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December 30, 2013

Gerard Poliquin, Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428
regcomments@ncua.gov

RE: Comments on Proposed Rule—Capital Planning and Stress Testing
(78 FR 65583, RIN 3133-AE27)

Dear Secretary Poliquin:

The Washington State Department of Financial Institutions, by and through its Director of Credit Unions, Linda K. Jekel ("Washington State"), takes this opportunity to make official comment on the proposed rule on capital planning and stress testing, 78 FR 65583, dated November 1, 2013 ("Proposed Rule"), which has been promulgated by the National Credit Union Administration ("NCUA") and would add a Subpart E to 12 C.F.R. Part 702 (§§ 702.501 through 702.506).

1.0 Introduction

Washington State is home to the fourth largest credit union in the United States, BECU, which is over $10 Billion in assets and which is state-chartered and state-regulated under the Washington Credit Union Act, chapter 31.12 RCW ("Washington State Act"). Therefore, Washington State has a direct interest in the final form of the Proposed Rule. In addition, Washington State has a keen interest in the outcome of the Proposed Rule in terms of how its final form will affect the credit union industry as a whole.

In general, Washington State supports capital planning and stress testing for U.S. credit unions with assets of $10 Billion or greater ("Covered Credit Unions"), of which there are four at present and a fifth nearing this asset threshold. However, Washington State has concerns about the Proposed Rule, as written. First of all, we believe that there should be parity in the requirements (if any) for stress testing as between banks and credit unions, consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203 ("Dodd-Frank Act"). Second, we believe that a final rule should address cost-benefit factors more than has been given consideration in the Proposed Rule. Third, we are of the view that the timing for revision of a rejected capital plan is inadequate if NCUA or a government contractor is going to perform the stress-testing. Fourth, we believe that the requirements of the Proposed Rule related to non-maturity shares should be revised. Fifth, we are opposed to public disclosure of stress-testing results as *immediately* contemplated by the Proposed Rule. Sixth, the Proposed Rule needs to be revised so that there is more ongoing communication and cooperation in the capital planning process as between NCUA and a Covered Credit Union's state supervisory authority ("SSA"). Seventh, we have concerns that key terms, if left undefined as they are in the Proposed Rule, remain ambiguous and subject to problems of interpretation. And finally, we have technical concerns about the data source and collection requirements contained in the Proposed Rule.

2.0 Parity on Stress-Testing between Credit Unions and Banks

One of the foundation principles of Washington State's regulation of both state-chartered banks and state-chartered credit unions is assurance, to the greatest degree within our power and authority, that the risk management responsibilities as between banks and credit unions are similar when banks and credit unions, in terms of size and risk profile, are similarly situated. This principle has several laudable purposes, but certainly one of them is to further the viability of the credit union industry in the interest of Washington State citizens. To the extent that the Proposed Rule is federal rulemaking applicable to all Covered Credit Unions (whether federal- or state-chartered), it is NCUA's and not Washington State's ultimate decision on whether this principle will adhere. But we believe that NCUA is of the same general mind with respect to furthering the viability of the credit union industry. Therefore, we believe that NCUA will seek to adopt and publish a final rule which does not unfairly burden Covered Credit Unions relative to the requirements imposed by the Dodd-Frank Act upon banks similarly situated.

Under the Dodd-Frank Act, certain bank holding companies ("BHCs") and banks are required, in addition to conducting stress-test scenarios, to perform comprehensive capital analysis reviews ("CCARs").[1] But CCARs are only required for BHCs and banks of $50 billion or more in assets. In spite of this, the Proposed Rule would require all Covered Credit Union to perform CCARs. Washington State believes that this proposed required is arbitrary, disproportionate, and unnecessary as applied to any Covered Credit Union except those with $50 Billion or more in assets.

[1] See capital planning rules implementing the Dodd-Frank Act, at 76 FR 74631 (Dec. 1, 2011).

Furthermore, NCUA should reconsider the $10 billion threshold for application of a capital planning submission rule. At a minimum, NCUA should discuss why $10 billion is the appropriate credit union threshold given the bank threshold. We note that using the bank threshold would still capture half of the assets over $10 billion. Furthermore, that the next 4 largest credit unions below the proposed $10 billion threshold have combined assets over three times the size of the NCUSIF suggests that the threshold is arbitrary.

