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March 2017

PRIVATE DEPOSIT INSURANCE

Credit Unions Largely Complied with Disclosure Rules, but Rules Should Be Clarified

GAO-17-259

GAO Highlights

Highlights of GAO-17-259, a report to congressional committees

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Why GAO Did This Study

The Federal Deposit Insurance Act requires privately insured credit unions to disclose to consumers that they do not have federal deposit insurance and CFPB has implemented regulations on these requirements. The Fixing America's Surface Transportation Act includes a provision for GAO to review private deposit insurers and privately insured credit unions' compliance with disclosures. This report (1) discusses regulatory and other assessments of ASI, the sole private insurer, and (2) examines the level of compliance with disclosure requirements for privately insured credit unions. GAO reviewed documentation from and interviewed federal and state regulators, ASI management, and ASI's third-party actuarial firm. GAO reviewed certain key methods and assumptions used by the actuarial firm. GAO also analyzed regulatory ratings (2006–2015) and selected financial data (2011–2015) on privately and federally insured credit unions. In addition, GAO reviewed 102 websites for all privately insured credit unions that had websites, conducted unannounced site visits at 47 credit unions (selected based largely on asset size and geography), and reviewed printed materials from 36 of the credit unions it visited that had materials readily available.

What GAO Recommends

GAO recommends that CFPB issue guidance for privately insured credit unions to clarify whether drive-through windows require disclosure, describe what constitutes clear and conspicuous disclosure, including minimum signage dimensions and font size, and explain and provide examples of which communications are advertising. CFPB agreed with these recommendations.

View GAO-17-259. For more information, contact Alicia Puente Cackley at (202) 512-8678 or cackleya@gao.gov.

What GAO Found

About 2 percent of credit unions (125) have private deposit insurance, which is provided by one company—American Share Insurance (ASI). Regulatory and other assessments have suggested that ASI's reserves have been adequate and that the company has had a strong ability to cover present and future losses for the credit unions it insures. The most recent examination of ASI by its primary regulator (Ohio Department of Insurance) determined that ASI's reserves for losses were adequate and appropriate and consistent with legal requirements. An independent actuarial firm hired by ASI reported that it had a strong ability to cover losses under different economic scenarios. The Ohio regulator and the actuarial firm both noted risk factors that could affect ASI's financial condition, including changes in macroeconomic conditions or major losses by the largest credit unions it insures. In the event of financial difficulties, Ohio law allows ASI to tap into additional sources of funding, including lines of credit and special assessments from its insured credit unions.

Privately insured credit unions largely complied with the Bureau of Consumer Financial Protection (CFPB) requirements to disclose that they do not have federal deposit insurance. For instance, 45 of 47 credit unions GAO visited displayed required disclosures at teller windows (see fig.), and 99 of 102 websites GAO reviewed included the disclosure on their main Internet page, as required. However, 7 of 17 credit unions with drive-through windows that GAO visited did not have disclosure signs at these windows. Additionally, printed materials (such as brochures and flyers) GAO reviewed from 8 of 36 credit unions did not include disclosures. The regulations require all advertising to include a disclosure, but do not define what constitutes advertising. In some cases, disclosure signs or text size were too small to be easily read, or were not placed conspicuously. CFPB's regulations on disclosures for privately insured credit unions do not specify signage dimensions or font size. Without clear disclosure requirements, state credit union supervisors and credit unions may not be consistent in how they interpret disclosure requirements and some consumers may not be informed that their deposits are not federally insured.

Figure: Example of Disclosure at a Privately Insured Credit Union

Source: GAO. | GAO-17-259

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Abbreviations

ASI	American Share Insurance
CDFI	community development financial institution
CFPB	Bureau of Consumer Financial Protection
FAST Act	Fixing America's Surface Transportation Act
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
FTC	Federal Trade Commission
IRIS	Insurance Regulatory Information System
NAIC	National Association of Insurance Commissioners
NASCUS	National Association of State Credit Union Supervisors
NCUA	National Credit Union Administration

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March 29, 2017

The Honorable Michael Crapo
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Jeb Hensarling
Chairman
The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

Deposit insurance enhances the stability of financial institutions and helps protect depositors in the event of bank or credit union failures.[1] The vast majority of U.S. credit unions have federal deposit insurance, which is provided by the National Credit Union Administration (NCUA) and backed by the full faith and credit of the U.S. government. However, in certain states, some credit unions also have the option of choosing a private insurer.[2] In 2015, a private company, American Mutual Share Insurance Corporation, or American Share Insurance (ASI), provided deposit insurance for 125 credit unions (about 2 percent of all credit unions).[3] By law, any credit union that does not have federal deposit insurance must clearly and conspicuously inform consumers—through signage on

[1]Deposit insurance for credit unions is sometimes referred to as share insurance. For this report, we use the term deposit insurance.

[2]By law, federally chartered credit unions must have deposit insurance provided by NCUA. In most states, state law requires state-chartered credit unions to also have federal deposit insurance, according to the National Association of State Credit Union Supervisors (NASCUS). NASCUS also told us that in some states, state law permits credit unions to have private deposit insurance, although in some of these states no credit unions have chosen to do so. There are nine states where private deposit insurance is permitted and at least some credit unions have chosen to use it: Alabama, California, Maryland, Idaho, Illinois, Indiana, Ohio, Nevada, and Texas. For nearly all banks, primary deposit insurance is provided by the Federal Deposit Insurance Corporation.

[3]The company's legal name is American Mutual Share Insurance Corporation, but it does business as American Share Insurance or ASI.

premises, on its websites, and in its advertising—that the institution is not federally insured.[4]

The Fixing America's Surface Transportation Act (FAST Act) includes a provision for GAO to review private deposit insurers and privately insured credit unions' compliance with certain disclosures.[5] This report (1) discusses regulatory and other assessments of ASI, which is the sole private deposit insurer, and (2) examines the level of compliance with disclosure requirements for privately insured credit unions. For the purposes of this report, the regulatory and other assessments of ASI include information on loss reserves, capital adequacy, and the credit unions ASI insures. This report does not compare ASI's reserves and capital adequacy to those of NCUA's National Credit Union Share Insurance Fund.

To gather information about ASI, we reviewed documentation, such as examination reports and state legal requirements, and interviewed its primary regulators (Ohio Departments of Insurance and Commerce), as well as state regulators in the other eight states in which ASI operates. Additionally, we reviewed ASI's annual reports, underwriting policies, and documentation about the credit unions the company insures, and we interviewed ASI management. We reviewed reports from the third-party actuarial firm that ASI retains, and interviewed the actuarial firm's staff.[6] We did not conduct our own independent assessment of ASI's capital adequacy. However, our internal actuarial staff reviewed the third-party actuarial firm's modeling approach and certain key methods and assumptions for the firm's assessment of ASI's capital adequacy (which incorporates loss reserves as part of a broad definition of capital). Additionally, we reviewed the regulatory ratings, commonly known as CAMEL ratings, for privately and federally insured credit unions, and used financial data from SNL Financial to analyze selected financial indicators

[4]Section 43(b) of the Federal Deposit Insurance Act requires disclosure by depository institutions lacking federal deposit insurance. The section is codified at 12 U.S.C. § 1831t(b).

[5]Pub. L. No. 114-94, § 82002, 129 Stat. 1312, 1796 (2015). Some credit unions in Puerto Rico are insured by a quasi-governmental entity—the Public Corporation for the Supervision and Insurance of Cooperatives—and these credit unions are not included in the scope of this report.

[6]ASI retains a third-party firm to prepare an independent actuarial analysis of the adequacy of its capital, including loss reserves, and to provide an annual actuarial opinion. We refer to this firm as the actuarial firm throughout this report.

for privately and federally insured credit unions.[7] We assessed the reliability of the CAMEL ratings and SNL Financial data by requesting information about the underlying data and how they are collected, and by conducting data reliability testing. We found the data to be sufficiently reliable for the purposes of our review.

To determine compliance with disclosure requirements, we reviewed the Federal Deposit Insurance Act provisions regarding disclosure requirements, as well as the corresponding regulations (known as Regulation I). We conducted 47 unannounced site visits at a nonprobability sample of credit unions (41 visits to unique credit unions and 6 visits to an additional branch of some of the 41 credit unions), selected to achieve variation in asset size, geographic location, main retail or branch locations, and urban and nonurban locations. We reviewed the websites of all 102 privately insured credit unions that had them, and obtained and reviewed examples of printed materials from 36 credit unions we visited that had them readily available. We also interviewed representatives from the Bureau of Consumer Financial Protection (CFPB) and state credit union supervisory authorities about credit union compliance with disclosure requirements. For comparison purposes, we reviewed NCUA's disclosure requirements for federally insured credit unions. Finally, we reviewed our previous work in this area.[8]

We conducted this performance audit from February 2016 to March 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Appendix I contains additional information on our objectives, scope, and methodology.

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[7]CAMEL ratings consist of an assessment of a credit union's capital adequacy, asset quality, management, earnings, and liquidity. The CAMEL rating system is designed to take into account and reflect all significant financial, operational, and management factors that regulators assess in their evaluation of a credit union's performance and risk profile. SNL Financial is a private service that aggregates and disseminates comprehensive regulatory financial data on financial institutions, among other information. Data for year-end 2015 were the most recently available when we conducted our review.

[8]GAO, *Federal Deposit Insurance Act: FTC Best among Candidates to Enforce Consumer Protection Provisions*, GAO-03-971 (Washington, D.C.: Aug. 20, 2003).

Background

Credit unions can be federally or state-chartered, which determines their primary regulator for safety and soundness and also their options for deposit insurance. Federally chartered credit unions are regulated by NCUA and must be federally insured by the National Credit Union Share Insurance Fund, which is administered by NCUA and provides up to $250,000 of insurance per depositor for each account ownership type.[9] State-chartered credit unions are usually regulated by credit union supervisors in their respective state. These credit unions can be federally insured (and thus also supervised) by NCUA or, in some states, can choose to be privately insured.[10] As of February 2017, ASI was the only company providing private primary deposit insurance.[11] ASI provides up to $250,000 of insurance per account (rather than per depositor for each ownership type, as with NCUA).[12] Deposit insurance covers deposit products such as checking and savings accounts, money market deposit accounts, and certificates of deposit. It does not cover other financial products, such as investments in stocks, bonds, or mutual funds.

[9]In addition to NCUA's coverage for individual accounts, options are available for additional deposit insurance coverage, such as retirement or joint accounts.

