NASCUS
National Association of State Credit Union Supervisors

March 19, 2015

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

Re: NASCUS Comments on Regulatory Review Pursuant to EGRPRA

Dear Mr. Poliquin:

The National Association of State Credit Union Supervisors (NASCUS), the professional association of the state credit union regulatory agencies and the nation's state credit union system, submits the following comments in response to the National Credit Union Administration's (NCUA's) notice of regulatory review and request for comments. As noted in our September 2, 2014 comments in response to the first notice and request for comments under the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), we commend NCUA for voluntarily participating in the EGRPRA review process. NASCUS appreciates the opportunity to aid NCUA in its effort to identify outdated, unnecessary, or unduly burdensome regulations.

This second notice pursuant to the decennial EGRPRA review solicits comments regarding rules organized within three categories: Agency Programs, Capital, and Consumer Protection. For ease of reference, NASCUS has organized its comments in corresponding manner.

Agency Programs

The three rules published for comment within the Agency Programs category are §705, Community Development Loan Programs; §725, Central Liquidity Facility; and §701.34, Designation of low-income status; receipt of secondary capital accounts by low-income designated credit unions.[1]

- Part 705.8 Community Development Loan Program

With respect to the Community Development Loan Programs, NASCUS submits a single recommendation related to the wording of §705.8, Qualifying state-chartered credit unions. Currently, NCUA's rule requires a state chartered credit union to obtain the written "concurrence" of its state regulator before NCUA will approve its application to participate in the program. The provision reads in full:

> *A Qualifying Credit Union that is a state-chartered credit union and has submitted an Application to NCUA for participation must obtain written concurrence from its respective state*

[1] 12 CFR 705, 12 CFR 725, and 12 CFR 701.34 respectively.

regulatory authority before NCUA will approve its Application. A Qualifying Credit Union that is a state-chartered credit union must also make copies of its state examination reports available to NCUA and must agree to examination by NCUA.

- 12 CFR 705.8

While it is appropriate that NCUA consult with the state regulator before taking any action related to a state chartered credit union, we believe the above provision is vague with respect to the nature of the state regulator's "concurrence." Part 705.8 should be amended to clarify that the "concurrence" of the state regulator is limited to allowing the state-chartered credit union to apply to participate in the program, and not a validation of the credit union's application.

- Part 741.204 Maximum Public Unit and Nonmember Accounts, and Low-income Designation

Part 701.34 of NCUA's rules applies to federally insured state charters by incorporation thru Part 741.204. The provision requires the state regulator to make the low-income designation with the concurrence of the NCUA. The §701.34 low income-designation, and the benefits conferred by such a designation, are products of NCUA rules, not state rules. In fact, while NCUA's share insurance rules allow low income designated credit unions to receive secondary capital accounts and exempt low-income credit unions from the statutory and NCUA regulatory 12.25% aggregate limit for member business loans, the low-income designation does not affect state regulations.[2] Therefore the designation of a federally insured state chartered credit union as low-income should be made by NCUA with the concurrence of the state regulator. The rule should explicitly allow for the state's abstaining from opining to serve as concurrence.

- Part 701.34 Designation of Low Income Status; Acceptance of Secondary Capital Accounts by Low-income Designated Credit Unions

Part 701.34(a) provides that NCUA will notify federal credit unions if they qualify for low-income designation based upon information collected during the course of examination. The provision is silent as to the process for federally insured state chartered credit unions. For FISCUs, the process for having their information evaluated is established in guidance.[3]

Federally insured state chartered credit unions are directed by reference in §741.204 to §701.34 for the rules regarding low-income designation. It is incumbent on NCUA to provide those federally insured state charters the equivalent information as their federal credit union peers with respect to the process for determination of low-income status within the prescribed regulation. NCUA should incorporate the relevant elements of the guidance issued to federally insured state chartered credit unions into the rules and regulation for ease of reference.

Throughout §701.34, the provision refers to federal credit unions, and fails to reference federally insured credit unions. As the insurer, NCUA should ensure that all of its insured credit unions, state or federal, can understand unambiguously the applicability of a regulation when referencing

[2] 12 CFR Part 701.34 and 12 CFR Part 723.17.
[3] See NCUA Letter to Credit Unions 13-CU-04 (April, 2013).

it. NCUA show amend §701.34 to reflect its applicability to both state and federal credit unions insured by the NCUSIF.