3.0 Cost-Benefit Factors in Stress-Testing

Washington State is very concerned about the provision in Subsection 702.506(a) of the Proposed Rule, which would have the NCUA perform stress-testing either on its own or by contracting with a third-party. In our view, the cost of having the NCUA perform this task internally or by government contract would far exceed what could be accomplished more expeditiously and less expensively by choosing another course. To accomplish the NCUA's same goal, we recommend that the NCUA use a Covered Credit Union's own stress test and that NCUA back-test or validate the results of the Covered Credit Union's own stress test. Not only would this be a better use of NCUA resource. It would also facilitate NCUA building its expertise on stress testing rather than completely delegating that function by way of a government contract with a third party. By NCUA back-testing or validating the results of the Covered Credit Union's own stress test, this method would be a savings to the NCUA and ultimately Covered Credit Unions.

4.0 Time for Revision of Capital Plan

Washington State also has concerns about the proposed time for revision of a capital plan which NCUA has rejected, particularly assuming that NCUA (contrary to Section 3.0 of this Comment Letter) ultimately adopts a final rule in which NCUA or a third-party government contractor conducts the stress-testing. Currently, the Proposed Rule provides thirty (30) days for a Covered Credit Union to revise a capital plan. This may be adequate *if* NCUA is in communication with the Covered Credit Union during its analysis (in April and May) of the NCUA-prepared or -procured capital plan. However, if NCUA were finally to notify a Covered Credit Union only on May 31st of its rejection of a capital plan and do so without previous ongoing dialogue and comment with the Covered Credit Union, then a period of 30 days to revise a capital plan would likely be inadequate. This would be particularly true if parallel stress-testing (conducted by NCUA) indicated inadequate levels of capital. If that should prove to be the case, demands for revised capital plans and negotiation over stress-test results could be highly demanding on limited credit union expertise.

5.0 The Proposed Rule's "Non-Maturity Shares" Requirement

Washington State believes that the final rule should not require that non-maturity shares not exceed two years. Again, this is an issue of parity as between banks and credit unions. The proposed requirement for Covered Credit Unions is not required of banks under rules promulgated for banks under the Dodd-Frank Act. The value of limited flexibility for determining the value of non-maturity shares is appreciated. However, the two-year limitation appears to be a long way from normal operating expectations and is likely unrealistic even when a stressed condition is present. In our view, the only time such an assumption would likely be realized would be in the absence of federal deposit insurance.

As a solution, Washington State believes the Proposed Rule should be modified to provide that NCUA will evaluate and validate the Covered Credit Union's own analysis of maturities of its non-maturity shares.

6.0 Confidentiality of Stress-Testing Results

The exemption from public disclosure (confidentiality) of bank and credit union examination information is one of the core principles of financial institution regulation. There are several reasons for this core principle. This core principle of confidentiality (1) protects competition as between banks and credit unions, (2) maintains the public confidence in financial institutions, and (3) increases the likelihood of candor by banks and credit unions toward their federal and state supervisors. This core principle is preserved by maintaining the confidentiality of all bank examination information. We understand that there has been a general departure from this core principle when applied to stress-testing of institutions that are large enough to pose a system risk to the financial system or, in the case of Covered Credit Unions, to the health of the National Credit Union Share Insurance Fund (NCUSIF). Despite this general departure, however, we are grievously concerned that the *premature* publishing of stress-testing results would undermine this core principle in ways which would have adverse consequences to the credit union industry.

Notwithstanding our strong caution in this area, if NCUA is determined that stress-testing results should eventually be published, then we urge that this requirement be revisited by NCUA only after a period of three-to-five years of stress-testing experience with Covered Credit Unions. In that way, NCUA would in the future be making a publication decision with a better understanding of what was going to be disclosed and what effect such disclosure might have on Covered Credit Unions and the credit union industry as a whole. Such publication should not occur until: (1) understanding is reached between NCUA and Covered Credit Unions on specific requirements and procedures as well as the impact of certain variables and assumptions; (2) new credit union procedures and systems are developed and tested; (3) adjustments are made to balance sheets to mitigate disclosure risk, and (4) there is a better understanding by the public of stress-tests and their potential meaning.

