National Association of State Credit Union Supervisors

August 25, 2014

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

Re: NASCUS Comments on Proposed Rulemaking – Asset Securitization

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS)[1] submits the following comments in response to the National Credit Union Administration's (NCUA's) proposed changes to NCUA Rules and Regulations Part 721 and Part 741 regarding securitization of assets. As proposed, the rule would apply to both federal credit unions (FCUs) and federally insured state-chartered credit unions (FISCUs), clarifying the authority for FCUs to securitize self-originated loans while limiting FISCU authority under state law to that granted for FCUs.

NASCUS opposes the extension of this rule to FISCUs. As discussed in more detail below, NCUA has not demonstrated a pressing safety and soundness concern that warrants preemption of state authority. In addition, NASCUS believes the rule as proposed is too narrow in the scope of the activity it would allow. Finally, NASCUS objects to the NCUA's use of reference in Part 741 to apply Part 721 to FISCUs.

Preempting State Authority is Unnecessary and Unjustified

As stated in our introductory remarks, NCUA proposes extending the FCU securitization rule to FISCUs, preempting state authority and limiting FISCUs to only what is allowed for FCUs. The only justification presented for preempting state authority is NCUA's belief that "there could be a risk to the National Credit Union Share Insurance Fund if state law permits a FISCU to sponsor a securitization and the state's associated safety and soundness requirements vary from those applicable to FCUs."[2]

The preamble to the proposed rule contains no safety and soundness analysis of divergent state authority, cites no examples of existing unsafe or unsound securitization practices among FISCUs, and references no losses to the National Credit Union Share Insurance Fund (NCUSIF) resulting from FISCU securitization activities.

[1] NASCUS is the professional association of the nation's state credit union regulatory agencies.
[2] 79 FR 36266 (June. 26, 2014).

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With respect to the suggestion that differing state authority ***might*** present a safety and soundness concern, we note that NCUA itself acknowledges in the preamble that aspects of securitization activities are "unchartered waters" for the agency.[3] In contrast, many state regulators are familiar with supervising securitization activities due to their responsibilities for supervision of large banks. As we have noted in comments to previous NCUA rulemaking, state regulators supervise the safety and soundness of many diverse and complex financial service providers beyond credit unions, including banks, trust companies, securities issuers, money transmitters, mortgage brokers, and others. All told, state regulators oversee more than $2.5 trillion in assets in various financial service providers. Although many states do not currently allow securitization activities in their FISCUs, those states that do have the experience to supervise the activity to the full extent it is allowed by state law.

There is no compelling reason to preempt state law with respect to securitization. NCUA, as the administrator of the NCUSIF, may always address a specific materially unsafe and unsound practice or condition at a specific FISCU through its supervisory process in conjunction with the state regulator. NASCUS also notes that NCUA retains the right to revisit these issues should concern arise among state and federal regulators about state specific securitization authority. Excluding FISCUs from this rulemaking would protect the integrity of the dual charter by allowing for a more informed discussion of the issues based on accumulated data, rather than mere supposition.

<u>Limiting Securitization to Self-Originated Loans is too Narrow</u>

NCUA proposes limiting securitization authority to loans originated by the securing credit union, citing the limitations of FCU incidental powers and FCU and agency inexperience with securitization as the primary concerns.[4] NCUA should reconsider a blanket prohibition on securitizing purchased loans.

With respect to FISCUs, NCUA's incidental power analysis is not applicable. If state law provides FISCUs the authority to purchase loans for securitization, NCUA should not preempt that power simply because it might not be expressly provided for FCUs. The added level of risk from securitizing purchased loans, combined with FCU and NCUA inexperience, while a valid concern, should not preclude this activity for FISCUs as a matter of course.

Supervisory concerns regarding both the complexity of these transactions, and any increased level of risk, may be mitigated through the examination process. In exams, a credit union's policies, procedures, internal controls and expertise could be evaluated on a case by case basis.

In addition, some FISCUs may choose to originate loans through a CUSO. NCUA should clarify whether such loans would be considered originated by the credit union pursuant to the proposed rule. We believe such loans should be explicitly allowed as though originated by the credit union itself. We note that state regulators and NCUA have broad access to a CUSO's books and records in order to evaluate such activities, as well as the ability to focus on the credit union's due diligence in managing loans originated by a CUSO.

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[3] See 79 FR 36265 (June. 26, 2014), discussing the purchase of loans to be included in securitization.
[4] See 79 FR 36264 and 36265 (June. 26, 2014).

NCUA’s CUSO Rule and Issuing Entities

In discussing the requirements for the special purpose entity (SPE) to issue the securitizations, NCUA notes that the activity is not preapproved for CUSOs pursuant to Part 712.5. We note that NCUA’s rules regarding permissible activities for CUSOs do not apply to FISCUs. A FISCU’s CUSO meeting the other requirements established by the proposed rule might be permissible pursuant to state law. NCUA should amend the preamble to distinguish between FCUs and FISCUs.

The Residual Interest Limit of 25% too Restrictive

Proposed Part 721.3(n)(6)(iii) would limit a credit union’s residual interests to 25% of net worth. We recommend NCUA take a more flexible approach. NCUA should allow qualified credit unions to set residual interest limits in policy rather than promulgate a blanket restriction. Such an approach might be modeled after NCUA’s recently proposed fixed asset rule where credit union exceeding a pre-established benchmark would be required to have detailed policies and procedures to mitigate risk.[5] In addition, states should retain the authority to set the threshold for FISCUs.

NCUA also has an opportunity to account for the risk of higher residual interest thresholds by incorporating residual interest into its final risk-based capital rule. By assigning a risk weighting to those interests, NCUA would provide greater operational flexibility for credit unions while providing a supervisory mitigation on risk to the NCUSIF.

Application of the Rule to FISCUs by Reference is Unnecessarily Burdensome and Confusing

NCUA would apply its FCU securitization rules to FISCUs by reference in Part 741. Specifically, NCUA would promulgate new §741.226 that would direct FISCUs to §721.3(n). This creates an unnecessary compliance burden for FISCUs. NCUA’s Part 721 is the FCU incidental power rule and does not apply to FISCUs. However, with this proposed rule, NCUA would have FISCUs reference Part 741, then require FISCUs go through a provision of NCUA’s rules that generally does not apply to FISCUs in order to find the one applicable section of regulation. NCUA could ease regulatory burden by reconsidering this unnecessary preemption of state authority, or by incorporating applicable FISCU regulations in §741 in their entirety.

Furthermore, we note that the entire wording of the proposed rule is composed with no thought to the confusion that might be caused for FISCUs. From start to finish, NCUA’s proposed rule is written for FCUs, without ever referencing FISCUs or acknowledging FISCU differences (such as the permissible CUSO activities). This structure would be appropriate if NCUA intends, as NASCUS advocates, to limit the rule’s applicability to FCUs. However, as proposed, with the inclusion of FISCUs, it is puzzling why NCUA chooses to word the rule itself, and the preamble, in terms of FCUs. Incorporating rules applicable to FISCUs in their entirety in Part 741 eases regulatory burden by consolidating FISCU rules in a more easily accessible manner. This in turn

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[5] See 79 FR 46727 (Aug. 11, 2014).

could improve compliance as credit unions may more efficiently understand regulatory requirements.

The authority to securitize loans could provide an additional tool for some credit unions to manage interest rate risk and manage liquidity. We commend NCUA for addressing this issue for FCUs as a strong federal charter, alongside strong varying state charters, is the foundation of a vibrant dual chartering system. We strongly encourage NCUA to consider our recommendation and would be pleased to discuss these comments at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
General Counsel