- Part 701.34(a)(4)

Part 701.34(a)(4) provides that a low-income designated credit union that "no longer meets the criteria" for the designation will be given five years by NCUA to meet the criteria for the designation or come into compliance with the regulations for non-low-income designated credit unions. On its face, the provision is unclear under what metric a designated credit union is judged to no longer meet the low-income criteria. NCUA should clarify if the tolling of the five year remedial period begins at a single point in time, or whether the failure to maintain the criteria is a window of time. In addition, the provision should clarify whether the credit union has the full five years to re-establish eligibility before beginning the process of coming into non-designated compliance, or whether the credit union must simultaneously beginning coming in to non-designated compliance (such as MBL thresholds) within the five year period it is working to re-establish its qualification for low-income designation.

NASCUS recommends that the rule clarify that the loss of low-income designation is an event triggered by series of benchmarks rather than a single point in time. The five year tolling period should not begin until a credit union has fallen below the threshold for designation for at least four consecutive quarters. Once the tolling begins to requalify, low-income credit unions should be given the full five years to retain the designation before a plan be put in place to come under compliance for credit unions not designated as low-income.

- Part 701.34(a)(5)

Part 701.34(a)(5) applies to credit unions with the low-income designation on January 1, 2009, and provided those credit unions five years to come into compliance with the low-income thresholds established by the rule. As the five year threshold has tolled, NCUA should consider eliminating §701.34(a)(5).

- Part 701.34(b) Acceptance of Secondary Capital Accounts by Low-income Designated Credit Unions

Part 701.34(b) contains NCUA's rules for the acceptance of secondary capital accounts by low-income designated credit unions. The provision limits secondary capital accounts to those of non-natural persons. NCUA should amend the provision to allow for other forms of secondary capital, as developed by the marketplace, to be permissible under the rules. From a regulatory perspective, so long as the secondary capital accounts meet the safety and soundness criteria of availability to cover losses, other attributes of these accounts should be more flexible. As the chartering authority of federal credit unions, NCUA might have a policy interest in prohibiting federal credit union members from purchasing secondary capital, however as insurer for state chartered credit unions, such policy decisions are properly left to the state chartering authority.

Part 701.34(d)(1)(vi) requires a request for redemption of secondary capital to be authorized by a resolution of the credit union's board of directors. Given the increasing regulatory obligations of

a credit union's board, many credit unions might find it more efficient, and more productive, to divide various "board" responsibilities among board committees to allow board members to focus on various pieces of compliance and management in more detail. We recommend this provision be amended to make clear that the resolution for redemption of secondary capital may be made by the "credit union's board of directors or committee there-of."

Capital

Within the scope of its Capital review, NCUA solicits comments on §702, Prompt Corrective Action, and §741.3(a), Reserves (incorporating §702 into the rules for federally insured state chartered credit unions). In addition, because NCUA also lists §741.3(a) in the notice, comments may be submitted on Subpart L of §747. Subpart L contains the administrative rules for NCUA's enforcement authority pursuant to Prompt Corrective Action.

- Statutory Change for Calculation of Credit Union Net Worth

Although NCUA is on record as supporting capital reform for credit unions, NASCUS takes this opportunity to advocate once again, for the record, for Congress to expand the definition of "net worth" to allow all credit unions to recognize contributed capital accounts in the calculation of net worth. As NCUA moves to implement risk-based capital for credit unions comparable to banking regulatory structure, a change to the statutory definition of net worth for credit unions makes sense in fully modernizing credit union prompt corrective action.[4]

- Part 702.103 Applicability of Risk Based Net Worth Requirement

Part 702.103 establishes the criteria for a credit union to be classified as complex and subject to a risk based net worth requirement. Currently, NCUA uses, in part, an asset threshold of $50 million dollars. Currently, NCUA has a proposed rule published for public comment that would raise the asset threshold to $100 million dollars for a complex credit union.[5] Both the existing asset threshold of $50 million dollars, and the proposed asset threshold of $100 million dollars, are too low.

As we wrote NCUA in response to the first risk based capital rule proposal, Congress clearly envisioned a more intricate definition of "complex" for application of prompt corrective action. If NCUA chooses to retain, for ease of administration, a simple asset threshold for "complex" under prompt corrective action, such a threshold should be no less than $500 million in assets. Per our comments filed in May, 2014:

> *In authorizing a risk-based capital structure, Congress explicitly directed NCUA to consider more than just asset size in defining complexity. The Federal Credit Union Act (FCUA) directs the NCUA to develop risk-based capital requirements for "complex" credit unions as defined "by the Board based on the portfolios of assets and liabilities of credit unions."[6] Congress could have just as easily directed NCUA to develop risk-based*

[4] See 12 U.S.C. 1790d and 12 U.S.C. 1831o.

