December 30, 2013

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

VIA EMAIL: regcomments@ncua.gov

Subject: BECU – Comments on Proposed Rule – Capital Planning and Stress Testing

Dear Mr. Poliquin:

Thank you for the opportunity to comment on the proposed rule (Proposal) concerning capital planning and stress testing of federally insured credit unions (FICUs) with assets of $10 billion or more (covered credit unions). By way of background, BECU is a state-chartered, federally insured credit union headquartered in Washington State with assets of $11.5 billion. Our size ranks BECU as the fourth largest credit union in the United States.

In general, we support the concept of capital planning and stress testing for covered credit unions. We believe these concepts are a vital component of risk management and we have already incorporated these exercises into our practices. However, we believe that the regulatory requirements for capital planning and stress testing for credit unions should parallel those applicable to banks. As discussed in more detail below, certain important aspects of the Proposal do not appear to parallel these requirements. We strongly recommend that the Proposal be amended to achieve such parity.

<u>The CCARs requirement</u>

Under the Dodd-Frank Act (DFA), certain large bank holding companies (BHCs) and banks are required, in addition to conducting stress-test scenarios, to perform comprehensive capital analysis reviews (CCARs). But CCARs are only required for BHCs and banks of $50 billion or more in assets. In spite of this, it appears that the Proposal would require all covered credit unions to perform CCARs-type reviews. We believe that this proposed requirement is arbitrary, disproportionate, and unnecessary as applied to any covered credit union, especially those with less than $50 billion in assets.

Additional comments on the Proposal follow.

<u>Capital Planning</u>

The requirement in the Proposal for calculation of a net economic value (NEV) impact using a 2 year final maturity of non-maturity (core) shares is inconsistent with banking regulatory requirements, as no other regulator mandates such a specific scenario, and certainly not by rule. The 2 year assumption is extremely conservative, given that our most recent back-tested results demonstrate a 7-10+ year range. This assumption leans toward a "run on the credit union" scenario and is typically utilized to highlight liquidity and interest rate risk sensitivity, not in creating the foundation for an actionable capital adequacy plan. It is unclear why this requirement was included, other than to demonstrate a significant reduction in a hypothetical NEV result.

We recommend the removal of the specific 2 year final maturity assumption requirement. We believe it would be more prudent to require credit unions to evaluate capital stress sensitivity under a variety of institution-specific final maturity assumptions that reflect the current economic cycle. This would be consistent with other key assumptions, such as credit losses and deposit inflows (as in a flight to quality scenario).

The Proposal also lacks specificity in how the results of the sensitivities will be evaluated. This is a concern as an NEV calculation encapsulates all of the theoretical assumptions, and assumed co-variances, imbedded within the scenario. NEV results provide very high level snapshots of capital change, which is not consistent in evaluation of an absolute regulatory "floor" or in the determination of a specific capital adequacy threshold. Furthermore, the Proposal lacks specificity related to the credit loss assumptions to be included in the "mandatory capital analyses". Are these "sand state" experiences, an average national bank experience, an average national credit union experience, specific to the institutions running the analysis, etc.? We recommend that covered credit unions be allowed to use institution-specific assumptions.

We would also like to propose that the NCUA include the concept of materiality when evaluating each capital plan, as capital adequacy is the primary objective of such an exercise. Any deficiencies in a covered credit union's plan that does not materially affect its capital position should be resolved outside of a formal rejection.

Stress Testing

As stated above, covered credit unions would be better served by regulatory parity, by requiring credit unions to perform annual internal stress testing similar to the requirements of the DFA rather than the more complex CCARs external stress tests. BECU will be running adverse and severely adverse scenarios as part of the capital adequacy and planning process, regardless, given that we believe it to be a prudent exercise in understanding our appropriate capital levels. As we have just been through a major recession, we do not intend to ignore the actual lessons learned relative to the impact on our capital. And, in order to determine actionable, necessary and realistic capital needs, we must run the scenarios with appropriate, institution-specific variables in mind, regardless of whether they are better or worse than national average results.

