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December 31, 2013

Mr. Gerard Poliquin
Secretary of the Board,
[redacted]
Alexandria, Virginia 22314-3428

Re: Comments on Proposed Rule – Large Credit Union Annual Stress Tests and Capital Plans

[redacted]

Dear Mr. Poliquin:

This letter represents the views of the Credit Union National Association on the pending proposal from the National Credit Union Administration Board to conduct annual stress tests of federally insured credit unions (FICUs) with assets of at least $10 billion and to require those credit unions to develop and maintain capital plans that would be reviewed annually by the agency. Covered credit unions could be subject to sanctions if the minimum level of stress test capital is not met or material issues regarding a credit union's capital plan arise. CUNA is the largest credit union advocacy organization in this country, partnering with our state leagues to represent state and federal credit unions nationwide, which serve nearly 99 million members. This letter was developed under the auspices of our Examination and Supervision Subcommittee, with input from affected credit unions, our CFO Council, leagues and other stakeholders. We are particularly grateful to the largest credit unions with whom we discussed the proposal.

I. Summary of CUNA's Views

CUNA is a staunch supporter of strong safety and soundness principles, and we recognize that as the manager of the National Credit Union Share Insurance Fund, NCUA is constantly alert to the development of additional tools that will enhance its ability to oversee the Fund and federally insured credit unions. Nonetheless, we have major concerns regarding the proposal.

Although we absolutely agree that it is important for the largest credit unions to determine they have sufficient capital to withstand a range of economic conditions and that NCUA has an important role in working with these institutions in this area, our overarching concern is that we do not agree a new regulation such as the one NCUA is proposing is necessary to ensure these credit unions will conduct robust stress tests and comprehensive capital planning, since it is in their own best interests, and those of their members, to do so.

We do not believe that NCUA has sufficiently substantiated the need for a new regulation, given the financial performance of credit unions in general and the largest credit unions that would be covered by the rule in particular. The fact that Congress under the Dodd-Frank Consumer Protection and Wall Street Reform Act (Dodd-Frank Act) did not include NCUA among the agencies directed to implement capital plans or stress testing for the largest institutions they regulate supports our view that a new regulation is not the best course of action.

We are concerned about the costs that the agency has estimated would be associated with the final rule. Agency staff have indicated that the rule initially will cost $4 million, or $1 million per covered credit union, to implement. NCUA has not shared with credit unions how it arrived at the $4 million level, and we feel the agency should have provided more information regarding these cost figures. In addition, NCUA has not said that implementation of the rule will cost no more than $4 million, so even though the estimate is a high one, there is no guarantee that promulgation of the rule once adopted would not cost much more well into the future. We simply do not think that NCUA has made a sufficient case for a new rule, given how much it will cost to put into place for covered credit unions as well as for the agency.

Rather than a new rule, we urge the agency to issue guidance that covers key points addressed in the proposal and to administer the guidance through the annual examination of the largest credit unions under the auspices of NCUA's Office of National Examinations and Supervision. As discussed below, covered credit unions should not be subjected to sanctions under a new stress testing and capital planning rule. The issuance of guidance, as opposed to a new regulation, would remove this major concern. The guidance would also be less costly for credit unions and the agency to implement and would provide additional flexibility for credit unions to develop their own models and plans.

We also urge the agency to incorporate our recommendations for improvements that we discuss below in the final guidance. To summarize, our additional recommendations for improvements include the following:

- NCUA should not conduct stress tests but should review, either directly or through a third party, the stress tests that covered credit unions conduct.

