NASCUS
National Association of State Credit Union Supervisors

March 22, 2016

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

Re: NASCUS Comments on Regulatory Review Pursuant to EGRPRA # 4

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) notice of regulatory review and request for comment pursuant to §2222 of the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA).[2] We applaud NCUA for voluntarily participating in the EGRPRA review process. The Agency is not required to undertake EGRPRA review, and its commitment to identifying and minimizing outdated, unnecessary, or unduly burdensome requirements is commendable. NASCUS appreciates the opportunity to aid NCUA in that effort, and is hopeful that the process will lead to more efficient and effective regulation.

NCUA exercises partial regulatory and supervisory authority over federally insured state chartered credit unions (FISCUs) in its role as administrator of the National Credit Union Share Insurance Fund (NCUSIF). However, state regulatory authorities remain the primary prudential regulator of FISCUs. This shared regulatory oversight means FISCUs are subject to a more complicated compliance regime (subject to both state and federal rules) than their federal credit union (FCU) counterparts.

Given the dual regulatory oversight of FISCUs, our comments here in will focus on improvements in NCUA Rules and Regulations that reduce regulatory burden by either amending existing NCUA rules to conform to contemporary business needs, or suggest exemption of FISCUs from NCUA rules in areas where alternate state regulation provides comparable safe and sound risk mitigation. In either circumstance, our recommendations are consistent with both the EGRPRA mandate, as well as NCUA's own regulatory relief initiative announced in 2011.

Voluntary and Involuntary Liquidation; Part 709 and Part 710

The Involuntary Liquidation provisions of Part 709 establish NCUA's responsibilities as liquidating agent and payout priorities, including addressing low-income credit unions and

[1] NASCUS is the professional association of the nation's state credit union regulatory agencies.
[2] Pub. L. 104–208, Div. A, Title II, § 2222, 110 Stat. 3009 (1996); codified at 12 U.S.C. 3311.

secondary capital accounts. See § 709.5(b)(8). On October 15, 2015, NCUA published a final Risk Based Net Worth rule.[3] Although that final rule did not contain provisions for supplemental capital, NCUA has publically committed to implementing supplemental capital for non-low income natural person credit unions subject to the new risk based net worth requirements. During the October 15, 2015 NCUA Board meeting, NCUA Chairman Matz stated that NCUA planned "to address supplemental capital as soon as possible in a new proposed rule. The new proposed rule will present stakeholders with a specific outline of our plans to count supplemental capital, and provide opportunities for further comments. The effective date of a final supplemental capital rule would coincide with the effective date of risk-based capital in 2019."[4]

- **NCUA should amend Part 709 to address the payout priority for supplemental capital in non-low income natural person credit unions.**

Amending the liquidation provisions now, streamlines NCUA's rules and regulations in anticipation of its forthcoming supplemental capital rule. We also note that the authority to issue a supplemental capital instrument for a state chartered credit union resides with state law and state regulation. Currently, federal law controls whether such an issuance counts toward regulatory capital, but the issuance itself is determined under state law. As such, it also makes sense for NCUA to amend its existing regulations to recognize such instruments.

Lending, Part 701.21

NCUA's lending regulation, § 701.21, applies in part to FISCUs by incorporation in § 741.203. Pursuant to the incorporation provision, FISCUs must comply with rules for federal credit unions (FCUs) related to prohibited fees, non-preferential loans, and 3rd-party servicing of indirect vehicle loans.[5] However, § 741.203(a) provides FISCUs an exemption from the prohibited fees and non-preferential loans if "the state supervisory authority for that state adopts substantially equivalent regulations as determined by the NCUA Board…" There is no exemption for the application of Part 701.21(h) third-part service provisions to FISCUs.

- **NCUA should amend the exemption provisions related to prohibited fees and non-preferential loans to focus on risk to the share insurance fund rather than the current focus on how similar the state rules might be to NCUA's rules.**

As noted above, the exemptions available to FISCUs related to prohibited fees and non-preferential loans require a state to promulgate a "substantially equivalent" rule. A better approach would focus on a state specific rule's mitigation of risk to the safety and soundness of the credit union. In fact, amending current § 741.203(a) qualification of the applicability of FCU lending rules to FISCUs would be consistent with NCUA's previous acknowledgement that

[3] Risk Based Capital, 80 Fed. Reg. 66626 (October 29, 2015).
[4] See Statement of NCUA Chairman Matz, October 15, 2015, available at https://www.ncua.gov/newsroom/Pages/speeches/2015/october/Matz-Statement-on-the-Risk-Based-Capital-Final-Rule.aspx.
[5] See 12 C.F.R. §701.21(c)(8), prohibited fees; 12 C.F.R. §701.21(d)(5) non-preferential loans; and 12 C.F.R. §701.21(h) 3rd-party servicing of indirect loans.

safety and soundness, not "equivalence," is the better standard for evaluating a state specific rule that would exempt FISCUs from NCUA share insurance rules.