We are not supportive of the NCUA hiring a third party to perform stress tests. We feel a better approach would be for the NCUA to hire a third party to validate our model and assumptions. Our experience with prior third party validations is that the resulting back-and-forth dialogue provides a significant amount of value for both parties. We believe this dialogue could significantly assist both ourselves and the NCUA in arriving at the common objective of balancing risk with capital adequacy, while helping the CU remain competitive in the marketplace. This approach will significantly reduce the operational burden of data security, transfer, and format, and enable the majority of the effort to revolve around understanding the modeling assumptions and the significant risks inherent with inadequate capital levels.

Public Disclosure

We do not support public disclosure of the results of capital stress tests. These results have not been proven to be both stable and indicative of a credit union's capital adequacy. They have also not been proven to be of value to the typical credit union member. Unlike banks, credit unions do not have sophisticated institutional investors who may be able to decipher the results of stress tests. Other measures of a credit union's financial strength are available to members, including the call reports. In addition, financial ratings of financial institutions, including credit unions, are available to the public at little or no cost. Public disclosure of the results may be read incorrectly and put the covered credit unions at a competitive disadvantage and, worst case, could cause excessive outflows of deposits. We believe that the potential downside risk of disclosure is greater than any speculative benefit to be derived.

Confusion resulting from wording and organization of the rule

It has been said that "we should not write so that it is possible for the reader to understand us, but so that it is impossible for him to misunderstand us." This is a laudable goal, nowhere more important than in the writing of statutes and rules. The Proposal does not meet this goal in several respects:

1. The meaning of "Capital policy." The definitional section of the rule defines the term "capital policy.'' Yet the text of the rule uses the terms "capital planning policy" (section 702.503(a)), "capital policy" (702.503(b)), and "capital analysis policy" (702.504(a)). Reading the definition of the term capital policy, the reader realizes that the capital policy must address both a capital planning component and a capital analysis component. If so, the final rule should stick to using the defined term and delete the other terms.

2. The Proposal requires that certain actions be taken by the board alone, and that certain other actions be taken by the board or a designated board committee. It is confusing and unnecessary to set up two levels of approvals and it is entirely appropriate for all of these required actions to be undertaken by the board or one of its designated committees. The Proposal should be made consistent in this regard. This is an area that is particularly subject to examiner misinterpretation that should be clarified to avoid unnecessary disagreement.

3. The organization of and interplay between sections 702.503 and 702.504 is confusing. Section .503 starts with the capital plan requirement, weaves in mention of the capital policy requirement, then .504 goes on to additional plan requirements, and ends up addressing capital policy requirements. Since the board–approved (or board committee-approved) policy is the foundation for a credit union's capital planning and analysis, we suggest that the policy requirements be discussed first in their entirety, with the plan requirements to follow. For the

ease of understanding, attached on Exhibit A is a re-draft of these two sections per our suggestion. We have incorporated some of the other changes recommended in this letter.

Timing

The NCUA should delay implementation of the stress tests for at least one year to allow for the development of assumptions, models and processes. NCUA should work with the covered credit unions to develop their models and perform a 'dry-run' to identify implementation issues and/or unique credit union parameters which could impact the results of the stress tests that were designed for banks. The results of the dry-run should be evaluated before the initial capital plan is required to ensure the stress tests are appropriate for the credit union business model.

Thank you for consideration of our comments.

Sincerely,

Katherine Elser
CFO / Senior Vice President – Finance & Administration
BECU

Enclosure: Exhibit A

Exhibit A

702.503 Credit union capital policy.

(a) General requirements. The extent and sophistication of a covered credit union's governance over its capital planning and analysis process must align with the extent and sophistication of that process. The process must be consistent with the financial condition, size, complexity, risk profile, scope of operations, and level of regulatory capital of the covered credit union.

