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**National Association of Federally-Insured Credit Unions**

August 3, 2017

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

**RE: Supervisory Review Committee; Procedures for Appealing Material Supervisory Determinations**

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the National Credit Union Administration's (NCUA) proposed amendments to its procedures for appealing material supervisory determinations (MSDs) to the Supervisory Review Committee (SRC).

NAFCU believes that this proposal and its related benefits would greatly enhance the current process by which credit unions can challenge MSDs. By providing broader avenues of redress, NCUA's proposal takes a commendable step forward in responding to industry complaints about lack of a satisfactory appeals process. We applaud Chairman McWatters' and Board Member Metsger's leadership on this issue.

While we broadly support this proposal, NAFCU would like to make several additional recommendations that would increase the efficacy of the SRC process while simultaneously keeping the administrative burden low. We believe the agency could make slight adjustments that would make these relief measures even more beneficial. Namely, we believe the agency could: (1) ease the process further by adding more optionality; (2) expand appealable MSDs; (3) increase disclosure of publicly available data; (4) establish a credit union advisory council and an exam outreach officer; (5) create a consistent SRC; (6) increase the utility of the Ombudsman; (7) adopt recent amendments made by other federal banking agencies; and (8) support legislative efforts that would create an *inter-agency* MSD review panel. These suggestions are discussed below.

**Background**

The examination and supervision of federally insured credit unions (FICUs) are critical components to ensuring the safety and soundness of the National Credit Union Share

Insurance Fund (NCUSIF or SIF). A good examination process is essential to a sound credit union and a sound industry. Routine visits by examiners help identify potential problems at individual credit unions, and help flag systemic risks before they plague the system. If the examination team and credit union management work collaboratively, substantive issues of concern can be identified and courses of action agreed upon.

However, NAFCU understands that examiners must strike a difficult balance, and that there will be times where a judgement call can and should be challenged. This is not to imply that an examiner did a poor job, but that there are certain circumstances where reasonable minds may disagree regarding the findings of an exam. The *Riegle Community Development and Regulatory Improvement Act of 1994* (Riegle Act) was passed, in part, to address this issue by establishing SRCs at federal banking agencies.

When the Board first established the SRC, it had considered creating a five-member panel, but ultimately elected for three members to comprise the SRC. Upon initial creation of the SRC, the Board limited the SRC's jurisdiction to matters specifically listed as material supervisory determinations in the Riegle Act, although the Board reserved the right to expand the number of supervisory determinations appealable to the SRC after gaining some experience with the process. After nearly two-decades of experience, the Board is now considering improvements to the SRC process to be more consistent with other federal banking agencies.

NCUA's proposal seeks to accomplish this by: (1) expanding the number of supervisory determinations appealable to the SRC; (2) providing credit unions with the opportunity for additional review by the Director of the Office of Examinations and Insurance (E&I); and (3) codifying the SRC procedures, which are currently prescribed in a series of Interpretive Ruling and Policy Statements (IRPS).

**Increased opportunities for additional review is beneficial; Increased flexibility will add to this benefit**

Although NCUA's SRC process has been in place for over 20 years, NAFCU has found that not many of our members use it. For example, our most recent annual survey found that although two-thirds of respondents believed their Documents of Resolution (DOR) were unjustified, only 9.1 percent of respondents reported that they had contested the results in the last five years. Clearly there is a disconnect and NAFCU believes the rigidity of the current process is partly to blame.

The current process for appealing exam findings is the following: first, if an examiner takes an action against the credit union, the credit union can directly contest it with the examiner. If the credit union is not satisfied with the result, then it may contact the supervisory examiner, who reviews the examiner's analysis. If that result is not satisfactory, then the credit union may send a letter to the regional director. After all these steps have been taken, a credit union may appeal to the NCUA SRC.

If a credit union and examiner disagree on a MSD, many credit union management teams engage in informal negotiation with their supervisory examiner (SE). Unfortunately, this is often the only step that credit unions take to resolve these differences. Although credit unions understand that the current SRC process exists to challenge adverse MSDs, many see it as a lengthy and unfavorable process that is not worth their time.

The proposal would add an optional intermediate level of review by the Director of Examination and Insurance (E&I) before a FICU appeals to the SRC. NAFCU appreciates the added option of an intermediate level of review by the Director of E&I.

First, NAFCU believes that credit unions benefit when the agency affords additional flexibility that allows each credit union to choose the option that is best suited to their needs. However, under the current and proposed rule, FICUs must first request reconsideration of a MSD from the appropriate program office before appealing to the Director of E&I or the SRC. NAFCU believes that there could be some benefit to FICUs appealing a MSD directly to the SRC without being required to first request reconsideration from the program office. This would put NCUA more on par with other banking agencies, such as the Office of the Comptroller of the Currency (OCC) which allows direct appeals to the SRC.

