive to perform well, rather than simply to avoid criticism or follow needless procedures. In this vein, the OCC revised its examination guidelines to emphasize operational results, such as default rates, rather than operational procedures, such as loan underwriting.

## E. Streamlining CRA Rules

Responding to complaints about how the CRA has been implemented over the years, the President, in 1993, called on the federal banking agencies to rewrite their CRA rules to stress performance, not paperwork. In 1995, after one of the most comprehensive joint rule-making efforts the regulators have ever conducted, the agencies promulgated final regulations, culminating a lengthy process in which they sought and obtained the input of thousands of interested parties, including banks, savings associations, trade associations, customers, and community groups. The regulators received over 6,700 comments in 1993 and over 7,200 in 1994. The new rules provide real incentives for depository institutions to serve all our communities, and a streamlined, straightforward process for assessing their success.

## F. Regulatory Burden Relief Legislation

In 1996, the Administration worked with Congress on regulatory burden relief legislation and supported the final passage of the Economic Growth and Paperwork Reduction Act. The Act included nearly 300 pages of regulatory burden relief legislation. Among other things, the 1996 Act streamlined the home mortgage lending process and eliminated numerous unnecessary regulatory requirements, such as eliminating the need to file a branch application to establish an ATM.

### G. Simplifying Small Bank Capital Standards

Most recently, the federal banking agencies published an interagency advance notice of proposed rulemaking that will lead to simplified capital requirements for small banks.[113] The purpose of the proposal is to develop a simplified capital framework that will reduce the regulatory burden on smaller non-complex banks and thrifts.

## II. Eligibility of Depository Institutions for Taxation Under Subchapter S

In general, U.S. tax law treats corporations and their investors as separate taxable entities. Corporate earnings are taxed first at the corporate level and again at the shareholder level, as dividends if the corporation distributes earnings to shareholders, or as capital gains from the sale of stock. In contrast, the earnings of S corporations are taxed only once at the shareholder level, whether or not the income is distributed. Corporations that elect Subchapter S status are subject to certain restrictions on the number of shareholders and capital structure. For example, an S corporation may not have more than 75 shareholders, all of whom must be U.S. resident individuals (except for certain trusts and estates) and may issue only one class of stock. Prior to 1996, banks and other depository institutions could not elect S corporation status. A provision of the Small Business Job Protection Act of 1996 repealed this prohibition.

By the end of 1999, more than 1,260 banks were operating as S corporations. These institutions represent over 15 percent of U.S. banks but only about 2 percent of banking assets, suggesting that smaller institutions have been among the first to elect S corporation status. This strong response by smaller banks suggests that Subchapter S offers considerable advantages in terms of more favorable tax treatment and lower compliance burdens.

In view of a continuing, and perhaps even accelerating, election of Subchapter S status by small banks, additional modifications intended to reduce or simplify the tax burden of smaller banks may be premature at this time. In addition, they may raise tax policy concerns with respect to their effect on S corporations in other industries and concerns about their potential effect on the competitive position of all S corporations, including small banks. If policy changes are considered, however, they should satisfy two broad requirements:

First, any additional measures to simplify the tax treatment of small banks must be crafted with a recognition that small businesses electing Subchapter S status play a vital role in the U.S. economy, and that only a small number of these firms are banks. In fact, banks and depository institutions account for less than one percent of all entities electing Subchapter S status. Thus, any changes to Subchapter S in order to accommodate small banks must not complicate or otherwise disrupt the broader effect of Subchapter S to benefit a small number of firms in one specific industry.

In addition, proposed modifications to Subchapter S must be evaluated with respect to potential effects on the competitive environment faced by smaller banks. As noted above, the

[113] 65 Fed. Reg. 66,193 (Nov. 3, 2000).

first firms to elect Subchapter S treatment have been disproportionately smaller banks. The expressed intent of the Small Business Job Protection Act of 1996 was to protect the viability of such institutions; further modifications to Subchapter S that would permit larger banks with greater access to capital to elect simplified treatment may be inconsistent with this aim. Unfortunately, some proposals offered in recent years are intended specifically to facilitate the election of Subchapter S status by larger depository institutions.

# APPENDIX

## COMPARISON OF DEPOSITORY INSTITUTION POWERS AND REGULATORY REQUIREMENTS[1]

| Rule | OCC/FDIC/FRB | OTS | NCUA |
|---|---|---|---|
| *Customer Base* | | | |
| Field of membership | National banks face no restrictions on the customers they may serve. | Same as national banks. | Federal credit unions may only serve persons within the field of membership who join the credit union. 12 U.S.C. § 1759. Federal credit unions may choose from among three types of charters: (1) single common bond (*i.e.*, occupational and associational); (2) multiple common bond (*i.e.*, more than one group each having a common bond of occupation or association); and (3) community common bond. 63 Fed. Reg. 71,998 (Dec. 30, 1998).<br><br>The immediate family and those residing in the household of one satisfying the common bond requirement are themselves eligible to join the credit union, whether or not the eligible individuals actually join the credit union. 12 U.S.C. § 1759(e)(1); 63 Fed. Reg. 71,998, 72,027 (Dec. 30, 1998). |

[1] This table compares statutory and regulatory rules across *federally chartered* depository institutions (*i.e.*, national banks, federal savings associations, and federal credit unions), although many of these rules apply to all federally insured depository institutions. However, the table does not attempt to catalogue all of the authority available to federally chartered depository institutions; rather, it presents a sample that will illustrate how federal credit unions compare with other federally chartered depository institutions.

| Rule | OCC/FDIC/FRB | OTS | NCUA |
| --- | --- | --- | --- |
| *Depository Institution Powers*[2] | | | |
| *Deposits* | | | |
| Checking accounts (demand deposits) | National banks may offer demand deposits to any customer. Such accounts may not earn interest. However, banks may offer NOW accounts (negotiable order of withdrawal accounts) to individuals and nonprofit organizations, but not to businesses, which may earn interest. The bank may reserve the right to require at least seven days notice prior to withdrawal of funds from such accounts, but such restrictions are rarely enforced. 12 U.S.C. § 24(seventh), 12 C.F.R. §§ 204.130 and 217.3. | Similar to national banks. 12 U.S.C. § 1464(b); 12 C.F.R. part 557, subpart B and § 561.29. | Federal credit unions may offer to their members share draft accounts (*i.e.*, demand deposits). 12 U.S.C. § 1757(6); 12 C.F.R. § 701.35(a).[3] Generally, credit unions may only serve individuals. However, community credit unions may accept businesses as members. 63 Fed. Reg. 71,998, 72,037 (Dec. 30, 1998). Similarly, credit unions that primarily serve predominantly low-income members may accept deposits from non-members, including businesses. 12 U.S.C. § 1757(6); 12 C.F.R. § 701.34(a)(1).<br><br>Unlike national banks and federal savings associations, federal credit unions with businesses as members may pay interest on business checking accounts. |
| Time deposits | National banks may offer certificates of deposit, savings accounts, and similar deposits without significant restrictions. 12 U.S.C. § 24(seventh). | Same as national banks. 12 U.S.C. § 1464(b), 12 C.F.R. part 557, subpart B. | Federal credit unions may offer share certificate accounts. 12 U.S.C. § 1757(6); 12 C.F.R. § 701.35(a). |
| Trust accounts | National banks may offer trust and other fiduciary accounts. 12 U.S.C. §§ | Generally the same as national banks, except that specific permission is | Federal credit unions may not offer trust services directly, but may do so through |

[2] This portion of the table primarily addresses those activities in which depository institutions may engage directly. Activities engaged in through affiliates are discussed elsewhere in this table.