The ultimate responsibility for governance over a covered credit union's capital planning and analysis process rests with the credit union's board of directors. Senior management must establish a comprehensive, integrated, and effective process that fits into the broader risk management of the credit union. Senior management responsible for capital planning and analysis must provide regular reports on capital planning and analysis to the credit union's board of directors (or a designated committee of the board).

(b) Capital policy. A covered credit union's board of directors (or a designated committee of the board) must review and approve a capital policy, along with procedures to implement it.

The capital policy must address the principles and guidelines used for capital planning, including analyzing capital, establishing capital levels, describing the strategies for addressing potential capital shortfalls, and describing the internal governance procedures around capital policy principles and guidelines. In addition, the capital policy must:

(1) State the governance over the capital analysis process, including all the activities that contribute to the analysis;

(2) Articulate consistent and sufficiently rigorous capital analysis practices across the entire credit union;

(3) Specify capital analysis roles and responsibilities, including controls over external resources used for any part of capital analysis (such as vendors and data providers);

(4) Describe the frequency with which capital analyses will be conducted;

(5) State how capital analysis results are used, and by whom, and outline instances in which remedial actions must be taken; and

(6) Require senior management to review the policy, at least annually, and update the capital analysis process as necessary to ensure that it remains current with changes in market conditions, credit union products and strategies, credit union exposures and activities, the credit union's established risk appetite, and industry practices. Senior management will report to the

board (or a committee) on the results of its reviews. Changes to the policy must be submitted to the board (or committee) for prior approval.

702.504 Capital plan

(a) Annual capital planning.

(1) A covered credit union must develop and maintain a capital plan. A covered credit union must submit its complete capital plan to NCUA each year by March 31, or such later date as directed by NCUA. The plan must be based on the credit union's financial data as of September 30 of the previous calendar year. NCUA will assess whether the capital planning and analysis process is sufficiently robust in determining whether to accept a credit union's capital plan.

(2) A covered credit union's board of directors (or a designated committee of the board) must at least annually and prior to submission of the capital plan under paragraph (a)(1) of this section:

(A) Review the credit union's process for assessing capital adequacy;

(B) Ensure that any deficiencies in the credit union's process for assessing capital adequacy are appropriately remedied; and

(C) Approve the credit union's capital plan.

(b) Mandatory elements of capital plan. A capital plan must contain at least the following elements:

(1) A quarterly assessment of the expected sources and levels of capital over the planning horizon that reflects the covered credit union's financial state, size, complexity, risk profile, scope of operations, and existing level of capital, assuming both expected and unfavorable conditions, including:

(A) Estimates of projected revenues, losses, reserves, and pro forma capital levels, over each quarter of the planning horizon under expected conditions and under a range of unfavorable conditions, appropriate to its financial state, size, complexity, risk profile, and scope of operations; and

B) A detailed description of the credit union's process for assessing capital adequacy;

(2) A discussion of how the credit union will, under expected and unfavorable conditions, maintain capital commensurate with its risks;

(3) A discussion of how the credit union will, under expected and unfavorable conditions, maintain ready access to funding, meeting its obligations to all creditors and other counterparties and continuing to serve as an intermediary for its members; and

(4) A discussion of any expected changes to the credit union's business plan that are likely to have a material impact on the credit union's capital adequacy and liquidity.

(c) Mandatory credit union capital analysis planning. As a fundamental part of its capital planning process, a covered credit union must, at a minimum:

(1) Conduct a sensitivity analysis to evaluate the effect on its capital of changes in variables, parameters, and inputs used by the credit union in preparing its capital plan.
(2) Perform an analysis of the net economic value of the credit union using interest rate risk shocks of at least +/- 300 basis points.

(3) Analyze the impact of credit risk to capital under unfavorable economic conditions, both separately and in combination with the impact of unfavorable interest rate scenarios.

702.502 Definitions

Delete the definition of "capital policy"