

December 24, 2013

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

*Delivered Electronically*

**Subject:** Capital Planning and Stress Testing: RIN 3133-AE27

Dear Mr. Poliquin:

On Friday, November 1, 2013, the NCUA published a notice of proposed rulemaking to conduct annual stress tests of federally insured credit unions (FICUs) with assets of \$10 billion or more, and to require those credit unions to develop and maintain capital plans. The board issued the rule to protect the National Credit Union Share Insurance Fund (NCUSIF) and the credit union system.

I have carefully reviewed the proposal and sought input from experts within our membership on this important topic. Complex credit unions of all sizes recognize the importance of stress testing and capital planning as a tool to evaluate projections and assess risk related to a range of macroeconomic scenarios. While we recognize the value of stress testing and capital planning, the rule is unwarranted.

The Association appreciates the opportunity to submit comments on the proposed stress testing and capital planning rule. We have concerns with the rule, specifically with the broad interpretation of statute, the overall scope of the rule, , and the application of a Dodd Frank provision not intended for credit unions. The NCUA already has the power to require credit unions to create capital plans and run adverse scenarios. The costs of the proposed regulation far outweigh the benefits. Should the NCUA move forward the Association would encourage the NCUA to consider a number of changes prior to finalizing this rule.

### **General Comments**

Banking regulators were required by Dodd-Frank section 165 (i) to promulgate stress testing rules in order to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, of large, interconnected financial institutions. This section of Dodd Frank does not apply to credit unions or their federal regulator the NCUA. Credit unions are very different than banks and should be treated differently. Even the most complex credit unions have a very different mix of products and services with far less exposure to high risk activities, such as trading, private equity, & counterparty exposure from derivatives and financing transactions. Furthermore exposure to commercial real estate and commercial industrial lending is minimal in comparison. Finally credit unions do not have the same ability as banks to raise capital through high risk channels. Credit unions are not-for-profit financial institutions that invest in their communities in products and services that their members understand. The NCUA has sufficient ability to regulate the largest credit unions and does not need an additional tool designed to put a well capitalized credit union into PCA or to force them to raise capital through limited high cost channels.

## **Broad Interpretation of Statute**

The NCUA cited two sections of the Federal Credit Union Act (12 U.S.C. 1766a Powers of the board, and 1790d Prompt Corrective Action (PCA)) as justification for the rule. The proposed rule would create Subpart E in the PCA regulation (Title 12, Part 702) indicating that PCA could result from failure to meet stress testing and capital planning requirements.

The NCUA's justification for the stress testing rule was to protect the National Credit Union Share Insurance Fund (NCUSIF) and the credit union system. The NCUA goes on to point out that the FRB, FDIC, and OCC have issued stress test regulations, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The NCUA's current tools are sufficient to protect the NCUSIF against a loss that poses a significant risk to the financial stability of the United States or the failure of the NCUSIF. Therefore the proposed collection of information is not necessary for the proper performance of the functions of NCUA, and the information will not have a practical use.

The NCUA should not promulgate a rule because bank regulators, regulating an industry 14 times the size of the credit union movement, were required to because of the risks posed to the financial stability of the United States. Credit unions were exempted from this provision of Dodd Frank, and NCUA is proposing an un-equivalent standard that poses additional risk to the ability of credit unions to compete in the financial market place.

## **Specific Recommendations if the NCUA Moves Forward With Rule Making**

### **Scope of the Rule**

The scope of the rule is not clear. Questions remain about how assumptions will be scored, the severity of the scenarios, and what types of action the NCUA will take if they are not satisfied with the results. Guidance may be the appropriate place to answer these questions, but there should be significant involvement and dialogue early on between the NCUA and credit unions to set appropriate expectations. We would encourage the NCUA to perform stress tests commensurate with each company's size, complexity, and sophistication.

### **Capital Ratio**

The NCUA has indicated that they will run stress tests based on the scenarios developed by the Federal Reserve, FDIC, and the OCC. The stress tests will evaluate a credit union's ability to absorb losses over a nine quarter horizon, requiring a 5% minimum capital ratio. If at any point during the nine quarter horizon, they fall below 5%, they would be subject to regulatory action. Because the scenarios are unknown from year to year it is hard to predict whether a 5% capital ratio is reasonable.

