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 an economic review of the second quarter and a third-quarter economic outlook.

As always, we provide an NCUA update covering the latest agency developments and opportunities. This quarter also includes an update on GoWest credit unions' advocacy efforts with the Consumer Financial Protection Bureau, and regulatory advocacy efforts with the Federal Home Loan Bank, FedNow, the Central Liquidity Facility, and the Community Development Financial Institutions program.

Second Quarter Update and Third Quarter Economic Outlook

As the second quarter ends and we begin the third quarter, the economic outlook materialized much as anticipated, with a few bumps along the way including the failure of First Republic Bank, and a debt ceiling showdown that pushed the government to the brink of default. As expected, the Fed hiked interest rates in the second quarter, the cost of funds continued to rise, liquidity remained tight, pre-payments slowed, and loan demand weakened, compared to the historical demand in the second quarter. In addition, borrowings from the Fed, FHLB, and other liquidity sources remained high.

Looking ahead, the Association anticipates a slower, more measured approach from the Fed. The debt deal is expected to help ease inflationary concerns as it included significant recissions in funding and capped spending. We continue to anticipate an additional 25-50 basis points in rate hikes this year, likely skipping a July hike and making a single 25 - 50 basis point hike in September should inflation and employment data remain elevated. Following a September rate hike, we expect the Fed to hold them steady throughout 2024. Based on current conditions, we see a relatively low downrate risk over the 18-month horizon. One economic risk factor that could change our forecast would be if rising delinquencies in office space turn into foreclosures and losses that reverberate through the economy. In addition, large banks are expecting to see BASEL capital requirements proposed which, if they take effect, would result in higher capital requirements for large banks.

Credit unions remain relatively strong as we head into the third quarter. Auto loan portfolios continue to perform well and turn over quickly, creating liquidity that is reinvested in higher-yielding assets. Interest Rate Risk looks manageable as credit unions have repositioned balance sheets increasing shorter maturity assets. However, managing liquidity, rising cost of funds, higher losses, and growing operational expenses will strain balance sheets and that is expected to put loss-absorbing capital to the test in some instances.

Some things that credit unions might consider doing include:

- Cashing out low-yielding CDs which typically have small penalties that can be made up quickly when reinvested in loans or short-term investments.

- Prudently borrowing long to fund short-term assets. For example, utilizing the bank term funding program for a one-year duration and investing in overnights. Just make sure to stress-test balance sheets for downrate risk.

NCUA

Board Member Rodney Hood's term ends in August, which gives the Biden Administration the opportunity to appoint a Board member that is more closely aligned with its priorities. Past administrations have typically allowed Board members to hold over until the confirmation of their successor.

Liquidity, Operational Expenses, and Commercial Loan Portfolios

As we head into the second half of the year, liquidity, operational expenses, and commercial loan portfolios will be priorities for NCUA examiners.

On June 29, The NCUA, along with the OCC, FRS and FDIC, issued a joint policy statement outlining prudent commercial real estate loan accommodations and workouts. Credit unions have relatively little exposure to commercial loans and even less exposure to commercial office space compared to regulated banking entities. However, expect examiners to spend additional time reviewing commercial loan portfolios and exposure to CMBS investments.

Examiners have also been spending additional time looking at operational expenses, in institutions that saw significant increases in operational expenses relative to PEER. Liquidity, cost of funds, and net interest margin will be looked at closely. Expect examiners to ask about lines of credit and whether you have tested your lines. Finally, expect regulatory agencies to spend additional time discussing the ability of capital to absorb losses while staying well capitalized.

Central Liquidity Facility - The GoWest Regulatory Advisory Committee met in the second quarter hosting Anthony Capetta, President of the NCUA's Central Liquidity Facility, and Tim Dodds, Vice President of the CLF, for an informative discussion on accessing the facility. Capetta provided an overview of the CLF covering when and how to borrow, types of collateral that can be pledged, loan types, and terms. Cappetta also sought input on what changes could be adopted to make the CLF work better for credit union members.

