



Credit Union National Association

cuna.org

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May 2, 2011

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

Re: References to Credit Ratings; RIN 3133-AD86

Dear Ms. Rupp:

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the National Credit Union Administration Board's (Board's) proposed rule to eliminate references to credit ratings in its regulations, which is required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). By way of background, CUNA is the largest credit union advocacy organization in the country, representing approximately 90 percent of our nation's nearly 7,600 state and federal credit unions, which serve approximately 93 million members.

CUNA's Views on the Proposed Rule

The Dodd-Frank Act requires each federal agency to replace references to or requirements in its regulations regarding credit ratings with new standards of creditworthiness as established by each agency. The Board's proposed rule would delete the two dozen references to credit ratings in NCUA's regulations and add certain provisions to address assessment of credit risk. However, we have concerns with some aspects of the proposal. Further, certain proposed changes are beyond what is required under the Dodd-Frank Act.

Investment Authority

Under the proposed rule, NCUA's regulations that require a security to have a particular rating in order to be a permissible investment would be amended by replacing the minimum rating (e.g., AA, A, or BB) with a narrative standard on credit quality. The proposal generally requires a credit union to conduct and document an internal analysis demonstrating that the issuer of the security has a certain, specified capacity (such as "very strong," "strong," or "adequate") to meet its financial commitments.



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We are concerned that the subjective nature of narrative standards may cause confusion as to whether the standard has been met. To address such possible confusion, the proposal's supplementary information states that NCUA will provide additional supervisory guidance on the indicators that support a determination that an issuer has the necessary capacity—"very strong," "strong," or "adequate"—to meet its financial commitments. While we appreciate the Board's indication that it will provide this guidance, we believe the guidance should be issued for comment from the credit union system well before the effective date of the final rule.

We are concerned with the potential unintended effects of the Board's proposal to completely prohibit credit unions from relying on credit ratings. The Dodd-Frank Act does not require that regulators preclude the institutions they oversee from relying on credit ratings. We believe the use of NRSRO ratings can be useful to credit unions as part of a comprehensive approach to assessing credit risk.

In light of this reality, we urge the Board to consider permitting credit unions to rely on NRSRO ratings as long as the credit union also conducts further reasonable and appropriate due diligence—consistent with what the Board would allow regarding the credit union's board of directors' standards when counterparties are involved.

Counterparty Transactions

Under the proposed rule, current NCUA regulations that require a transaction counterparty to have a particular rating would be amended to instead require that the counterparty meet minimum credit quality standards as established by the credit union's board of directors. In developing and applying credit quality standards, the proposal would permit the board of directors to incorporate external ratings, reports, analyses, opinions, and other assessments issued by third parties. Credit unions would be expected to document credit assessment and analysis using a system similar to their internal loan grading system. These internal processes would be subject to examiner review and classification, similar to the process used for credit union loan classification.

We are very concerned with these provisions because we do not believe there is sufficient clarity in terms of what is expected of a board of directors regarding the establishment of these standards. We do not think credit unions or their advocacy organizations can fully assess the implications of these provisions and provide meaningful comments beyond superficial reactions without being able to review the guidance on these issues that NCUA has indicated it will develop. Again, we urge the Board to hold off promulgating this and other provisions without the benefit of being able to assess the proposed guidance.

Refrain from Addressing Certain References to Credit Ratings

We also urge the Board to hold off addressing certain references to credit ratings so that other key federal regulators may first revise their regulations, since their actions will impact NCUA's rules. Specifically, the Board should not amend its regulations regarding mortgage-related securities and small-business related securities in Part 703 at this time, as explained below.

The current definition of "mortgage related security" in § 703.2 of NCUA's regulations cross-references the definition in the Securities Exchange Act (Securities Act). However, the Dodd-Frank Act redefined the Securities Act's definition of "mortgage related security" as, a security that "meets standards of creditworthiness as established by the [Securities and Exchange] Commission (SEC)." The SEC has until mid-2012 to establish such standards of creditworthiness.

Under the proposal, in order for a credit union to purchase a mortgage related security, it would need to determine and document that the security is, in fact, a mortgage related security as defined by the SEC. Until the SEC establishes "standards of creditworthiness" for mortgage related securities, a credit union would be prohibited from purchasing such securities unless the credit union has "specific evidence that the SEC considers that security to meet the requirements of the [Securities Act]," which references the SEC's definition (which has not yet been finalized).

Similarly, NCUA's definition of "small business related security" in § 703.2 of its regulations cross-references the definition in the Securities Act. As with the definition of "mortgage related security," the definition of "small business related security" prior to the Dodd-Frank Act included a reference to NRSRO ratings. Under the proposal, in order for a credit union to purchase a small business related security, it would need to demonstrate that the security meets the requirements of the relevant section of the Securities Act, which references the yet-to-be established definition in the SEC's regulations.

The circularity associated with the Board's proposed definitional changes that rely on the SEC's regulations regarding mortgage related and small business related securities demonstrates why the Board should refrain from adopting its proposed changes, at least until the SEC has amended the relevant sections of its regulations. In addition, we note that NCUA is sole federal financial agency that did not issue an advance notice of proposed rulemaking (ANPR) regarding references to credit ratings.¹

¹ The Office of Thrift Supervision, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and the Federal Reserve Board issued a joint ANPR on references to credit ratings in mid-2010.

Thank you for the opportunity to express our views on the Board's proposed rule to address references to credit ratings in its regulations. If you have any questions about our comments, please do not hesitate to give CUNA Senior Vice President and Deputy General Counsel Mary Dunn or me a call at (202) 508-6743.

Sincerely,

A handwritten signature in cursive script that reads "Luke Martone". The signature is written in black ink and is positioned above the printed name and title.

Luke Martone
Assistant General Counsel