In 1999, NCUA promulgated a new member business lending rule that provided for an exemption for FISCUs if NCUA approved a state specific rule.[6] The standard established by NCUA to determine whether to exempt FISCUs from the new rule focused on safety and soundness, not how similar the state's rule was to NCUA's rule. The exemption provision, Part 723.20 reads in part:

> (a) The NCUA Board may exempt federally insured state chartered credit unions in a given state from NCUA's member business loan rule if NCUA approves the state's rule for use for state chartered federally insured credit unions. In making this determination, the Board is guided by safety and soundness considerations and reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business loan rule in this part.
>
> - 12 C.F.R. §723.20[7]

Prior to 1999, NCUA utilized the "substantially equivalent" standard for recognizing exemptions for FISCUs from its member business lending regulations. ***In adopting the better approach in 1999, a safety and soundness analysis, NCUA stated "in deciding whether to allow a state to implement its own rule, the NCUA Board is concerned, as insurer, with safety and soundness issues and not whether the language of the rule is virtually identical to NCUA's rule."*** This is right, and should be the standard wherever NCUA provides in its rules for NCUA Board approved exemptions for individual states.

- **NCUA should amend § 701.21(h), third party servicing of indirect vehicle loans, from its current prescriptive form to a principle based approach.**

NCUA's §701.21(h) contains both very prescriptive constraints and waiver provisions. The rule limits federally insured credit unions' acquisition of, or interest in, vehicle loans serviced by any single third-party in aggregate to 50 percent of the credit union's net worth during the initial thirty months of that third-party servicing relationship and 100 percent of net worth after the initial thirty months of that third-party servicing relationship.[8] The credit union's NCUA Regional Director may grant a waiver to the third-party servicing limitations.[9]

Eliminating the prescriptive limits of current §701.21(h) and replacing those limits with a requirement that credit unions set their own limits in policies would be consistent with NCUA's recent rulemaking for FCU fixed assets and FICUs MBL and commercial lending.[10] So doing

[6] Organization and Operation of Federal Credit Unions; Appraisals; Member Business Loans; and Requirements for Insurance, 64 Fed. Reg. 28721 (May 27, 1999).
[7] NCUA has promulgated a new final member business lending/commercial lending rule which will change the state exemption standard effective 2017. See Member Business Lending; Commercial Lending, 81 Fed. Reg. 13530 (March 14, 2016).
[8] 12 C.F.R. 701.21(h)(1)(i) and 701.21(h)(1)(ii).
[9] 12 C.F.R. 701.21(h)(2).
[10] Member Business Loans; Commercial Lending, 81 Fed. Reg. 13530 (March 14, 2016), and Federal Credit Union Ownership of Fixed Assets, 80 Fed. Reg. 45844 (August 3, 2015).

would reduce regulatory burden and provide credit unions "with greater flexibility and individual autonomy in safely and soundly providing … [service]…" to their members.[11]

Supervisory Committee Audit, Part 715

Some, but not all, of NCUA's § 715 audit provisions apply to FISCUs by incorporation in Part 741.202. However, the full extent of § 715's application to FISCUs is unclear. In general, Part 741.202(a) requires every FISCU to obtain an annual audit that meets the applicable requirements of § 715 (or state regulations if the state regulations are more restrictive) and to verify all passbooks and accounts at least once every 2 years.[12] The confusion arises because NCUA's audit rule, Part 715, contains numerous provisions, some of which directly address audit requirements, others of which are more tangential in nature. For example § 715.3, General responsibilities of the Supervisory Committee, establishes requirements for the Supervisory Committee and the credit union's board of directors. Part 715.11, Sanctions for failure to comply with this part, establishes penalties for non-compliance with § 715. While these provisions are related to audits, they are not themselves specifically setting standards for the audit and therefore it is unclear if these provisions are incorporated in § 741.202.