Although the Board might be concerned that the availability of appeals made directly to the SRC would increase the administrative burden and overly tax staff, NAFCU believes that this added flexibility would not create undue burden. According to a study published in NCUA's Office of the Inspector General's (OIG) 2012 report on the appeals process, approximately 30 appeals are filed per year (see Figure 1). Even in the unlikely scenario that every MSD appeal was made directly to the SRC, NAFCU believes that 30 appeals per year is still a relatively low number that would not unduly burden SRC members.

In the alternative to permitting MSD appeals to be made directly to the SRC in all scenarios, NAFCU asks NCUA to consider allowing FICUs to appeal directly to SRC in time-sensitive cases. The Board could permit the SRC to make those determinations on a case-by-case basis.

In lieu of either of the recommendations proposed above, NAFCU would appreciate if the Board automatically raises a MSD appeal to the SRC if the program office takes longer than 90-days to come to a determination. As Figure 1 illustrates, the average time for a program office's resolution is only 43 days, yet there are some cases where the resolution took as long as 464 days; this is entirely too long for a FICU to wait until being permitted to have an audience with the Director of E&I or the SRC.

Regional Office Complaints – FCU Examinations January 1, 2007 through December 31, 2011						
	Region I	Region II	Region III	Region IV	Region V	Overall Average
Total Complaints (5-Yr Period)	30	31	45	19	24	6 (Yearly Avg)
Average Resolution Time (Days)	55	28	48	26	60	43
Shortest Resolution Time (Days)	3	1	1	9	12	
Longest Resolution Time (Days)	197	80	321	63	464	
Complaints Resolved in Agency Favor	25 (83%)	31 (100%)	38 (84%)	15 (79%)	18 (75%)	85%

Figure 1

### Expand supervisory determinations that are appealable

The proposed rule would expand the SRC's jurisdiction by redefining the term "material supervisory determination" (MSD) to include supervisory determinations that may affect the capital, earnings, operating flexibility, or that may otherwise affect the nature and level of supervisory oversight of a federally insured credit union (FICU).

Currently, composite CAMEL ratings of 3, 4, or 5, as well as component ratings of those composite ratings, are classified as MSDs. Noting that the Board does not believe that component ratings are "material" in most cases if the FICU otherwise maintains an overall composite CAMEL rating of 1 or 2, the proposal would keep this structure. NAFCU believes that NCUA should reconsider this provision.

First, other federal banking agencies permit financial institutions to appeal CAMELS 1 or 2, both component and composite. If the stated purpose of this proposal is to be more consistent with other federal banking agencies, then NAFCU believes that NCUA should follow suit and allow for similar appeal.

Second, although NCUA asserts that composite CAMEL rating of 2 would not have a material effect on the supervisory oversight of a FICU, NAFCU has heard from members that component ratings that trend toward increased CAMEL ratings should be addressed and challenged early, as reasonable and appropriate.

### Increase disclosure of publicly available information

In its 2012 report, OIG indicated that there is no written guidance that NCUA require its 5 regional offices to keep statistics on each regional determination in response to credit union complaints. In response to the report, NCUA management responded that such information would be useful regarding the types of disputed exam issues.

NCUA OIG recommended that NCUA establish a national reporting requirement requiring each regional office to regularly provide to the Office of E&I specific details on disputed examination issues elevated by credit unions to the Regional Director for a regional determination. The report stated that such a requirement could “include providing information on the number of elevated disputed examination issues, details about the disputed issue and the level of effort needed to resolve it at the examiner level, the outcome of the regional determination, and the length of time it took to close the disputed issue.”

It is unclear whether such efforts have been implemented, or if they have been, whether such information is available for public consumption. NAFCU believes that such summary information would be valuable to the industry, but still be broad enough to avoid confidentiality concerns associated with credit union exams.

It is also worth noting that Federal Deposit Insurance Corporation (FDIC) adopted a requirement for the publication of annual reports on Division Directors' decisions with respect to MSDs in its revised "Guidelines for Appeals of Material Supervisory Determinations," adopted July 18, 2017. In order to keep pace with other federal banking agencies, NAFCU recommends that NCUA also adopt such requirements.

#### **Establishment of credit union advisory council & exam outreach officer**

Although not contemplated in the proposal, NAFCU believes that the Board should address how an advisory council and exam outreach officer could play a role in the MSD appeals process. NAFCU believes that an exam outreach officer should deliver reports to the council as part of the officer's responsibility. Although it would likely require separate Board action and rulemaking, NAFCU would support an exam outreach officer that conducts post-exam interviews with credit unions to determine whether the goals of a healthy exam are being met, and if not, what parts of the exam can be improved upon to achieve those goals.

