

**7535-01-U**

**NATIONAL CREDIT UNION ADMINISTRATION**

**12 CFR Part 791**

**RIN: 3133-AE45**

**Promulgation of NCUA Rules and Regulations**

**AGENCY:** National Credit Union Administration (NCUA).

**ACTION:** Proposed Rule and Interpretive Ruling and Policy Statement 15-1 with request for comments.

**SUMMARY:** The NCUA Board (Board) proposes to amend Interpretive Ruling and Policy Statement (IRPS) 87-2, as amended by IRPS 03-2 and 13-1. The amended IRPS would increase the asset threshold used to define small entity under the Regulatory Flexibility Act<sup>1</sup> (RFA) from \$50 million to \$100 million and, thereby, provide transparent consideration of regulatory relief for a greater number of credit unions in future rulemakings. The proposed rule and IRPS also make a technical change to subpart B of Part 791 of NCUA's regulations,

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<sup>1</sup> P.L. 96-354.

replacing its reference to IRPS 13-1 with a reference to IRPS 15-1, in connection with NCUA's procedures for developing regulations.

**DATES:** Comments must be received on or before [Insert date 60 days from date of publication in the FEDERAL REGISTER].

**ADDRESSES:** You may submit comments by any of the following methods  
**(Please send comments by one method only):**

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- NCUA Web Site:  
<http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx>. Follow the instructions for submitting comments.
- E-mail: Address to [regcomments@ncua.gov](mailto:regcomments@ncua.gov). Include “[Your name]—Comments on Proposed Rule 791 and IRPS 15-1” in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Gerard Poliquin, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

**PUBLIC INSPECTION:** You can view all public comments on NCUA's website at <http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx> as submitted, except for

those we cannot post for technical reasons. NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9 a.m. and 3 p.m. To make an appointment, call (703) 518-6546 or send an e-mail to [OGCMail@ncua.gov](mailto:OGCMail@ncua.gov).

**FOR FURTHER INFORMATION CONTACT:** Kevin Tuininga, Lead Liquidations Counsel, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428 or telephone: (703) 518-6543.

## **SUPPLEMENTARY INFORMATION**

- I. Background
- II. The Proposed Rule and IRPS
- III. Regulatory Procedures

### **I. Background**

#### **A. What Changes Does This Proposed Rule Make?**

The RFA, as amended, generally requires federal agencies to determine and consider the impact of proposed and final rules on small entities. Since adopting IRPS 13-1 in 2013, the Board has defined "small entity" in this context as a

federally insured credit union (FICU) with less than \$50 million in assets.<sup>2</sup> This proposed rule and IRPS 15-1 redefines “small entity” as a FICU with less than \$100 million in assets. In addition, the proposed rule amends §791.8(a) of NCUA’s regulations to cross reference proposed IRPS 15-1. Section 791.8(a) governs NCUA’s procedures for developing regulations and incorporates IRPS 87-2 and each of its amendments.

## **B. Why is the Board Proposing This Rule and IRPS?**

The Board is proposing this rule and IRPS to increase the number of FICUs that receive special consideration of regulatory relief under the RFA. Congress enacted the RFA in 1980 and amended it with the Small Business Regulatory Enforcement Fairness Act of 1996.<sup>3</sup> A principal purpose of the 1996 amendment was to provide an opportunity for judicial review of agency compliance with the RFA.<sup>4</sup>

The RFA, in part, requires federal agencies to determine whether a proposed or final rule would have a significant economic impact on a substantial number of small entities.<sup>5</sup> If so, the RFA requires agencies to engage in a small entity impact analysis, known as an initial regulatory flexibility analysis (IRFA) for

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<sup>2</sup> IRPS 13-1, 78 FR 4032 (Jan. 18, 2013).

<sup>3</sup> P.L. 104-121.

<sup>4</sup> Id.

