

State Employees' Credit Union



Accounting Department

December 29, 2017

Gerard S. Poliquin,
Secretary of the Board,
National Credit Union Administration
1775 Duke Street,
Alexandria, Virginia 22314-3428

Re: Comments on Proposed Rule - Capital Planning and Supervisory Stress Testing
RIN 3133—AE80

Dear Mr. Poliquin,

State Employees' Credit Union (SECU) of Raleigh North Carolina provides the following comments on the National Credit Union Administration's (NCUA) proposed amendments to its regulations regarding capital planning and stress testing for federally insured credit unions with \$10 billion or more in assets.

SECU is the second-largest credit union in the United States and has been subject to NCUA's capital planning and stress testing rules since their inception in 2014. In offering the comments below, we draw upon our experience and insight gained as one of the few credit unions implementing the capital planning and stress testing regulations over this entire period.

The proposed changes are intended to reduce regulatory burden by removing some of the more onerous capital planning and stress testing requirements. 82 Fed. Reg. 50,094, 50,095 (Oct. 30, 2017). The changes also aim to "more closely align" NCUA's supervisory expectations with its regulatory requirements. *Id.*

We support the goal of reducing regulatory burden and applaud NCUA's efforts to foster accountability and transparency by making its published rules more closely align with unwritten supervisory expectations. We recognize the importance of capital planning and supervisory stress testing within our industry. A prudent credit union manages capital in current economic conditions and plans for the potential impacts of adverse conditions. However, as outlined below, additional changes should be considered to further reduce the burden on covered credit unions while still providing sufficient oversight of a credit union's capital planning and stress testing processes.

Credit Union-Conducted Supervisory Stress Tests

The proposed amendment eliminates the requirement that the NCUA conduct supervisory stress tests and provides instead that covered credit unions perform their own supervisory stress tests. According to the proposal, having Tier III credit union's conduct their own stress tests would make them "better informed of risk" and eliminate the "unintentional, negative consequence []" that a covered credit union might "abdicate its responsibility to perform rigorous capital analyses to the NCUA." *Id.* at 50,096.

We support this change and commend NCUA for proposing it. We have incorporated the analyses and results of our supervisory stress tests in our capital plan document since the implementation of the original regulation in 2014. We felt and continue to feel it is important that we understand the impact of stressed scenarios on our capital position.

Instructions for Supervisory Stress Tests

The proposal requires covered credit unions to administer the supervisory stress tests “in accordance with the instructions provided by the NCUA” which the NCUA will publish each year on its website. The NCUA Board included this requirement to ensure that supervisory stress tests are conducted in a manner that promotes consistency and comparability. *Id.* at 50,099.

The instructions may necessitate significant adjustments to existing quantitative models. Such changes could take months to properly test and implement. We therefore recommend that the instructions be made available far enough in advance to allow credit unions adequate time to prepare for the directives. We suggest six months prior to the “as of” date set forth in 12 C.F.R. § 702.506(a) as an appropriate deadline for the NCUA to publish instructions. Moreover, to better promote consistency and comparability from year to year, changes to the instructions should be kept to a minimum.

Supervisory Stress Test Scenario Assumptions

We are extremely concerned that NCUA mandated scenarios in the future will deviate from the Federal Reserve Bank stress test assumptions which have been adopted and utilized by bank and credit union regulators as the standard and basis for stress testing since 2014. If NCUA imposes unreasonably stringent (or lax) stress test assumptions, the credit union industry will be severely disadvantaged. Individual credit unions could be subject to onerous capital requirements which will damage their effectiveness and ability to compete in the financial services marketplace. Unequal or arbitrary tests will reduce the safety and soundness of the credit union industry. Stress tests run by financial institutions (banks and credit unions) should be consistent--the public will surely perceive them to be. We therefore request that the NCUA continue utilizing the Federal Reserve Bank stress test assumption scenarios rather than designing their own unique tests.

Differentiating Capital Planning/Stress Testing Based on Individual Credit Union Characteristics

Likewise, we are concerned how attempts to “differentiate the capital planning and stress testing requirements applicable to . . . [covered credit unions] by size, complexity and financial condition” will be applied to covered credit unions. While the theory may be reasonable the prospect opens the process to regulatory bias which can be used to disproportionately influence the scenario results. Covered credit unions must use the scenario assumptions as provided and interpreted by NCUA and there is no guidance in the proposal on how such determinations will be made. The process is arbitrary and unique to each covered credit union as proposed.

The resounding success of our Mortgage Assistance Program in reducing loan losses since the beginning of the Great Recession is not afforded the recognition it has earned as a proven, effective means of reducing loan losses. Our actual loss experience is the basis for beginning the loan loss projection process inherent in the modeling. Actual results over the past decade speak for themselves. Attempts by NCUA to influence model projections by layering on unique approaches to loss modeling may result in complexity and inconsistent or incorrect results. Additionally, it will result in significant additional

expense to covered credit unions—a potentially unfunded mandate. We express concerns over how the “individual characteristics” will be applied to the modeling process. We recommend that if a covered credit union has demonstrated ability to model scenarios or have obtained independent, qualified and reputable sources for loss modeling and model validation these sources should be accepted by NCUA as meeting the standards for size, complexity, financial condition inclusive of the individual characteristics of the covered credit union.

