December 30, 2013

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

RE: Comments on Proposed Rule - Capital Planning and Stress Testing

Dear Gerald Poliquin,

I am writing on behalf of the California and Nevada Credit Union Leagues (Leagues), one of the largest state trade association for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million member-consumers. The Leagues welcome the opportunity to provide comments to the National Credit Union Administration (NCUA) on the Proposed Rule for Capital Planning and Stress Testing.

The NCUA has proposed requirements for capital planning and stress testing of federally insured credit unions (FICUs) with assets of $10 billion or more. The NCUA believes these requirements are necessary to protect the NCUSIF and the credit union system, noting that losses by FICUs with assets of $10 billion or more would likely require replenishment of the NCUSIF by all FICUs through assessments.

In general, the Leagues support the proposed rule. However, we have concerns regarding lack of parity between the proposed rule and rules governing banks and bank holding companies (BHCs), the proposed 2-year maturity assumption for non-maturity shares (NMS), NCUA's estimated costs to the NCUSIF to conduct independent stress testing, and the implications of publicly disclosing the results of stress tests. The Leagues respectfully submit the following comments and recommendations on the proposal.

Capital Planning

The proposed rule requires FICUs with assets of $10 billion or more (covered credit unions) to develop and maintain a capital plan and submit this plan to NCUA by March 31 of each year. The proposed rule sets forth mandatory elements of a covered credit union's capital plan and requires, as part of the planning process, that the credit union perform a capital analysis. The Leagues generally agree with the proposed capital planning and analysis requirements, as well as the proposed governance requirements for board oversight. However, the Leagues have some concerns and respectfully submit the following comments and recommendations.

<u>Unfavorable Conditions (Part 702.503(b),(c)</u>

The proposed rule requires an assessment and analysis of capital assuming both expected and "unfavorable conditions." However, the proposed rule does not define "unfavorable conditions." The Leagues encourage the NCUA to clarify that unfavorable conditions are institution specific and are meant to stress key vulnerabilities and idiosyncratic risks facing the specific FICU.

<u>Two-Year Final Maturity on Non-maturity Shares (NMS)</u> (Part 702.503(c)(2)

As part of the annual capital planning process, the proposed rule requires covered credit unions conduct a capital analysis. The requirements include an analysis of the net economic value of the credit union using interest rate risk shocks of at least +/- 300 basis points and an assumption that all NMS have final maturities not exceeding two years.

The Leagues contend it does not make sense to prescriptively include an assumption in a regulation that will neither pass the test of time nor achieve the desired objectives under different economic rate cycles – rising or falling rate environments..

Further, specifying a 2-year assumption in the regulation is not consistent with other prudential regulatory requirements. The OCC requires its regulated institutions to demonstrate the ability to model core deposits, validate these assumptions through back testing, and perform scenarios around these assumptions to highlight the impacts if baseline assumptions are wrong. This method makes sense and is specific to the financial institution.

The Leagues also question why NCUA has proposed to evaluate capital adequacy using interest rate risk shocks of at least +/- 300 basis points with a 2-year final maturity assumption on core deposits. In addition to being inconsistent with banking regulators, these assumptions are typically used to evaluate liquidity risk and interest rate risk; not capital adequacy. This scenario would be more appropriate for liquidity risk because liquidity, not capital, is held to manage the risk of deposit instability. Additionally, this scenario highlights the interest rate risk impact of a loss in stable deposits and the cost of replacing those deposits. Capital adequacy would be better managed by focusing on the losses that have an immediate impact to net worth, rather than the long-term impacts of potential margin compression under a highly improbable event – a run on the credit union of non-maturity shares.

The Leagues strongly urge the NCUA remove the 2-year requirement from the rule and instead require covered credit unions to provide capital stress scenarios under a variety of core deposit assumptions. These assumptions would be institution specific and reflect the then current economic environment.

<u>NCUA Action on Capital Plans</u> (Part 702.505)

Under the proposal, covered credit unions must submit a completed capital plan to NCUA by March 31 of each year. NCUA will notify a covered credit union of the agency's acceptance or rejection of the capital plan by June 30 of the year it is submitted. In the event NCUA objects to the credit union's capital plan, the credit union must update and re-submit a plan within 30 days of receiving notice of the objection. The proposed rule states the NCUA may reject a plan if: there are material unresolved supervisory issues associated with the planning process; the assumptions, methodologies, or analysis underlying the plan are not reasonable or appropriate; or, if the data used lacks integrity or is not sufficiently detailed.

The Leagues are fine with the proposed timing requirements for submission of capital plans and believe a maximum 3-month turnaround by NCUA is reasonable. However, we do not agree with a 30-day requirement for covered credit unions to resubmit a capital plan. It is unlikely that 30 days is sufficient time to effectively address any issues, appropriately modify the plan, and obtain credit union board review and approval of the modified plan.

The Leagues also strongly recommend that NCUA engage in open dialog with a covered credit union during the review of their plan and to consider materiality when determining whether to accept or reject a covered credit union's capital plan. We encourage NCUA to work with a covered credit union to clarify or address any perceived shortcomings during the review of their plan. Deficiencies in a plan that do not affect capital strength (e.g., NCUA's desire for more robust documentation or better refined processes) should be resolved without formally rejecting the plan.