- Alternatively, NCUA should coordinate with the Federal Reserve Board to have the Fed conduct the reviews of the credit unions' tests.
- NCUA should not subject covered credit unions to sanctions for failure to meet capital planning or stress test benchmarks.
- NCUA should not establish a formal process for rejecting a credit union's capital plan.
- NCUA should not publicly disclose the results of the stress tests.
- NCUA should not require a three-year event horizon for the capital adequacy analysis.
- NCUA should not require credit unions to assume a two-year maturity for non-maturity deposits for purposes of capital adequacy analysis.
- NCUA should not require covered credit unions to deduct the 1% NCUSIF deposit from the stress test capital ratio.
- NCUA should not require a minimum stress test capital ratio of 5%.
- NCUA should not undermine the authority of state regulators to work with the institution they charter to determine the adequacy of their capital planning and stress testing.

II. Discussion of CUNA's Concerns and Recommendations

A. Need and Authority for the Proposal Have Not Been Sufficiently Addressed

The Board cites as authority for the proposal sections 1766(a) and 1790d of the Federal Credit Union Act. We do not believe individually or taken together that these provisions support NCUA's adoption of the rule.

Subsection 1766(a) applies only to federal credit unions and generally authorizes the Board to issue rules for the administration of the provisions that Congress has provided in Chapter I of the Act. As you know, Chapter I for the most part addresses the agency's authority over federal credit unions and does not address capital planning or stress testing. Section 1790d applies to federal and state chartered credit unions but focuses on prompt corrective action; the bank regulators did not cite parallel PCA authority for their capital plan and stress testing rules and guidance.

The bank regulators' rules on capital planning and analysis only apply to the largest and most complex bank holding companies, consistent with the capital and stress testing statutory requirements for these entities under the Dodd-Frank Act. (Guidance has been developed for less complex banks.) Moreover, the Dodd-Frank Act specifically directs the bank regulators to impose stress testing for banking institutions of under $50 billion (but not for capital planning). No similar statutory provisions are contained in the Dodd-Frank Act for credit unions regarding capital planning or stress testing. In light of these facts, we urge NCUA to reconsider the legal basis for the regulation.

Regarding justification for the rule, the Supplementary Information accompanying the proposal states that the "NCUA Board (Board) has determined, to protect the National Credit Union Share Insurance Fund (NCUSIF) and the credit union system, that the largest FICUs should have systems and processes to monitor and maintain their capital adequacy." This statement, along with information on the asset sizes of the covered credit unions relative to the NCUSIF are the only justification that the agency provides for the new rule, which would subject covered state and federal credit unions to significant supervisory actions for noncompliance.

We believe that the Administrative Procedure Act requires more substantial analysis than these limited statements to justify such a costly and burdensome rule. The proposal also fails to recognize that these institutions, as well as many that are much smaller, already undergo routine capital planning and stress testing that while individualized, is likely sufficient given the relatively low level of risk that a credit union demonstrates.

As an alternative to a new rule, we urge NCUA to consider the issuance of guidance regarding capital planning and stress testing. In light of NCUA's lack of specific authority to issue the rule, we urge the agency to reformat the proposal as guidance.

B. Burden of Compliance and Impact on Federalism

The agency has specially asked for comments on the collection of information under the capital assessments and stress testing processes, including whether the information NCUA is seeking will have a practical use. We believe that the information would have a practical use, if the agency collects it under guidance rather than a rule or in the alternative, makes important changes to the final rule that are addressed in this letter.

Even so, just because information will have a practical use does not mean that it is necessary, such as to protect the NCUSIF, as NCUA has stated. The Fund and credit unions that would be covered initially are functioning well without the rule.

It is very difficult to analyze whether NCUA's estimate of the burden of the proposed collection of information is accurate. However, we are endeavoring to assess this and plan to provide our analysis to the Office of Management and Budget as NCUA directs.

The Supplementary Information references Executive Order 13132, which directs independent regulatory agencies to consider the impact of their regulations on states. NCUA has concluded that the proposal would not "have a substantial direct effect on the states."   We strongly disagree with this mischaracterization, most notably because under the proposal, NCUA alone may approve or reject a capital plan and would need only “consult” with the state supervisor before an action is taken.[1]

Also, NCUA’s proposal calls for the agency to conduct an annual stress test of each covered credit union, but does not strictly require NCUA to share the results of the test with the credit union’s state regulator. While the stress testing provisions also require NCUA to “consult” with the relevant state regulator, they are far from clear as to how extensive that process needs to be or what information must be shared with the state regulator prior to NCUA taking action against a state credit union.