<sup>5</sup> 5 U.S.C. 603, 604, 605(b). The term “small entity” as used in the RFA includes small businesses, small organizations, and small government jurisdictions. 5 U.S.C. 601(6). Credit unions fall within the definition of organization. 5 U.S.C. 601(4).

proposed rules and a final regulatory flexibility analysis (FRFA) for final rules.<sup>6</sup> The IRFA and FRFA each must be published in the Federal Register.<sup>7</sup> If an agency determines that a proposed or final rule will not have a “significant economic impact on a substantial number of small entities,” the agency may certify as much in the Federal Register and forego the IRFA and FRFA.<sup>8</sup>

For an IRFA, the procedural requirements include, among other things, “a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply,” a description of reporting, recordkeeping, and other compliance burden, and an identification of any overlapping or conflicting federal rules.<sup>9</sup> In addition, the IRFA must “contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives . . . and which minimize any significant economic impact of the proposed rule on small entities.”<sup>10</sup> This discussion must include alternatives such as allowing “differing compliance or reporting requirements or timetables,” “the clarification, consolidation, or simplification of compliance and reporting requirements,” “the use of performance rather than design standards,” and a full or partial exemption for small entities.<sup>11</sup>

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<sup>6</sup> 5 U.S.C. 603, 604.

<sup>7</sup> *Id.*

<sup>8</sup> 5 U.S.C. 605(b).

<sup>9</sup> 5 U.S.C. 603(b). The IRFA must also include a description of why the agency is considering action and “a succinct statement of the objectives of, and legal basis for, the proposed rule . . . .”

*Id.*

<sup>10</sup> 5 U.S.C. 603(c).

<sup>11</sup> *Id.*

The FRFA must meet requirements similar to that of the IRFA, but must also discuss and respond to public comments and describe “the steps the agency has taken to minimize the significant economic impact on small entities . . . , including a statement of factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule . . . was rejected.”<sup>12</sup> These processes encourage federal agencies to give special consideration to the ability of smaller entities to absorb compliance burdens imposed by new rules.

The RFA establishes terms for various subgroups that fall within the meaning of “small entity,” including “small business,” “small organization,” and “small governmental jurisdiction.”<sup>13</sup> FICUs, as not-for-profit enterprises, are “small organizations,” within the broader meaning of “small entity.” The RFA permits a regulator, including NCUA, to establish one or more definitions of “small organization,” as appropriate to the activities of the agency.<sup>14</sup> An agency’s definition must be subjected to public comment and published in the Federal Register.<sup>15</sup> The RFA provides a default definition of “small organization” as “a not-for-profit enterprise which is independently owned and operated and is not dominant in its field . . . .”<sup>16</sup>

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<sup>12</sup> 5 U.S.C. 604(a).

<sup>13</sup> 5 U.S.C. 601.

<sup>14</sup> 5 U.S.C. 601(4).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

In 1981, the Board initially defined “small entity” in the credit union context as any FICU with less than \$1 million in assets.<sup>17</sup> IRPS 87-2 superseded IRPS 81-4, but retained the definition of “small entity” as a FICU with less than \$1 million in assets.<sup>18</sup> The Board updated the definition in 2003 to include FICUs with less than \$10 million in assets with IRPS 03-2.<sup>19</sup> The last update occurred in 2013, when the Board increased the defining threshold to include FICUs with less than \$50 million in assets in IRPS 13-1.<sup>20</sup> In addition, in IRPS 13-1, the Board pledged to review the RFA threshold after two years and thereafter on a three-year cycle, similar to its regulatory review process.<sup>21</sup>

As a result of conducting its review two years following the issuance IRPS 13-1, the Board believes it should increase the asset threshold used to define “small entity” from \$50 million to \$100 million. In its last two adjustments to the RFA threshold, the Board primarily referenced inflation, asset growth, and the percentage of FICUs covered by certain 1998 amendments to the Federal Credit Union Act to justify increasing the threshold.<sup>22</sup> In light of the persistent economic trends in the industry that are discussed below, the Board has decided to bypass the extrapolation approach it has used in the past, which would justify only an incremental increase to the RFA threshold at this time. Instead, the Board believes it should weigh competitive disadvantages within the credit union

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<sup>17</sup> IRPS 81-4, 46 FR 29248 (June 1, 1981).

<sup>18</sup> 52 FR 35231 (Sept. 8, 1987).

<sup>19</sup> 68 FR 31949 (May 29, 2003).

<sup>20</sup> 78 FR 4032 (Jan. 18, 2013).

<sup>21</sup> Id. IRPSs 87-2, 03-2, and 13-1 are incorporated by reference into NCUA’s rule governing the promulgation of regulations. 12 CFR 791.8(a).

<sup>22</sup> 68 FR 31949, 31950 (May 29, 2003); 78 FR 4032, 4034 (Jan. 18, 2013).

industry, relative threats to the National Credit Union Share Insurance Fund (Insurance Fund), and the need for broader regulatory relief to adopt a larger increase.