Link to: CLF Discussion
Link to: CLF PowerPoint

NCUA Second Quarter Board Meetings:

NCUA held three board meetings in the second quarter. This included a much-anticipated RFI on climate change at the April meeting. The RFI asks 38 questions related to physical risk, transition risk, operations, governance, business strategies, risk management, reporting and targets, climate-related opportunities, suggestions for the NCUA, and data gathering.

The Association had a positive conversation with Chairman Todd Harper on the topic of climate change. In the discussion, we suggested how future regulatory actions such as rulemaking should focus on positive regulatory changes. This would include extending loan maturity dates out on certain asset classes like solar panels, which would help make solar installations more affordable. Credit union leaders also expressed concerns about future policies limiting whom credit unions could lend to and have encouraged the Board to stay away from actions that could limit the ability to serve members.

April NCUA Board Meeting analysis:

At the May meeting the NCUA Board issued a proposed rule that if adopted would expand the ability of Charitable Donation Accounts to make distributions to veterans' organizations under 501(c)(19). Examples of organizations include the Marines Memorial Association, National Guard Association of the United States, Military Officers Association of America, and others. The current rule limits donations to 501(c)(3) organizations.

The NCUA Board also received a Share Insurance Fund Board Briefing in May.
The Association is not anticipating the NCUA Board will consider a special assessment in 2023. Signs point to continued deposit runoff and increased yield from investments which would result in a natural increase in the equity ratio and makes the possibility of a Share Insurance Fund distribution more likely.

May NCUA Board Meeting analysis

GoWest credit union leaders attended the June NCUA Board Meeting and were recognized by the Chair at the beginning of the meeting. At the meeting, the Board issued a notice and a request for comment on the Operating Fee Schedule Methodology. Specifically, the Board proposed to increase the threshold below which federal credit unions are exempt from paying an operating fee from $1 million to $2 million and establish a process to update the exemption threshold in future years based on the credit union system's annual asset growth. This would be a significant benefit for small credit unions.

Following the June meeting, GoWest member credit union leaders met with NCUA General Counsel Frank Kressman, followed by NCUA Executive Director Larry Fazio, and wrapped up our NCUA visit with a candid discussion with Chairman Harper on a number of priorities.

NCUA HTH talking points

CONSUMER FINANCIAL PROTECTION BUREAU

The Bureau's current focus is on non-depository institutions. However, we remain vigilant in our advocacy work as changes made can have ripple effects. There was movement on a few items on the CFPB agenda this quarter. In addition, there were multiple hearings and a successful Hike the Hill.

On June 21st GoWest Hike the Hill attendees met with CFPB Director Rohit Chopra to discuss many topics of importance to credit unions. GoWest members led the way with challenging questions, including sections 1033 and 1071 of the Dodd Frank Act, and we furthered our relationship with the CFPB. The goal with the Bureau is to have a collaborative relationship where we can provide direct feedback on the impact of rules and regulations on credit unions and influence the decisions at the source.

Additionally, GoWest is working with four candidates from our region to apply for the Credit Union Advisory Committee for the CFPB.

As a result of input received from credit unions across the region, GoWest has submitted a variety of comments on relevant issues including the Credit Card Penalty Fees rule that the CFPB added to the unified agenda, and the new ECIP quarterly reporting. In our communications and opportunities for advocacy with the CFPB, there are some widespread themes that GoWest is supporting:

- The CFPB must make it clear that rules will be to reign in repeat offenders and not the institutions that are relationally focused and whose mission it is to serve marginalized and underserved communities. This is most important in the rules about "junk fees" and the public dialogue that harms credit unions' reputations.
- Any changes to rules should be driven by research, data, and testing, which will take more time than the agencies have allowed for stakeholder comment. CFPB should adhere to the established process of the SBREFA to understand and appreciate the impacts of a proposed rule.
- That, where possible, the rules should be applied on a scaled basis for larger and smaller financial institutions.

