GoWest CREDIT UNION ASSOCIATION

REGULATORY REPORT 1ST QUARTER, 2023

The GoWest Credit Union Association is pleased to provide our quarterly analysis of regulatory developments at the state and federal levels.

In this edition, we provide a 2022 regulatory recap, an economic outlook and how it relates to credit unions, and a preview of what we are anticipating on the regulatory front in 2023.

2022 RECAP

As we reflect on 2022 there are a lot of key wins to be proud of on the regulatory front as we continued to see a focus on regulatory modernization. These included updates to the Interest Rate Risk Supervisory Framework, raising the supervisory threshold for the Office of National Examination and Supervision (ONES) from $10 billion to $15 billion, National Credit Union Administration (NCUA) budget concessions, and successful negotiations on exams. Additionally, rules that could have been harmful to credit unions were removed from the unified agenda.

We also saw credit unions utilize past regulatory improvements to the benefit of credit union members. Sub-debt in the GoWest region grew nearly 10-fold with much of the subordinated debt secured with 30-year terms with interest rates at less than 2%. Thanks to Treasury's Emergency Capital Investment Program (ECIP), we saw strong business lending growth which a number of credit unions have attributed to added regulatory flexibility.

Even as the NCUA announced the end of pandemic-related regulatory relief, the agency also offered guidance that allows credit unions to continue to hold virtual annual meetings and count virtual attendees for purposes of the quorum. CECL also took effect on January 1 and thanks to our collective advocacy efforts the NCUA provided a tool to help credit unions calculate expected losses over the life of the loan. The Western Region office has been very clear that its team will be reasonable and flexible when considering the impacts of CECL on capital.

ECONOMIC OUTLOOK

On January 12 we received the inflation numbers for December which showed month-over-month deflation. In normal economic times, that would be very concerning. However, the market reaction and Fed watchers are touting this as good news as it could mean a more muted response from the Fed as it pertains to interest rate hikes. At the January Federal Reserve meeting we saw a 25 basis-point increase in the federal funds rate rather than a 50 basis-point hike. While inflation remained high in 2022, over the last six months of the year inflation was less than 1% which puts us on track to be in line with the Fed's stated goal of 2% by mid-year.

While inflation has been slowing over the last six months, the GDP remained elevated with the advanced estimate putting GDP growth in 2022 at 2.9% despite declining GDP reported in the first and second quarters. The GDP numbers provide support to the Federal Reserve Board's strategy of continuing monetary tightening and raising interest rates and the January jobs report added additional fuel to the monetary tightening argument. While Fed forecasters are predicting interest rates will peak mid-year, comments coming from the Fed have been more

hawkish. GoWest is anticipating the Fed to increase rates incrementally throughout 2023 by 100 to 150 basis points. More measured rate hikes in 2023 should mean that existing asset values should stabilize, while the cost of funds is expected to continue to rise.

The NCUA released its supervisory priorities in January. It is a great cheat sheet for knowing what to expect during exams for both federal and state charters. The NCUA lists the priorities in rank order, and it should come as no surprise that interest rate risk followed by liquidity are the two top priorities. In addition, the NCUA went from 11 exam priorities last year to six this year. The most notable thing removed from the list was capital adequacy which was near the top of the list last year.

Read more about the **NCUA Supervisory Priorities**

NCUA

The Fall 2022 Unified Agenda which sets regulatory priorities for the next six months was published in January which was unusually late. A couple of things came off the agenda including some items that we had expressed concern about as they had the potential to negatively impact credit unions. Lender compensation was removed from the Unified Agenda as were the restrictions on golden parachutes and indemnification payments, rules that could have impacted credit unions' ability to attract and retain talent in a tight labor market.

Climate change was added to the Unified Agenda, and we are anticipating a Request for Information to be proposed at the February NCUA Board meeting. On January 10, Fed Chairman Jerome Powell indicated that this is an issue that is outside the purview of a financial regulator, a position that GoWest shares. However, the Fed detailed a week later the climate scenario analysis pilot program which will be conducted with the nation's largest banks. GoWest will respond to the RFI and will recommend the Board limit any rulemaking to disclosures of probability of flood, fire, storm, drought, and other natural disasters that could impact collateral in a weather-related event.