Increasing the RFA threshold to \$100 million will account for FICUs that generally face significant challenges from their relatively small asset base, membership, and economies of scale. The Board believes competitive disadvantages, rather than industry percentages, better delineate which FICUs should receive special consideration during future rulemakings. This new approach would result in a more inclusive threshold with respect to RFA coverage, reflecting the Board's intent to reduce regulatory burdens for FICUs under \$100 million in assets.

## **II. The Proposed Rule and IRPS**

This proposed rule and IRPS 15-1 would amend IRPS 87-2 (as amended by IRPS 03-2 and IRPS 13-1) by changing the definition of "small entity" to include FICUs with less than \$100 million in assets. The increased threshold would cause NCUA to give special consideration to the economic impact of proposed and final regulations on an additional 745 small FICUs, bringing the total number of FICUs covered by the RFA to approximately 4,869. The proposed rule and IRPS 15-1 retains the three-year review cycle that the Board adopted in 2013. IRPS 15-1 would be incorporated by reference into §791.8(a) of NCUA's



regulations governing regulatory procedures, and it would replace the reference to IRPS 13-1.

In IRPS 13-1, the Board combined adjustments to existing regulatory asset thresholds with an increase to the RFA threshold.<sup>23</sup> Specifically, asset thresholds addressed in IRPS 13-1 included the threshold governing the definition of “complex” in §702.103(a) of NCUA’s regulations, which determines the application of risk-based net worth requirements, and the threshold providing an exemption to NCUA’s interest rate risk (IRR) rule in §741.3(b)(5). Rather than replicate this approach in this proposal, the Board will separately establish the asset threshold used to define which FICUs are “complex” in §702.103(a) in the risk-based capital rule itself. Further, other regulatory asset thresholds, including those applying to IRR and liquidity requirements, will be separately considered in the Board’s general three-year regulatory review cycle. Individual review will facilitate consideration of unique risks and compliance burdens that are specific to those rules, rather than encouraging a one-size-fits-all approach.

**A. How did the Board Identify \$100 Million as an Appropriate Asset Threshold for the RFA?**

The Board believes that the RFA threshold proposed in this rule and IRPS will result in thorough consideration of regulatory relief for a larger number of FICUs in future rulemakings. Thus, to determine an appropriate asset threshold for the

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<sup>23</sup> 78 FR 4032 (Jan. 18, 2013).

RFA and support a significant increase, the Board considered which FICUs are most disadvantaged in comparison to their peers, as well as risk to the Insurance Fund. The concept of competitive disadvantage aligns well with Congress's default description of RFA-covered entities as those that are "not dominant" in their field.<sup>24</sup> In an effort to determine which institutions fall within that concept in this proposed rule and IRPS, the Board examined the following industry metrics for the period between 2001 and 2013:

- deposit growth rates;
- asset growth rates; membership growth rates;
- loan origination growth rates;
- inflation-adjusted average loan amounts;
- ratio of operating costs to assets;
- merger and liquidation trends;
- average year-to-date loan amounts;
- non-interest expenses per dollar loaned;
- average assets per full-time employee; and
- average non-interest expense per annual loan originations.

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<sup>24</sup> 5 U.S.C. 601(4).

As discussed below, rates of deposit growth, rates of membership growth, rates of loan origination growth, and the ratio of operating costs to assets exemplified the results of the Board's examination.<sup>25</sup>

#### (i) Slower Deposit Growth Rates

Smaller FICUs have consistently demonstrated an inability to grow their deposit base at a rate that keeps pace with larger FICUs. This slower growth rate makes it difficult for smaller FICUs to cover fixed costs, which are increasing over time. FICUs with growing deposits and loans are able to spread out fixed costs and incrementally reduce operating costs.

In general, deposit growth rates drop off significantly for FICUs with less than \$100 million in assets. FICUs with less than \$100 million in assets as of the end of the year 2000 grew their deposits by an average of 4.0 percent annually over the next 13 years. In comparison, FICUs with greater than \$100 million in assets as of the end of the year 2000 grew deposits at 7.3 percent annually, on average, over the same period. On an asset-weighted basis, the industry's average deposit growth rate from 2001 to 2013 was 7.0 percent per year.

#### (ii) Slower Membership Growth Rates

FICUs with less than \$100 million in assets also had significantly slower membership growth rates than larger FICUs. On average, FICUs with less than

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<sup>25</sup> The data used to calculate each of the metrics is adjusted to prevent outliers from skewing the average results.