[10]State law determines whether a state-chartered credit union can provide members with private deposit insurance in lieu of federal deposit insurance. A state-chartered credit union that is federally insured is supervised by both the chartering state and NCUA. According to representatives from the Idaho state credit union supervisor, credit unions in their state, in the past, could choose not to provide deposit insurance to members and one credit union does not offer deposit insurance. We excluded this credit union from our scope because this report focuses on credit unions with private deposit insurance.

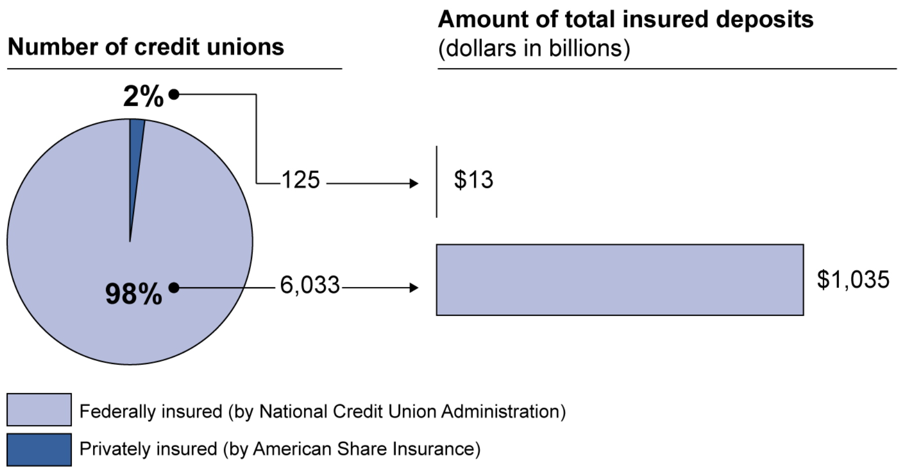
[11]Other nonfederal (private and state-based) deposit insurance systems had been in place in prior years, but no longer exist. For additional information on these other deposit insurance systems, see Stephanie O. Crofton, Luis G. Dopico, and James A. Wilcox, "American Share Insurance: The Sole Surviving Private Deposit Insurer in the United States," *Essays in Economic & Business History, vol. 28 (2010).*

[12]While this report focuses on primary deposit insurance coverage—up to $250,000—both federally and privately insured credit unions can choose to offer additional coverage to members, through what is known as excess deposit insurance. Excess deposit insurance is solely provided by the private market. ASI wholly owns a subsidiary known as Excess Share Insurance Corporation that offers excess deposit insurance to credit unions. We took into account this wholly owned subsidiary in our discussion of ASI's financial condition.

Overview of Credit Union and Deposit Insurance Markets

The vast majority of credit unions are federally insured. As seen in figure 1, in 2015, there were more than 6,000 federally insured credit unions with more than $1 trillion in insured deposits, and 125 privately insured credit unions with $13 billion in insured deposits.

Figure 1: Number and Percentage of Federally and Privately Insured Credit Unions and Total Insured Deposits, 2015



Source: GAO analysis of SNL Financial data. | GAO-17-259

The mix of asset sizes is largely similar for federally and privately insured credit unions, and the majority of both have assets of less than $100 million. Between 2011 and 2015, the number of federally and privately insured credit unions declined by about 15 percent, due largely to mergers and liquidations. Some credit unions chose to convert between private and federal deposit insurance and appendix II contains information about the reasons that some credit unions switch insurers.

American Share Insurance

ASI is a private, not-for-profit company, headquartered in Ohio. The company is governed by Ohio law and licensed by the Ohio Department of Insurance, and its primary regulators are the Ohio Departments of Insurance and Commerce, although regulators in the other eight states in which ASI operates also have an oversight role.[13] ASI has provided deposit insurance since 1974 and the company is owned by the credit unions for which it provides deposit insurance. The company does not normally charge premiums, which are common in the insurance industry, but instead requires its credit unions to maintain a capital contribution with the company, adjusted annually, equal to a rate of 1.3 percent of the credit union's total insured deposits. In addition, ASI has the authority to charge special premium assessments under certain conditions with regulator approval, as it did in 2009–2013.[14]

ASI is overseen by a board of directors that is made up of six chief executives from the credit unions it insures, as well as one ASI management representative. Quarterly, according to ASI management, ASI's board of directors meets to review and monitor the company's financial statements, investment activities, risk management practices, information technology issues, and sales and marketing activities. An independent auditor annually audits and renders an opinion on ASI's consolidated financial statements prepared in accordance with generally accepted accounting principles. Additionally, ASI retains an independent actuarial firm to conduct a capital adequacy study (at least every 3 years), annually review and help estimate loss reserves, and render an annual actuarial opinion on the adequacy of its loss reserves.

Federal Law and Regulation I

Federal law requires that any depository institution that does not have federal deposit insurance clearly and conspicuously disclose that the institution is not federally insured.[15] CFPB and the Federal Trade Commission (FTC) are the federal entities responsible for enforcing these requirements.[16] In December 2011, CFPB issued an interim final rule restating the implementing regulation, which had been promulgated by

[13]ASI is licensed as a credit union share guaranty corporation by the Ohio Department of Insurance. Ohio Revised Code Chapter 1761 establishes powers and authorities governing credit union guaranty corporations. ASI is also governed by the regulations found in the Ohio Administrative Code Chapter 1301:9.3.

[14]Ohio Rev. Code Ann. § 1761.10 (D)(1).

[15]12 U.S.C. § 1831t(b).

[16]CFPB inherited the rulemaking authority from FTC, which, prior to CFPB's existence, had jurisdiction over this area. Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act transferred rulemaking authority for a number of consumer financial protection laws from seven federal agencies to CFPB as of July 21, 2011.

FTC.[17] This regulation, known as Regulation I, contains the disclosure requirements for credit unions that do not have federal deposit insurance. CFPB published a final rule in April 2016, which adopted its 2011 interim final rule without changes.

Regulation I requires disclosure that an institution does not have federal deposit insurance (1) at locations where deposits are normally received (stations or windows) except enumerated exceptions, (2) on the institution's main Internet page (website), (3) in all advertising except enumerated exceptions, and (4) in periodic statements and account records.[18] Regulation I generally requires depository institutions to obtain a written acknowledgment from depositors that the institution does not have federal deposit insurance.

FAST Act and Federal Home Loan Bank System

The FAST Act amended the Federal Home Loan Bank Act to permit privately insured credit unions to apply for membership in a Federal Home Loan Bank (FHLBank) and, if approved, obtain the benefits of membership, including access to loans (known as advances). The FHLBank System is a government-sponsored enterprise, composed of 11 regional banks.[19] Federally insured credit unions have been allowed to apply for membership since 1989; other members of the FHLBank

[17]Disclosure Requirements for Depository Institutions Lacking Federal Deposit Insurance (Regulation I), 76 Fed. Reg. 78126 (Dec. 16, 2011) (codified at 12 C.F.R. Part 1009). According to CFPB staff, the December 2011 interim final rule was largely adopted from FTC's prior rule without substantive changes (16 C.F.R. Part 320).

[18]For the first category, the regulation includes exceptions for automated teller machines and point of sale terminals. 12 C.F.R. § 1009.4(a)(1). For the fourth category, in addition to disclosing that the institution is not federally insured, the institution must also disclose that "if the institution fails, the Federal Government does not guarantee that depositors will get back their money." 12 U.S.C § 1831t(b)(1); 12 C.F.R. § 1009.3.

[19]The FHLBank System represents 11 districts, with FHLBanks located in Atlanta, Boston, Chicago, Cincinnati, Dallas, Des Moines, Indianapolis, New York, Pittsburgh, San Francisco, and Topeka. Eligible entities may become members of an FHLBank, generally in the district in which they have their principal place of business.

System include commercial banks, thrifts, and insurance companies.[20] The FHLBank of Cincinnati approved ASI as a member in June 2011.

The Federal Housing Finance Agency (FHFA) regulates the FHLBanks and issued a proposed rule in September 2016 to implement provisions of the FAST Act.[21] By law, certain types of prospective FHLBank members must have at least 10 percent of their assets in residential mortgage loans to be eligible. As of December 31, 2015, FHFA estimated that 78 of the 125 privately insured credit unions met this eligibility criterion.[22] As of December 31, 2016, the FHLBanks had approved 16 privately insured credit unions for membership.

[20]The Housing and Economic Recovery Act of 2008 expanded membership eligibility to community development financial institutions (CDFI) in 2008. Pub. L. No. 110-289, § 1206, 122 Stat. 2654, 2787 (2008). Regulations state that CDFI credit unions are included within those eligible for membership and define a CDFI credit union as a state-chartered credit union that has been certified as a CDFI by the CDFI Fund and that does not have federal deposit insurance. 12 C.F.R. § 1263.1, 1263.6(a).

[21]Federal Home Loan Bank Membership for Non-Federally-Insured Credit Unions, 81 Fed. Reg. 66545 (Sept. 28, 2016).

[22]12 U.S.C. § 1424(a)(2). Year-end 2015 data were the most recently available at the time of our review.

Regulatory and Other Assessments Indicate ASI Has Had Adequate Reserves and Strong Claims-Paying Ability

Regulators Have Not Cited Concerns about ASI

The Ohio Department of Insurance's most recent examination of ASI, which covered 2008–2012, did not identify any deficiencies in ASI's financial condition and determined that ASI's reserves for losses were consistent with Ohio's legal requirements and were adequate and appropriate.[23] According to Ohio Department of Insurance staff, the department has not identified any issues and was not aware of any problems with ASI's loss reserves in at least the past 10 years.[24] They noted that ASI is classified as a nonpriority insurer by the department, which means that the company is considered low-risk and does not require enhanced oversight. This determination was based on factors such as ASI's Insurance Regulatory Information System (IRIS) ratios and management competency.[25] As a result of this classification, the department conducts full-scope examinations of ASI every 5 years, rather than annually or every 3 years as conducted for insurers deemed riskier.

[23]Loss reserves are an estimate of liability or provision in an insurer's financial statement, indicating the amount the insurer expects to pay for losses incurred, but not yet reported, and reported claims that have not been paid.

[24]We requested information for the past 10 years, including the most recent examination. We did not request or obtain information relating to earlier examinations; department staff told us findings from previous examinations carry forward to the next examination.

[25]State insurance regulators participating in committees of the National Association of Insurance Commissioners (NAIC) developed IRIS to assist state insurance departments in targeting resources to those insurers in greatest need of regulatory attention. The ratios and trends are used to identify insurers likely to experience financial difficulties. NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia, and five U.S. territories. Through NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight.

