September 2, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NASCUS Comments on Regulatory Publication and Review under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA)

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS)[1] submits the following comments in response to the National Credit Union Administration's (NCUA's) notice of regulatory review and request for comments. First, we congratulate NCUA for voluntarily participating in the EGRPRA review process. The Agency is not required to undertake EGRPRA review, and its commitment to identifying and minimizing outdated, unnecessary, or unduly burdensome requirements is commendable. NASCUS appreciates the opportunity to aid NCUA in that effort, and is hopeful that the process will lead to more efficient and effective regulation.

Our comments are separated into the designated EGRPRA buckets, and broken out by regulation number for ease of review.

Applications and Reporting

IRR Policy and Program (741.3)

Interest rate risk (IRR) management is an essential component of a credit union's safe and sound operations, and all credit unions, regardless of size, should identify and manage IRR. Although the current regulation attempts to ease regulatory burden by creating a three tiered system based on asset size, the result is an overly complex and detailed regulation that essentially exempts small credit unions from managing IRR regardless of their balance sheet structure. NASCUS recommends that NCUA adopt a simple, flexible, and unequivocal mandate that requires every credit union to identify and effectively manage IRR, including shock testing as appropriate. The following language would achieve this goal and is consistent with the IRR program requirements contained in Federal Deposit Insurance Corporation (FDIC) regulations:[2]

> *741.3(b)(5) Interest Rate Risk – (A) An effective interest rate risk management program that is appropriate for the size and complexity of the credit union. An effective program:*

[1] NASCUS is the professional association of the nation's state credit union regulatory agencies.

[2] 12 C.F.R. Appendix A to Part 364(II)(E).

(i) considers the assets and liabilities of the institution;
(ii) is documented;
(iii) provides for management reports to the credit union's board; and
(iv) utilizes testing as appropriate or directed by state regulators or NCUA.

(B) State specific rules – upon application to NCUA, state-chartered credit unions in compliance with a state specific interest rate risk rule will be deemed in compliance with this part if NCUA determines the state rule provides sufficient protection to the fund.

This suggested change would minimize regulatory burden by eliminating unnecessary minutiae that should be left to the discretion of credit union management. It also explicitly retains the authority for regulators to direct IRR testing where there is a safety and soundness concern.

Financial and Statistical and Other Reports (741.6)

NASCUS encourages NCUA to work with state regulators and industry stakeholders to undertake a comprehensive and holistic review of the 5300 Call Report. The Call Report is a critical tool in the supervisory oversight process, and yet both credit unions and regulators struggle to derive value from the current patchwork of collected data. As an off-site monitoring tool for regulators, the Call Report should provide a clear picture of a credit union's complete balance sheet so that regulators can identify growing or unmitigated risks between on-site examinations. As currently structured, however, the Call Report too often raises red flags where risk is properly managed and misses areas of true concern.

NASCUS recommends that NCUA systematically review the Call Report, and where possible, amend it to more closely follow the FFIEC standard. This would not only improve data capture in several vital areas, including indicators of IRR, but would also bring NCUA into line with the other federal financial regulators and facilitate inter-agency information sharing, training, and regulatory burden reduction efforts.

State regulators also support NCUA's efforts to ensure timely and accurate submission of Call Report data.[3] Late and inaccurate filings are serious problems that drain regulatory resources and undermine the ability of regulators to quickly and effectively address emerging safety and soundness concerns. NASCUS is confident that, working together, we will be able to establish a fair and balanced process that inspires prompt and comprehensive reporting without exhausting credit unions' compliance resources. We look forward to continued dialogue and cooperation with NCUA on this issue.

Purchase of Assets and Assumption of Liabilities (741.8)

Under current regulations, credit unions must receive approval from NCUA before purchasing loans or assuming liabilities from a federally insured non-credit union financial institution. The same restriction does not apply to identical transactions with insured credit unions. Non-credit union financial institutions are stringently regulated for safety and soundness at both the state and federal level. In fact, the state regulator may be the primary prudential regulator for both the credit union and the bank or other financial institution involved in a given transaction. Many

[3] Letter to Credit Unions 14-CU-03

non-credit union financial institutions are also federally insured by one of NCUA's sister agencies. As such, there is no inherent safety and soundness rationale for this restriction and it should be removed or limited to federal credit unions. To the extent that a credit union is limited in transacting with certain classes of federally-insured depositories, it is a chartering decision and not an insurance consideration.