[3] Federal credit unions are member-owned cooperatives. 12 U.S.C. §§ 1752(1) and (5). Therefore, the Federal Credit Union Act refers to member deposits as member shares, whether the share represents a demand deposit, time deposit, or certificate of deposit. 12 U.S.C. § 1752(5).

| Rule | OCC/FDIC/FRB | OTS | NCUA |
| --- | --- | --- | --- |
| | 24(seventh) and 92a; 12 C.F.R. part 9. | required. 12 U.S.C. § 1464(n). | affiliates called Credit Union Service Organizations (CUSOs). 12 C.F.R. § 712.5(o). |
| *Customer Services* | | | |
| Travel services and foreign exchange services | National banks may offer traveler's checks and travel information, but may not act directly as a travel agent. However, financial subsidiaries may act as a travel agent. They may also provide directly foreign exchange services for their customers, but not for their own account. OCC Interpretive Letter No. 553, May 2, 1991; *Arnold Tours v. Camp*, 472 F.2d 427 (1st Cir. 1972); 12 U.S.C. § 24a; 12 C.F.R. § 5.39. | Same as national banks. 12 U.S.C. § 1464; FHLBB Op. Gen. Couns., Nov. 24, 1965. | Federal credit unions may offer travelers checks, 12 U.S.C. § 1757(12), and foreign exchange services. NCUA Op. Gen. Couns., Dec. 9, 1999. Like national banks, federal credit unions may not act as travel agents directly, but may do so through CUSOs. 12 C.F.R. § 712.5(n). |
| Electronic banking services | National banks may offer any services electronically that it is otherwise authorized to offer. 12 C.F.R. § 7.1019. | Same as national banks. 12 C.F.R. § 555.200(a). | Same as national banks. 12 U.S.C. § 1757(17). |
| Insurance | National banks may sell liability, casualty, automobile, life, health, and accident insurance on an agency basis from places of 5,000 or less in population without restriction on the location of a bank's customers. Through a financial subsidiary, a national bank may engage in general insurance agency activities without the restrictions. 12 U.S.C. §§ 92 and 24a; 12 C.F.R. § § 7.1001 and 5.39. | Federal savings associations have similar powers, but without geographic restriction. OTS Op. Acting Ch. Couns., Oct. 17, 1994. Moreover, through service corporations, federal savings associations may sell insurance on an agency basis without geographic restriction. 12 C.F.R. § 559.4(f)(3). | Federal credit unions may not offer insurance products directly, but may broker and sell any type of insurance through a CUSO. 12 C.F.R. § 712.5(g). No geographic restriction applies to a CUSO's insurance authority. *See* 12 C.F.R. part 712. |
| Securities brokerage | National banks directly and without registering with the SEC may engage in many types of securities brokerage | Federal savings associations may only engage this activity through a service corporation, and then only on an | Federal credit unions may not broker securities directly, but may do so through a CUSO. 12 C.F.R. § 712.5(k). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
|---|---|---|---|
| | activities. 12 U.S.C. §§ 78c(a)(4) and (5). | agency basis. 12 C.F.R. § 545.74. | |
| Investment advice and financial consulting | National banks may provide financial and investment advisory services, including advising an investment company. 12 U.S.C. § 24(seventh). | Federal savings associations may offer certain forms of investment advice, but only through a service corporation. 12 C.F.R. § 545.74. | Federal credit unions may not provide these services directly, but may do so through a CUSO. 12 C.F.R. § 712.5(e). |
| Securities underwriting | National banks may directly, and through operating subsidiaries, underwrite various types of securities, including U.S. government securities, municipal general obligation and revenue bonds, and asset-backed securities. Financial subsidiaries may engage in the underwriting of all types of securities. 12 U.S.C. §§ 24(seventh) and 24a; 12 C.F.R. parts 1 and 12. | No similar authority. | No similar authority. |
| Mutual fund activities | National banks and their operating subsidiaries may offer a broad range of administrative and investment advisory services, serve as custodian and transfer agent, and broker investment company shares. Interp. Let. Nos. 406-408. | Through a service corporation, federal savings associations may sponsor, advise, and distribute, as well as sell shares in both proprietary and third-party mutual funds. 12 C.F.R. § 545.74. | Federal credit unions may only broker mutual funds. 12 C.F.R. § 712.5(k). |
| Real estate brokerage | National banks may not engage in real estate brokerage, but may act as finders. 12 U.S.C. § 29; 12 C.F.R. § 7.1002. | Federal savings associations may engage in limited real estate brokerage, but only through a service corporation. 12 C.F.R. § 559.4(e). | Federal credit unions may not engage directly in real estate brokerage, but may do so through a CUSO. 12 C.F.R. § 712.5(p). |
| Derivatives activities | National banks may engage in a variety of derivatives activities as a financial intermediary or to control or reduce risk. 12 U.S.C. § 24(seventh). | Similar to national banks. 12 C.F.R. § 563.172. | Federal credit unions may purchase or sell derivatives only to manage the risk of loss through a decrease in value of its commitments to originate real estate loans at specified interest rates by entering into long put positions on Ginnie Mae, Fannie Mae, and Freddie Mac securities. 12 C.F.R. §§ 703.110(a) and 701.21(i)(2). |
| Asset securitization | National banks may directly securitize | Same as national banks. | No similar authority. |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | their assets. 12 U.S.C. § 24(seventh); 12 C.F.R. § 1.3(g). | | |
| *Lending: Non-Commercial* | | | |
| Lending limits[4] | Lending limits protect the safety and soundness of banks by preventing excessive lending to one person or to related persons. National banks follow federal statutory lending limits, while state banks follow state law in this regard.<br><br>A national bank's total outstanding credit to one borrower generally may not exceed 15 percent of the bank's capital and surplus. An additional 10 percent is permissible if fully secured by readily marketable collateral (*i.e.*, financial instruments and bullion salable under ordinary market conditions with reasonable promptness at a fair market value determined by quotations based upon actual transactions on an auction or similarly available daily bid and ask price market). 12 U.S.C. § 84(a); 12 C.F.R. part 32 (OCC).<br><br>State lending limits generally range from 10% to 20% of capital and surplus. William A. Lovett, *Banking and Financial Institutions Law*, West, 1992, pp. 156-157. | Section 84 of the National Bank Act applies to savings associations in the same manner and to the same extent as it applies to national banks. 12 U.S.C. § 1464(u)(1); 12 C.F.R. § 560.93.<br><br>In addition, a savings association may make loans to one borrower of up to $500,000 even if its general lending limit is less than that amount. Certain other special rules provide additional exceptions. 12 U.S.C. § 1464(u)(2). | A federal credit union's lending to any one member is limited to 10 percent of unimpaired capital and surplus. 12 U.S.C. § 1757(5)(A)(x). According to the NCUA, this amounts to 10% of the amount equal to a federal credit union's net worth plus its deposits.<br><br>The term unimpaired capital and surplus has not been defined in the lending limits regulation,[5] although the Federal Credit Union Bylaws define paid-in and unimpaired capital and surplus as a federal credit union's shares and undivided earnings. Art. XVIII, §§ 1(g) and (h).<br><br>In addition, the Federal Credit Union Act refers to member shares as equity, 12 U.S.C. § 1757(6). Based on this and the definition of paid-in capital and surplus, the NCUA interprets the applicable lending limit as including a federal credit union's deposits (shares) as equity for purposes of this limit. As a result, the limit for federal credit unions far exceeds that applicable to other federal depository institutions, which are only based |

[4] The lending limits apply to all forms of lending by all federally-chartered depository institutions unless specifically exempted.