[5] 80 FR 4432 (January 27, 2015).

[6] 12 C.F.R 1790(d)(1).

capital requirements for all credit unions and then exempted small credit unions. Rather, Congress clearly sought a more thoughtful and exclusive standard, hence the use of "complexity" rather than assets as a threshold.

If NCUA is committed to maintaining a pure asset size threshold, it should err on the side of setting that threshold high. Given the significant burden that would be imposed by this rule and the potential for unintended consequences it would be wise to phase-in the application of the rule slowly. By starting with credit unions with assets of $500 million or more, NCUA would be able to ensure smooth implementation of the rule without threatening the viability of smaller institutions. Once the full effects of the risk-based capital ratio are known, NCUA can always adjust the applicable threshold as necessary. Certainly, there is precedence for establishing $500 million as a threshold for application of the rule. We note that NCUA requires federal credit unions with assets of $500 million or greater to obtain an annual financial system audit.[7] In the 2012 liquidity and contingency funding proposed rule, NCUA also requested comments on applying Basel III liquidity measures to credit unions $500 million or greater.[8] Given that this risk-based capital system is also based on Basel III international standards, NCUA should likewise limit its initial application to the larger institutions in the credit union system.

- NASCUS Comments on NCUA Proposed Rule, Risk Based Capital, May 28, 2014

- Part 702.206(f)(3) Consultation with State Officials

Part 702.206(f)(3) requires NCUA to consult with state regulators when evaluating the net worth restoration plan submitted by a federally insured state chartered credit union, and to promptly notify of the state regulator of its decision to accept or reject the plan. While the provision implies NCUA will provide the state regulator not just notice of its decision regarding accepting or rejecting a net worth restoration plan, but also the reasoning for the decision, we believe the rule should be amended to make this clear. NCUA should provide the state regulator not only notice of its decision, but the reasoning supporting that decision. The rule should also provide time for the state regulator to respond to NCUA in the event the state and NCUA disagree on the merits of the submitted plan.

- Part 702.306(e)(3) Consultation with State Officials

Part 702.306(e)(3) requires NCUA to seek and consider the views of the state official when evaluating a revised business plan submitted by a state chartered credit union, and promptly notify the state official of its decision. As noted above with respect to §702.206(f)(30, the rule should be amended to clarify that NCUA will provide the state official with prompt notice of the both the decision and reasoning for the decision with respect to a revised business plan submitted by a state chartered credit union. The rule should also provide an opportunity for the state official to work through with NCUA divergent evaluations of a revised business plan.

- Subpart E Capital Planning and Stress Testing

[7] 12 C.F.R 715.5(a).
[8] 78 FR 64880 (Oct. 30, 2013).

NASCUS will file detailed comments in response to NCUA's proposed capital planning and stress testing rule published in the *Federal Register* January 26, 2015, and currently open for public comment.[9] However, for the record we emphasize the following recommendations in response to this request for public comment.

Part 702.503 contains a detailed description of NCUA's requirements for the required Capital policy, including numerous mandatory elements. However, the definitions provision of the rule, §702.502, is silent with respect to the Capital policy, despite the fact that it defines all the other major elements of the rule. By providing a Capital policy definition in §702.502, NCUA would further clarify the distinct, but integrated, nature of the Capital plan, the Capital policy, and the Capital planning process.

Part 702.506(c) of the rule provides covered credit unions the opportunity to apply to NCUA to conduct the regulatory stress tests themselves based on the published scenarios after NCUA has conducted three consecutive stress tests. NASCUS supports allowing covered credit unions to conduct the regulatory stress tests.[10] As noted in NASCUS' comments on the original proposed Capital Planning and Stress Testing rule, we believe a more efficient, meaningful, and beneficial approach continues to be requiring the covered credit unions to conduct stress tests under regulatory supervision accompanied by third party validation.[11] However, as NCUA has determined to conduct the stress tests itself, we recommend NCUA clarify the standards by which a covered credit union's request to conduct stress tests will be evaluated.