In addition, Part 741.8(c) currently stipulates that a credit union must request approval and submit documentation to NCUA's regional office. NCUA should defer to state regulators for approval of asset purchases or assumptions of liabilities at FISCUs, with notice to the NCUA. As the primary prudential regulator for state-chartered credit unions, state regulators have principal responsibility to review FISCU transactions. Simultaneous notice to NCUA would enable the insurer to raise any safety and soundness concerns prior to approval. These modifications would strengthen the delineation between NCUA's responsibilities as an insurer and as a chartering authority, without any implication for safety and soundness.

At a minimum, the approval timeline should be made more explicit. The regulation currently states that NCUA will approve or disapprove of the transaction "as soon as possible depending on the complexity of the proposed transaction." The regulation should be amended to include a 30 day default approval mechanism.

Charter Conversions (708a; 708b; IRPS 03-01)

Part 708a of NCUA's regulations lays out in detail the process by which an insured credit union may convert to a Mutual Savings Bank (MSB), or merge into a bank. The regulation contains specific provisions regarding communications to and by the membership concerning possible conversion to an MSB, as well as provisions regarding the voting process itself. Although ensuring strong corporate governance, protecting members' equity interests, and guarding against potential consumer protection harms are laudable goals, they are the purview of the primary prudential regulator, not the insurer. Consequently, FISCUs should be exempt from 708a requirements.

From an insurer's perspective, the conversion of a credit union to an MSB means only that one type of federal deposit insurance will be replaced by another type of federal deposit insurance. To the extent that members are notified of the change and appropriate signage and marketing materials are promptly replaced, NCUA should be satisfied that member deposits still enjoy the protection of the full faith and credit of the United States government.

NASCUS concedes that the current statutory framework confers rule-making and oversight authority on NCUA for the process by which state-chartered credit unions convert to non-credit union status.[4] We encourage NCUA to raise this issue in its report to Congress, and encourage the legislature to reconsider the appropriate delineation of authority between the insurer and the chartering authority in managing the charter conversion process. In the absence of congressional action, NCUA should streamline and simplify, to the extent possible, Part 708a and Part 741.208 in a manner that resolves procedural questions for federal credit union conversion while respecting state regulatory and statutory authority.

[4] 12 U.S.C. 1785(b).

Similarly, Part 708b, which governs mergers of federally-insured credit unions and the voluntary termination or conversion of insured status, should clarify which portions of the regulation apply to FISCUs, and which apply only to federal credit unions. Provisions dealing with the specific requirements of member votes and the responsibilities of the board of directors concern matters of corporate governance, which is a matter of state law. For example, 708b.106 addresses the process by which members must approve a merger proposal and, appropriately, appears to apply only to federal credit unions. However, Part 741.208, which informs FISCUs that they are subject to Part 708b, says only that FISCUs should "adhere to the applicable requirements stated in section 206 of the Act and parts 708a and 708b." This creates a real regulatory burden in that it sends FISCUs and federal examiners scrambling through 708a and 708b to determine which requirements FISCUs must meet.

Vague incorporation of rules by reference drain credit union and regulatory time and resources and can often cause confusion during examinations. This problem, and countless others of the same origin, could be remedied by incorporating all regulations that are applicable to FISCUs in Part 741 in their entirety. Furthermore, although the requirements that NCUA decides to apply to federal credit unions during the charter conversion process are completely within the purview of the Agency to determine, we note that there are opportunities to streamline that process as well, and encourage NCUA to consider limiting the requirements to those that pertain directly to safety and soundness concerns.

Powers and Activities

Loans to Members and Lines of Credit to Members (701.21)

FISCUs are subject to Part 701.21(c)(8) concerning prohibited fees and 701.21(d)(5) concerning non-preferential loans pursuant to Part 741.203. Under current regulations, FISCUs are exempt from these requirements if the state supervisory authority adopts "substantially equivalent" regulations as determined by the NCUA Board. NASCUS recommends the substantially equivalent standard be replaced (as it was in the MBL rule) with the standard of minimizing risk and accomplishment of NCUA's overall objectives. From a safety and soundness perspective, there is no reason to require a state rule be substantially similar to NCUA's rule. In fact, differing approaches to minimizing risk strengthen the credit union system by allowing for regulatory innovations that improve safety and soundness while minimizing regulatory burden. Removing the "substantially equivalent" language will allow the state laboratories of innovation to work, without sacrificing oversight from the share insurer.