[5] A similar term, "paid-in and unimpaired capital and surplus" is defined, for purposes of Central Liquidity Facility rules, as generally consisting of the paid-in balance of share accounts and deposits plus undivided earnings. 12 C.F.R. § 725.2(o). However, the regulations governing federal credit union lending limits contain no definition.

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | | | on a proportion of capital, rather than on a proportion of the combination of capital and deposits.<br><br>Federal credit unions also face restrictions on commercial lending. The aggregate amount of business loans outstanding to any one member may not exceed 15 percent of reserves or $100,000, whichever is higher. 12 C.F.R. § 723.8. The aggregate amount of member business loans made by a credit union may not exceed 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. 12 U.S.C. § 1757a(a); 12 C.F.R. § 723.16. Exceptions to the aggregate loan limit apply to: (1) low-income credit unions, or those participating in the Community Development Financial Institutions program; (2) those chartered for the purpose of making business loans; and (3) those with a history of primarily making such loans. 12 U.S.C. § 1757a(b); 12 C.F.R. § 723.17. Generally, federal credit union loans may not have terms that exceed 12 years, except for residential real estate loans. 12 U.S.C. § 1757(5). |
| Usury | A national bank may generally charge as much interest as a bank chartered by the state in which the national bank is located. 12 U.S.C. § 85. | Similar to national banks. 12 U.S.C. § 1463(g)(1). | Federal credit unions may not charge more than 18% on extensions of credit to their members. 12 U.S.C. § 1757(5)(A)(vi)(I); 12 C.F.R. § 701.21(c)(7)(ii)(B). |
| Loans secured by residential real estate | National banks may make these loans subject to OCC regulation. 12 U.S.C. § 24(seventh); 12 C.F.R. part 34. | Same as national banks. 12 U.S.C. §§ 1464(c)(1)(B), (E), and (R). | Federal credit unions may make long term real estate loans only for a member's principal residence and for a term not to exceed 40 years. 12 U.S.C. § 1757(5)(A)(i); 12 C.F.R. § 701.21(g)(1). In addition, any second mortgage may not exceed 20 years. |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | | | 12 U.S.C. § 1757(5)(A)(ii); 12 C.F.R. § 701.21(f)(2). |
| Unsecured home improvement loans | National banks may make these loans. 12 U.S.C. § 24(seventh). | Same as national banks. 12 U.S.C. § 1464(c)(1)(J); 12 C.F.R. § 560.30. | Same as national banks, except that such loans may not exceed 20 years. 12 U.S.C. § 1757(5); 12 C.F.R. § 701.21(f)(3). |
| Unsecured residential construction loans | National banks may make these loans. 12 U.S.C. § 24(seventh). | Federal savings associations may make these loans subject to a limit equal to the greater of 5% of assets or 100% or capital. 12 U.S.C. § 1464(c)(3)(C). | No similar authority. |
| Consumer loans | National banks may make these loans. 12 U.S.C. § 24(seventh). | Federal savings associations may make these loans as long as the aggregate amount does not exceed 35% of assets when combined with commercial paper and corporate debt securities. 12 U.S.C. § 1464(c)(2)(D). | Same as national banks, except for the 12-year term limit. 12 U.S.C. § 1757(5); 12 C.F.R. § 701.21(a). |
| Credit card loans | National banks may make these loans. 12 U.S.C. § 24(seventh). | Same as national banks. 12 U.S.C. § 1464(c)(1)(T). | Same as national banks, except for the 12-year term limit. 12 U.S.C. § 1757(5); 12 C.F.R. § 701.21(a). |
| Overdraft loans | National banks may make these loans. 12 U.S.C. § 24(seventh). | Similar to national banks. 12 U.S.C. § 1464(c)(1)(A). | Same as national banks, except for the 12-year term limit. 12 U.S.C. § 1757(5); 12 C.F.R. § 701.21(c)(3). |
| *Lending: Commercial* | | | |
| Commercial loans | National banks may make these loans. 12 U.S.C. § 24(seventh). | Federal savings associations may make these loans subject to a limit of 20% of total assets, provided that any amount over 10 percent of assets consists of small business loans. 12 U.S.C. § 1464(c)(2)(A); 12 C.F.R. § 560.30. | Federal credit unions may provide business loans to their members. The aggregate limit on outstanding business loans is the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. 12 U.S.C. § 1757a(a); 12 C.F.R. § 723.16. |
| Construction and development loans | National banks may make these loans. 12 C.F.R. part 34 (secured); 12 U.S.C. § | Federal savings associations may make unsecured construction loans, subject to | Federal credit unions may make member business loans to finance the acquisition or |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | 24(seventh) (unsecured). | a limit equal to the greater of total capital or 5% of total assets. They may also make loans secured by non-residential real estate, up to a limit of 400% of capital. 12 U.S.C. §§ 1464(c)(2)(B) and 1464(c)(3)(C). | construction of income-producing property. Such loans must not exceed 15% of net worth, and the borrower must have at least a 35% equity interest in the project. 12 C.F.R. § 723.3. |
| *Leasing* | | | |
| Leasing | National banks may acquire personal property for the purpose of leasing it, provided that the lease qualifies as a net, full-payout[6] lease. The bank's recovery of its investment and costs depends upon the residual value of the property. Any unguaranteed portion of the estimated residual value must not exceed 25% of the original cost of the property to the lessor. Any amount guaranteed may exceed 25% of the original cost if the guarantor has sufficient resources and is not an affiliate of the bank. 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 23.20 and 23.21.<br><br>Under separate statutory authority, national banks may engage in lease financing (with minimum lease periods of 90 days) up to a limit of 10% of assets. 12 U.S.C. § 24(tenth); 12 C.F.R. §§ 23.10-23.12.<br><br>National banks may purchase and lease | Federal savings associations may engage in lease financing of personal property subject to a limit of 10% of assets, without regard to residual value. 12 U.S.C. § 1464(c)(2)(C); 12 C.F.R. § 560.41(d).<br><br>Federal savings associations may also engage in lease financing that amounts to the functional equivalent of lending. Such leases may be for residential real estate, non-residential real estate, commercial, business, corporate, or agricultural purposes. These leases must be net, full-payout leases; and (2) the amount invested counts towards the appropriate limit on the particular type of lending (*e.g.*, commercial leases must be counted towards the limits on commercial lending). 12 C.F.R. § 560.41(c). | Federal credit unions lack express authority to engage in lease financing. However, they may engage in lease financing of personal property, provided that such leases are the functional equivalent of secured loans for personal property. Thus, federal credit unions must enter into only net, full-payout leases, and they operate under rules similar to those of national banks for their implied leasing authority. 65 Fed. Reg. 34,581 (May 31, 2000) (codified at 12 C.F.R. part 714).<br><br>Federal credit union CUSOs may engage in lease financing of personal property without these limitations. 12 C.F.R. § 712.5(h). |

[6] Under a net lease, the institution bears no obligation to service, repair, maintain, replace or insure the leased property. 12 C.F.R. § 23.2(f). With a full-payout lease, the institution reasonably expects to realize the return of its investment in the leased property, as well as estimated costs of financing. 12 C.F.R. § 23.2(e). For federal savings associations, a full-payout lease also requires that the estimated cost of financing the property over the term of the lease does not exceed 25% of the original cost of the property to the savings association. 12 C.F.R. § 560.41(b)(2). Under these leases, an institution's return comes from the periodic lease payments, tax benefits, and the residual value of the property.