Based on the plain language of the proposal, it is clear that if adopted, the rule would have a significant, negative impact on federalism and would impede the ability of state regulators to supervise their institutions covered by the final rule.

C. Definitions, § 702.502

The proposed definition of “planning horizon” covers a period of time over which relevant projections extend, but must be at least three years.
We are concerned that this period is too long for covered credit unions to have to contend with and would likely result in analyses that are weighted by data that obscures current trends. The bank regulators have chosen to use a nine-quarter planning horizon. We feel that this approach would be less wieldy for credit unions and would result in analyses that are more useful to each institution as well as to NCUA. The proposal indicates a nine-quarter stress test period, and we urge NCUA to change the definition of “planning horizon” to also reflect this shorter period.[2]

D. Capital Plans, § 702.503

1. More Time to Submit Plans

Under this section, a covered credit union would have to develop and maintain a capital plan that is submitted to NCUA each year by March 31, unless NCUA directs a later date. The plan would reflect financial data as of September 30 of the previous year. This approach mirrors what the bank regulators have developed but it is unclear whether this reporting schedule will impose hardships on covered credit unions. We believe NCUA should consider moving the reporting date to June or allowing a process under which a credit union could have a reasonable amount of additional time beyond March, if needed, to meet all of the requirements of the capital plan for a particular year.

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[1] See proposed section 702.505(f).

[2] Proposed section 702.506(a).

2. Flexibility on Quarterly Assessments

We also question whether a quarterly assessment of the expected sources and levels of capital over the planning horizon, as the proposal would require the capital plan to include, is necessary in every situation for every covered credit union. We believe there should be a process under which less frequent assessments, such as covering two quarters, could be permitted following consultation with the credit union's examiner.

3. Mandatory Elements of Capital Plans

The proposal details the elements that must be included in the capital plans. However, it also states that the plan "must contain at least" the provisions listed in the proposal. We urge the Board to drop the words "at least." The hallmark of an effective rule is that it is clear to all parties affected. We are concerned that by adding the words "at least" credit unions will be unsure that their plans are complete and examiners will feel emboldened to add requirements that are not included in the rule.

The bank regulators have provided extensive guidance on the development of capital plans under their rules, and we urge NCUA to also include further instructions for credit unions and examiners on the contents and maintenance of the capital plan and planning process. In particular, we think the agency should provide detailed discussion on the capital policy so credit unions can be assured that if they follow the guidance they will not be written up or their capital plan rejected.

a. Rate Shock Requirements

Under the proposal, in preparing its capital plan, a covered credit union would be required to perform an analysis of its net economic value using interest rate (IR) risk shocks of at least +/- 300 basis points. This interest-rate shock analysis would have to be conducted both separately and in combination with unfavorable credit-risk conditions. This requirement is both unnecessary and unrealistic. A capital plan should consider the effects on capital of all relevant variables, under a variety of circumstances, including adverse scenarios. However, the scenarios considered should be internally consistent, and the relevant interest-rate assumptions should be consistent with the adverse conditions being evaluated, and not separately applied regardless of the rest of the scenario.

For example, it would be misleading to consider the effects of dramatic increases in interest rates in a scenario that entails sharp increases in credit losses due to a deep and long recession. By analogy, a utility company planning to meet peak demands for electricity for air conditioning in a prolonged heat wave in the summer would be misguided to plan for a simultaneous ice storm. Likewise, a separate requirement to conduct a net economic value calculation under shocked interest rates in addition to whatever adverse conditions are considered should be eliminated.