Loan Participations (701.22)

NCUA's regulation of loan participations is applicable to FISCUs pursuant to 741.225. This regulation creates a number of documentation and structural requirements for loan participations that erode state regulatory authority but do little to strengthen the safety and soundness of credit unions. In the final rule, NCUA cites "the interconnectedness between participants" as an inherent risk to the NCUSIF that justifies the rule and the preemption of state regulation. However, the rule does not provide the NCUA with a mechanism for identifying or tracking interconnectedness throughout the industry; it merely sets aggregate limits on purchases from a single originating lender or single borrower and makes those limits waivable by NCUA. To the extent the rule only serves to codify, in detail, the basic tenants of a safe and sound lending program (i.e., underwriting standards, concentration policies, and legally binding loan agreements) it is duplicative of existing safety and soundness regulations and infringes upon credit union management and state regulatory authority. Where states already have procedures in place to evaluate these safety and soundness concerns in loan participation programs, NCUA should defer to state regulation. At a minimum, NCUA should streamline the regulation to reinforce the basic safety and soundness tenants listed above without overburdening credit union management with intricately detailed regulatory requirements.

Member Business Lending (Part 723)

NCUA's current member business lending rule consists of both direct statutory implementation as well as discretionary rulemaking. Pursuant to NCUA's request for comments on needed statutory changes as well as regulatory changes, we offer recommendations regarding both.

The most urgent statutory change needed is for the 12.25% limit on member business loans in the aggregate to be raised. The 12.25% limit is too low as a general prohibition. Many credit unions have expressed valid concerns that the cost of a truly effective member business loan program is not readily recoverable with such a low cap. This cost-to-return deficiency in turn creates a disincentive to invest in the infrastructure, in some cases, for an optimal safe and sound program. Given that the limit was not based on safety and soundness concerns, we urge NCUA to continue to support statutory changes that would raise the threshold.

NASCUS also believes that statutory and regulatory changes are needed to the definition of a member business loan. Currently, a member business loan is defined as:

> (a) *General rule.* A member business loan includes any loan, line of credit, or letter of credit (including any unfunded commitments) where the borrower uses the proceeds for the following purposes:
> (1) Commercial;
> (2) Corporate;
> (3) Other business investment property or venture; or
> (4) Agricultural.
> (b) *Exceptions to the general rule.* The following are not member business loans:
> (1) A loan fully secured by a lien on a 1 to 4 family dwelling that is the member's primary residence;
> (2) A loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions;
> (3) Loan(s) to a member or an associated member which, when the net member business loan balances are added together, are equal to less than $50,000;
> (4) A loan where a federal or state agency (or its political subdivision) fully insures repayment, or fully guarantees repayment, or provides an advance commitment to purchase in full; or
> (5) A loan granted by a corporate credit union to another credit union.

The definition excludes commercial loans with balances less than $50,000.00. This exception was developed to exclude from the aggregate cap limit smaller business loans. We agree with the exception in that regard. In fact, in terms of encouraging small business loans, we believe the exception with respect to the cap should be raised to loans under $100,000. However, from a regulatory perspective, we also believe it is equally import to reinforce the message that commercial loans of all sizes, as reported on the Call Report, are different from consumer loans in terms of underwriting and monitoring, and should be treated as such. We recommend amending the definition of a member business loan to better distinguish the issues related to underwriting and the statutory limit.

We continue to recommend NCUA reorganize Part 723 to better distinguish between the strict implementation of statute, and the discretionary rulemaking. Such a distinction will facilitate future discussions regarding the rule by clarifying exactly where NCUA's discretion is applicable.