Ohio Department of Insurance staff told us that as part of their full-scope examinations every 5 years, the examination team reviews ASI's audited financial statements, analyzes estimates for loss reserves, and evaluates any risks to the company by reviewing legal issues, corporate governance, and management. In particular, the department's actuary performs an analysis of ASI's information to derive the department's own estimate for ASI's loss reserves. The department compares its derived estimate to ASI's held reserves, as well as to the range of estimates reported by ASI's third-party actuarial firm. Staff said that if the department were to identify significant differences in the estimates, it would request additional information from ASI to understand the reasons for the differences. Additionally, the department uses the IRIS ratios to aid in evaluation of the adequacy of ASI's loss reserves. According to representatives from the National Association of Insurance Commissioners (NAIC), the procedures the department uses for assessing ASI's capital, including its loss reserves estimates, are consistent with NAIC's guidelines for conducting such assessments.

Ohio Department of Insurance staff also told us that on an annual basis they review the statement of actuarial opinion of ASI's loss reserve estimates (as rendered by the third-party actuarial firm and discussed later in this report) and ASI's audited financial statements, and also compute financial ratios. According to the staff, as part of this review, analysts review ASI's capital position and monitor ASI's asset quality to ensure they did not deteriorate significantly in a given period. Under Ohio law, ASI is required to maintain at least $5 million in capital, and as of December 31, 2015, ASI's capital was roughly $219 million.[26] In addition, Ohio Department of Insurance staff said they consider any risks that could affect ASI's financial condition. For example, they said they evaluate risk in terms of growth, underwriting, how the company invested its assets, and any legal concerns. In addition, the department analyzes the risk-based capital ratio. They also said that a company's risk-based capital ratio must be at least 200 percent of its calculated authorized control level risk-based capital.[27] From 2009 through 2015, according to

[26]This number is based on statutory accounting practices. Later in the report, we refer to $218 million in funds available to pay claims as identified by the actuarial firm. According to ASI management, this amount is based on generally accepted accounting principles and was derived by subtracting cash and investments held by the Excess Share Insurance Corporation from the consolidated cash and investments.

[27]According to NAIC's model law, authorized control-level risk-based capital is the number determined under the risk-based capital formula.

examination records from the Ohio Department of Insurance, ASI's risk-based capital ratio was well above this standard.[28] Ohio Department of Insurance staff told us that ASI management is very transparent about disclosing risk that new credit unions may pose to the company. The staff said that they engage in quarterly discussions with ASI management about the company's quarterly financial statements and the credit unions for which ASI is considering providing deposit insurance coverage.

Ohio Department of Insurance staff said that their concern with ASI, as with any insurer, generally has been the risk posed by macroeconomic issues. For example, they stated fluctuations in the economy could pose significant concerns for insurers such as ASI. Therefore, a decline in the economy could have a significant (negative) impact on a company like ASI. The staff further noted that while the frequency of claims for losses for ASI would be low, the severity of such losses could potentially be high, which could pose a risk to the company. According to ASI management, roughly 2 percent of its privately insured credit unions failed during or since the 2007–2009 financial crisis (as compared to roughly 2 percent of federally insured credit unions, according to NCUA).[29] In 2009, ASI reported that almost all of its loss expense was related to just two of its insured credit unions, both in Nevada. One of these credit unions merged with another.[30] The second troubled credit union had approximately $1 billion in total assets when it received assistance from ASI.[31] Department staff told us that during and just after the financial crisis, they monitored ASI more frequently and met monthly with ASI management to discuss the company's exposures and potential losses, but the department never determined there was a need to conduct an additional full-scope examination.

[28]According to department staff, ASI's risk-based capital ratio also exceeded the 200 percent standard for a number of years before 2009, but we did not obtain information prior to that year.

[29]According to ASI management, the 2 percent includes purchase and assumptions (i.e., assisted mergers) and there were no involuntary liquidations of credit unions. NCUA defines failures as involuntary liquidations and assisted mergers.

[30]According to ASI management, the merger was through a purchase and assumption transaction in which ASI guaranteed the performance and collection of loans and real estate owed to the acquiring credit union.

[31]ASI can provide assistance to a troubled credit union by advancing it funds. ASI reported that the institution had fully repaid the advanced funds with interest, and according to ASI management there was no net loss to ASI.

In addition to the Ohio Department of Insurance's oversight, the Ohio Department of Commerce annually performs a risk-based safety and soundness examination of ASI in collaboration with the eight other state credit union supervisors that regulate privately insured credit unions. However, the Ohio Department of Commerce could not share with us the results of these examinations because, as interpreted by the department, it is prohibited by law from providing details about its examination findings to third parties other than those specified in the regulations.[32] According to Ohio Department of Commerce staff, their annual safety and soundness examination of ASI focuses on risk areas similar to those reviewed during the examination of a credit union. As a part of this process, the Ohio Department of Commerce reviews ASI's audited financial statements, statement of actuarial opinion, and reports from ASI's internal system used to monitor insured credit unions. Ohio Department of Commerce staff told us that on a quarterly basis, examiners review quarterly financial statements and monitor any troubled credit unions that ASI insures.

As well as participating in the Ohio Department of Commerce's annual examination of ASI, the eight other state credit union supervisors told us that they monitor ASI's financial condition on an annual or quarterly basis.[33] This process generally involves a review of ASI's annual audited or quarterly unaudited financial statements and its actuarial reports. None of the eight state supervisors with whom we spoke raised concerns about ASI's financial condition at the time of our review. But one state credit union supervisor expressed concern that during volatile economic times, ASI might not be able to cover losses once it had exhausted its capital because ASI is not backed by the full faith and credit of the U.S. government and has no access to state guaranty funds. According to the National Conference of Insurance Guaranty Funds—whose funds provide protection for various property and casualty lines of insurance written by its member insurers—private deposit insurers are not covered. Additionally, representatives from the state credit union supervisors also told us that none of the states in which ASI operates, including Ohio, had a state guaranty fund to assist in covering losses or credit union member deposits if ASI ran into financial difficulties. However, in the event of

[32] Ohio Admin. Code §1301:9-3-15(E).

[33] According to Ohio Department of Commerce staff, not all of the eight states in which ASI also operates participate in the annual review each year, but usually five or more states participate.

potential impairment of ASI's funding, Ohio law allows ASI to charge a special assessment, with regulator approval, against the credit unions it insures.[34]

Moreover, FHFA reviews information about ASI as part of its oversight of the FHLBanks. As noted earlier, ASI is a member of the FHLBank of Cincinnati and bank representatives told us that they monitor ASI's financial condition by reviewing ASI's annual audited financial statements, statutory quarterly financial filings, and reports on ASI's loss reserves. FHLBanks protect against credit risk on advances by requiring members to pledge collateral. Representatives from the FHLBank of Cincinnati told us ASI, like all FHLBank members (including privately insured credit unions), must pledge collateral to receive advances. According to FHFA staff, while FHFA may review ASI information as part of its supervision of FHLBanks, FHFA has no supervisory authority over ASI and no plans to independently assess the company's financial condition. The FAST Act does require ASI to provide FHFA a copy of its annual audit. The audit must be conducted by an independent auditor and must include an assessment by the auditor that ASI follows generally accepted accounting principles and has set aside sufficient reserves for losses. This FAST Act requirement allows FHFA to review the independent auditor's opinion to confirm that ASI has met these requirements. FHFA staff told us FHFA planned to use the ASI audited financial statements to prepare for its next annual examination of the FHLBank of Cincinnati.

ASI has several processes in place to mitigate risk and help prevent and control losses to the company. ASI management told us that applicant credit unions undergo an insurability assessment that includes a review of the credit union's financial data, corporate governance, and CAMEL rating, and an evaluation of its operating policies and procedures.[35] Additionally, the company continuously monitors the financial condition of the credit unions the company insures. ASI management said that quarterly they compare their credit unions against federally insured credit unions in terms of capital adequacy, earnings, and liquidity. The company conducts an examination of about 70 percent of its credit unions annually,

[34]Ohio Rev. Code Ann. § 1761.10(C)(1). According to ASI management, the company has not made such an assessment.

[35]ASI management told us the company applies more stringent underwriting guidelines to credit union applicants with assets above $1 billion because the Ohio Department of Insurance views these credit unions as a potential risk to ASI. Further, ASI's internal policy is to refrain from marketing to credit unions with assets of more than $2 billion.

and the rest on a 2–3 year cycle. ASI management noted that they conduct most of their examinations jointly with state credit union supervisors. For credit unions with at least $100 million in assets, ASI has a process of enhanced monitoring, which includes quarterly reviews, as well as on-site reviews annually or semiannually. As needed, ASI can issue a corrective action, such as advancing funds to an insured credit union on a short-term basis to aid in the credit union's liquidity needs.

Independent Actuarial Reviews Found That ASI Had a Strong Financial Ability to Pay Claims under Different Scenarios

ASI retains an independent actuarial firm to conduct analyses for the company. The actuarial firm conducts

- a study of the adequacy of ASI's capital every 3 years, which looks at the company as a whole and its ability to pay present and future claims for losses experienced by the credit unions it insures, under different economic scenarios;[36] and
- an annual study of ASI's loss experience to help estimate loss reserves and render an annual statement of actuarial opinion on the adequacy of its loss reserves.[37]

Capital Adequacy

The four most recent capital adequacy studies, which covered calendar years 2009–2015, indicated that ASI's ability to pay claims was strong.[38] The 2010 capital adequacy study—conducted near the end of the financial crisis—indicated ASI's ability to pay claims was strong, but it

[36]The actuarial firm defines capital adequacy as the adequacy of capital, loss reserves, member deposits, retained earnings, reinsurance, and lines of credit, taken as a whole. According to ASI management, in April 2011, the actuarial firm prepared an additional study, off the 3-year cycle, at the request of the company to evaluate the impact of an increase in the capital contribution rate and ASI's plans to charge a special premium assessment. ASI management told us the company took both of these actions in response to the financial crisis. That study used ASI's data and information as of December 31, 2010.

[37]Reserves for losses refer to estimates of unpaid losses and loss adjustment expense. The estimates include an actuarial central estimate, as well as estimates above and below the central estimate, which according to ASI management, form a range of possible expected losses.