It is unclear why the agency is requiring covered credit unions to conduct a net economic valuation using an IR shock of +/- 300 basis points. As others have noted, this exercise seems out of place in determining the likely level of actual capital under a variety of adverse scenarios, as opposed to the theoretical value of capital under potentially inconsistent interest rate scenarios. Other methods of interest-rate risk analysis are more appropriate for capital planning and analysis.

We agree with the recommendation that IR shocks should be part of general safety and soundness reviews but should be excluded from the mandatory elements of the capital analyses, particularly since this is not required by the bank regulators.

b. Assumption for Non-Maturity Deposits

In particular, if some form of separate interest-rate risk analysis is required, we have significant concerns regarding the requirement to analyze the net economic value of non-maturity deposits on the basis of a two-year maturity. By definition, the credit unions to which this capital planning and analysis requirement would be applied are large, complex institutions. Their capital planning and analysis should therefore be sophisticated and complex, and NOT dependent on simplistic, arbitrary and unrealistic assumptions.

We are concerned that the requirement to model deposits assuming a two-year maturity will under value credit unions' core deposits, a number of which, such as savings and regular money market accounts, have longer weighted average lives than two years. We strongly urge NCUA to drop this provision from the list of mandatory capital evaluation elements.

E. Credit Union Oversight of Capital Planning, § 702.504

Under the proposal, senior management responsible for capital planning would be required to report to the credit union's board of directors or a designated committee regarding their analyses and planning process. While there is a key role for a credit union's board to play in directing the affairs of the credit union, including in the area of capital planning, we believe a careful balance must be struck between the board's primary function of determining policy and management's role of carrying it out. We are concerned that those distinctions will be blurred under the proposed provisions, such as through the very prescriptive provisions required for the board policy. We urge NCUA to address these issues in guidance and discuss the implementation of these provisions to ensure clear lines remain between the roles of the credit union's board and management.

F. NCUA Action on Capital Plans, §702.505

We have a number of concerns about provisions in this section. Under the proposal, NCUA would be required to notify a covered credit union whether its capital plan has been approved by June 30 following submission of the plan in March of the same year.

Above in this letter, we recommend that NCUA provide more time for credit unions that need beyond March to submit their plans. That could also mean that NCUA would have additional time to respond.

Under the proposal, NCUA would be allowed to reject a plan for a number of reasons. We believe several of the reasons are too vague and would provide too much latitude to examiners to inject subjectivity into the process. For example, NCUA could reject a plan if the credit union has "material unresolved supervisory issues associated with its capital planning process." While we appreciate that the issues have to be "material" we are concerned that the language "issues associated with its capital planning process" could result in a broad interpretation by examiners. We urge NCUA to change this provision to state: "material unresolved supervisory issues *directly related* to its capital planning process."

NCUA could also reject a plan if "the data lacks integrity." On what basis would the integrity of the data be determined? This standard is too imprecise and we believe it should be deleted.

The proposal would allow NCUA to reject a plan if it violates "any" NCUA order, or any condition imposed by NCUA. We also think this provision is far too sweeping and thus should be removed as it is very unclear how it might be used.

The proposal would require NCUA to notify the credit union in writing regarding the reasons for a rejection. However, it does not provide a time frame for providing the reasons. Since a rejected plan must be resubmitted within 30 days, we feel NCUA should provide the written reasons within two business days. We also think that credit unions should have 45 business days or longer rather than calendar days to resubmit their plans.

A credit union that operates without an approved capital plan after September 30 would be subject to NCUA supervisory sanctions. However, we think that flexibility should be provided for credit unions that have resubmitted plans that may not yet be approved.

We have already addressed our concerns about the proposal's impact on state chartered credit unions and state regulators, which stem from the fact that the agency would be the sole arbiter of whether a capital plan is acceptable. We urge the agency to work with state regulators to ensure their authority over state credit unions is not eroded more than it already has been.

G. Annual Stress Testing, §702.506

This section also raises several issues of concern that we urge the agency to address. For example, it is not clear why it is essential that NCUA conduct the stress tests itself.