#### **Facilitate a consistent SRC**

The proposed rule would restructure the SRC by creating a rotating SRC pool of not less than eight individuals appointed by the NCUA Chairman from among NCUA's senior staff.

NAFCU believes that members of the SRC should remain fixed and not rotate. Ideally, this would create a uniform environment that produces consistent appeals. The alternative could lead to varying appeals decisions despite nearly identical fact patterns, based simply on which panel the appealing FICU received.

NAFCU recognizes that a rotating SRC panel of three members selected from a pool of eight allows for flexibility when conflicts of interest arise. However, NAFCU believes that a pool of alternates could be made available to replace the permanent SRC member in such cases of conflict. That is, NAFCU advocates for a default SRC panel made-up of

permanent committee members, *unless* a conflict is present, upon which alternates are selected.

### **Increase utility of Ombudsman**

While the Riegle Act required NCUA to establish the SRC, a lesser discussed provision was the requirement to establish an Ombudsman.

According to NCUA's website, the Ombudsman "make[s] recommendations to appropriate agency officials for systemic changes to deal with recurring problems reveal through investigations," and reports directly to the NCUA Board. However, it is not apparent that this role is being used to its fullest extent. At the very least, information that could indicate the utility of this role as it relates to review of MSDs is lacking.

Any additional support that an Ombudsman could provide to the review process would add utility to the SRC process. Further benefits could include the Ombudsman serving as custodian of examination aggregated exam dispute information or as a credit union advocate when appeals are made.

Finally, the Ombudsman could serve as an added check on appeals that have been received, but are not deemed eligible for formal review for lack of establishing the issue as a MSD.

### **Adopt recent amendments made other financial banking agencies**

Also adopted in FDIC's recently amended "Guidelines for Appeals of Material Supervisory Determinations," bank MSDs are now more broadly defined in two respects. First, banks will be allowed to appeal MSDs regarding an institution's level of compliance with a formal enforcement action. More specifically, matters that require a bank board's attention are deemed to be MSDs.

Second, the appealable MSDs will include decisions to initiate informal enforcement actions, such as Memoranda of Understanding (MOUs).

Both these amendments will broaden banks' avenues of redress, thereby increasing the utility of their SRC process. NAFCU strongly encourages NCUA to follow suit and similarly broaden the definition of MSD.

### **Legislative improvements**

NAFCU strongly supports *The Financial Institutions Examination Fairness and Reform Act* (Exam Fairness Act), H.R. 1941, introduced in the 114th Congress, and we ask that NCUA demonstrate support if a similar bill is introduced in the 115<sup>th</sup> Congress.

The Exam Fairness Act would establish the Office of Independent Examination Review within the Federal Financial Institutions Examination Council (FFIEC). The Act would

also create an independent Ombudsman for credit union examination. As discussed above, NAFCU believes that expanded use of an Ombudsman, as well as truly disinterested reviews of MSDs, would considerably benefit credit unions.

### **Additional supported provisions**

#### Oral appeal to Board

The proposal sets standards by which a FICU is permitted to raise an appeal the NCUA Board. The proposal explains that an appeal to the Board would not be granted as a matter of right, and that at least one Board Member is required to agree to hear an appeal.

Although it would be a lengthy process before a FICU could appeal to the Board, NAFCU appreciates this provision of the proposal, particularly the possibility of an oral hearing. Although NAFCU does not anticipate that this provision will be invoked at a high rate, our members welcome the opportunities that this would avail. Further, the possibility of appeal to the Board ensures that all levels of previous appeal are subject to review by the Board. Merely having this oversight available would help both parties make earnest cases.

#### Relocating SRC Procedure from IRPS to Code of Federal Regulations is useful

NAFCU appreciates NCUA's proposal to codify SRC procedure. Simply in terms of utility, having the SRC procedure codified and made available in the electronic code of federal regulations adds a large degree of transparency and ease of access. NAFCU members have routinely expressed frustration in being able to access or navigate IRPS, or even know which version of IRPS is controlling regulation.

Although much of this letter has focused on additional ways to improve upon the proposal put forth, many of our members support the positive direction that the agency is headed with this proposal. Should you have any questions or would like to discuss these issues further, please contact me at (703) 842-2249 or [memancipator@nafcu.org](mailto:memancipator@nafcu.org).

Sincerely,



Michael Emancipator  
Senior Regulatory Affairs Counsel