[38]Willis Towers Watson, *American Mutual Share Insurance Corporation: Actuarial Analysis of Capital Adequacy - Stress Scenarios* (Minneapolis, Minn.: May 3, 2016); Towers Watson, *American Mutual Share Insurance Corporation: Actuarial Analysis of Capital Adequacy - Stress Scenarios* (Chicago, Ill.: Apr. 9, 2013); *Actuarial Analysis of Capital Adequacy - Stress Scenarios* (Chicago, Ill.: Apr. 26, 2011); and *Actuarial Analysis of Capital Adequacy - Stress Scenarios* (Chicago, Ill.: May 19, 2010).

also reported that ASI's ability to pay claims had decreased.[39] For the most recent capital adequacy study, the actuarial firm's analysis found that ASI's ability to pay claims was strong under each of three economic scenarios (expansion, recession, and depression).[40] For example, the actuarial firm estimated the probability that ASI could withstand a 1-year and 5-year recession as 99.7 percent and 97.3 percent, respectively.[41] According to staff from the actuarial firm, the capital adequacy study serves as a financial model to assist ASI management in its decision making. They noted ASI's management is as important as the study's findings because even with adequate capital, a company could fail based on mismanagement or fraud, which cannot be modeled.

According to staff from the actuarial firm, ASI could face difficulty paying claims for losses if one or more of its largest credit unions were to suffer severe losses. The firm reported that as of December 31, 2015, ASI had $218 million in assets (cash and investments) readily available to pay claims, but as of year-end 2015, 14 of its credit unions each had more than that amount in total insured deposits. However, the actuarial staff told us they factored this risk into their analysis and that the larger the credit union (by asset size), the smaller the probability of a severe loss (expressed as a percentage of the credit union's total assets).

Additionally, the actuarial firm analyzed the capital adequacy of ASI's wholly owned subsidiary, Excess Share Insurance Corporation, which can affect ASI's financial condition because ASI offers it various funding sources and a guarantee. The actuarial firm's 2016 study showed the subsidiary's ability to pay claims under the three economic scenarios was strong.[42] ASI management told us they believe the risk posed by its subsidiary to be small, and that multiple adverse events would have to occur simultaneously for it to impair ASI's financial condition. To transfer

[39]Towers Watson, *Actuarial Analysis of Capital Adequacy - Stress Scenarios* (May 19, 2010).

[40]Willis Towers Watson, *Actuarial Analysis of Capital Adequacy - Stress Scenarios* (May 3, 2016).

[41]Similarly, the firm estimated the probability that ASI could withstand a 1-year and 5-year depression as 99.5 percent and 96.6 percent, respectively.

[42]Willis Towers Watson, *Excess Share Insurance Corporation: Actuarial Analysis of Capital Adequacy - Stress Scenarios* (Minneapolis, Minn.: May 3, 2016). This study covered the period ending December 31, 2015.

some of this risk, the subsidiary carries a reinsurance policy for its excess insurance line of business.

The actuarial studies also noted that ASI has other sources of funding to help pay claims, including special assessments, lines of credit, and increases to the capital contribution rate it charges. For example, during and after the 2007–2009 financial crisis, ASI (1) charged its insured credit unions a special premium assessment each year in 2009–2013; (2) borrowed $22 million from its line of credit to pay initial claims in 2009 (which according to ASI management was repaid in full within 6 months); and (3) increased the credit unions' capital contributions rate in 2010, from a rate ranging between 1 percent and 1.3 percent to a rate of 1.3 percent of total insured deposits, which ASI management told us enhanced the company's capital adequacy.

Loss Reserves

Each of the actuarial firm's annual loss reserve studies conducted during 2011–2015 found that ASI's reserves for losses were reasonable and consistent with amounts computed based on actuarial standards of practice, and met the requirements of Ohio insurance laws.[43] ASI maintains a reserve for losses to cover its estimated unpaid liability for reported and unreported loss claims.[44] To assist management with its determination of loss reserves, the actuarial firm annually analyzes ASI's loss reserve experience and reviews the assumptions ASI uses to determine its reserves for losses. The reserve studies identified some potential risks—for example, the possibility that some of ASI's credit unions could cancel their deposit insurance coverage and withdraw their capital contributions, which would reduce ASI's capital (but also reduce its exposure to potential losses).

[43]Willis Towers Watson, *American Mutual Share Insurance Corporation: Analysis of Unpaid Loss and LAE as of December 31, 2015* (Minneapolis, Minn.: Feb. 25, 2016); Towers Watson *American Mutual Share Insurance Corporation: Analysis of Unpaid Loss and LAE as of December 31, 2014* (Minneapolis, Minn.: Feb. 25, 2015); *American Mutual Share Insurance Corporation: Analysis of Unpaid Loss and LAE as of December 31, 2013* (Minneapolis, Minn.: Mar. 5, 2014); *American Mutual Share Insurance Corporation: Analysis of Unpaid Loss and LAE as of December 31, 2012* (Chicago, Ill.: Mar. 7, 2013); and *American Mutual Share Insurance Corporation: Analysis of Unpaid Loss and LAE as of December 31, 2011* (Chicago, Ill.: Mar. 15, 2012).

[44]According to the actuarial firm, losses generally arise from defaulted loans, investment losses, mismanagement, fraud, or embezzlement.

In its 2016 loss reserve study, the actuarial firm stated that it did not believe that significant risks and uncertainties were present that could result in material adverse deviation of ASI's loss reserves.[45] The firm based its conclusion on the presence of certain favorable factors that offset the risks and uncertainties identified in previous years. These factors included the low ratio of the company's held reserves to its capital, and that ASI's held reserves were at the high end of the actuarially-determined range of reserves estimated to be reasonable. However, the actuarial firm staff stated that the absence of such risks and uncertainties did not imply that factors could not be identified in the future that could have a significant influence on ASI's reserves.

[45]Willis Towers Watson, *American Mutual Share Insurance Corporation: Analysis of Unpaid Loss and LAE as of December 31, 2015* (Feb. 25, 2016). This study covered the period ending December 31, 2015.

Privately and Federally Insured Credit Unions Had Similar Regulatory Ratings, but Differed in Geographic and Deposit Concentration

ASI's risk profile depends in large part on the financial condition of the privately insured credit unions that it insures. We reviewed the CAMEL ratings (which regulators use to rate a credit union's performance and risk profile) of privately insured credit unions, and compared them to those of federally insured credit unions.[46] We found that, in the aggregate, privately and federally insured credit unions had similar CAMEL ratings during 2006–2015.[47] For example, as seen in figure 2, roughly the same percentages of privately and federally insured credit unions were rated satisfactory (CAMEL ratings of 1 or 2). For both groups, the percentage of troubled credit unions (CAMEL ratings of 4 or 5) peaked in 2011 and then declined. These similarities remained roughly the same (for both satisfactory and troubled credit unions) when we reviewed the percentage of assets in credit unions by CAMEL rating rather than percentage of individual credit unions.[48]

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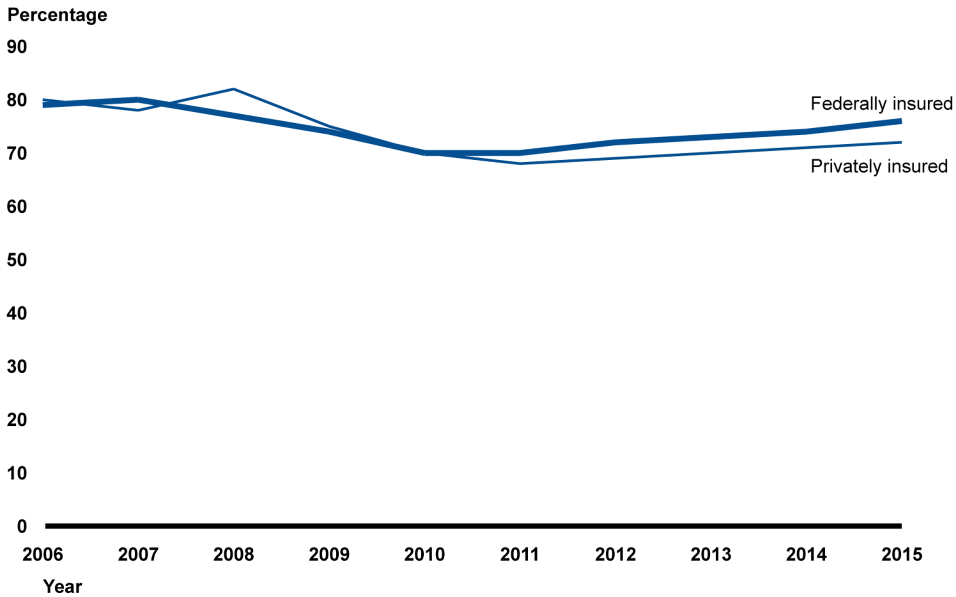
[46]CAMELS ratings consist of an assessment of a financial institution's capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk. Most credit unions are not separately assessed on this last component. NCUA's CAMEL rating system is designed to take into account and reflect all significant financial, operational, and management factors that field staff assess in their evaluation of a credit union's performance and risk profile. Composite CAMEL ratings range from 1 to 5, with 1 being the best rating. Ratings of 1 or 2 indicate satisfactory condition, a rating of 3 reflects some degree of supervisory concern in one or more areas, a rating of 4 indicates that an institution generally exhibits unsafe or unsound practices, and a rating of 5 indicates extremely unsafe or unsound practices and conditions. NCUA refers to CAMEL 4 and 5 credit unions collectively as "troubled credit unions."

[47]CAMEL ratings are assigned (1) by NCUA for federally chartered, federally insured credit unions, (2) by both NCUA and the state credit union supervisory authority for state-chartered, federally insured credit unions, and (3) by the state credit union supervisory authority for privately insured credit unions. We obtained CAMEL ratings only from NCUA for all federally insured credit unions (federally and state-chartered). While there may be some differences in how NCUA and each state credit union supervisory authority assign ratings, we solely present NCUA's CAMEL ratings for federally insured credit unions (federally and state-chartered) to minimize limitations in comparisons of NCUA and state credit union supervisory authorities' ratings. Nine state credit union supervisory authorities assign ratings to privately insured credit unions. We assumed these ratings were comparable in the aggregate with those of NCUA because 8 of the 9 supervisory authorities told us they follow the same standards and procedures as NCUA when assigning ratings to both federally and privately insured credit unions. Texas authorities told us they follow the Uniform Financial Institution Rating System adopted by the Federal Financial Institutions Examination Council, which includes an additional assessment of market sensitivity (which NCUA has not yet adopted). ASI does not assign CAMEL ratings, but the company told us it uses CAMEL ratings as part of its underwriting and ongoing monitoring for privately insured credit unions.

[48]The percentage of assets in troubled credit unions peaked in 2009 and 2010 for privately and federally insured credit unions, respectively, and then declined.