While this issue will continue to be discussed, we are not anticipating that a final rule on climate change will be done this year and all indications point to the NCUA starting this process with a request for information (RFI).

Another rule we are anticipating that will benefit credit unions is the Simplification of Share Insurance Rules which will result in consistent SIF treatment of all mortgage servicing account balances held to meet principal and interest obligations to a lender as well as provide clarity around deposit insurance for trust accounts. This rule is expected to be substantially similar to the FDIC rules.

Real more about the: **Fall Unified Agenda**

Learn more on the **FDIC Fact Sheet**

GoWest continues to encourage the NCUA to propose:

- A **Fintech Rule** that, among other things, allows for equity investments beyond CUSOs.

- That NCUA reduces the Normal Operating Level (NOL) to 1.3% of insured shares. The NCUA currently is maintaining the NOL at 1.33%. Reducing the NOL would significantly increase the possibility of a credit union distribution from the Share Insurance Fund. While the NCUA has calculated that the equity ratio will be just below 1.3% as of year-end 2022, GoWest calculations have the equity ratio rising above 1.3% as of the end of 2022. Our calculations are based on slower deposit growth than the NCUA is projecting and higher yields on SIF investments. We expect the year-end 2022 equity ratio to be released at the March NCUA board meeting.

The association is also asking the NCUA to finalize a number of proposed rules which will positively impact the credit union system including the loan participation proposed rule and the FCU Bylaws Final Rule allowing for member expulsion.

We are advocating for these two rules along with a Fintech Rule to be finalized by the July NCUA Board meeting.

In addition, we support the NCUA congressional request to modernize the Central Liquidity Facility (CLF) and approve expanded borrowing authority and the ability of Corporates to subscribe on behalf of some members. GoWest is also advocating for the CLF to be turned into a true liquidity facility that can lend similarly to the Fed window.

Another statutory change we are working on with a member of our GoWest congressional delegation is a bill that will make it clear that annual meetings can continue to be hosted virtually. Thanks to advocacy from the GoWest region, we saw a letter in December that created a hybrid path to having a virtual annual meeting. Of note, it allows credit unions to count people not participating in person to be counted for purposes of a quorum.

The association is also working on a bylaw amendment that will expand member participation in Board of Directors elections. The amendment will allow FCUs to hold electronic board votes without also requiring a paper ballot option. When the amendment is approved, the association will provide details to any FCU interested in expanding member participation in board elections.

NCUA January 26 Board Meeting:
The National Credit Union Administration (NCUA) held its first meeting of the year on January 26, 2023, where there were two items on the Board's agenda. The issues included a review of the loan interest rate ceiling, which is required every 18 months, and approval of the 2023 annual performance plan which sets the agency's measurable goals for the year.

Loan Interest Rate Ceiling
By law, federally chartered credit unions (FCUs) have a 15% loan interest rate cap; however, the law also allows the NCUA Board to raise the interest rate ceiling for up to 18 months in consultation with Congress, Treasury, and other federal financial agencies. The law allows federal credit unions to charge an additional 10% for short-term unsecured loans known as payday alternative loans.

The cap was set at 18% in 1987. Since then, the NCUA Board has reviewed the 18% rate cap 24 times and, in each instance, has voted to maintain the cap. While the board unanimously voted to maintain the 18% interest rate ceiling at their meeting on the 26th, there was a lively discussion about the merits of increasing it.

The GoWest Advocacy Team has previously asked for and continues to advocate for the NCUA to consider raising the interest rate threshold from the current 18% to 21%, which is where it was

held between 1980 and mid-year 1987. We support increasing the interest rate cap considering the rapidly rising interest rate environment which is expected to continue. The intensity of the interest rate environment has pushed up the cost of borrowing and has put significant pressure on the bottom line of our member credit unions. We have also utilized loan data, market analytics, and other statistics in making the recommendation.

Over the past decade, the NCUA has worked to improve the payday alternative lending rules so that more FCUs would offer these loans as an alternative. However, even with those changes, less than one in five FCUs offers a Payday Alternative Loan (PAL) program and total outstanding balances are less than $100 million. Many FCUs have indicated that the challenge with payday alternative loans is not the rules that govern them, but rather, the interest rate ceiling which makes it very challenging to operate a PAL program that is not in the red.