Eliminate Unnecessary Data Submissions

Under existing 12 C.F.R. § 702.506(e), a covered credit union must provide the NCUA with any relevant qualitative or quantitative information requested by the NCUA pertinent to the stress tests. Currently, the NCUA requires covered credit unions to provide comprehensive monthly data on a quarterly basis to support NCUA-conducted stress testing. The collection and validation of the quarterly data submissions represents a costly, time-consuming regulatory exercise for covered credit unions.

Since the proposed amendment now provides that credit unions—not the NCUA—will be conducting the supervisory stress tests, the need to continuously compile and provide this voluminous data to the NCUA should substantially diminish. Eliminating the unnecessary monthly data collection, validation and quarterly submission task would meaningfully reduce regulatory burden for covered credit unions and free up credit union resources to conduct the supervisory stress tests that the NCUA is now proposing that credit unions perform. Accordingly, the NCUA should make clear in the final rule that covered credit unions will not be required to submit monthly data on a quarterly basis for stress testing except where the NCUA has elected to perform its own supervisory stress tests for the covered credit union.

Eliminate Qualitative Assessment as Basis to Reject a Capital Plan

The proposed rule continues to include a qualitative assessment as a criterion for acceptance or rejection of a tier III credit union’s capital plan. NCUA should eliminate the qualitative assessment as a basis to reject a capital plan and instead address any perceived qualitative deficiencies through the examination/supervisory process.

Under the current capital planning rules, the NCUA may reject a capital plan if, among other things, the NCUA determines that the plan contains “unacceptable weakness,” the data utilized in the plan is “insufficiently detailed” or “lacks integrity,” or the capital analysis is “not reasonable or appropriate.” 12 C.F.R. § 702.505(b). Serious penalties can attach to a rejection: a credit union operating without an approved capital plan is subject to supervisory action. 12 C.F.R. § 702.505(e).

The severe consequences resulting from a plan rejection heighten the importance of supplying clear standards for plan approval. However, the current qualitative criteria are too vague and subjective to serve as an appropriate basis for plan rejection. For example, “unacceptable weakness,” “insufficiently detailed” and “not ... appropriate” each represent a subjective conclusion, not an objective measurement which a covered credit union can use in advance to ensure its plan complies with the rule’s requirements. The presence of hopelessly subjective plan approval criteria creates an environment hospitable to arbitrary action, and inhibits accountable, transparent, and consistent agency decision-making.

The capital plan components evaluated through a qualitative assessment are better addressed through the examination/supervisory process rather than as a tool deployed after the fact to reject a capital plan. A

dialogue between the credit union and NCUA staff would more effectively address qualitative concerns surrounding the capital planning process.

Bank regulatory agencies have retreated from the practice of using qualitative grounds as a basis to reject a capital plan. In January 2017, the Federal Reserve Board eliminated the qualitative assessment requirement for large and noncomplex firms (generally under \$250 billion in total consolidated assets) subject to the Federal Reserve's Comprehensive Capital Analysis and Review. 82 Fed. Reg. 9,308 (Feb. 3, 2017). The NCUA should modify the proposal. We recommend that the NCUA remove the qualitative assessment as part of the capital plan acceptance determination and handle this type of review through the examination/supervisory process.

Scale Regulatory Requirements to Risk

The proposal states that the “size, complexity and financial condition are significant determinants regarding each covered credit union’s risk to the NCUSIF.” 82 Fed. Reg. 50,094, 50,095. We agree. Yet, the proposal continues to differentiate regulatory requirements based only on one factor: size. Indeed, the tier structure and its corresponding regulatory burdens are based almost entirely on the size of the institution. Regulatory relief should be afforded to credit unions that pose less risk to the share insurance fund, and risk should be measured on size, complexity and financial condition. Asset size, in and of itself, is not an indication of the risk posed to the share insurance fund. For example, thirty-nine percent (39%) of our balance sheet is in cash or cash equivalents—which pose no risk of loss. On a risk-based measurement (the NCUA risk-based capital calculation) our capital-to-assets ratio approaches 20% of risk assets!

We suggest that the NCUA tailor the capital planning and stress testing requirements to reflect a covered credit union’s size, complexity and financial condition. We recommend that the NCUA reduce the frequency with which the supervisory stress tests must be conducted for covered credit unions that (a) have passed three or more consecutive supervisory stress tests, and (b) have either a (i) net worth ratio of 10% or greater, or (ii) risk-based capital ratio of 12% or greater (under the NCUA calculation). Further, for those credit unions we recommend reducing the frequency of supervisory stress tests to once every three years which affords targeted, prudent regulatory relief for a set of covered credit unions that have demonstrated a consistent ability to maintain capital under stressed conditions and continue to maintain a heightened level of capital as an additional buffer against unknown risk.

Rejection Subject to Supervisory Review Committee Process

The proposal provides that the NCUA’s formal rejection of a capital plan would be subject to the Supervisory Review Committee process. This approach enhances agency accountability and provides covered credit unions with clear procedural protections. We support it.

We appreciate the opportunity to provide comments on the NCUA’s proposed changes to the capital planning and stress testing rules.

Gerard S. Poliquin
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Sincerely,

A handwritten signature in black ink that reads "Michael J. Lord". The signature is written in a cursive, flowing style.

Michael J. Lord
President / CEO
State Employees' Credit Union
Raleigh, North Carolina