Annual Supervisory Stress Testing

<u>Definition - Stress Test Capital</u> (Part 702.502)

The proposed regulation excludes the credit union's NCUSIF deposit from the definition of stress test capital. The NCUA reasons the NCUSIF deposit is carried by credit unions as an asset rather than being expensed. It therefore elevates credit union net worth ratios compared to banks without representing capital on which a credit union may draw to absorb losses from stresses as they occur. The Leagues, however, contend the NCUSIF deposit should be included in capital because if an FICU left the system, the credit union would have a claim on the deposit. Therefore, the NCUSIF deposit should be counted as part of equity.

NCUA Independent Stress Tests Part 702.506(a)

The NCUA proposes to conduct annual stress testing of each covered credit union. NCUA estimates this independent stress testing will cost up to $4 million in the first year of the program ($1 million for each covered credit union) and the cost will be charged to the NCUSIF. NCUA staff noted that the expenses will be greatest in the first year for any covered credit union and less in subsequent years.

The Dodd-Frank Act does not require stress tests for credit unions. However, pursuant to the Dodd- Frank Act, the Federal Reserve, the FDIC, and the OCC have issued regulations requiring their supervised institutions with assets of $10 billion to $50 billion to conduct annual stress tests. These agencies allow their covered institutions to conduct company-run stress tests, using scenarios provided by the applicable agencies, and the financial institutions then report the results to their regulatory agency. The agencies then review and validate the stress tests, rather than incurring substantial costs to conduct independent stress-test.

The Leagues also note that the Federal Reserve issued Comprehensive Capital Analysis and Review (CCAR) rules for bank holding companies (BHCs) with assets greater than $50 billion. Under CCAR, covered BHCs are required to develop and submit capital plans to the Federal Reserve and conduct company-run stress tests. To assess a BHCs capital plan, the Federal Reserve reviews the supporting analyses in the BHC's capital plan, including the BHC's own stress test results.

The Leagues fervently oppose NCUA's plan to conduct independent stress testing of covered credit unions and passing that cost on to all credit unions by charging the cost to the NCUSIF. The Leagues strongly recommend the NCUA allow covered credit unions to conduct their own stress tests and submit the results to the NCUA for review. The NCUA would then only validate a covered credit union's models, assumptions, and results. This approach will create parity between banks and credit unions and significantly reduce the projected cost to the NCUSIF.

Public Disclosure

The Federal Reserve, OCC, and FDIC require their covered institutions to publicly disclose summaries of the results of their annual stress tests. The NCUA recognizes that public disclosure helps to provide valuable information to market participants, enhances transparency, and facilitates market discipline. However, the NCUA also understands that stress test results can be misinterpreted and lead to inaccurate conclusions about the health of an institution. The NCUA seeks comment on the benefits and costs associated with disclosure of stress test results.

The Leagues believe the NCUA should not require disclosure of covered credit unions' stress test results. FICUs are not publically traded; therefore, providing information to market participants is not a valid reason. The Leagues are also concerned that the comparisons will be made between covered credit unions, banks, and BHCs' stress test results. These comparisons could create a competitive disadvantage since credit unions do not have the same tools available to them for capital planning as banks and BHCs do, such as the ability to engage in derivatives for hedging purposes and to inject secondary capital. Lastly, a credit union's CAMEL rating is not made public, in part to prevent a run on a credit union with a poor CAMEL rating. Public disclosure of stress test results, if poor or interpreted adversely, could have the same affect.

While the Leagues completely oppose public disclosure, should NCUA require public disclosure, the Leagues strongly recommend that public disclosure be delayed until after at least two full reporting cycles. This will allow time to ensure implementation issues are resolved and that the results have been proven to be both stable and valid as to an FICU's capital adequacy. In addition, the Leagues recommend that public disclosure be on par with the disclosure requirements of banks. That is, banks are only required to disclose a summary of the results under the severely adverse scenario, not all scenarios.

General Comments

The Leagues question the timing of this proposed rule and the risk-based capital proposed rules anticipated in the first quarter 2014. Issuance of these rules within a short period of time creates the risk that the rules will potentially have conflicting requirements and/or conflicting compliance demands for implementation resources and costs.

The Leagues recommend the NCUA provide a 12- to 24-month implementation period to allow covered credit unions to develop the systems and procedures necessary to conduct self stress tests and to collect the information that may be required for such tests or by the NCUA.

Conclusion

There is a lack of parity between the NCUA's proposed rule and the rules governing banks and BHCs. The NCUA is proposing rules more severe than those for banks, yet FICUs demonstrated safety and soundness and performed better than banks during the financial crisis, have simpler business models, and have fewer factors that erode capital levels. The Leagues recommend the NCUA establish rules in alignment with the risk profile of larger FICUs.

The NCUA should not conduct independent stress-tests at substantial costs to the credit union movement. Instead, covered credit unions should conduct their own stress-tests and submit the results to the NCUA for review.

The NCUA should not identify a 2-year final maturity assumption for NMS in regulation. Doing so increases the risk the assumption will not remain appropriate over time and is not consistent with other prudential regulatory requirements.

The NCUA should not require public disclosure of stress test results. As non-public business entities, public disclosure is not warranted. Further, public disclosure could result in comparisons that are not appropriate – comparing FICUs to banks is not comparing apples to apples. These comparisons could create a competitive disadvantage.

Thank for the opportunity to comment on the proposed rule and considering our views on Capital Planning and Stress Testing.

Sincerely,

Diana R. Dykstra
CEO/President
California and Nevada Credit Union Leagues

cc: CCUL