- **NCUA should clarify that only the following provisions of Part 715 apply to FISCUs by amending § 741.202 to include the specific applicable language of § 715.4, § 715.6, § 715.7, and § 715.8.**

As discussed in more detail below, NCUA could significantly reduce regulatory burden, without compromising the supervisory integrity of existing regulations, by consolidating share insurance rules applicable to FISCUs within Part 741 in their entirety rather than the current approach of incorporation by reference.

Appraisals, Part 722

FISCUs are required to comply with NCUA's Part 722 appraisal rules for FCUs by incorporation in § 741.203(b). In particular, § 722(a)(1) of NCUA's rules generally requires "[a]n appraisal performed by a State certified or licensed appraiser is required for all real estate-related financial transactions" for a consumer mortgage in excess of $250,000.00. We are aware that federal banking agencies, as part of their §2222 EGRPRA process, might be considering whether this $250,000.00 threshold should be raised.

[11] Id.

[12] 12 C.F.R. 741.202 reads:

(a) The supervisory committee of each credit union insured pursuant to title II of the Act shall make or cause to be made an audit of the credit union at least once every calendar year covering the period elapsed since the last audit. The audit must fully meet the applicable requirements set forth in part 715 of this chapter or applicable state law, whichever requirement is more stringent.

(b) Each credit union which is insured pursuant to title II of the Act shall verify or cause to be verified, under controlled conditions, all passbooks and accounts with the records of the financial officer not less frequently than once every 2 years. The verification must fully meet the requirements set forth in §715.8 of this chapter.

- **We urge NCUA to ensure that appraisal thresholds remain consistent across the federal bank agencies.**

Examination, Part 741.1

This provision requires federally insured credit unions to submit to examination by NCUA. It also reiterates the statutory mandate that NCUA rely on examinations conducted by state regulators to the "maximum extent feasible." See FCUA § 1782(a)(5) "To the maximum extent feasible, the Board shall use for insurance purposes reports submitted to State regulatory agencies by State chartered credit unions."

- **NCUA should take steps to limit its presence in FISCUs and increase its reliance on state reports of examination.**

As Administrator of the NCUSIF, NCUA has a duty to monitor the condition of federally insured credit unions, including FISCUs. NASCUS has always supported NCUA's authority, and duty, to examine FISCUs, in its capacity as share insurer, as necessary. However, as both the FCUA, and NCUA's own regulations make clear, the agency should be relying on state examinations for the preponderance of FISCU exams.

Regulations Codified Elsewhere in NCUA's Regulations that Apply to FISCUs, Part 741 Subpart B

Part 741 Subpart B contains, most, but not all, of the rules codified elsewhere in NCUA's regulations that apply to FISCUs. NASCUS notes that provisions of § 741 Subpart A also contain incorporated rules applicable to FISCUs but codified elsewhere in NCUA's regulations.[13]

Part 741.3 contains cross references to provisions of Part 702, Part 703, and Part 747. Part 741.6 cross references Part 715. Part 741.8 cross references to Part 701.23 and Part 701.22. Part 741.9 contains cross references to Part 745.

- **NCUA should consolidate all share insurance rules applicable to FISCUs within a single section, or sections, of its rules.**

As currently organized, NCUA's rules are confusing at best, and unacceptably burdensome at worst. At a minimum, it is incumbent on NCUA to present its regulations in a manner which makes clear to FISCUs what rules apply. On their face, NCUA's regulations fail this basic test. As noted above, even though § 741 Subpart B purports to "Regulations Codified Elsewhere in NCUA's Regulations that Apply to FISCUs," several rules codified elsewhere that apply to FISCUs are referenced in § 741 Subpart A. Furthermore, even when NCUA's rules accurately organize the cross reference, the wording of the Part 741 incorporation of "other rules" raises questions as to the extent of the applicability of the FCU rules. This comment letter has already discussed the ambiguity of Part 741.202 references to the audit requirements of Part 715, but

[13] 12 C.F.R 741, Subpart A.

another example is found in the minimum bond requirements of § 741.201(a), which read in part, "Any credit union which makes application for insurance of its accounts pursuant to title II of the Act must possess the minimum fidelity bond coverage stated in part 713 of this chapter in order for its application for such insurance to be approved and for such insurance coverage to continue."[14] The difficulty is that § 713, Fidelity Bond and Insurance Coverage for Federal Credit Unions, contains more prescriptions than levels of fidelity bond coverage. For example, § 713.2 requires a FCU board of directors to review its bond and insurance coverage annually. It is unclear if this provision is considered part of "possessing minimum fidelity bond coverage" as incorporated by reference in § 741.201 for FISCUs. Similar questions are raised by the "form" requirements stated in § 713.[15]