Figure 2: Privately and Federally Insured Credit Unions with Satisfactory Regulatory Ratings (CAMEL ratings 1 or 2), 2006–2015



Source: GAO analysis of National Credit Union Administration and state credit union supervisory authorities' data. | GAO-17-259

For further review, we also selected one indicator in each of five categories—capital adequacy, asset quality, loss coverage, profitability, and liquidity—regulators commonly use to assess the financial health of credit unions.[49] The median values for all of these indicators were similar for privately and federally insured credit unions from 2011–2015.[50]

The sizes of privately and federally insured credit unions also were roughly similar. In 2015, the majority of insured credit unions had less than $100 million in total assets (see table 1). For privately and federally insured credit unions, respectively, the median total assets were roughly

[49]The specific indicators we reviewed were (1) net worth ratio, (2) delinquent loans ratio, (3) net charge-offs to average loans ratio, (4) return on average assets, and (5) liquidity ratio. We selected these indicators for further review because they had been previously identified by regulators as metrics to assess a credit union's financial health and used in prior reports looking at credit unions. See appendix I for additional information.

[50]We analyzed these indicators using the median rather than the mean because means can be skewed by extremely high or low values.

$34 million and $27 million, and the median numbers of members were roughly 4,300 and 3,200.

Table 1: Percentage of Privately and Federally Insured Credit Unions, by Asset Size, 2015

Asset size	Privately insured (n = 125)	Federally insured (n = 6,033)
Less than $100 million in total assets	74	75
More than $100 million, less than $500 million in total assets	18	17
More than $500 million in total assets	8	8
Total	**100**	**100**

Source: GAO analysis of SNL Financial data. | GAO-17-259

However, our analysis shows that privately insured credit unions have higher geographic and deposit concentration than federally insured credit unions, which can present risks. Specifically,

- Privately insured credit unions are much less geographically diverse than federally insured credit unions because they operate solely in nine states. Forty-two percent of ASI-insured credit unions are in Ohio and an additional 30 percent are in Illinois (18 percent) and Indiana (12 percent). This geographic concentration may create risks for ASI because economic downturns are sometimes concentrated in particular regions of the country. NCUA staff noted that previous private deposit insurers have failed mostly as a result of severe regional economic shocks (or in some cases a single major fraud).[51]
- The total insured deposits of privately insured credit unions are concentrated in a much smaller number of credit unions than for federally insured credit unions. In 2015, ASI's 2 largest credit unions (by total assets) represented 15 percent of its total insured deposits, and its 10 largest represented 54 percent of its insured deposits. In comparison, NCUA's 10 largest insured credit unions (by total assets) made up 15 percent of total insured deposits in 2015. This concentration of insured deposits may be viewed as a risk to ASI because, as discussed previously, ASI could face difficulty paying

[51]For additional information about failures of prior private deposit insurers see Stephanie O. Crofton, Luis G. Dopico, and James A. Wilcox, "American Share Insurance: The Sole Surviving Private Deposit Insurer in the United States," *Essays in Economic & Business History, vol. 28 (2010).*

claims for losses if one or more of its largest credit unions were to suffer severe losses.

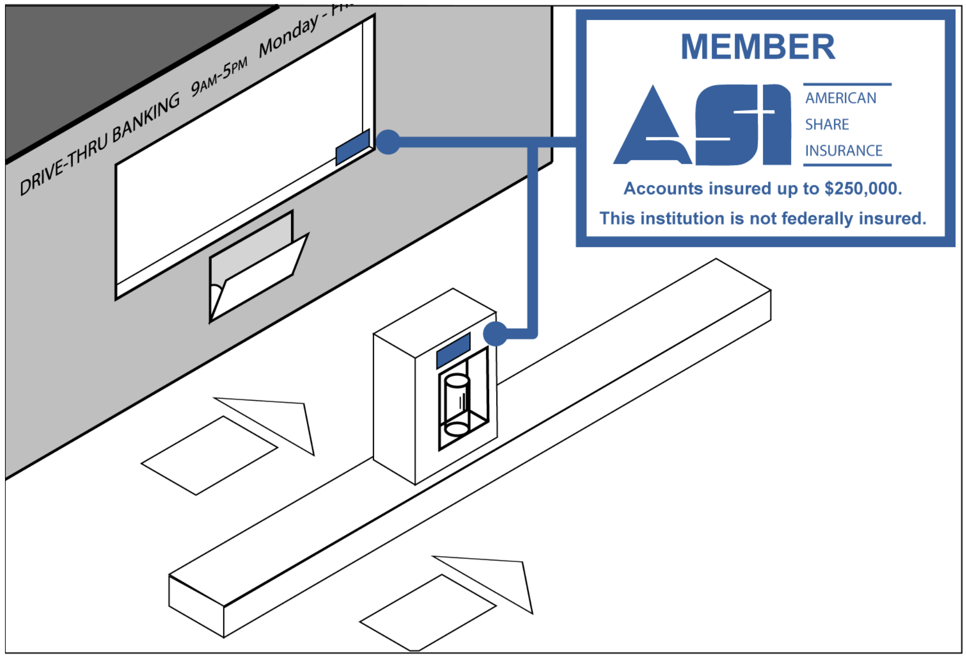
Credit Unions We Reviewed Largely Complied with Disclosure Requirements, but Some Disclosure Provisions Lack Specificity

Privately insured credit unions we reviewed largely complied with requirements to disclose that they are not federally insured. But a lack of specificity in Regulation I provisions that relate to disclosure location (drive-through windows), format (signage dimensions and font size), and advertising (printed materials) may have contributed to some variations we saw in compliance with disclosure rules.

Disclosure signage at teller and drive-through windows. The 47 privately insured credit unions we visited were largely in compliance with CFPB's requirement for disclosures at each station or window where deposits are normally received.[52] For example, 45 of the 47 credit unions displayed a disclosure at teller windows. Of the two that did not display signs at teller windows (both of which were small employer-based credit unions), one had a disclosure on the front door and the other had a disclosure on a bulletin board outside the credit union, but still within the employer's building. However, 7 of the 17 credit unions we visited that had drive-through windows did not have disclosures at the window (see fig. 3). While Regulation I states disclosures are needed at each station or window where deposits are normally received, it does not specifically cite drive-through windows. In contrast, the regulation specifically excludes certain other places of deposit from requiring the disclosure. For example, it states that disclosure is not needed at automated teller machines or point-of-sale terminals. CFPB staff told us that, in their view, a plain reading of Regulation I would include a drive-through window as a "station or window where deposits are normally received," and thus require disclosure.

[52]12 C.F.R. § 1009.4. The disclosures that the institution is not federally insured are required at certain places at the principal place of business and all of its branches where the credit union accepts deposits or opens accounts. We conducted unannounced site visits at a nonprobability sample of 47 credit unions (selected primarily to represent a mix of asset sizes and geographic locations). The credit unions were located in California, Illinois, Maryland, and Ohio.

Figure 3: Example of Drive-Through Windows with Disclosure Signage

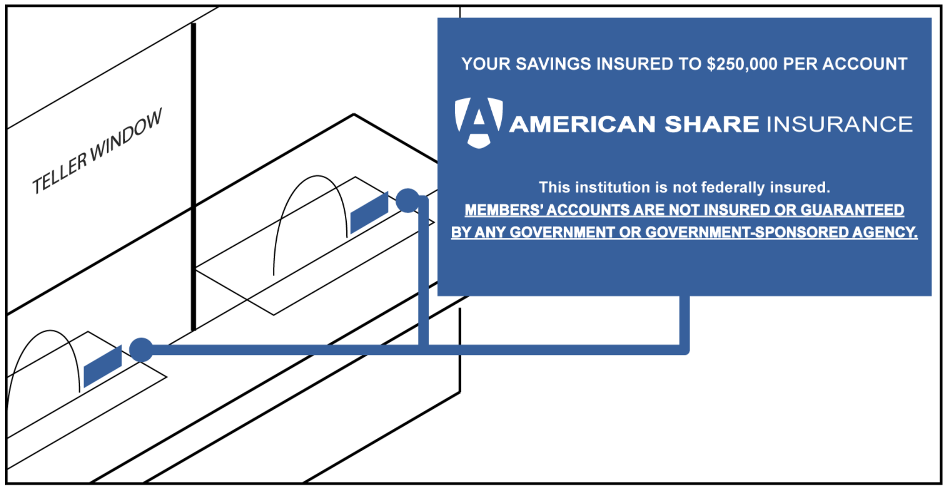


Source: GAO. | GAO-17-259

We also observed that the dimensions and font sizes of the disclosure signage varied among credit unions, with some having signage too small to be easily read, or not placed conspicuously. At 28 of 47 credit unions we visited the signs measured smaller than 3 by 7 inches.[53] The sign we commonly observed measured 2-¼ inches by 4 inches, which is larger than a business card, but smaller than an index card (see fig. 4). Additionally, in more than half the credit unions we visited, we found the font size of the disclosures was too small to be easily read when standing at the teller window. Further, at 7 of 47 credit unions, disclosures were placed where they were not easily noticed. For example, one was placed on a windowsill across the room, another at a teller station covered with other materials, and another at the bottom of an 8 by 10 inch sign containing a lot of other information about the credit union's policies.

[53]We used 3 by 7 inches for comparative purposes because those are the dimensions of the signage provided by NCUA to federally insured credit unions, as discussed later in this report.

Figure 4: Example of Disclosure Signage at a Teller Window



Source: GAO. | GAO-17-259

CFPB does not provide official signage to privately insured credit unions and Regulation I does not specify signage dimensions or font size requirements. Instead, Regulation I states the disclosures must be "clear and conspicuous and presented in a simple and easy-to-understand format, type size, and manner" but does not provide definitions, parameters, or illustrative examples of what would constitute simple and easy to understand. By comparison, NCUA provides official signs to federally insured credit unions to display at each station or window where insured account funds or deposits are normally received.[54] NCUA's regulation notes credit unions should not alter the font size of the official sign when used for this purpose. The sign itself, which measures 3 by 7 inches. can be ordered and downloaded from NCUA's website.