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| | real estate only under special circumstances, such as the purchasing and leasing of municipal buildings. 12 C.F.R. § 7.1000 and part 23. | | |
| *Investments* | | | |
| U.S. government securities and state and local securities | Without limit, national banks may invest in securities issued or guaranteed by the United States, any U.S. agency, or by any state or local general obligation. 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 1.2 and 1.3. Subject to a 10% of capital limit on the holdings of any one obligor, national banks may invest in state and local obligations (that are not general obligations) and municipal revenue bonds. 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 1.2 and 1.3. | Same as national banks. 12 U.S.C. §§ 1464(c)(1)(C) and (H). | Similar to national banks. Federal credit unions face various regulatory limitations. 12 U.S.C. §§ 1757(7)(B) and (K); 12 C.F.R. §§ 703.100 and 703.110. |
| Government-sponsored enterprise securities | Without limit, national banks may invest in the securities of Fannie Mae, Freddie Mac, the FHLBank System, and Ginnie Mae. 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 1.2 and 1.3. | Same as national banks. 12 U.S.C. §§ 1464(c)(1)(D), (E), (F), (M), (N), and (P); 12 C.F.R. § 566.1(g)(3). | Same as national banks. 12 U.S.C. § 1757(7)(E). |
| Residential mortgage-backed securities | Without limit, national banks may invest in securities issued or guaranteed by Fannie Mae, Freddie Mac, Ginnie Mae, or any U.S. agency, and in privately issued mortgage-backed securities if rated in one of the two highest rating categories. 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 1.2 and 1.3. | Same as national banks. 12 U.S.C. §§ 1464(c)(1)(E), (F), and (R). | Generally, federal credit unions may invest in mortgage-backed securities. However, they may not invest in stripped mortgage-backed securities, residual interests in CMOs/REMICS, or commercial mortgage-related securities, unless issued by certain government sponsored enterprises. 12 U.S.C. § 1757(7);12 C.F.R. § 703.110(c). |
| Other asset-backed securities | Subject to a 25% of capital limit on the holdings of any one obligor, national banks | Federal savings associations may invest in small business related securities (*i.e.*, | Federal credit unions may invest in such securities if issued by certain government |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | may invest in non-residential asset-backed securities (*e.g.*, securities backed by credit card, auto loans, or small business loans). 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 1.2 and 1.3. | securities rated in one of the four highest rating categories that represents an interest in loans or leases of personal property evidencing the obligations of a small business. 12 U.S.C. § 1464(c)(1)(S).<br>Federal savings associations may also invest in commercial real estate mortgage-backed securities. 12 U.S.C. § 1464(c)(1)(R). | sponsored enterprises. 12 U.S.C. § 1757(7). |
| Mutual fund shares | National banks may purchase for their own account shares in mutual funds, provided the national bank complies with certain investment limitations that would be applicable to the underlying investments of the mutual fund portfolio. 12 U.S.C. § 24 (seventh); 12 C.F.R. § 1.4(e). | Federal savings associations may purchase for their own accounts, without limit, the shares of any registered open-end mutual fund, provided the fund invests exclusively in assets that federal savings associations may hold without limitation. 12 U.S.C. § 1464(c)(1)(Q). | Federal credit unions may invest without limit in any mutual fund that may itself invest in assets and engage in transactions permissible for a federal credit union. 12 C.F.R. § 703.100(d). |
| Corporate debt securities | National banks may invest in corporate debt under certain limited conditions. Among other things, such debt must be of investment grade and exposure to any one issuer may not exceed 10% of the bank's capital. 12 U.S.C. § 24(seventh); 12 C.F.R. §§ 1.2 and 1.3. | Federal savings associations may invest in corporate debt. Among other things, such debt must be rated in one of the four highest rating categories by a national statistical rating organization, and may not exceed 35% of the institution's assets when combined with commercial paper and consumer loans. 12 U.S.C. §§ 1464(c)(1)(M) and (c)(2)(D), and 1831e(d); 12 C.F.R. § 560.40. | Federal credit unions may invest in zero coupon bonds, provided that they mature no later than 10 years after the settlement date. 12 C.F.R. § 703.110(d). |
| *Affiliates*[7] | | | |
| Operating subsidiary | National banks may establish or acquire | Substantially the same as national | Federal credit unions may own as a |

[7] Federal credit unions cannot be owned by a holding company, but may only exist in a cooperative form, 12 U.S.C. § 1753, and they may not own other depository institutions, 12 U.S.C. § 1757(7)(I). Therefore, the discussion of affiliates does not include holding companies.

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | operating subsidiaries, which may engage only in activities that the national bank may engage in directly. The bank must own more than 50% of the voting stock of its operating subsidiary or otherwise controls the subsidiary. 12 C.F.R. § 5.34. | banks. 12 C.F.R. §§ 559.3(c) and (e)(1). | subsidiary or jointly with others a credit union service organization (CUSO). Federal credit unions may only invest up to 1% of their capital in such entities, 12 U.S.C. § 1757(7)(I), and may only lend an amount up to 1% of their capital to such entities. 12 U.S.C. § 1757(5)(D).<br><br>CUSOs may engage in a wide range of activities, only some of which a federal credit union may engage in directly. However, all CUSO activities must be approved by the NCUA Board. 12 U.S.C. § 1757(5)(D). Therefore, CUSOs may engage only in those activities specifically permitted in regulation. Any additional activities require an amendment to the regulation. 12 C.F.R. § 712.7. CUSO activities include providing ATM services, data processing, securities brokerage, insurance agency, travel advisory service, financial consulting, and personal property leasing. 12 C.F.R. § 712.5. |
| Service companies or corporations | National banks may invest up to 10% of their capital in any one service company and no more than 5% of their assets in all such companies, after giving notice to the OCC.<br><br>Such companies may provide only to depository institutions certain limited services, such as check and deposit posting and sorting, preparation and mailing of checks and statements, and accounting services, without being subject to approval requirements and other limitations.<br><br>If a state and a national bank jointly own the company, the company may only | Federal savings associations may invest up to 2% of their assets (and in some cases, up to 3%) in service corporations engaged in any activity reasonably related to the activities of federal savings associations. Such activities include real estate development, real estate management for third parties, and selling insurance on an agency basis. 12 U.S.C. § 1464(c)(4)(B); 12 C.F.R. § 559.4. | CUSOs may engage in some of these activities, but generally may not engage in 4(c)(8) activities. 12 C.F.R. § 712.5. |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | provide those products and services that the state and national banks both could provide. However, the company may not accept deposits.<br><br>In serving any customers, including depository institutions, a company may engage in any nonbanking activity (with the approval of the Federal Reserve and subject to certain other limitations) that the Federal Reserve has determined to be so closely related to banking (for a bank holding company or its subsidiary) or to managing or controlling banks as to be a proper incident thereto (under section 4(c)(8) of the Bank Holding Company Act). Such activities include securities brokerage, owning a savings association, financial advisory services, acting as a futures commission merchant, underwriting and dealing in government obligations, and engaging in insurance brokerage pursuant to the town of 5,000 authority. 12 U.S.C. § 1861 *et seq*.; 12 C.F.R. § 5.35. | | |
| Financial subsidiary | A well capitalized and well managed national bank may control or invest in a financial subsidiary, subject to certain other limitations and safeguards. A financial subsidiary may engage: (1) in any activity closely related to banking (as determined under section 4(c)(8) of the Bank Holding Company Act); (2) in any activity in the United States that a bank holding company may engage in outside of the United States; and (3) in the underwriting, distributing, and dealing in of all types of securities; (4) in selling | *See* service companies above. | No similar provision. |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | insurance nationwide; and (5) in any activity that the Treasury, in consultation with the Federal Reserve, determines to be financial in nature or incidental to a financial activity. Financial subsidiaries may also engage in activities permissible for operating subsidiaries. 12 U.S.C. § 24a; 12 C.F.R. § 5.39. | | |
| Transactions with affiliates | Specific limits apply to certain covered transactions between a bank and its affiliated companies (*e.g.*, loans; guarantees; and other extensions of credit to, and purchases of assets from, those companies). Such transactions with any one affiliate may not exceed 10% of the bank's capital. Such transactions with all affiliates may not exceed 20% of capital. Generally, high-quality collateral must fully secure all such transactions. 12 U.S.C. § 371c.<br><br>Most transactions between a bank and its affiliates must also be conducted at arm's length. 12 U.S.C. § 371c-1. These statutory provisions also apply to state-chartered non-member banks. 12 U.S.C. § 1828(j). Affiliates in this context do not generally include bank subsidiaries. However, these affiliate restrictions do apply to transactions between banks and their "financial subsidiaries," subject to certain exceptions. 12 U.S.C. § 371c(e). | Same as national banks. 12 U.S.C. § 1468(a).<br><br>In addition, a savings association may not make any extension of credit to any affiliate engaged in activities not permissible for a bank holding company. 12 U.S.C. § 1468(a)(1)(A). | Federal credit unions do not have affiliate transaction restrictions similar to those applicable to other depository institutions. However, a specific conflict of interest provision prohibits a person who serves as a credit union official or in senior management, or any immediate family members, from receiving any compensation from a CUSO. All transactions with the organization must be conducted at arm's length. 12 C.F.R. § 712.8.<br><br>A federal credit union may invest up to 1 percent of its total paid-in and unimpaired capital and surplus in a CUSO. 12 U.S.C. § 1757(7)(I). In addition, a credit union may lend another 1 percent of its total paid-in and unimpaired capital and surplus to a CUSO. 12 U.S.C. § 1757(5)(D). According to the NCUA, unimpaired capital includes deposits, less any losses that may have been incurred for which there are no reserves or which have not been charged against undivided earnings. Federal Credit Union Bylaws, Article XVIII, Section 1(g). |
| *Safety and Soundness Rules* | | | |