All of this confusion would be resolved, and a substantial regulatory relief granted, if NCUA reorganized its rules. We acknowledge the complexity of such an undertaking, but note recently that the Consumer Financial Protection Bureau (CFPB) and the Financial Crimes Enforcement Network (FinCEN) both undertook wholesale reorganization of their rules.[16]

Noting that changes to FinCEN's rules over the years had left those rules not optimally organized and difficult to navigate, FinCEN Director James H. Freis, Jr. stated ***"In reorganizing these regulations, FinCEN is making BSA rules more accessible, easier to research and easier to understand. This change will promote the goals of the Bank Secrecy Act to protect the financial system from criminal abuse by facilitating compliance by regulated financial institutions***."[17]

What was true for FinCEN's regulations is true for NCUA's regulations. As Director Freis so aptly, and accurately, observed, organizing regulations in a common sense and usable manner furthers the goals of those regulations and aids compliance.

In addition to reorganizing and consolidating share insurance rules applicable to FISCUs, we recommend the following changes to improve regulations incorporated by Part 741 Subpart B.

- **NCUA should amend Part 701.22, Loan Participations, which applies to FISCUs by incorporation in Part 741.8, to clarify that an auto dealer that originates an indirect**

[14] 12 C.F.R 741.201(a), which reads in full " Any credit union which makes application for insurance of its accounts pursuant to title II of the Act must possess the minimum fidelity bond coverage stated in part 713 of this chapter in order for its application for such insurance to be approved and for such insurance coverage to continue. A federally insured credit union whose fidelity bond coverage is terminated shall mail notice of such termination to the Regional Director not less than 35 days prior to the effective date of such termination."
[15] 12 C.F.R. 713.4, What bond forms may be used?
[16] The CFPB transferred its consumer protection rules into a new organization over the course of several rulemakings. See "Consumer financial protection regulation moving to new home," Barbara S. Mishkin (December 21, 2011). Available at https://www.cfpbmonitor.com/2011/12/21/consumer-financial-protection-regulations-moving-to-a-new-home/. FinCEN reorganized it regulations in a single comprehensive recodification. See Transfer and Reorganization of Bank Secrecy Act Regulations, 75 fed. Reg. 65806 (October 26, 2010).
[17] "FinCEN Simplifies Structure of its Rules and Regulations; Makes Rules Easier to Find and Follow: FinCEN to Implement New Chapter X on March 1, 2011" FinCEN Press Release (October 18, 2010). Available at https://www.fincen.gov/news_room/nr/html/20101012.html.

auto loan and then promptly assigns that loan to a credit union is an agent of the assignee credit union.

NCUA's EGRPRA notice requests comment on rules codified elsewhere in NCUA's Rule and Regulations that apply to FISCUs. NCUA should move the reference to § 701.22 into Subpart B of § 7141. In addition, NCUA should amend § 701.22 to incorporate the clarification of loan participations provided by NCUA's August 10, 2015 Legal Opinion.[18]

- **NCUA should amend the state specific MBL rule exemption, referenced in Part 741.203, to reinstate the Part 723.20 standard that focuses on risk to the share insurance fund.**

On February 18, 2016, NCUA promulgated a comprehensive new member business loan/commercial lending rule.[19] Since 1999, NCUA's standard for evaluating a state specific member business lending rule for a state exemption was "guided by safety and soundness considerations and reviews whether the state regulation minimizes the risk and accomplishes the overall objectives of NCUA's member business loan rule in [NCUA's rules]"[20] As discussed at length above, this is the proper standard. Unfortunately, NCUA changed this standard in the new final rule to one which ensures the "state rule at least covers all the provisions in this part and is no less restrictive, upon determination by NCUA."[21]

We believe the new standard unnecessarily purports to limit innovative approaches to commercial lending regulation. In particular, the wording regarding "covers all provisions" confuses whether a state rule must be substantially equivalent or will be judged based on safety and soundness. Of course, other provisions of NCUA's new final rule borrows from concepts pioneered by state MBL regulation.[22] We know it is unusual to recommend changes to a rule published in the *Federal Register* a mere week earlier. Unfortunately, NCUA's change of the standard by which a state specific MBL rule is to be judged was never presented in the proposed draft of the MBL/commercial lending rule, making this our first opportunity for comment.[23]