We believe that it would be far more efficient and likely just as useful for NCUA to issue guidance that provides that the agency will evaluate stress tests that the covered credit unions themselves conduct. In that connection, NCUA could employ a third party to evaluate the methodology, assumptions and results of the credit unions' stress tests.

Another alternative would be for NCUA to partner with the Federal Reserve Board for its staff to review the tests that covered credit unions have conducted.

In any event, we urge NCUA to rethink its role regarding the stress tests and to consider more viable, cost-effective alternatives, such as allowing credit unions to conduct their own tests that would be evaluated by NCUA, either directly or using a third party.

Under the proposal, NCUA would provide a description of the scenarios, baseline, adverse and severely adverse, by December of a calendar year, using September 30 financial data. We urge that in the guidance, NCUA state that the scenarios will be provided to the covered credit unions and that the agency will be specific in sharing the details of the scenarios and results of the agency's review of the stress tests with affected credit unions.

The proposal would require a 5% net worth ratio stress test floor under adverse conditions, which is a full percentage point higher than the minimum leverage ratio for banks. NCUA states that this higher minimum is necessary because credit unions do not have access to additional forms of capital, and because of accounting requirements for credit unions' 1% share insurance fund deposits.

CUNA believes the stressed minimum net worth ratio for large credit unions should be set at the same 4% level that applies to banks for the following reasons:

- Access to additional capital for stock-owned banks is in reality severely limited in stressful economic times.
- From the point of view of an individual credit union, the 1% share insurance fund deposit is a low-risk asset. If a scenario envisions conditions that could lead to the simultaneous failure of a large number of credit unions, the NCUSIF deposit should be written down. If a scenario envisions adverse factors local to the subject credit union, that credit union's 1% deposit would not be at risk.

- Even the very largest credit unions are exposed to a more limited set of risks than are very large banks because banks are permitted by law to engage in many activities and acquire many types of assets that are not available to credit unions.

H. Public Disclosure

Though not included in the proposal, NCUA is seeking comments on whether the results of the stress tests could be made public. We realize that the bank regulators make such information public. However, we do not think such disclosure is appropriate for credit unions. Credit unions already have a number of incentives to avoid risks. This includes limits on how credit unions build capital, limits on activities and investments, and certain membership conditions. A number of mortgage lending credit unions are also concerned that the new mortgage rules, particularly with the emphasis on "qualified mortgages," may mean they will limit loan offerings for those who do not meet QM requirements.

No one knows for certain what the impact of the disclosure of stress test results would be on covered credit unions. (One good reason in itself not to disclose the results.) It is easy to see, however, that such disclosure could result in self-limiting of services if credit unions fear risk taking will result in a poor showing under the stress testing.

Public disclosure of stress tests may be appropriate for banks, many of which are publicly traded. However, we cannot agree that it is appropriate or useful for credit unions, and we urge NCUA not to pursue this approach.

III. Conclusion

We agree that capital planning, including assessing capital sufficiency under stressed conditions, comprises a highly significant set of management and supervisory tools that when developed and used properly can benefit credit unions and regulators alike.

However, rather than address the use of such tools through the imposition of a new rule, we urge the Board to issue new guidance on the concerns addressed in the proposal and work with affected credit unions through the examination process under the Office of National Examinations and Supervision. We believe this approach will accomplish the agency's objectives to help protect the NCUSIF particularly under adverse economic conditions, while minimizing costs to NCUA and credit unions alike. It would also avoid sanctions for credit unions and allow them some flexibility in implementing their capital planning processes.

We have raised a number of specific issues regarding the proposal and we urge the agency to adopt our recommendations in the final guidance.

We appreciate your consideration of our concerns and recommendations. Please do not hesitate to contact me if you have any questions about our letter.

Sincerely,

Mary Mitchell Dunn

Mary Mitchell Dunn
CUNA Senior Vice President and Deputy General Counsel