7.0 NCUA-SSA Cooperation Regarding Capital Planning Process.

Another major issue arising from a reading of the Proposed Rule is the nature and manner of NCUA consulting with a SSA during NCUA's review of a Covered Credit Union's capital plan. 12 C.F.R. 702.505(f) requires NCUA to consult with an SSA of a Covered Credit Union before taking any action. However, it is not clear if NCUA would be required to consult with an SSA (1) *before* accepting or rejecting the Covered Credit Union's capital plan,[2] (2) *at the time* that NCUA would declare its reasons for a decision to *reject* a capital plan,[3] and (3) *before* taking any supervisory action.[4]

Joint regulation of credit unions by NCUA and SSAs is a continuous and ongoing process of communication and cooperation with mutual consultation and approval. Consistent with this pattern and practice of joint regulation, we believe that SSAs of Covered Credit Unions, including Washington State, should be consulted throughout the capital planning formation and review process. This is particular the case because, as the *primary* regulator of a state-chartered Covered Credit Union, and SSA is has access to the experience and expertise from its sister division, Division of Banks, who works with state banks and stress testing. Ultimately, this process of communication and cooperation would be more beneficial to the work of NCUA and to the safety and soundness of Covered Credit Unions, since it would be likely to produce more workable capital plans.

8.0 Need for Definition of Key Terms

Washington State is concerned that there are important terms used in the Proposed Rule that are ambiguous or misleading and therefore susceptible of inconsistent interpretation. One of the proper functions of the executive branch of government, operating within the bounds of its authority granted by a legislature, is to adopt rules of enforcement of its legislative mandate that are specific enough and unambiguous so as to remove any concern that agency officials could ignore due process and by way of "interpretation" make things up as a they go along. Proper rulemaking seeks to preclude inconsistent interpretation by agency officials and staff in the administration of a requirement imposed on a regulated entity. One of the best ways assure that this does not happen is to identify key terms in a proposed rule which are ambiguous and may be susceptible of different interpretations.

While we have not exhaustively identified all such terms which may be ambiguous or susceptible of different interpretations, there are four areas of particular concern to Washington State in this regard.

[2] Proposed 12 C.F.R. §702.505(a).

[3] Proposed 12 C.F.R. §702.505(c).

[4] Proposed 12 C.F.R. §702.505(e).

8.1 "Consensus View". In reference to the definition of "baseline scenario" set forth in Section 702.502, proposed use of the term "consensus view" is, in our view, problematic. What is a "consensus" for purposes of the requirement intended here? Without a definition, Washington State believes there could be considerable problems with the implementation of a final rule.

8.2 "Material Impact". Subsection 702.503(b)(5), in setting forth the required elements of a capital plan, declares that it must contain "[a] discussion of any expected changes to the covered credit union's business plan that are likely to have a ***material impact*** on the credit union's capital adequacy and liquidity." [Emphasis added.] Washington State is of the view that there should be a prescriptive standard for what constitutes a "material impact" in this context and that this be defined in the language of a final rule.

8.3 "Sensitivity Analysis". Section 702.503(c)(1) sets forth the requirement of a "sensitivity analysis" to evaluate the effect on capital of changes in "variables, parameters, and inputs." This provision as current written, without setting forth parameters of what is expected, could result in a Covered Credit Union undertaking massive analysis and documentation without exercising proper circumspection or judgment. Washington State therefore recommends that the parameters of what is expected in a "sensitivity analysis" be set forth with specificity.

8.4 "Unfavorable Economic Condition". Section 702.503(c) (3) declares that "[a] covered credit union must 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." Washington State is of the view that the term "unfavorable economic condition," without more specificity, is susceptible of many different interpretations. To avoid uncertainty, the final rule should articulate some reasonable, threshold standard for what would constitute an "unfavorable economic condition" in this context.

9.0 Data Requirements

Finally, we note that the Proposed Rule is unclear regarding the depth of the data requirements for these stress-tests. Reliance on data similar to the quarterly "5300 reporting" requirements will be considerably less demanding than data specific to each loan. In either case, the 500-hour estimate for the Initial Report requirement appears to be inadequate.

10.0 Conclusion

Taken as a whole, NCUA's proposal has identified aspects of a workable framework that could benefit the credit union system. However, that NCUA's proposal departs in substantial ways from the parameters established by Congress and the federal bank regulators remain a concern for Washington State. As stated at the beginning of our comments, we recommend that NCUA seek to adopt and publish a final rule which does not unfairly burden Covered Credit Unions relative to the requirements imposed by the Dodd-Frank Act upon banks similarly situated. In addition, the complexity of importing a bank stress testing framework into the unique parameters

of credit union operations requires additional thought and consultation between NCUA and state regulators before any rule is finalized.

Washington State remains committed to working with NCUA to mitigate material risk throughout the credit union system. We appreciate the opportunity to submit comments on this proposed rule.

Respectfully yours,

WASHINGTON STATE DEPARTMENT
OF FINANCIAL INSTITUTIONS

Division of Credit Unions

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