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| *Capital* | | | |
| Definition of capital | Total capital consists of core capital (Tier 1) and supplementary capital (Tier 2).<br><br>Tier 1 capital includes common stock, noncumulative perpetual preferred stock, and minority interests in the equity accounts of consolidated subsidiaries.<br><br>Tier 2 includes cumulative perpetual preferred stock, the allowance for loan and lease losses, and hybrid instruments that combine debt and equity features. Tier 2 also includes subordinated debt and limited amounts of unrealized gains on equity securities.<br><br>Deductions from capital include goodwill and other intangibles and investments in certain subsidiaries. 12 C.F.R. part 3, app. A (OCC); 12 C.F.R. part 325, app. A (FDIC); 12 C.F.R. part 208, app. A (FRB). | Similar, but with some minor variations. 12 C.F.R. part 567. For example, in the case of mutual savings associations, Tier 1 capital also includes certain nonwithdrawable accounts and pledged deposits. 12 C.F.R. § 567(a)(iv). | Credit union capital consists of "net worth," that is, retained earnings, as determined under generally accepted accounting principles. For low-income designated credit unions only, "net worth" includes uninsured secondary capital accounts, which are subordinate to the claims of creditors, shareholders, and the National Credit Union Share Insurance Fund. 12 U.S.C. § 1790d(o)(2). This statutory definition of "net worth" reflects that credit unions are not-for-profit entities that lack the means to raise capital available to other federally-insured depository institutions, for example, by selling shares to the public. |
| Capital adequacy | Banks must meet two minimum capital requirements: (1) a minimum leverage ratio, generally requiring 4% Tier 1 capital to total assets; and (2) a total risk-based capital ratio of 8% capital to risk-weighted assets. 12 C.F.R. part 3, app. A (OCC); 12 C.F.R. § 325.103(b)(2) (FDIC); 12 C.F.R. § 208.43(b)(2) (FRB).<br><br>The risk-based system assigns each class of assets a risk weight of 0%, 20%, 50%, or 100%. The 0% category includes assets such as cash and direct claims on OECD governments (*e.g.*, securities). The 20% | Savings associations must generally meet the same basic capital requirements as banks. 12 U.S.C. §§ 1464(t)(1)(C), (2)(C); 12 C.F.R. § 567.5. | To be "adequately capitalized," a credit union must maintain net worth of at least 6%, as measured by the ratio of net worth to total assets. 12 U.S.C. § 1790d(c)(1)(B). This statutory framework prescribes five net worth categories (*i.e.*, well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized). 65 Fed. Reg. 8,584 (Feb. 18, 2000) (to be codified at 12 C.F.R. part 702).<br><br>To be "well capitalized," a credit union must have at least 7% net worth. Credit unions |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | category includes most claims on banks and securities issued by the federal government or its agencies that are not backed by the full faith and credit of the United States. The 50% category includes some types of mortgage loans and certain mortgage-backed securities. Also includes most derivative transactions. The 100% category—the standard risk category—includes typical commercial loans. Off-balance sheet items are also factored into the four risk categories. 12 C.F.R. part 3, app. A (OCC); 12 C.F.R. part 325, app. A (FDIC); 12 C.F.R. part 208, app. A (FRB).<br><br>Tier 2 capital may count toward meeting the 8% risk-based capital requirement, but only up to 50% of the total capital requirement. *Id*. | | that have a net worth ratio of less than 7% are required, on a quarterly basis, to set aside quarterly as net worth an amount equal to at least 0.1% of their total assets. 12 U.S.C. § 1790d(e)(1); 65 Fed. Reg. 8,586 (Feb. 18, 2000) (to be codified at 12 C.F.R. § 702.201(a)).<br><br>A risk-based capital requirement applies to credit unions that meet the definition of a complex credit union (*i.e.*, any credit union with more than $10 million in assets and whose risk-based net worth requirement exceeds 6%). 65 Fed. Reg. 44,950 (Jul. 20, 2000) (to be codified at 12 C.F.R. part 702). The risk-based requirement takes into account material risks against which the 6% net worth ratio, the level required to be adequately capitalized, does not provide adequate protection. 12 U.S.C. § 1790d(d).<br><br>To determine whether a credit union is complex, it must calculate its risk-based net worth requirement by combining eight risk-based components, each consisting of a risk portfolio multiplied by a corresponding risk factor.[8] A credit union whose net worth ratio does not meet its risk-based requirement has the option of substituting three specific risk-based components with any of three corresponding alternative components that may reduce its risk-based requirement. |
| Regulatory capital | No similar authority. | No similar authority. | Federal credit unions serving predominantly low-income members may offer uninsured |

[8] For example, the total value of long-term real estate loans in excess of 25% of the institution's portfolio (*i.e.*, real estate loans and lines of credit–excluding member business loans and lines of credit–that will not mature or reprice within five years). 12 C.F.R. § 702.104(b).