NCUA should eliminate the waiver requirement of Part 723.3 and Part 723.10. NCUA recently proposed rulemaking to replace a waiver requirement for fixed assets with a threshold over which additional policy and program requirements would apply. We believe that approach should be applied to member business loans. Requiring waivers creates an unnecessary burden for credit unions and regulators. NCUA should explicitly state its expectations for a safe and sound program and supervise to those standards. As currently organized, Part 723 allows for waivers for the following:

- Appraisal requirements under §722.3
- Aggregate construction and development loans limits under §723.3(a);
- (c) Minimum borrower equity requirements for construction and development loans under §723.3(b);
- (d) Loan-to-value ratio requirements for business loans under §723.7(a);
- (e) Requirement for personal liability and guarantee under §723.7(b);
- (f) Maximum unsecured business loans to one member or group of associated members under §723.7(c)(2);
- (g) Maximum aggregate unsecured member business loan limit under §723.7(c)(3); and
- (h) Maximum aggregate net member business loan balance to any one member or group of associated members under §723.8.

The rule also contains a lengthy waiver process. If it is acceptable for credit unions to exceed these limits, than NCUA's rules should reflect that and allow credit unions to operate freely up to whatever level is ultimately unacceptable. NCUA should also consider codifying the process by which a credit union must seek forbearance for an existing member business loan, as opposed to requesting a waiver for a prospective loan.

Part 723.5 should be amended to eliminate the two year statutory requirement. Credit unions should be required to possess the experience with administering a member business loan program commensurate with the risk presented by the specific activities undertaken. NASCUS believes the two year requirements as established by the rule is counterproductive in communicating that more expertise may often be required for a given program.

Maximum Borrowing Authority (741.2)

Part 741.2 limits aggregate borrowing of any federally insured credit union to 50% of paid-in and unimpaired capital and surplus. For FISCUs, this section provides for a waiver of this limit upon application to the appropriate regional director, with prior written approval from the state regulator. The regulation provides that "the regional director will approve the waiver request if the proposed borrowing limit will not adversely affect the safety and soundness of the federally insured state-chartered credit union."[5] In order to minimize regulatory burden, NASCUS recommends replacing the waiver process with a simple notice requirement. FISCUs would still be required to get approval from their state regulator, and NCUA would still be able to assert safety and soundness concerns to block the increase. If NCUA is unwilling to adopt a notice framework, the regulation should be amended to specify default approval of a waiver request after 30 days.

Payments on Shares by Public Units and Nonmembers and Supplementary Capital Accounts (701.32; 701.34)

State law should control thresholds for public deposits and limitations on secondary capital accounts. The limitations placed on FISCUs under Part 701.32 and 701.34 (pursuant to Part 741.204) are unnecessarily preemptive and unduly burdensome. While secondary capital accounts do not count toward regulatory capital requirements for non-low income credit unions, the ability to offer the accounts is not inherently unsafe and unsound, and therefore should be subject to state law.

Credit Union Service Organizations (712)

In November 2013, NCUA issued a final rule that expanded the application of certain Credit Union Service Organization (CUSO) regulations to FISCUs, authorized the development of a CUSO registry system, and required all CUSOs to register and report directly to NCUA and the state regulator where appropriate. Although this rule has not yet become fully operational, NASCUS is concerned that, as currently envisioned, the registry commissioned by NCUA will dramatically increase regulatory burden without realizing the full potential benefits of the data collected.

If NCUA proceeds in collecting CUSO data, we encourage the Agency to consider utilizing existing registration systems rather than attempting to build a new system at credit unions' expense. Utilizing a registration system that has already been developed would alleviate regulatory burden, minimize cost, and improve utility of the data collected for all regulators, and may even return equal value to the industry. A robust system could enable CUSOs to provide financials and other information to both their investors and their clients in a single upload. This could save time and money for the CUSO as well as simplify the due diligence process for the CUSO's owners and clients. Regulators could use the system to confidentially transmit examinations between agencies, to transmit documents within the agency (as a substitute for agency maintained IS&T infrastructure), to transmit appropriate vendor examination findings to the CUSO's credit union clients and investors, and to receive information from regulated entities.

[5] 12 C.F.R. 741.2(c).

Given the modest budget proposed for development of the CUSO registry, it seems unlikely that these efficiencies will be realized with a proprietary NCUA system.

Again, we commend NCUA for its willingness to undertake meaningful regulatory reform, and appreciate the opportunity to comment on these regulations. We look forward to continuing to work with NCUA to maintain and improve the safe, sound, and efficient regulation of the credit union movement.

Sincerely,

Mary Martha Fortney

Mary Martha Fortney
NASCUS President and CEO