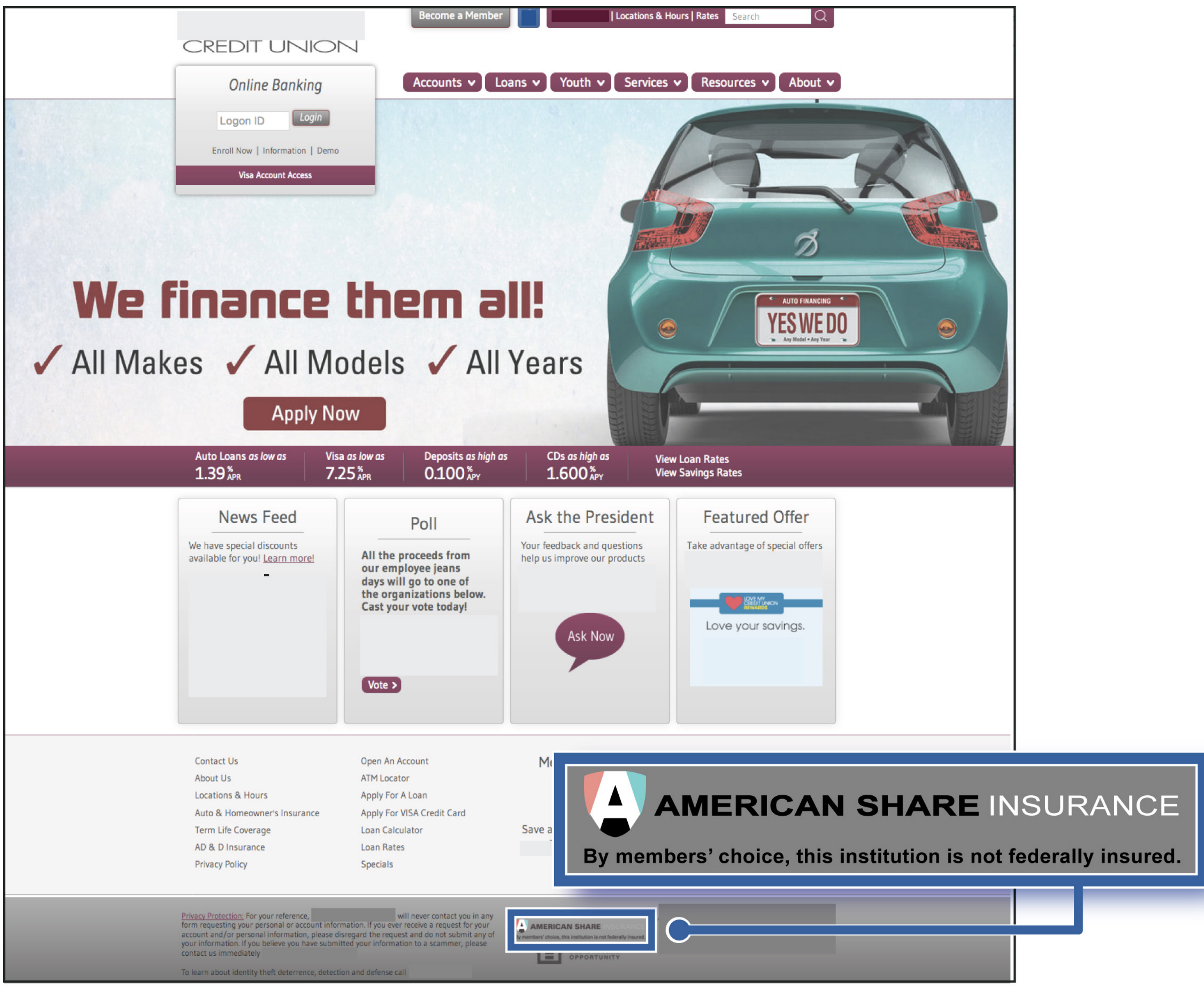
Disclosures on websites. We also reviewed 102 privately insured credit union websites and found that almost all of these websites complied with CFPB's requirement to disclose on their main Internet page that the institution is not federally insured.[55] Three credit unions did not have the disclosure on their main Internet page (each of the three had the disclosure on a different page of its website). However, on many websites

[54]12 C.F.R. § 740.4.

[55]12 C.F.R. § 1009.4. At the time of our review, 102 of 125 privately insured credit unions had active websites.

(28 of 99) the disclosures were not easily seen or readable. For example, the overall space the disclosure occupied or its placement next to or between colorful or larger graphics made it difficult to notice the disclosures in these cases. Additionally, we observed that more than half the websites (60 of 99) used a font size that was smaller than that used for the other text on the same webpage (see fig. 5).

Figure 5: Example of Credit Union Website in Which Font for Disclosure Is Smaller Than That Used on Rest of Page



Source: Credit union website. | GAO-17-259

CFPB's Regulation I states that the website disclosures, like all other required advertising and premises disclosures, should be "clear and conspicuous and presented in a simple and easy to understand format, type size, and manner," but CFPB does not define these terms or specify font size requirements for websites.[56] In comparison, NCUA's regulation for federally insured credit unions specifies that the disclosure must be in a size and print that is clearly legible and no smaller than the smallest font size used elsewhere.[57]

Disclosures in advertising (printed materials). On our visits to privately insured credit unions we obtained printed materials (such as brochures, promotional flyers, and newsletters which could be considered advertisements), and 8 of the 36 credit unions from which we obtained samples of printed materials had at least one item that did not contain a disclosure.[58] Regulation I states "all advertisements" except those specifically enumerated must disclose a lack of federal deposit insurance, but the regulation does not define what constitutes an advertisement.[59] CFPB staff told us the agency does not have any guidance or commentary on what constitutes "all advertisements." In comparison, NCUA's regulation for federally insured credit unions defines advertising, and also provides examples. In NCUA's regulation, an advertisement is "a commercial message, in any medium, that is designed to attract public attention or patronage to a product or business."[60] Furthermore, NCUA's regulation specifies that advertising includes print, electronic, or broadcast media, displays and signs, stationery, and other promotional material.[61]

[56]As previously stated, CFPB inherited the rulemaking and enforcement authority for Regulation I from FTC and adopted FTC's rule without substantive changes. CFPB staff noted that FTC has historically relied on the "clear and conspicuous" standard in its regulations of advertisements and advertisers.

[57]12 C.F.R. § 740.5(b).

[58]While we visited 47 privately insured credit unions, we obtained printed material from 36 because printed materials were not always readily available.

[59]The regulation notes a couple of exceptions that would not require a disclosure, such as small utilitarian items that do not mention deposit products or insurance, if inclusion of the notice would be impractical. 12 C.F.R.§1009.4(c)(2).

[60]12 C.F.R. § 740.1(b).

[61]12 C.F.R. § 740.2.

Disclosures in periodic statements, account records, and signature cards. Representatives of all nine state credit union supervisors with whom we spoke told us that privately insured credit unions were generally compliant with the requirements to (1) disclose on periodic statements and certain other account records a lack of federal deposit insurance, and (2) obtain written acknowledgment from depositors on this lack of federal insurance, as is generally required.[62] The state credit union supervisors said they checked a sample of periodic statements, account records, and signature cards for new accounts as part of their routine examinations of privately insured credit unions.

Reviews of compliance. Overall, compliance levels with disclosure requirements have improved since our 2003 review of privately insured credit unions, which included an assessment of their compliance with federal disclosure rules.[63] In 2003, we found that 36 of 57 credit unions had the required disclosures on premises. Similarly, in 2003, 39 of 78 websites and 93 of 227 printed materials we reviewed had the required disclosures.

CFPB has not had any findings, observations, or evaluations regarding privately insured credit unions' disclosures.[64] CFPB staff told us the agency has not received any complaints related to private deposit insurance. CFPB staff said they have reviewed privately insured credit unions' websites at a very informal level and the websites seemed to be complying with Regulation I. As previously noted, CFPB shares enforcement authority for Regulation I with FTC.[65] CFPB staff told us that

[62] 12 C.F.R. §§ 1009.3 and 1009.5.

[63] GAO-03-971. For the 2003 review, we visited 57 credit unions in Alabama, California, Illinois, Indiana, and Ohio, reviewed websites, and obtained and reviewed printed materials from the credit unions we had visited. For our current review, we did not visit the same credit unions for reasons that include the changed composition of the group of privately insured credit unions.

[64] CFPB's prioritization process has not, to date, identified privately insured credit unions and their related disclosure requirements as a consumer-facing activity that poses sufficient risk to merit supervisory examination (to the extent such credit unions would be subject to such examination) or enforcement investigation. CFPB is required by statute to exercise its supervisory authority, in part, consistent with its assessment of risks posed to consumers. 12 U.S.C. § 5514(b)(2). Pursuant to statute, the CFPB's risk prioritization process takes into consideration a given institution's overall asset size and transaction volume combined with other factors, including an evaluation of the risk posed to consumers by its consumer-facing activities and the extent to which such entities are subject to oversight by state authorities for consumer protection.

[65] 12 U.S.C. § 1831t(f) and 12 C.F.R. §1009.7.

state credit union supervisors and attorneys general also have the authority to enforce Regulation I, as necessary.

The state credit union supervisors in the nine states with privately insured credit unions similarly told us that compliance with disclosure requirements has not been a problem in recent years. They said that their routine examinations of state-chartered credit unions check for disclosures on premises, on websites, in advertising materials, and, as noted earlier, by reviewing selected periodic statements, account records, and signature cards.[66] They said that if examiners observe noncompliance with disclosure requirements, they cite it as an examination finding and expect the credit union to promptly correct the issue and display the proper signage or disclosure.

While we generally found that compliance levels were high, Regulation I may be interpreted and enforced differently by different credit unions and state regulators. Without clarity on whether or not drive-through windows are required to have disclosures, some credit unions may continue to not display them at these windows. Additionally, without more clarity or guidance around dimensions and font sizes for disclosures, the disclosures may be too small to be easily read or noticed. Further, there may continue to be confusion about what constitutes “advertising” and whether certain printed materials are required to include disclosures. As a result, the state credit union supervisors and the credit unions themselves may face challenges consistently monitoring and complying with Regulation I. In turn, credit union members may not always be consistently and adequately informed that deposits are not federally insured.

Conclusions

Deposit insurance helps protect depositors from losing their money in the event a financial institution fails. By law, any institution that does not have federal deposit insurance must clearly and conspicuously inform consumers that the institution is not federally insured and privately insured credit unions we reviewed largely complied with disclosure requirements. However, the instances we observed of missing disclosures or disclosures that were too small to be easily read or

[66]According to NASCUS, state credit union supervisors typically examine credit unions on a schedule. For example, while state law may require examinations of state-chartered credit unions every 24 months, the state credit union supervisors generally conduct examinations on a 12-18 month schedule.

inconspicuous suggest that the lack of specificity in some provisions of Regulation I has led to inconsistencies in interpretation. By clarifying Regulation I, CFPB would facilitate state credit union supervisor monitoring and credit union compliance and would better ensure that consumers were informed that their deposits are not federally insured.