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| | | | regulatory capital accounts to businesses and organizations, whether they are members or not. Such capital must be issued for at least five years, may not be redeemable prior to maturity, must be subordinate to all other claims, and must be available to cover losses. 12 C.F.R. §701.34. |
| Prompt corrective action | All FDIC-insured depository institutions are subject to a regulatory system of prompt-corrective action: a set of statutory provisions aimed at resolving capital deficiencies before they grow into large problems. The system classifies depository institutions into five capital categories (*i.e.*, well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized). These capital categories are defined in terms of four capital measures: (1) a total risk-based capital ratio; (2) a Tier 1 risk-based capital ratio; (3) a leverage ratio; and (4) a statutory tangible equity ratio of 2%, below which a bank is deemed to be critically undercapitalized. To be well capitalized, a bank must have a total risk-based capital ratio of 10%, Tier 1 risk-based capital ratio of 6%, and a leverage ratio of 5%. 12 U.S.C. § 1831o; 12 C.F.R. part 6 (OCC); 12 C.F.R. part 325, subpart B (FDIC); 12 C.F.R. part 208, subpart B (FRB). | Same as national banks. 12 C.F.R. part 565. | Similar to the rules of the banking agencies. 65 Fed. Reg. 8,560 (Feb. 18, 2000) (to be codified at 12 C.F.R. part 702). |
| *Audit Requirements* | | | |
| General audit requirements | All FDIC-insured institutions must submit annual reports to their appropriate federal banking regulator on their financial | Same as national banks. 12 U.S.C. § 1831m(a). | A credit union's board of directors must appoint a supervisory committee. 12 U.S.C. § 1761b(5). The supervisory committee |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | condition and management. 12 U.S.C. § 1831m(a). | | must conduct, or hire competent parties to conduct, an annual audit, depending on the credit union's size. The supervisory committee must also verify that the institution's financial statements accurately and fairly represent the institution's financial condition and that management practices and procedures sufficiently protect member assets. 12 U.S.C. § 1761d; 12 C.F.R. §§ 715.3 and 715.4. |
| Independent audit requirements | Each large FDIC-insured institution must establish an independent audit committee and obtain an annual independent audit of its financial statements by an independent public accountant in accordance with generally accepted auditing standards. 12 U.S.C. §§ 1831m(d), (g)(1). This requirement does not apply to institutions with less than $500 million in assets. 12 C.F.R. §§ 363.1 *et seq*. | Same as national banks. However, the OTS also requires any savings association with an unsatisfactory CAMEL rating (3, 4, or 5) to obtain an independent audit. 12 C.F.R. § 562.4(b)(1). | Similar with respect to credit unions having assets of $500 million or more. If a credit union with more than $10 million in assets, but less than $500 million, chooses to obtain a financial statement audit, the audit must be performed in a manner consistent with the accountancy and licensing laws of the appropriate jurisdiction. 12 U.S.C. § 1782(a)(6)(D); 12 C.F.R. part 715. |
| *Miscellaneous* | | | |
| Frequency of safety and soundness examinations | All FDIC-insured institutions, must generally be examined at least once each year. However, an 18-month examination cycle is permissible for certain healthy, well-capitalized and well managed institutions with less then $250 million in assets. 12 U.S.C. § 1820(d). | Same as national banks. | No statutory annual examination requirement applies, but since 1985 the NCUA has had a policy of examining federal credit unions annually, and allowing exceptions only with the approval of the agency's Executive Director. Federally insured state-chartered credit unions are examined by their chartering state at least once every 18 months. If these institutions are troubled, however, they may be examined every 120 days either by the NCUA alone or jointly by the NCUA and the state. NCUA, Examiner's Guide (Alexandria, VA: NCUA, 1996). |
| Liquidity | Depository institutions may obtain | Same as national banks. Savings | Same as national banks. Credit unions can |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | emergency liquidity from the Federal Reserve discount window, as well as short-term adjustment credit or longer-term seasonal credit. 12 C.F.R. part 201.3 and §§ 347a and 347b. | associations must also comply with separate statutory liquidity requirements. 12 U.S.C. § 1465. | also obtain liquidity from the Central Liquidity Facility and from corporate credit unions. 12 U.S.C. §§ 1795-1795k; 12 C.F.R. parts 725 and 704.<br><br>The NCUA recently provided general guidance to federal credit unions concerning both balance sheet liquidity management and contingency funding. Letter to Credit Unions 00-CU-13. |
| Change in officials | An FDIC-insured institution that does not meet its capital requirement or is otherwise in troubled condition must notify its federal regulator of any new senior executive officer or board member at least 30 days before such additions become effective. Notice must also be given if the agency determines it is appropriate in connection with its review of a plan required under the prompt corrective action provisions of 12 U.S.C. § 1831i. The regulator then may disapprove the new addition before the end of the notice period. 12 U.S.C. § 1831i. | Same as national banks. 12 U.S.C. § 1831i. | Similar to national banks. Regional directors, who have delegated authority to approve or disapprove changes, must comply with slightly different time frames. 12 C.F.R. § 701.14. In addition, the notification of such personnel changes must be made if the institution has been chartered for less than two years. 12 U.S.C. § 1790a. |
| Bond coverage | All officers and employees of a national bank must have adequate fidelity coverage. 12 C.F.R. § 7.2013. | Each savings association must maintain fidelity bond coverage for each director, officer, employee, and agent who has control over or access to cash, securities, or other property of the savings association. 12 C.F.R. § 563.190. | Federal credit union employees and officials must be covered by fidelity bonds. In addition, federal credit unions must have general insurance to cover losses due to vandalism, theft, holdups, *etc*. 12 U.S.C. §§ 1761a, 1761b(2), 1766(h); 12 C.F.R. part 713, § 741.201. |
| Management interlocks | The Depository Institution Management Interlocks Act prohibits a management official from serving two nonaffiliated depository institutions where such management interlocks would be anti- | Same as national banks. 12 C.F.R. part 563f. | Similar to national banks. However, the statute exempts interlocking arrangements between two credit unions and, therefore, in the case of credit unions, only restricts interlocks between credit unions and other |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
|---|---|---|---|
| | competitive. 12 U.S.C. § 3201 *et seq.*; 12 C.F.R. part 26 (OCC); 12 C.F.R. part 348 (FDIC); 12 C.F.R. part 212 (FRB). | | depository institutions. 12 U.S.C. § 3204(3); 12 C.F.R. § 711.4(c). |
| | *Enforcement* | | |
| Bank Secrecy Act | The Bank Secrecy Act (BSA) requires financial institutions to file reports and records of certain transactions where they may have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. 31 U.S.C. § 5311 et seq.<br><br>The Treasury Department promulgates regulations concerning the BSA that apply to all financial institutions. *Id*. Each federal banking regulator has promulgated regulations to ensure BSA compliance. 12 C.F.R. part 21, subpart B (OCC); 12 C.F.R. part 326, subpart B (FDIC); 12 C.F.R. § 208.63. | Same as national banks. 12 C.F.R. § 563.177. | Same as national banks, except that the NCUA has also promulgated guidelines for BSA compliance. 12 C.F.R. part 748. |
| Cease and desist orders | If a bank or an institution-affiliated party[9] has engaged or will engage in an unsafe or unsound practice or violate a statute, regulation, written agreement, then the regulator may issue a notice of charges stating the alleged violation and setting a time for a hearing to determine if the agency should issue a cease-and-desist order. The hearing must occur 30 to 60 days after the notice is issued. 12 U.S.C. § | Same as national banks. 12 U.S.C. § 1818(b)(1); 12 U.S.C. §§1818(b)(6)-(7). | Same as national banks. 12 U.S.C. § 1786(e)(1). |

[9] Institution-affiliated parties include: directors, officers, employees, and agents of the institution; anyone who has or is required to file a change-in-control notice; a shareholder, joint venture partner, or consultant who participates in the conduct of the institution's activities; and any independent contractor who knowingly or recklessly participates in any violation of statute or regulation, any breach of fiduciary duty, or any unsafe or unsound practice which has or may harm the institution in a significant fashion. 12 U.S.C. § 1813(u).