The Semi-Annual Report to Congress of the Consumer Financial Protection Bureau

As expected, the congressional hearing discussion ranged from thanking the CFPB for its commitment to the consumers of America, to questioning its overreach and handling of its own data breach. The CFPB was lauded for its defense of older Americans with Director Chopra stating, "Fraud against older Americans in general has been a pernicious problem." Additionally, Director Chopra was asked to comment on the Bureau's involvement in the SVB bank failure, merger, and insurance action. The Financial Stability Oversight Council and its role in the SVB bank failures was also noted, along with the need for analytical rigor and due process.

GoWest will remain apprised of all changes that are instigated from this hearing, especially in regard to how the CFPB will be reformed and the impacts this might have on credit unions.

Rule movement and announcements:

The CFPB published a Notice of Proposed Rulemaking and request for comment on Quality Control Standards for Automated Valuation Models. With the finding that both in-person and algorithmic appraisals can be subject to bias and inaccuracy, the CFPB, in collaboration with federal partners (including the Board of Governors of the Federal Reserve System, the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Association (NCUA), and the Federal Housing Finance Agency (FHFA)), have developed safeguards.

On June 21, 2023, the OCC, Board, FDIC, NCUA, CFPB, and FHFA (collectively, the agencies) invited comment on this proposed rule. Comments are due on August 21st. GoWest will share our comments with the Regulatory Advocacy Subcommittee before submitting them – if you're interested in participating in this process, please reach out. You are welcome to sign on to our letter or to write one of your own.

To provide some historical context, attention to this issue has been steady and the recommendations come from an Interagency Task Force on Property Appraisal and Valuation

Equity (PAVE) created by the Department of Housing and Urban Development in 2021. Thirteen federal agencies developed a set of recommendations to avoid appraisal bias that informs the AVM rule.
Those recommendations include:

- Expanded use of alternatives to traditional appraisals as a means of reducing the prevalence and impact of appraisal bias.
- Use of value estimate ranges instead of exact amount as a means of reducing the impact of racial or ethnic bias in appraisals.
- The potential use of alternatives and modifications to the sales comparison approach that may yield more accurate and equitable home valuation.
- Public sharing of aggregated historical appraisal data to foster development of unbiased valuation methods.

Additional automation and the use of AI
On June 7th the CFPB posted a blog on ChatBots that outlined legal obligations, including obligations regarding responding to disputes or questions from customers. To comply, financial institutions need to be able to competently interact with customers about the products or services they provide, and concerns here fall under Unfair, Deceptive, or Abusive Act or Practice (UDAAP).

Additional Updates from Spring Hike the Hill

During our conversation on June 22nd with the CFPB Director, GoWest credit unions expressed concern with the Bureau's flawed estimates about how many credit unions would be impacted by the proposed business lending data collection rule. Director Chopra shared that they will be monitoring the data closely to see how many CUs are in fact impacted and invited us to continue a dialogue as the rule rolls out over the next few years.
We also discussed Section 1033 of the Dodd Frank Act: Required Rulemaking on Personal Financial Data Rights. The CFPB is accelerating the shift to open banking through the personal data rights rule. Jim Morell, President and CEO of Shelton, Washington-based Peninsula Credit Union, participated in a Small Business Regulatory Enforcement Act (SBREFA) Panel for this rule. Of particular concern for credit unions is the lack of a federal data privacy law. The CFPB will be soliciting comments in the near future and the goal is to finalize this rule in 2024.

Earlier in the year, the CFPB added the Credit Card Penalty Fees rule to the unified agenda and released a proposed rule. At our June Hike the Hill, we heard from Director Chopra that the $8 safe harbor amount financial institutions could charge for credit card late payments is only the safe harbor and any fee above $8 can still be used. However, credit unions should be able to justify the cost and be prepared to provide documentation explaining the higher late payment.