Recommendations for Executive Action

We are making three recommendations to help state credit union supervisors and privately insured credit unions better interpret Regulation I and inform consumers when an institution is not federally insured. CFPB should issue guidance to (1) clarify whether drive-through windows require disclosures; (2) describe what constitutes clear and conspicuous disclosure, including minimum signage dimensions and font size for disclosures; and (3) explain and provide examples of which communications are advertising.

Agency Comments

We provided CFPB, FHFA, and NCUA with a draft of this report for review and comment. In its written comments, reproduced in appendix III, CFPB agreed with our recommendations. CFPB noted that the agency recognizes that providing guidance clarifying Regulation I may improve privately insured credit unions' understanding of and compliance with the federal disclosure requirements. Additionally, CFPB stated that the agency intends to explore options that will most effectively provide guidance regarding Regulation I, such as issuing a bulletin that could be published in the *Federal Register* or posted on the agency's website. CFPB, FHFA, and NCUA also provided technical comments, which we incorporated as appropriate. We also provided selected relevant portions of the draft to ASI, its third-party actuarial firm, the Ohio Departments of Insurance and Commerce, and the other eight state credit union supervisory authorities for their technical review, and we incorporated their comments as appropriate.

We are sending copies of this report to the appropriate congressional committees, agencies, and other interested parties. In addition, this report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or cackleya@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Alicia Puente Cackley
Director, Financial Markets and Community Investment

Appendix I: Objectives, Scope, and Methodology

This report (1) discusses regulatory and other assessments of American Share Insurance (ASI), the sole private deposit insurer, and (2) examines the level of compliance with disclosure requirements by credit unions that do not have federal deposit insurance. The Fixing America's Surface Transportation Act (FAST Act) includes a provision for us to review private deposit insurers and privately insured credit unions' disclosure compliance in the United States.[1] Our scope includes the nine states that permit credit unions to use private deposit insurance and have credit unions that have chosen to do so: Alabama, California, Idaho, Illinois, Indiana, Maryland, Nevada, Ohio, and Texas. Some credit unions in Puerto Rico are insured by a quasi-governmental entity—the Public Corporation for the Supervision and Insurance of Cooperatives—and these credit unions are not included in the scope of this report. In addition, this report does not compare ASI's reserves and capital adequacy to those of the National Credit Union Administration's (NCUA) National Credit Union Share Insurance Fund because the two entities have different legal requirements and risk profiles, use different models to help estimate reserves, and use different assumptions and methods to help determine capital adequacy. Based on this, we limited the scope of the report to solely cover regulatory and other assessments of ASI, instead of an analysis or comparison of the two entities.

To gather information about ASI, we identified the company's regulators and legal requirements and reviewed laws and regulations pertaining to the company. We reviewed Ohio law and implementing regulations, which establish the powers and authorities governing credit union guaranty corporations, such as ASI.[2] We interviewed the company's primary regulators (Ohio Departments of Insurance and Commerce), as well as representatives from the state credit union supervisors in the other eight states in which ASI operates.[3] To determine how the Ohio Department of Insurance assessed ASI's financial condition, we reviewed documentation such as the most recent examination report covering calendar years 2008–2012 and financial analyses of ASI covering calendar years 2013–

[1]Pub. L. No. 114-94, § 82002, 129 Stat. 1312, 1796 (2015).

[2]Ohio Revised Code Chapter 1761 and Ohio Administrative Code Chapter 1301:9.3. A credit union guaranty corporation is a corporation licensed by the Ohio Department of Insurance to engage in the business of guaranteeing payment of a credit union share account of an individual member of a credit union.

[3]We interviewed state supervisors in Alabama, California, Maryland, Idaho, Illinois, Indiana, Nevada, and Texas.

2015. We also compared the department’s process with the guidelines recommended by the National Association of Insurance Commissioners (NAIC) and confirmed with NAIC staff that the department’s procedures were consistent with NAIC guidelines. Finally, we interviewed staff at the Federal Housing Finance Agency (FHFA), which oversees the Federal Home Loan Bank (FHLBank) System, and the FHLBank of Cincinnati (of which ASI is a member) to determine their oversight role with regard to ASI and to obtain information about the number and status of privately insured credit unions applying for membership to the FHLBanks.

We reviewed ASI’s annual reports and audited financial statements for 2008–2015 and other documentation, such as the company’s investment policy, its examination and insurance policy, and its application form and process for credit unions seeking private deposit insurance. We interviewed ASI management about the company’s history, governance structure, regulatory and financial reporting requirements, underwriting policies, and capital and reserves requirements. We also reviewed reports from the third-party actuarial firm that ASI retains, including the firm’s analyses of ASI’s capital adequacy for 2009–2015 (conducted every 3 years), annual analyses of ASI’s unpaid loss and loss adjustment expense for 2011–2015, and annual statements of actuarial opinion for 2011–2015, as well as the firm’s analysis of capital adequacy for ASI’s wholly-owned subsidiary for 2015. We interviewed the actuarial firm’s staff about their analyses related to these studies and obtained information about the assumptions and methods used. For the most recent capital adequacy study, our internal actuarial staff reviewed the actuarial firm’s modeling approach and certain key methods and assumptions, including those related to the three economic scenarios used in the study. Additionally, we inquired about the firm’s internal peer review process and steps taken to ensure the completeness and accuracy of the models used to assess ASI’s capital adequacy and reserves for losses. We did not conduct our own independent assessment of ASI’s capital adequacy and reserves for losses and therefore cannot make our own actuarial determination or opinion.

To review information about the credit unions that ASI insures, we reviewed CAMEL ratings for privately and federally insured credit unions for 2006–2015.[4] We also used financial data from SNL Financial (2011–

[4]CAMEL ratings consist of an assessment of a credit union’s capital adequacy, asset quality, management, earnings, and liquidity. The CAMEL rating system is designed to take into account and reflect all significant financial, operational, and management factors that regulators assess in their evaluation of a credit union’s performance and risk profile.

2015) to analyze selected financial indicators for privately and federally insured credit unions.[5] We selected these financial indicators for further review because they had been previously identified by regulators as metrics to assess a credit union's financial health and used in prior reports looking at credit unions.[6] For our previous work, we had obtained information from NCUA on the indicators it typically uses to assess credit unions' financial health and we selected one indicator in each of the following five categories: capital adequacy, asset quality, loss coverage, profitability, and liquidity.[7] We analyzed data from SNL Financial in September 2016 for year-end 2011–2015. We presented median rather than the mean because means can be skewed by extremely high or low values. We assessed the reliability of the CAMEL ratings for privately and federally insured credit unions, as well as the SNL Financial data for the five financial indicators, by requesting information about the underlying data, how they are collected, and data reliability testing. We found the data to be sufficiently reliable for the purposes of our review.

To determine compliance with disclosure requirements, we identified disclosure requirements for credit unions that do not have federal deposit insurance by reviewing the Federal Deposit Insurance Act disclosure provisions and the Bureau of Consumer Financial Protection's (CFPB) corresponding Regulation I.[8] To review on-site disclosure requirements (at stations or windows), we selected a nonprobability sample of 53 privately insured credit unions and conducted in-person, unannounced

[5]SNL Financial is a private service that aggregates and disseminates comprehensive regulatory financial data on financial institutions, among other information.

[6]GAO, *Troubled Asset Relief Program: Most Community Development Capital Initiative Investments Remain Outstanding*, GAO-16-626 (Washington, D.C.: July 5, 2016); *Community Development Capital Initiative: Status of Program Investments and Participants*, GAO-15-542 (Washington, D.C.: May 5, 2015); and *Community Development Capital Initiative: Status of Program and Financial Health of Remaining Participants,* GAO-14-579 (Washington, D.C.: June 6, 2014).

[7]The financial indicators were the (1) net worth ratio—the total of a credit union's regular reserves, any secondary capital, its undivided earnings, and its net income or loss divided by its total assets; (2) delinquent loans ratio—the sum of loans 60 days or more past due divided by total loans; (3) net charge-offs to average loans ratio—the total dollar amount of loans charged off, less amounts recovered on loans previously charged off divided by the average dollar value of loans outstanding for the period; (4) return on average assets––a credit union's net income divided by the average of its assets over a specific period, such as a quarter or year; and (5) liquidity ratio—liquid assets as a percentage of short-term liabilities.

[8]12 U.S.C. § 1831t; 12 C.F.R. Part 1009.

site visits at 47 of these 53 (41 site visits to unique credit unions and 6 site visits to multiple locations of the 41 credit unions). We were unable to enter the other six credit unions, usually because they were closed when we attempted our visit. The sample was selected to ensure diversity across a number of criteria related to possible differences in compliance. We selected credit unions for their geographic diversity (credit unions in different regions of the country and different states), and to achieve a mix of credit unions of different asset sizes, main retail and branch locations, and urban and nonurban areas. We also took proximity to GAO offices into account as a secondary criterion. Because there may be variation in how state regulators and examiners check for compliance with disclosure requirements, we conducted site visits in four different states. We selected these states to obtain a mix of states in terms of numbers of privately insured credit unions—two with many (Ohio and Illinois), one with a moderate number (California), and one with few (Maryland)—and for geographic diversity. For the geographic distribution (by number and percentage) of all the privately insured credit unions across the nine states that have them, see table 2.

Table 2: Geographic Distribution of Privately Insured Credit Unions, 2015

State	Number	Percentage of total	Region
Ohio	53	42	Midwest
Illinois	22	18	Midwest
Indiana	15	12	Midwest
California	12	10	West
Idaho	9	7	West
Nevada	7	6	West
Texas	3	2	South
Maryland	2	2	South
Alabama	2	2	South
Total	**125**		

Source: GAO analysis of American Share Insurance data. | GAO-17-259

Note: We conducted site visits in four of the nine states: Ohio, Illinois, California, and Maryland. Percentages do not total 100 due to rounding.

We selected privately insured credit unions of varying sizes, as defined by total assets, and selected credit unions for site visits that were roughly representative of the overall population of credit unions. For instance, almost 75 percent of privately insured credit unions had total assets of less than $100 million and therefore the majority of credit unions we selected for our site visits did as well.

We conducted site visits at both main retail and branch locations. We selected locations to include both urban and nonurban areas. We roughly defined “urban” as a downtown area where consumers are more likely to walk to the credit union and “nonurban” as an area where they are more likely to drive. Credit unions in nonurban areas were more likely to have drive-through teller windows. Staff conducted site visits between June and August 2016. On each visit, staff followed a protocol to help ensure consistency and completed a data collection instrument to record their observations. The protocol included checking for signs at teller and drive-through windows and observing sizes and clarity of signs, among other items. When possible, we obtained photographic evidence to document examples of disclosure signage. Two GAO analysts recorded their observations at each site, and any discrepancies were reconciled by discussions and photographic evidence where available. We aggregated the site visit data and present summary-level information in this report.