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | 1818(b)(1).<br><br>The remedies sought in the order may limit an institution's activities or functions or require the institution to take affirmative action to address the problems cited in the order (*e.g.*, restitution, growth restrictions, disposition of loans or assets, and hiring qualified officers or employees). 12 U.S.C. §§1818(b)(6)-(7). | | |
| Temporary cease-and-desist order | If the regulator determines that the activity covered in a notice of charges may weaken the bank or compromise its depositors before the proceedings described above can be completed, it can issue a temporary cease-and-desist order, which becomes effective immediately and remains effective until the issue has been resolved. 12 U.S.C. § 1818(c)(1). | Same as national banks. 12 U.S.C. § 1818(c)(1). | Same as national banks. 12 U.S.C. §§ 1786(e)(3)-(4), (f)(1). |
| Permanent cease-and-desist order | After a hearing on a notice of charges, the regulator may issue a permanent cease-and-desist order against the bank. The order becomes effective 30 days after issuance (except that a consensual order becomes effective immediately). 12 U.S.C. §§ 1818(b)(1)-(2). | Same as national banks. 12 U.S.C. §§ 1818(b)(1)-(2). | Same as national banks. 12 U.S.C. §§ 1786(e)(1)-(2). |
| Removal and prohibition authority | If the regulator determines that an institution-affiliated party has, directly or indirectly, engaged in prohibited practices, the regulator may permanently remove the party from office or prohibit the party from any further participation in the affairs of any insured depository institution. Prohibited practices include violations of statutes, regulations, cease-and-desist orders, and written conditions or | Same as national banks. 12 U.S.C. § 1818(e)(1); 12 U.S.C. §§ 1818(e)(3)-(4). | Similar to national banks. 12 U.S.C. §§ 1786(g)(1), (3), (4). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | agreements; unsafe or unsound practices; and breaches of fiduciary duty. Such actions must also: (1) harm or threaten to harm the institution, prejudice or potentially prejudice depositors, or result in financial gain to the party; and (2) involve dishonesty or demonstrate willful or continuing disregard for the institution's safety and soundness. 12 U.S.C. § 1818(e)(1). A notice of intent to remove or prohibit must describe the charge and set a hearing date that must occur 30 to 60 days after issuance. If appropriate, the regulator may suspend the party before the hearing until the matter is resolved. 12 U.S.C. §§ 1818(e)(3)-(4). | | |
| Civil money penalties | For violations of statute or regulation, permanent or temporary orders, or written conditions or agreements, the regulator may require an institution, or a person affiliated with the institution, to pay a civil money penalty of up to $5,000 for each day the violation continues. The agency may impose a penalty of up to $25,000 a day for such violations, or for recklessly engaging in an unsafe or unsound practice, or breaches of a fiduciary duty, if those acts: (1) are part of a pattern of misconduct; (2) are likely to cause the institution a significant loss; or (3) result in financial gain to the person committing the act. If the acts described above are committed knowingly, the daily fine may be up to $1 million for individuals or the lesser of $1 million or 1% of assets for institutions. 12 U.S.C. §§ 1818(i)(1), (2)(A)-(D). | Same as national banks. 12 U.S.C. §§ 1818(i)(1), (2)(A)-(D). | Same as national banks. 12 U.S.C. §§1786(k), (2)(A)-(D), (H). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| *Consumer Protection* | | | |
| Truth in Savings Act | The Truth in Savings Act (TISA) requires depository institutions to disclose in a standard form the terms of deposit accounts so that customers can meaningfully compare these terms across institutions. 12 U.S.C. § 4301 *et seq*. Depository institutions must also disclose to their existing customers changes in the terms of deposit accounts. 12 U.S.C. § 4305(c).<br><br>TISA directs the Federal Reserve to promulgate regulations applicable to banks and savings associations, but permits the other regulators to promulgate rules for enforcing TISA. 12 U.S.C. § 4308(a); 12 C.F.R. part 230. | Same as national banks. 12 U.S.C. § 4305(c).<br><br>Same as national banks. 12 U.S.C. § 4308(a); 12 C.F.R. part 230. | Same as national banks. 12 U.S.C. § 4305(c).<br><br>TISA directs the NCUA to promulgate rules "substantially similar" to those promulgated by the Federal Reserve. 12 U.S.C. § 4311; 12 C.F.R. part 707. Non-automated credit unions have been exempted from TISA. 12 U.S.C. § 4313(6). |
| Truth in Lending Act | The Truth in Lending Act (TILA) requires creditors to disclose the cost and terms of credit to promote the informed use of credit by consumers, establishes remedies for consumers injured by violations of the law, and provides a process for resolving billing disputes. 15 U.S.C. § 1601 *et seq*.; 12 C.F.R. § 226.1(b).<br><br>TILA directs the Federal Reserve to promulgate regulations, but permits the other regulators to promulgate rules for enforcing TILA. 15 U.S.C. § 1604. The regulations of the Federal Reserve apply to all creditors, including credit unions. 15 U.S.C. § 1602(f). | Same as national banks. 15 U.S.C. § 1601 *et seq*.; 12 C.F.R. § 226.1(b).<br><br>Same as national banks. 15 U.S.C. § 1602(f). | Same as national banks. 15 U.S.C. § 1601 *et seq*.; 12 C.F.R. § 226.1(b).<br><br>Same as national banks. 15 § 1602(f). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| Equal Credit Opportunity Act | The Equal Credit Opportunity Act (ECOA) seeks to ensure the availability of credit to all creditworthy applicants regardless of race, color, religion, national origin, sex, marital status, or age. ECOA achieves this end by directing creditors to notify applicants of action taken on their application, and by retaining records of credit applications. 15 U.S.C. § 1691 *et seq*.; 15 C.F.R. § 202.1(b).<br><br>ECOA directs the Federal Reserve to promulgate regulations applicable to all creditors, including credit unions, but permits the other regulators to promulgate rules for enforcing ECOA. 15 U.S.C. §§ 1691a(e), 1691b; 12 C.F.R. part 202. | Same as national banks. 15 U.S.C. § 1691 *et seq*.; 12 C.F.R. § 202.1(b). | Same as national banks. 15 U.S.C. § 1691c(a)(1)(C)(3); 12 C.F.R. § 701.31. |
| Fair Debt Collection Practices Act | The Fair Debt Collection Practices Act (FDCPA) seeks to eliminate the abusive practices of debt collectors. 15 U.S.C. § 1692(e). FDCPA achieves this end by, among other things, regulating the ability of the debt collector to communicate with consumers, by circumscribing the manner in which debt collectors may obtain information from consumers, prohibiting harassment by debt collectors, and by providing a procedure within which consumers may dispute the validity of a debt. 15 U.S.C. § 1692 *et seq*.<br><br>The Federal Trade Commission generally enforces the FDCPA with respect to nonbank institutions, 15 U.S.C. § 1692l(a), while the federal depository institution regulators enforce it with regard to their | Same as national banks. 15 U.S.C. § 1692 *et seq*.<br><br>Same as national banks. 15 U.S.C. § 1692l(a); 15 U.S.C. § 1692l(b). | Same as national banks. 15 U.S.C. § 1692l(b)(3). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | regulated entities. 15 U.S.C. § 1692l(b). | | |