Since the NCUA suggested the comparison to banks Tier 1 capital ratio we looked at the stress test results from the 18 banks over \$50 billion that published results of their stress tests over nine quarters ending Q4 2014. Twenty two percent of the banks tested fell between a 3.9% tier 1 leverage ratio and 5.1% tier 1 leverage ratio at some point during the nine quarter horizon.

If the NCUA is going to use the same or similar scenarios as the OCC, FDIC, or FRB, then the ratio should be lowered to 4%. It is important to note that the OCC has created flexible standards for \$10 billion to \$50 billion

banks, differentiating between banks within that range. The Association would once again encourage the NCUA to perform stress tests commensurate with each credit unions size, complexity, and sophistication.

### **Disclosure**

In the proposed rule the NCUA asks whether or not credit union stress test results should be kept confidential. The Association supports the position taken by the National Association of State Credit Union Supervisors to treat stress test results as a confidential examination product.

It makes sense for banks to disclose the results of their stress tests because of their primary responsibility to investors who need to be able to analyze financial information and understand the risk profiles to make sound investment decisions. The credit union movement is very different, as they are not-for-profit cooperatives striving to serve their communities and members, not investors. While the Association certainly supports transparency, we have concerns that stress tests could be misinterpreted and lead to inaccurate conclusions about the health of an institution, or the credit union movement as a whole.

At a very minimum the Association would encourage the NCUA to not require public disclosure until the scope of the rule has been more clearly defined, and the modeling understood. A three year non-disclosure trial period would be appropriate.

### **Extend Capital Planning Timelines**

The only way a plan can be truly effective is if the credit union buys into the plan. The current capital planning timeline does not allow for consensus to be reached.

Under the proposed rule a covered credit union is required to submit a capital plan by March 31 to the NCUA. The NCUA will have three months to review the capital plan of the year it is submitted, and may reject the plan if there are material unresolved supervisory issues associated with the planning process. 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. Any covered credit union operating without an NCUA-approved capital plan after September 30 of the year in which the plan was submitted will be subject to supervisory actions on the part of NCUA.

Credit unions and the NCUA should engage in a continuous dialogue. A credit union should not learn of an issue only after submitting its report. We ask that the ONES group offer instruction, assistance, and feedback to facilitate capital planning that will be acceptable to the NCUA.

Since problems do inevitably arise, the Association would encourage the NCUA to consider extending the time frame to 45 days for resubmitting the capital plan and extending the time frame for taking supervisory action until November 30. This would allow time for dialogue, and to develop a consensus for assumptions, methodologies, or analysis underlying the plan.

### **Extend Frequency of Stress Tests for Well Capitalized Credit Unions**

The NCUA has the flexibility to craft a regulation that fits the credit union system while still protecting members. As proposed, the stress testing regulations add significant costs to both the credit union system as well as the individual credit unions affected by this mandate. The Association would encourage the NCUA to allow credit unions that meet the definition of well capitalized under the severely adverse scenario to perform the

subsequent stress tests once the nine quarter horizon has expired instead of annually. This common sense solution could save individual credit unions and the NCUA significant time and money and incentivize credit unions to increase capital.

### **Conclusion**

The NCUA has sufficient ability to regulate the largest credit unions and does not need an additional tool designed to put a well capitalized credit union into PCA or to force them to raise capital through limited high cost channels. The NCUA could alternatively issue guidance that could be easily updated and would allow for credit unions to challenge key assumptions.

However if the NCUA feels that it is necessary to promulgate a rule we would ask that you consider the following:

- Issuing guidance instead of a rule and working with credit unions to develop credit union specific assumptions;
- Lowering the capital ratio to 4% if the NCUA uses the same or a similar set of scenarios and assumptions as the OCC, FDIC, or FRB;
- Do not require public disclosure, or at minimum have three year non-disclosure trial period;
- Extend capital planning timelines to allow for necessary dialogue;
- Incentivize credit unions to increase capital by extending the frequency of stress testing if under severely adverse conditions they meet the definition of well capitalized.

The Association appreciates the opportunity to submit comments on the proposed stress testing and capital planning rule. We appreciate the NCUA's commitment to improving the regulatory landscape for credit unions. Thank you for the opportunity to comment on this issue. We would be pleased to answer any questions you may have.

Respectfully,

John Trull  
Director of Regulatory Advocacy  
Northwest Credit Union Association