- **NCUA should amend Part 741.204 to clarify the relationship between NCUA and state regulators.**

Several provisions of § 741.204(b) require NCUA and the state regulators to decide concurrently on the application of a FISCU for low-income designation. In many cases, the state regulator works proactively to facilitate the ability of FISCUs in their state to avail themselves of an

[18] See NCUA Legal Opinion 15-0813, August 10, 2015.
[19] Member Business Loan; Commercial Lending 81 Fed. Reg. 13530 (March 14, 2016).
[20] 12 C.F.R. 723.20.
[21] New 12 C.F.R. 723.10, Member Business Loan; Commercial Lending 81 Fed. Reg. 13559 (March 14, 2016).
[22] See the treatment of the personal guarantee, more flexible LTV ratios, and experience requirements comparable to the portfolio rather than a generic two years.
[23] See the proposed rule, 80 Fed. Reg. 37898, 37911 (July 1, 2015). There is no "Part 723.10" provision in the proposed rule which is where the new standard is articulated. As for the request for comments on state specific MBL rules, there is again, no specific indication of a change to the standard.

NCUA low-income designation. However, in some states, the state regulators are constrained by a lack of state based authority with respect to low income designation, in making a determination that a FISCU qualifies for the NCUA designation. To accommodate FISCUs in states where the state regulator cannot make the determination pursuant to § 741.204(b), NCUA's rule should be amended to include a provision allowing NCUA to make the determination unless the state regulator objects.

- **NCUA should allow for diverse state chartered corporate credit union regulation.**

Part 741.206 requires all corporate credit unions to adhere entirely to § 704. NASCUS remains concerned that the homogenization of the corporate credit union system contributed to the weaknesses exposed during the economic downturn. NCUA should allow states to enact alternative regulations for corporates to re-establish dual chartering and diversity in the corporate system.

- **NCUA should amend § 741.208 to recognize that state law should govern the conversion of FISCUs to non-federally insured credit union status.**

Part 741.208 applies NCUA's restrictive charter conversion and termination of share insurance rules to FISCUs.[24] NASCUS concedes that the FCUA gives NCUA authority for rulemaking with respect to credit union to non-credit union charter conversions. However, Congress's grant of authority in this arena was intended as limiting.[25] NCUA should show deference to state laws addressing conversions or mergers into non-credit unions. With respect to FISCUs, NCUA is only the share insurer, not the chartering authority. NCUA's only concern in the conversion of a FISCU to non-credit union or non-NCUSIF charter is preventing regulatory arbitrage, or any safety and soundness risk posed by reputational concerns. However, in the case of conversion to bank charter, the entity would remain federally insured, mitigating reputational risk. Vindication of the members' rights and other governance issues are properly left to the chartering regulator – in these cases, the states.

- **NCUA should amend § 741.214 regarding the Bank Secrecy Act to recognize that not all FISCUs hold monthly board meetings.**

Part 741.214 applies § 748, NCUA's Bank Secrecy Act (BSA) regulation to FISCUs. One of the provisions applied through incorporation is that Suspicious Activity Reports (SARs) filed by a credit union must be reported to the credit union's board "promptly."[26] In guidance issued in December, 2006, NCUA defined "promptly" as at least monthly, and notes that reporting at the monthly board meeting satisfies this requirement.[27] We note that not all states require monthly board meetings. NCUA should revise guidance to provide that notification at the next board meeting satisfies the requirement to report "promptly."

[24] Parts 708a and 708b.
[25] See PL 105-219 The Credit Union Membership Access Act of 1998, instructing NCUA to pass regulations that are no stricter than similar regulations promulgated by the other federal banking agencies.
[26] 12 C.F.R. §7481.1(c)(4)(i) *Notification to board of directors.*
[27] See NCUA Regulatory Alert 07-RA-07 Final Rule: Part 748, Filing Requirements for Suspicious Activity Reports.

Again, we commend NCUA for its willingness to undertake the EGRPRA process to identify meaningful regulatory reform, and appreciate the opportunity to comment on these regulations. We look forward to continuing to work with NCUA to maintain and improve the safe, sound, and efficient regulation of the credit union movement.

Sincerely,

[signature redacted for electronic publication]

Brian Knight
General Counsel