\$100 million in assets as of the end of the year 2000 had their membership shrink by 0.5 percent annually over the next 13 years. In contrast, FICUs with more than \$100 million in assets as of the end of the year 2000 grew their membership by 2.3 percent annually over the same period. On an asset-weighted basis, the industry's membership growth rate was 1.7 percent per year from 2001 to 2013.

#### (iii) Slower Growth in Loan Originations

FICUs with less than \$100 million in assets also had significantly slower growth in loan originations than larger FICUs. On average, FICUs with less than \$100 million in assets as of the end of the year 2000 grew loan originations by 2.3 percent annually over the next 13 years. In contrast, FICUs with more than \$100 million in assets as of the end of the year 2000 grew their loan originations by 8.5 percent annually over the same period. On an asset-weighted basis, the industry's loan origination growth was 6.9 percent per year from 2001 to 2013.

#### (iv) Higher Operating Expenses

FICUs with less than \$100 million in assets also had higher annual operating expenses per unit of assets and per dollar of loan originations compared to other asset groups. On average, FICUs with less than \$100 million in assets as of the end of the year 2000 had annual operating expenses equal to 4.0 percent of assets over the next 13 years. FICUs with more than \$100 million in assets as of

the end of the year 2000 had annual operating expenses of 3.5 percent of assets over the same period.

The impact of these differences in operating expenses can be dramatic.

Between 2001 and 2013, FICUs with less than \$100 million in assets as of the end of the year 2000, had operating expenses, on average, equal to 18 cents for every dollar in loan originations. This expense ratio was a third higher than at FICUs with more than \$100 million in assets as of the end of the year 2000, which averaged annual operating expenses equal to 13 cents for every dollar in loan originations over the same period.

The 50-basis-point difference in operating expenses (as a share of assets) between FICUs above and below the \$100 million asset threshold resulted in large and persistent differences in earnings between these FICUs. The earnings gap between FICUs above and below the \$100 million threshold averaged 40 basis points from 2001 to 2013. To put this in perspective, during that period, 25 percent of FICUs below the \$100 million asset threshold had negative earnings. Only 3.3 percent of FICUs with more than \$100 million in assets had negative earnings over the same period. FICUs with persistently weak or negative earnings are more likely to go out of business via failure or merger.

The Board believes that if smaller FICUs are going to be successful and meet their mission in the long term, they should have every feasible opportunity to

lower costs. Challenges related to lagging deposit growth, stagnant membership, and high operating costs have caused FICUs with less than \$100 million in assets to merge and/or fail at higher rates. Despite representing 83 percent of all FICUs, FICUs with less than \$100 million in assets experienced 96 percent of mergers and liquidations since 2004 (through the second quarter of 2014).

Although the number of mergers and failures for FICUs below \$100 million is disproportionately high, losses suffered by FICUs with assets between \$50 million and \$100 million have historically been relatively small. Seven FICUs between \$50 million and \$100 million in inflation-adjusted assets failed between the first quarter of 2002 and second quarter of 2014. Resulting losses totaled less than \$52 million. In contrast, losses for FICUs between \$100 million and \$200 million were more than triple that amount over the same period. Moreover, FICUs with between \$50 million and \$100 million in assets represent a small additional share of the system's assets (4.8 percent). Thus, to the extent the increase to \$100 million results in more FICU exemptions from rules governing safety and soundness, the Board does not believe it will present material risk to the Insurance Fund.

By increasing the RFA threshold to \$100 million in assets, the Board recognizes its role in ensuring additional scrutiny of the regulatory costs of FICUs under that threshold. The increase to \$100 million in assets will require the Board to

engage in the public analytical process the RFA requires for the benefit of significantly more FICUs whenever a regulation would impose significant economic burdens on a substantial number of FICUs under \$100 million. Further, it will encourage the consideration of alternatives for more FICUs and subject that consideration to the benefit of public comments.

### **B. How Will the Proposed Rule and IRPS Affect FICUs?**

The change to the RFA threshold will ensure that regulatory relief will be consistently and robustly considered for an additional 745 FICUs. Future rules are more likely to invoke an RFA analysis because of the significantly increased threshold. When an IRFA or FRFA is triggered, these additional FICUs will have the benefit of an opportunity to comment on a transparent and published analysis of impacts and alternatives.