In the preamble to its April, 2014, final rule stress testing rule, NCUA discusses the criteria it will use to determine whether a covered credit union may self-conduct stress tests after NCUA has conducted three consecutive tests. Among the criteria identified were the covered credit union's previous stress test results, recent supervisory history, current financial condition, CAMEL codes, and management continuity.[12] These criteria, absent from the final rule, should be established within §702.506. So doing would be consistent with §702.505, NCUA action on capital plans, where NCUA's criteria for rejecting a covered credit union's capital plan are expressly stated.

We anticipate that at the end of the initial three years of NCUA conducted stress testing, all of the covered credit unions are likely to apply for permission to conduct the regulatory tests themselves. We urge NCUA to provide additional clarity to the agency's expectations beyond that point. As established by the rule, the covered credit union must re-apply each year for the authority to conduct its own stress test. We recommend NCUA establish explicit criteria that allows covered credit unions not only to conduct the regulatory stress tests, but to invest with confidence in the infrastructure to conduct those tests in an ongoing manner.

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[9] 80 FR 3918 (Jan. 26, 2015).

[10] The Federal Deposit Insurance Corporation (FDIC), the insurer of deposits for banks, issued a stress testing rule pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act that required stress testing for banks. Under the FDIC rules, the banks conduct their own stress tests which are then validated by the federal regulator. See 77 FR 624171 (October 15, 2012).

[11] NASCUS Comments on Proposed Rule – Capital Planning and Stress Testing, December 31, 2013.

[12] 79 FR 24312 (April 30, 2014).

Consumer Protection

Under the final category for review in this round of comments, NCUA lists several of its consumer protection regulations. The rules open for comment that apply to FISCUs are §707, Truth in Savings, incorporated by reference in §741.217, Part 760, Loans in areas having special flood hazards, incorporated by reference in §741.216, Part 745, Share Insurance, incorporated by reference in §741.212, Part 740, Advertising, incorporated by reference in §741.211, Part 741.10, Disclosure of Share Insurance, Part 741.5, Notice of termination of excess share insurance, and Part 741.9 Uninsured membership shares (which also references Part 745)

- Part 707 Truth in Savings

In §707, and throughout NCUA's Rules and Regulations, NCUA uses the term dividends rather than interest. In practice, the terms are often used interchangeable in the marketplace by credit unions. In defining dividends, NCUA should include a reference to interest paid on member share accounts.

- Part 741.9 Uninsured Membership Shares

Part 741.9 prohibits a federally insured credit union from offering member shares that due to the conditions or terms of the account are uninsured. However, state chartered credit unions may be authorized under state law to accept deposits in addition to share accounts, and those deposit accounts might not qualify for federal insurance. There might also be a business reason to accept uninsured deposit accounts. NCUA should amend this provision to allow state chartered credit unions to offer uninsured accounts as approved or authorized by the state.

NCUA Regulatory Modernization Initiative

The organization of NCUA's Rules and Regulations continues to present an unnecessary hardship for federally insured state chartered credit unions. NCUA insurance rules applicable to federally insured state chartered credit unions are scattered throughout NCUA's rules applicable to federal credit unions. State charters must reference §741, and from there are redirected to other provisions within NCUA's rules to determine which rules apply to state charters. Even the largest state charters continue to report to NASCUS confusion as to which provisions outside of §741, or in many cases, subsections of provisions, apply. For modest sized credit unions, the burden is even greater in terms of more finite resources to dedicate to interpreting NCUA's rules.

It is incumbent on NCUA, as a regulator, to provide not just a clear road map for regulatory compliance, but a road map as devoid as possible, of opportunity for misunderstanding.

As this EGRPRA notice aptly demonstrates, while NCUA lists eight provisions of its rules applicable to state charters for review, those eight provisions require state charters to reference nearly nineteen provisions of NCUA's rules. The rules identified for comment with this notice that only apply to federal credit unions required state charters to review all ***thirty-seven*** provisions of §741, and three Appendices, just to determine they don't apply.

NCUA should reorganize its Rules and Regulations to consolidate and differentiate, to the fullest extent practical, the rules related to the share insurance fund and those applicable to its federal charters.

In closing, we again commend NCUA for voluntarily participating in the EGRPRA process with its sister federal banking agencies. We are confident NCUA will give thoughtful consideration to our recommendations for improving the federal regulatory, and statutory, framework for federally insured state chartered credit unions. We would be pleased to discuss these comments in detail at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
General Counsel