State Employees' Credit Union®

Accounting Department

December 20, 2013

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Notice of Proposed Rulemaking – Capital Planning and Stress Testing

Dear Mr. Poliquin,

We are pleased to have the opportunity to provide comments on the proposed rule of the National Credit Union Administration (NCUA) regarding Capital Planning and Stress Testing for large credit unions. We recognize the importance of capital planning and stress tests as tools which help assure that we remain a safe, sound, well capitalized, not-for-profit financial cooperative. We fully support the efforts to formally incorporate such practices within the credit union industry as other prudential financial institution regulators have done. For years we have included capital planning and stress testing into our strategic planning and risk analyses. Using the BASEL and FDIC risk based capital construct we already meet the 2019 capital requirements were we a bank.

Regarding the proposal we recommend the following:

<u>Planning Horizon</u>

We recommend clarifying that the 9 quarter planning horizon which is to be used for the stress testing scenarios be the time frame used for the capital plan planning horizon.

This would provide consistency for the evaluation of this information as well as comparability with the time frame required in bank capital plans and stress tests.

<u>Net Economic Value (NEV) and +/- 300 Basis Point Rate Shocks</u>

We recommend removing the NEV and +/- 300 basis point shock requirements from this proposal and have NCUA examiners continue to monitor and maintain NEV analyses within the examination/insurance review process.

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Currently the NCUA incorporates Net Economic Value (NEV) analysis as an integral part of the regulatory examination and insurance review processes. These processes are used to evaluate Asset Liability Management practices and results for all credit unions.

The mandatory elements of a capital plan for stress test purposes are based on quarterly projections which are to include estimated changes in balance sheet assets and liabilities over the planning horizon. Changes in "book capital" (net worth) are calculated based on changes in net income generated by the credit union. NEV analysis evaluates changes in base and shocked (+/- 300 basis points) scenarios to evaluate changes in the "economic value" of capital in a static balance sheet, i.e. the balance sheet is fixed at a point in time with no growth/decline in assets or liabilities. NEV is primarily designed to measure balance sheet sensitivity to changes in interest rates. Combining a stress test which primarily estimates changes in book capital as a result of credit and investment losses is not comparable to a test which measures changes in NEV capital in a static environment. The two analyses are fundamentally different and should not be combined and represented as the stress test for large credit unions.

NEV analysis is not part of the Comprehensive Capital Analysis and Review (CCAR) or the Dodd/Frank Act Stress Test (DFAST) analyses for the large banks. The results of these tests are published and made available to the public. Credit union members and the public-at-large will not be well served if there are significant differences between the stress test conventions of large banks and large credit unions. When and if the credit union stress test results are made public such differences would certainly cause confusion and lead to misinterpretations which have the potential to cause great harm to the large credit unions and to the credit union system as a whole.

2 Year Share Maturity

We recommend removing this requirement from the stress test proposal.

Imposing an arbitrary 2 year final maturity for all shares in this regulation is not reasonable. Such a prescription goes against ALM modeling best practices which NCUA has promoted for years in which credit unions are encouraged or required to use model inputs based on data specific to their unique investment, loan and deposit portfolios to the maximum extent possible. We agree that institution specific data adds a greater degree of accuracy to the modeling process which should not now be overridden and codified into regulation by regulatory mandate. It is inaccurate to impose a two year final maturity for all shares for all credit unions. Model inputs for share characteristics should be institution specific based on historical, observable data and utilized in NEV modeling monitored through the examination/insurance review process rather than this stress test regulation.

Annual Supervisory Testing and Stress Test Modeling

We recommend that NCUA require large credit unions to run the stress tests internally and provide the results to NCUA rather than NCUA outsourcing the stress test compilations to an outside vendor. Each of the large credit unions currently does, or will have to, run these tests anyway in order to coordinate capital plans and policies with the set of stress test assumptions. NCUA could hire a third party to review the results of the credit union models at much lower expense to all federally insured credit unions than outsourcing the entire stress test generation to a third party.

Having the large credit unions run the tests internally would reduce the financial burden of the stress tests to the credit union industry while affording the large credit unions additional opportunities to improve their modeling processes through interactions with the vendor chosen by NCUA to review the test results.

If the NCUA imposes capital requirements using a remote, "black box" modeling process in which the impacted credit unions have no participation other than providing pieces of data it creates the appearance that NCUA is taking on the role of managing and directing the large credit unions. Incorrect conclusions can be drawn from assumptions built on extrapolations of misinterpreted data. Since NCUA has decided not to run a model of its own then coordinating the stress tests with the credit union models would add value to the stress testing process.

National Credit Union Share Insurance Fund (NCUSIF) and Reduced Capital

We recommend making no reduction in capital for the NCUSIF asset.

The stress test proposal includes a requirement to reduce the capital base for each large credit union by the amount of their NCUSIF asset. Unless the NCUSIF is insolvent this asset should remain part of the capital for federally insured credit unions. An insolvent insurance fund is certainly not part of bank stress tests. Removing the NCUSIF asset from capital singles out and punishes credit unions for funding operations with member deposits rather than through other sources of funds. This may discourage in practice one of the fundamental philosophical underpinnings of credit unions which is to promote member thrift by providing one of the basic benefits of membership in the form of paying higher deposit interest rates to members.

Additionally, the insurance deposit asset is a refundable asset should a credit union move to a bank charter. It is as valuable and viable as other assets which provide the equity that is capital. To force large credit unions to write off 10% of their capital by declaring the share insurance fund insolvent is unreasonable and sends the wrong message to the participants and the public. You are correct that the credit union industry must maintain the solvency of the NCUSIF just as banks must maintain the solvency of the FDIC fund. Arbitrarily extinguishing legitimate capital that has been accumulated over the years effectively imposes a new and additional capital requirement by regulatory fiat on top of the PCA and stress test requirements. The higher leverage ratio requirement of 5% already accounts for differences between a bank and a credit union.

Will all credit unions in the United States be required to subtract the value of the share insurance asset from their regulatory capital to meet this new regulatory requirement when considering the adequacy of capital in stressed environments? A hypothetical stress test should not be used to exact an additional capital assessment on large credit unions. Such a higher capital requirement is unreasonable and puts large credit unions at a distinct disadvantage compared to bank stress test participants. This manipulation is not consistent with other prudential regulatory stress test conventions.

Public Disclosure

We recommend the public disclosure of the stress test results.

However, disclosures should take place after initial implementation issues have been identified and resolved. The results of these stress tests will be compared to the bank stress tests in the court of public opinion with little opportunity for amplification or explanation. All efforts should be made to make the stress tests and public disclosures of the NCUA and bank stress tests comparable. Stress test results which are not comparable have a huge potential to misinform and mislead the credit union members and the general public. Utilizing a stress test convention which parallels the tests of other prudential regulators will provide comparability between bank and credit union stress testing both in terms of modeled results and the public's interpretation of those results.

Large Credit Unions Conducting their own Stress Tests

As noted previously, most of the large credit unions already run internal stress tests using the bank stress test modeling assumptions. All will have to run internal models to coordinate the capital plan, capital plan policy and model results.

We support the concept of capital planning and stress testing. We appreciate having the opportunity to provide our recommendations for consideration of this important proposal. Credit unions should be subject to capital and stress test criteria that provide a methodology that brings value to the exercise. Providing comparability to the bank stress tests without penalizing credit unions for their uniqueness promotes equity and comparability and will avoid damaging their ability to compete in the financial marketplace and remain safe and sound financial cooperatives.

If you have any questions, please feel free to contact us at 1-800-438-1109.

Sincerely,

M J Lord

Michael J. Lord
Chief Financial Officer