In addition, due to rapidly rising rates over the last year and a half, outstanding loan balances for loans over 15% have doubled from $12 Billion to $24 Billion. The rising cost of funds directly dictates loan pricing and is creating a competitive disadvantage for FCUs to compete for fewer loans.

Learn more with **Supplemental Information and Interest Rate Statistics**

2023 Annual Performance Plan
The NCUA staff presented the Annual Performance Plan, which set out 45 measurable metrics and milestones to achieve the NCUA's strategic goals.

Measurable metrics that stood out included:

- Improve examination quality by incorporating relevant feedback from internal and external stakeholders;
- Improve compliance with consumer protection laws and regulations through effective guidance to the credit union system as well as conducting targeted compliance reviews and fair lending examinations; and
- Identify and work with impacted credit unions and state regulators to understand and mitigate asset concentration and other risks.

CFPB
There were also some new items added to the Consumer Financial Protection Bureau (CFPB) agenda that are important to credit unions and that we intend to weigh in on.

Final Rule Small Business Lending Data Collection

The CFPB indicated that we should expect a final rule on collecting small business lending data. This rule has been "lovingly" referred to as HMDA for business. This is a statutorily required rule that was part of the Dodd-Frank Act. In fact, the Bureau was sued by a consumer rights group out of California and for the last two years has had to update the judge on where rulemaking stood.

This rule is going to be impactful and will come with a significant compliance and implementation lift. GoWest had a representative on the SBREFA panel for this rule and our advocacy focused on staggered implementation allowing smaller institutions greater time to comply. In addition, we asked that the Bureau limit rulemaking to the statutorily required data points.

The association's compliance team and our legal partners at Farleigh Wada Witt will work to ensure that we have a detailed compliance guide and legal briefing to break down the steps for implementation. If the Bureau finalizes a rule that does not give credit unions at least 12 months to comply, we are prepared to advocate for a longer implementation period. Part of our GoWest regulatory advocacy promise is to leverage our compliance and legal resources, to make implementation as seamless as possible for GoWest member credit unions.

Automated Valuation Model

The Automated Valuation Model rule continues to be on the rulemaking agenda. As a reminder we had GoWest member credit union leaders on the SBREFA panel for this rule and we are anticipating that we will see a proposed rule this year. The rule is expected to focus on eliminating implicit bias in the use of artificial intelligence. Last year the GoWest Regulatory Advisory Committee brought in our AI business partner, ZEST AI, to talk directly with credit unions and state regulators on steps that they have taken to eliminate implicit bias from their AI model including working directly with and being examined by the CFPB. One key point that Zest AI made is that its model is constantly updated to account for new factors but the model itself is static, meaning it does not make predictive lending decisions.

While the CFPB continues to work on proposing an AVM rule, it has also indicated that it will not hesitate to take enforcement action against lenders that utilize machine learning resulting in disparate impact. Credit unions are not likely to be the target of enforcement actions as we've seen only one enforcement action ever against a credit union by the CFPB.

Additional Items on the CFPB Rulemaking Docket:

We saw four pre-rules added to the CFPB's fall agenda and are anticipating that the pre-rules will be issued as Advanced Notices of Proposed Rulemaking or requests for information.

Specifically, we may see some changes to the Fair Credit Reporting Act which controls Reg V and data-furnishing responsibilities. When the Fair Credit Reporting Act was passed the rules were written primarily for furnishing information to credit bureaus. The Bureau is working on modernizing Reg V as part of a suite of open banking rules.

Another part of the open banking rules is the Required Rulemaking on Personal Financial Data Rights. The CFPB changed the nomenclature of this rule. Previously it was referred to as Consumer Access to Financial Records. It is the same rule with a different name that implements section 1033 of the Dodd-Frank Act.

Jim Morell, President and CEO of Shelton, Washington-based Peninsula Credit Union, was invited to participate in a Small Business Regulatory Enforcement Act (SBREFA) Panel for this rule. GoWest and CUNA are working with Jim to provide stakeholder input on ways that the Bureau might effectively and efficiently implement this rule.

As a reminder, the SBREFA process provides a great opportunity to influence a rule prior to it being issued — front-end advocacy. If you have questions or want to share input, you can reach out to **Jim** or to **me** directly.