| Electronic Fund Transfer Act | The Electronic Fund Transfer Act (EFTA) establishes the rights, liabilities, and responsibilities of participants in electronic fund transfer systems (*e.g.*, telephone, ATM, or computer transactions). 15 U.S.C. § 1693.<br><br>The Federal Reserve promulgates EFTA regulations applicable to any financial institution that holds an account belonging to a consumer or issues an access device and agrees to provide EFT services. The Federal Trade Commission generally enforces the EFTA with respect to nonbank institutions, while the federal depository institution regulators enforce it with regard to their regulated entities. 15 U.S.C. §§ 1693b(a), 1693a(8); 12 C.F.R. part 205. | Same as national banks. 15 U.S.C. § 1693.<br><br>Same as national banks. 15 U.S.C. §§ 1693b(a), 1693a(8); 12 C.F.R. part 205. | Same as national banks. 15 U.S.C. § 1693a(8). |
| Home Mortgage Disclosure Act | The Home Mortgage Disclosure Act (HMDA) requires certain lenders to collect loan data to determine, among other things, whether financial institutions serve the housing needs of their areas and to identify possible discriminatory lending practices. 12 U.S.C. § 2801; 12 C.F.R. § 203.1(b).<br><br>Financial institutions must report to their supervisory agency data about home purchase and home improvement loans they originate or purchase, or for which<br><br>they receive applications. 12 U.S.C. § 2803; 12 C.F.R. § 203.1(c).<br><br>Based on these data, the Federal Financial Institutions Examination Council prepares | Same as national banks. 12 U.S.C. § 2801; 12 C.F.R. § 203.1(b);<br><br>Same as national banks. 12 U.S.C. § 2803; 12 C.F.R. § 203.1(c).<br><br>Same as national banks. 12 U.S.C. § 2803(f); 12 C.F.R. § 203.1(d). | Same as national national banks. 12 U.S.C. § 2801; 12 C.F.R. § 203.1(b);<br><br>Same as national banks. 12 U.S.C. § 2803; 12 C.F.R. § 203.1(c).<br><br>Same as national banks. 12 U.S.C. § 2803(f); 12 C.F.R. § 203.1(d). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
|---|---|---|---|
| | disclosure statements illustrating lending patterns by area, age of housing stock, income level, race, and sex. 12 U.S.C. § 2803(f); 12 C.F.R. § 203.1(d).<br><br>HMDA generally applies to banks, savings associations, credit unions, and certain mortgage banks. 12 U.S.C. § 2802; 12 C.F.R. § 203.2(e).<br><br>HMDA directs the Federal Reserve to promulgate any necessary regulations. 12 U.S.C. § 2804(a).<br><br>The federal depository institution regulators enforce the statute for those institutions they oversee. 12 U.S.C. § 2804(b). | Same as national banks. 12 U.S.C. § 2802; 12 C.F.R. § 203.2(e).<br><br>Same as national banks. 12 U.S.C. § 2804(a).<br><br>Same as national banks. 12 U.S.C. § 2804(b). | Same as national banks. 12 U.S.C. § 2802; 12 C.F.R. § 203.2(e).<br><br>Same as national banks. 12 U.S.C. § 2804(a).<br><br>Same as national banks. 12 U.S.C. § 2804(b). |
| Community Reinvestment Act | The Community Reinvestment Act (CRA) encourages insured depository institutions to help meet the credit needs of the local communities in which they are chartered. 12 U.S.C. § 2901(b). Each federal banking agency maintains regulations applicable to the institutions they oversee. 12 U.S.C. § 2905. | Same as national banks. 12 U.S.C. § 2901(b). | Federal credit unions are not subject to CRA. However, a recent NCUA regulation requires any federal credit union expanding, converting to, or chartering a community credit union to prepare a written plan for serving its entire community. Existing community credit unions are expected to have their plans in place by December 31, 2001. 65 Fed. Reg. 64,512 (Oct. 27, 2000). |
| Consumer Leasing Act | The Consumer Leasing Act (CLA) requires those leasing personal property (*e.g.*, cars, furniture, or appliance) to disclose in a uniform manner the terms of the lease. The CLA applies to leases exceeding four months. The CLA also requires advertised lease terms to be accurate, and it limits the amount of any balloon payments in consumer lease transactions. 15 U.S.C. §§ 1667-1667c; 12 C.F.R. § 213.1(b). | Same as national banks. 15 U.S.C. § 1667-1667c; 12 C.F.R. § 213.1(b). | Same as national banks. 15 U.S.C. § 1667-1667c; 12 C.F.R. § 213.1(b). |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| | The Federal Reserve has the authority to promulgate regulations concerning the CLA. 15 U.S.C. § 1604(a). | Same as national banks. 15 U.S.C. § 1604(a). | Same as national banks. 15 U.S.C. § 1604(a). |
| Expedited Funds Availability Act | The Expedited Funds Availability Act (EFAA) provides schedules detailing when depository institutions must make deposited funds available for withdrawal and requires the disclosure of funds availability schedules. 12 U.S.C. § 4001 *et seq*.; 12 C.F.R. part 229.<br><br>The Federal Reserve has the authority to promulgate regulations regarding the EFAA. 12 U.S.C. § 4008. | Same as national banks. 12 U.S.C. § 4001 *et seq*.; 12 C.F.R. part 229.<br><br>Same as national banks. 12 U.S.C. § 4008. | Same as national banks. 12 U.S.C. § 4001 *et seq*.; 12 C.F.R. part 229.<br><br>Same as national banks. 12 U.S.C. § 4008. |
| Privacy | National banks must disclose their privacy policies and practices, including their sharing of customer information with affiliated and non-affiliated entities. Before sharing consumers' non-public personal information with non-affiliated third parties, banks must provide consumers with an opportunity to "opt out." However, banks may share consumer information with service providers for such purposes as marketing the institution's products and services. 15 U.S.C. § 6802.<br><br>Each depository institution regulator bears the responsibility for implementing and enforcing these requirements. 15 U.S.C. §§ 6804 and 6805.<br><br>Joint regulations have been published by the banking regulators. 12 C.F.R. part 40 (OCC); 12 C.F.R. part 332 (FDIC); 12 C.F.R. part 216 (FRB). | Same as national banks. 15 U.S.C. § 6802; 12 C.F.R. part 573. | Substantially the same as national banks. 15 U.S.C. § 6802; 12 C.F.R. part 716. |

| Rule | OCC/FDIC/FRB | OTS | NCUA |
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| Real Estate Settlement Procedures Act | The Real Estate Settlement Procedures Act (RESPA) seeks to improve the disclosure of settlement costs to home buyers, eliminate kickbacks or referral fees that may unnecessarily increase the costs of certain settlement services, and reduce the amount of funds home buyers must place in escrow to cover real estate tax and insurance costs. 12 U.S.C. § 2601 *et seq*. | Same as national banks. 12 U.S.C. § 2601 *et seq*. | Same as national banks. 12 U.S.C. § 2601 *et seq*. |
| | The Department of Housing and Urban Development, in consultation with the Department of Veterans' Affairs, the FDIC, and the OTS promulgates regulations prescribing the form in which settlement costs must be disclosed. 12 U.S.C. § 2603(a); 24 C.F.R. § 3500.8. Federal depository institution regulators may enforce RESPA with respect to their regulated entities. 24 C.F.R. § 3500.19. | Same as national banks. 12 U.S.C. § 2603(a); 24 C.F.R. § 3500.8. | Same as national banks. 12 U.S.C. § 2603(a); 24 C.F.R. § 3500.8. |