The Director also addressed overdraft fees and indicated that their focus would be moving away from them.

Other Agencies

Treasury and CDFI Updates

During Hike the Hill, we met with Treasury representatives Noel Poyo, Deputy Assistant Secretary for Community and Economic Development and Jason Boehlert, Program Manager for Legislative and External Affairs for the CDFI Fund and discussed the CDFI application and Emergency Capital Investment Program (ECIP).

The second round of ECIP funds that were rescinded due to the debt legislation will likely not be reinstated. However, GoWest is committed to continue advocating for a permanent capital investment source for the CDFI program.

The Chair of the Community Development Advisory Board recently established a CDFI certification subcommittee to provide current members of the Advisory Board an opportunity to remark on these efforts. There will be a virtual public meeting of the CDFI Fund's Advisory Board, during which the subcommittee will present recommendations. The function of the Advisory Board is to advise the Director of the CDFI Fund on the policies regarding the activities of the CDFI Fund. We hope to see our suggested changes incorporated into this round of CDFI certification recommendations and changes.

Federal Reserve System

On June 29, the Federal Reserve announced that 41 financial institutions including seven corporate credit unions and six natural person credit unions had completed formal testing and certification on the FedNow Service in advance of its launch in late July.

These organizations will be live when the FedNow Service launches or shortly after, with financial institutions ready to send and receive transactions and service providers ready to support transaction activity. This group of early adopters, which includes PIMA FCU in Tucson AZ, is now performing final trial runs on the service to confirm their readiness to support live transactions over the new instant payments infrastructure. In addition, 15 service providers were certified to process on behalf of participants, and the U.S. Department of the Treasury.

The Federal Reserve continues to work with, and onboard financial institutions and service providers interested in access to the instant payment rails.

FHLB at 100 Review

The Association weighed in with the FHLB regarding the future of the Federal Housing Finance Agency, specifically requesting that the FHFA:

1. Expand Access to the FHLB to include all insured depositories regardless of lending mix;
2. Not require tracking of advance proceeds, mission tests, or collateral tests;
3. Improve the administration of the Affordable Housing Program; and
4. Enhance the FHL Bank System as a means of supporting housing and community investment.

In addition, during our Hike the Hill a small group of credit union advocates met directly with FHFA personnel responsible for outlining potential changes to the FHLB system and delivered our advocacy message directly.

FHLB letter

Additional Items:

LIBOR expired on June 30, 2023, as part of a transition that has been planned for several years.

Adjustable-rate loans based on LIBOR must change to a replacement index. In March, the ARRC (Alternative Reference Rates Committee) made recommendations of replacement indexes for use in consumer products that reference LIBOR. Most institutions will have transitioned to SOFR for their adjustable-rate mortgages, home equity lines of credit, reverse mortgages including Home Equity Conversion Mortgages, private student loans, and credit cards with interest rates that are currently based on LIBOR.

The CFPB joined an interagency statement back in 2021 on managing the LIBOR transition.

State Issues Work Groups

State Issues Work Groups are our working groups that take a deep dive into our state and federal laws and regulations every two years. The work groups are typically made up of credit union executives and professionals from as many verticals as possible, from different asset sizes, geographies, and charter type.

We ask participants to answer one simple question: What would the credit union do differently if you lived in a perfect world with no regulatory or statutory limitations? Often the reason that a credit union is doing something that they would not otherwise be doing is because of an outdated law or regulation.

Idaho, Wyoming, and Arizona have all convened State Issues Work Groups and are at various stages of developing their advocacy recommendations. Colorado is in the process of negotiating with the state to include recommendations in the Sunset process. Oregon just completed a legislative session where they not only updated the Credit Union Act, but also passed legislation that will require life skills and financial education into high school curriculum. Washington also wrapped up a successful legislative session.

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