Overdraft Fees and NSF Fees were also on the CFPB rulemaking agenda. We believe that the Bureau is considering whether an overdraft fee is a finance charge and subject to Reg Z when a deposit account is set up solely to pay a loan. The Bureau is also considering rulemaking that would prohibit NSF fees specifically on transactions that were declined electronically at the point of sale. We do not expect returned checks to be subject to this rule.

At this point, we are not anticipating that the CFPB will promulgate rules requiring financial institutions to specifically report the percentage of the revenue generated by overdraft and NSF fees or requiring that this information be published by the regulator as California recently did.

The CFPB added a Credit Card Penalty Fees rule to the unified agenda and released a proposed rule on February 1 that would among other things reduce the amount financial institutions could charge for credit card late payments to $8. The association is analyzing the rule and is asking credit unions to share what the impact would be to their fee income should this rule go into effect as proposed.

Initial concerns with the proposal include:

- Late payments require time and resources to collect and fees charged by credit unions are typically commensurate to the cost of collecting.
- Credit unions have smaller-scale credit card programs and fees at smaller institutions may be higher as there is not the same efficiency of scale.
- Operational impact - new forms, updated disclosures, etc are a significant cost and require time for implementation.

CDFI

GoWest and member credit unions have left no stone unturned as we advocate for our CDFI institutions. We have leveraged the power of our six-state region utilizing our regulatory advocacy function, federal advocacy, GoWest Foundation, and our member credit unions to bring awareness to a myriad of issues stemming from changes to the CDFI certification application, and target market methodology that has left credit unions questioning whether to maintain their CDFI designation and in some instances delaying millions of dollars in ECIP dollars from being distributed. We can report that following our initial advocacy efforts, all credit unions that had pending ECIP awards have received their funds and are no longer in CURE status, and on January 24, the CDFI announced a pause in its CDFI Certification Application to consider input on the proposed revisions.

However, there are still challenges. With the opening of a second round of ECIP, a number of CDFI credit unions still in cure status may not be able to apply. We continue to have concerns about the lack of transparency and engagement by the CDFI fund as they have updated the application for certification, and we are working to ensure that any credit union applying for second-round ECIP funds have their cure status prioritized.

Our federal advocacy team has engaged several members of the GoWest congressional delegation on this important effort. Our work with Senator Mike Crapo (R-ID) led to a letter from

him and Senator Mark Warner (R-VA), as co-chairs of the Senate CDFI Caucus, to Treasury Secretary Janet Yellen reinforcing and supporting our call for collaboration and involvement with the substantive changes to the CDFI certification application.

STATE ADVOCACY

Assessments – Over the past decade credit unions have seen their assets nearly triple and, in most cases, state-chartered assessments are tied directly to an asset-based formula. Many of these formulas have not been substantively evaluated and as a result, credit unions often pay significantly more than state-chartered banks.

Our approach has been to review the assessments across all GoWest states and ensure that funding is sufficient to maintain a healthy credit union regulatory environment with adequate reserves. We have a two-pronged approach which includes ensuring assessment waivers are granted when appropriate, and modernizing the assessment schedules so that credit unions can plan accordingly going forward.

In 2022, we initiated the rulemaking process to reduce state-chartered assessments in Oregon by nearly a third. The final rule was adopted February 1 and is effective immediately.

This year, we will continue to push for additional assessment review, and possibly relief across our six-state footprint. In Washington, the DFI has continued to grant assessment waivers, and in Idaho, the DOF has committed to working on a more equitable assessment model that would reduce the significantly higher assessments that state-chartered credit unions pay in comparison to Idaho state-chartered banks.

Also in Idaho, we are expecting long-awaited bylaws revisions to be adopted in the first quarter.

In Colorado, we had a productive meeting with the state analyst who is running the Sunset review process as well as with the state regulatory agency outlining our charter modernization priorities.

In Arizona, we have some follow-up to do regarding who will replace the outgoing leader of the state regulatory agency.

In Washington, we continue to seek a path forward on our state MBL rule.

And in Wyoming, we held a productive introductory meeting with the state regulatory agency to introduce the GoWest regulatory team and process.

Other Developments of Interest

Read the GoWest regulatory promise **here.**

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