In all, approximately 4,869 FICUs with less than \$100 million in assets would come within the RFA's mandates as of the adoption of this proposed rule and IRPS. This represents 76.7 percent of FICUs. For all of these FICUs, future regulations will be thoroughly evaluated to determine whether an exemption or other separate consideration should apply.

### **III. Regulatory Procedures**

#### **A. Regulatory Flexibility Act**

The RFA requires NCUA to prepare an analysis to describe any significant economic impact a proposed rule may have on a substantial number of small entities (currently defined by NCUA as FICUs with under \$50 million in assets). In this case, the proposed rule and IRPS expands the number of FICUs defined as small entities under the RFA. The proposed rule and IRPS therefore will not have a significant economic impact on a substantial number of FICUs under \$50 million in assets that are already covered by the RFA.

With respect to additional FICUs that would be covered by the RFA, a significant component of the proposed rule and IRPS will provide prospective relief in the form of special and more robust consideration of their ability to handle compliance burden. This prospective relief is not yet quantifiable. Further, the proposed rule and IRPS can only reduce, rather than increase, compliance burden for these FICUs and, therefore, will not raise costs in a manner that requires an IRFA or FRFA or a discussion of alternatives for minimizing the proposed rule's compliance burden. Accordingly, NCUA has determined and certifies that the proposed rule and IRPS will not have a significant economic impact on a substantial number of small entities. No regulatory flexibility analysis is required.



## **B. Paperwork Reduction Act**

The Paperwork Reduction Act of 1995 (PRA) applies to rulemakings in which an agency creates a new paperwork burden on regulated entities or modifies an existing burden.<sup>26</sup> For purposes of the PRA, a paperwork burden may take the form of either a reporting or a recordkeeping requirement, both referred to as information collections. The proposed changes to IRPS 87-2, as amended by IRPSs 03-2 and 13-1, will not create any new paperwork burden for FICUs. Thus, NCUA has determined that the terms of this proposed rule and IRPS do not increase the paperwork requirements under the PRA and regulations of the Office of Management and Budget.

## **C. Executive Order 13132**

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on state and local interests. NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5), voluntarily complies with the executive order to adhere to fundamental federalism principles. This proposed rule and IRPS would not have a substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the executive order.

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<sup>26</sup> 44 U.S.C. 3507(d).

#### **D. Assessment of Federal Regulations and Policies on Families**

NCUA has determined that this proposed rule and IRPS will not affect family well-being within the meaning of Section 654 of the Treasury and General Government Appropriations Act, 1999, Public Law 105–277, 112 Stat. 2681 (1998).

#### **List of Subjects**

##### **12 CFR Part 791**

Administrative practice and procedure, Credit unions, Sunshine Act.

By the National Credit Union Administration Board on February \_\_, 2015.

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Gerard Poliquin

Secretary of the Board

For the reasons discussed above, the Board proposes to amend 12 CFR part 791 and IRPS 87-2 (as amended by IRPS 03-2 and IRPS 13-1) as follows:

**PART 791 – RULES OF NCUA BOARD PROCEDURES; PROMULGATION OF NCUA RULES AND REGULATIONS; PUBLIC OBSERVATION OF NCUA BOARD MEETINGS**

1. The authority citation for part 791 continues to read as follows:

**Authority:** 12 U.S.C. 1766, 1789 and 5 U.S.C 552b.

2. Amend Section 791.8(a) to read as follows:

NCUA's procedures for developing regulations are governed by the Administrative Procedure Act (5 U.S.C. 551 et seq.), the Regulatory Flexibility Act (5 U.S.C. 601 et seq.), and NCUA's policies for the promulgation of rules and regulations as set forth in its Interpretive Ruling and Policy Statement 87-2, as amended by Interpretive Ruling and Policy Statements 03-2, 13-1, and 15-1.

3. Amend IRPS 87-2 (as amended by IRPS 03-2 and IRPS 13-1) by revising the second sentence of paragraph 2 of Section II and replacing the last two sentences of paragraph 2 of Section II to read as follows:

### **Interpretive Ruling and Policy Statement 87-2**

## **II. Procedures for the Development of Regulations**

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2. \* \* \* NCUA will designate federally insured credit unions with less than \$100 million in assets as small entities. \* \* \* Every three years, the NCUA Board will review and consider adjusting the asset threshold it uses to define small entities for purposes of analyzing whether a regulation will have a significant economic impact on a substantial number of small entities.

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