To determine compliance with disclosure requirements for the credit unions’ main Internet page, we reviewed the websites of all 102 privately insured credit unions that had a website during the time of our review. Analysts followed a protocol to help ensure consistency of observations about the clarity, placement, and font size of disclosures observed and completed a data collection instrument for each credit union. A second analyst independently reviewed each credit union’s website to verify the accuracy of information collected by the first analyst. Any discrepancies between the two analysts were identified, discussed, and resolved by referring to the source websites.

To determine compliance with disclosure requirements for advertising (printed materials), we obtained samples of printed materials (such as brochures, promotional flyers, and newsletters) from 36 of the 41 unique credit unions we visited where such printed materials were readily available. We assessed whether these printed materials had proper disclosures, taking into account the specified exclusions regarding advertising noted in Regulation I. To determine compliance with the requirement to (1) provide disclosures in periodic (monthly) statements and account records, and (2) get written acknowledgment from depositors that the institution does not have federal deposit insurance, we relied on testimonial evidence from the nine state credit union supervisors we interviewed because we determined that their compliance review in this area was adequate for our purposes—for example, each state reviews a sample of new accounts as part of the routine examination each credit union receives.

Because CFPB is the federal entity responsible for issuing disclosure regulations, we interviewed CFPB staff about the agency's oversight and findings related to compliance with these disclosure requirements. We compared CFPB's disclosure requirements for credit unions that do not have federal insurance with those of NCUA for federally insured credit unions.[9] Because privately insured credit unions are state-chartered, we interviewed the respective state credit union supervisors in each of the nine states about their annual examinations of privately insured credit unions, including their review of compliance with requirements to disclose a lack of federal insurance. We also interviewed representatives from the Credit Union National Association, National Association of State Credit Union Supervisors, and the Ohio Credit Union League to ask whether they were aware of any issues or concerns related to compliance with disclosure requirements for privately insured credit unions.

To determine reasons why credit unions chose private or federal deposit insurance and to obtain views on the benefits and risks of each, we interviewed representatives from 10 credit unions that had switched to or from private insurance in recent years. We identified these credit unions by reviewing NCUA's Insurance Activity Reports (from January 2008 to July 2016), which identify deposit insurance conversions, and then confirmed these conversions with NCUA and ASI. We interviewed representatives from five of the eight credit unions that converted from federal insurance provided by NCUA to private deposit insurance provided by ASI within the past 5 years.[10] Additionally, we interviewed representatives from five credit unions that most recently converted from private (ASI) to federal (NCUA) deposit insurance. The conversions took place in 2008–2009. These selection criteria were chosen because representatives from credit unions that recently converted should be able to provide reasons why their credit union made the choice to switch from federal to private deposit insurance, or vice versa, and have the most up-to-date information. We also interviewed representatives from credit union trade associations, NCUA, and ASI about the reasons credit unions choose private versus federal deposit insurance.

[9] 12 C.F.R. Part 740.

[10] The remaining three credit unions did not respond to our requests for interviews.

We conducted this performance audit from February 2016 to March 2017 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Reasons Credit Unions Chose Private or Federal Deposit Insurance

Credit unions in the United States can be federally or state-chartered, which determines their primary regulator for safety and soundness and also their options for deposit insurance. Federally chartered credit unions are regulated by the National Credit Union Administration (NCUA) and must be federally insured by NCUA's National Credit Union Share Insurance Fund, which provides up to $250,000 of insurance per depositor for each account ownership type. State-chartered credit unions are regulated by credit union supervisors in their respective state and also can be federally insured by NCUA or, in some states, choose a private insurer.[1] American Share Insurance (ASI) is the sole insurer for private deposit insurance to credit unions and provides coverage up to $250,000 per account. Credit unions sometimes change deposit insurers—for example, converting between federal and private deposit insurance. According to information provided by NCUA, eight credit unions converted from federal to private deposit insurance in 2012–2016, and five converted from private to federal deposit insurance in 2008–2009 (the most recent such conversions).

Representatives of some credit unions that converted from federal to private deposit insurance cited the following reasons:

- **Greater coverage for members**. ASI insures $250,000 per account, whereas NCUA insures $250,000 per depositer for each account ownership type. Thus, ASI provides more coverage for members with more than $250,000 in a particular deposit type because they can structure their deposits into multiple accounts of $250,000 or less.
- **Reduced federal oversight**. Representatives of some state-chartered credit unions described state regulation and oversight, including the examination process, as less burdensome than federal regulation and oversight.
- **Cost savings**. Credit union representatives said that private deposit insurance was less expensive than federal deposit insurance following the 2007-2009 financial crisis because ASI's special premium

[1]By law, federally chartered credit unions must have deposit insurance provided by NCUA. In most states, state law requires state-chartered credit unions to also have federal deposit insurance, according to the National Association of State Credit Union Supervisors (NASCUS). NASCUS also told us that in some states, state law permits credit unions to have private deposit insurance, although in some of these states no credit unions have chosen to do so. There are nine states where private deposit insurance is permitted and at least some credit unions have chosen to use it: Alabama, California, Maryland, Idaho, Illinois, Indiana, Ohio, Nevada, and Texas.

assessments were lower than the premiums of the National Credit Union Share Insurance Fund, and state regulatory fees are less than those of NCUA.[2]

- **Comparable business models**. A credit union representative noted that the credit union business model aligns well with ASI—both are not-for-profit organizations that exist to serve their members, and member credit unions sit on ASI's board of directors.

Representatives of some credit unions that converted from private to federal deposit insurance cited the following reasons:

- **Full faith and credit of U.S. government**. Deposits are backed by the full faith and credit of the U.S. government, which provides depositors with greater confidence and security.
- **Concern about private insurer during financial crisis.** A representative of one credit union told us the main reason it switched to NCUA insurance was because it was concerned that ASI might not survive the 2007–2009 financial crisis.
- **Access to additional funding source.** One credit union representative told us the credit union switched to federal deposit insurance in 2008 to allow it to join a Federal Home Loan Bank, which provided it with access to an additional funding source.[3]

[2]We did not request premium data from the credit unions to verify these statements about cost savings. NCUA staff told us they do not agree that private deposit insurance is less expensive than federal deposit insurance.

[3]Privately insured credit unions not certified as community development financial institutions were not allowed to become members of the Federal Home Loan Bank System until the enactment of the Fixing America's Surface Transportation Act in December 2015. Pub. L. No. 114-94, § 82001, 129 Stat. 1312, 1795 (2015).

Appendix III: Comments from the Consumer Financial Protection Bureau

Consumer Financial Protection Bureau

1700 G Street, N.W., Washington, DC 20552

March 8, 2017

Alicia Puente Cackley,
Director, Financial Markets and Community Investment
Government Accountability Office
441 G Street, NW
Washington DC, 20548

Dear Ms. Cackley:

Thank you for the opportunity to comment on the Government Accountability Office's (GAO) draft report, titled *Private Deposit Insurance: Credit Unions Largely Complied with Disclosure Rules, but Rules Should be Clarified (GAO-17-259).* We greatly appreciate GAO's consultation and collaboration with the Consumer Financial Protection Bureau over the course of this engagement and believe that the report provides important information regarding privately insured credit unions' compliance with federal disclosure requirements.

The Federal Deposit Insurance Act (FDIA) and its implementing regulation, Regulation I, require depository institutions that do not have federal deposit insurance to disclose "clearly and conspicuously" that their institutions are not federally insured.[1] GAO found there are 125 such credit unions (approximately 2 percent of all credit unions) and concluded that privately insured credit unions largely complied with federal disclosure requirements. For example, 45 of the 47 privately insured credit unions GAO reviewed complied with the disclosure requirement for teller windows. Moreover, 99 of the 102 websites GAO reviewed had the required disclosure on their main Internet page. These findings align with our understanding of the market. To date, the Bureau has not received any consumer complaints related to private deposit insurance. Nor has the Bureau's extensive consumer risk analysis process identified privately insured credit unions and their related disclosure requirements as consumer-facing activity that poses risk of the sort that would merit supervisory examination or enforcement investigation. The Bureau is also pleased to see that overall compliance levels with federal disclosure requirements have improved since GAO's last review in 2003.

Nevertheless, GAO did identify instances of noncompliance and determined that a lack of specificity in Regulation I contributed to privately insured credit unions' either failing to comply with or inconsistently complying with federal disclosure requirements. Specifically, GAO found

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[1] 12 U.S.C. § 1831t(b); 12 C.F.R. §§ 1009.3-4. As the report notes, the Bureau inherited rulemaking authority under the FDIA from the Federal Trade Commission (FTC) as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and subsequently adopted Regulation I substantially as promulgated by the FTC.

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that several institutions' drive-through windows did not contain the required disclosures, disclosure signage varied in dimensions and font size across credit unions, and some advertisements did not contain the required disclosures. For these reasons, GAO recommends that the Bureau provide guidance clarifying Regulation I in three respects: (1) clarify whether drive-through windows require disclosures; (2) describe what constitutes a clear and conspicuous disclosure, including minimum signage dimensions and font size for disclosures; and (3) explain and provide examples of which communications are advertising.

The Bureau recognizes that providing guidance clarifying Regulation I may improve privately insured credit unions' understanding of and compliance with federal disclosure requirements, and thus improve consumers' understanding of how deposits at non-federally-insured depository institutions are insured. Therefore, we intend to explore options that will most effectively and efficiently provide guidance regarding Regulation I. For example, one option the Bureau is considering is issuing a bulletin that could be published in the Federal Register and posted on the Bureau's website, as appropriate.

The Bureau looks forward to continuing to work with GAO as it monitors the Bureau's progress in implementing this recommendation. We will continue to monitor privately insured credit unions' compliance with federal disclosure requirements, consistent with our prioritization process.

Sincerely,

David Silberman
Associate Director for Research, Markets, and Regulations

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Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

In addition to the contact name above, Jason Bromberg (Assistant Director), Beth Faraguna (Analyst in Charge), Caitlin Cusati, Paul Foderaro, Alice Hur, Risto Laboski, Yola Lewis, Ned Malone, Scott McNulty, Marc Molino, Barbara Roesmann, Jessica Sandler, Frank Todisco, and Shana Wallace made key contributions to the report.

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