Cooperative
Credit Union Association

Creating Cooperative Power

December 16, 2019

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

RE: Cooperative Credit Union Association Inc.'s Comments on Proposed Interagency Guidance on Credit Risk Review Systems

BY EMAIL ONLY: regcomments@ncua.gov

Dear Secretary Poliquin:

On behalf of the member credit unions of the Cooperative Credit Union Association, Inc. ("Association"), please accept this letter relative to the National Credit Union Administration Board's ("NCUA") request for comments in response to the proposed interagency guidance on credit risk review systems. The Association is the state trade association representing credit unions located in the states of Delaware, Massachusetts, New Hampshire, New Jersey and Rhode Island, serving approximately 200 credit unions which further serve over 3.6 million consumer members.

In preparation for the development of this comment letter, the Association recently solicited the views of its members and received valuable perspectives from a variety of both state and federally-chartered credit unions. This letter incorporates feedback received through a member survey relative to the proposed policy statement published in the Federal Register on October 17, 2019.

A. Overview of the Purpose of the Proposal

The proposed guidance, *Interagency Guidance on Credit Risk Review Systems,* is designed to assist financial institutions in assessing credit risks. The Association believes, however, that the purpose and implementation of the document are unclear. The proposed guidance states:

> This guidance outlines principles that an institution ***should*** consider in developing and maintaining an effective credit risk review system. (emphasis added) 84 Fed. Reg. 55682

The proposed companion interagency policy on Topic 326 describes the proposed credit risk review policy as "guidance providing supervisory expectations for effective credit risk review," 84 Fed. Reg. 55510, 55512. If the purpose of the proposed credit risk review provisions is to provide supervisory expectations, then the Association suggests that it is not mere guidance.

As the federal financial regulators have determined, institutions are not required to follow their guidance. Yet the proposed credit risk review guidance seems to imply, if not expressly direct, credit union compliance. It is without question that the Association encourages credit unions to develop and maintain proactive credit risk review policies and procedures which are subject to examiner review. In that connection, guidance that facilitates sound credit risk review systems can be useful. Nonetheless, the Association questions the need for an additional supervisory document that examiners could use to increase expectations or expand credit risk review requirements in the oversight of credit unions. The Association strongly encourages the NCUA and its colleague regulators to be consistent, clarify intent, and provide insight into plans to implement the proposal.[1]

Over time, the Association has observed that one of the problems associated with regulatory guidance developed jointly with bank regulators is that it often treats credit unions as if they operate like other entities they supervise as regulators. This observation is echoed by members of the Association on an ongoing basis with a directive to address in all advocacy endeavors.

As a result, the Association notes that the pending proposal ignores the very low default and delinquency rates that credit unions demonstrate which are considerably lower in 2018 than such rates at other institutions. While detailed credit risk review system parameters may be needed by some, policy guidance for credit unions should acknowledge and reflect their performance and include more latitude to operate wherever possible, consistent with legal requirements and prudence.[2]

B. Specific Questions for Response

Three general questions were posed within the proposed guidance. Responses to each follow.

> Question 1: To what extent does the proposed credit review guidance reflect current sound practices for an institution's credit risk review activities? What elements should be added or removed, and why?

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[1] Respondents noted that guidance is beneficial in developing a program. Supervisory expectations are distinct while also serving a useful function. Compliance mandates are further distinguished and not warranted through guidance.

[2] Respondents raised the issue of serving emerging markets, which often arise when other financial institutions exit a marketplace and credit unions step into fill a void, and any associated credit risk. In addition, a community development credit union may be awarded grants to off-set potential losses enabling them to increase their risk threshold and therefore requires flexibility to account for this risk.

Association member credit unions work hard to develop and implement sound policies and practices. The area of credit risk management and assessments is no exception. The guidance generally comports with their practices, but members believe that it is too prescriptive.[3] To assist, several recommendations to modify the proposed guidance to avoid creating new regulatory requirements are set forth in this comment letter.

> Question 2: To what extent is the proposed credit review guidance appropriate for institutions of all asset sizes? What elements should be added or removed for institutions of differing sizes, and why?

The guidance seems excessively detailed for credit unions of any size, leaving little room for institutions to exercise flexibility or be innovative in managing credit risks. How credit unions implement credit risk review procedures should reflect their lending programs, types of loans, and resources. History has also demonstrated that, at times, risk can also be impactful on a regional basis. As credit unions are amongst the smaller groups subject to the rule, they should have latitude in documenting how they accomplish reasonable and appropriate local credit risk management.[4]

> Question 3: What if any additional factors should the agencies consider incorporating into the guidance to help achieve a sufficient degree of independence and why? To what extent does the approach described for small or rural institutions with fewer resources or employees provide for an appropriate degree of independence in the credit review function? What if any modifications should the agencies consider and why?

No additional factors should be addressed in the guidance. Credit unions should be allowed to structure staff positions to facilitate sound credit management practices without having to duplicate functions or create positions to reflect regulatory-imposed independence. Well-managed credit unions of any size should be allowed to determine how best to identify problems and minimize conflicts of interest in the loan review process.

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[3] Elements of credit risk review captured in part of the proposed guidance include: regular portfolio credit migration reviews, credit reporting agency performance insight reporting, and business loan risk ratings. Yet respondents noted that NCUA examiners already have the tools necessary to address credit risk issues. The required policy and reporting expectations are generally not aligned with current, effective risk management practices.

[4] Survey respondents were unanimous in that any credit risk review system should be tailored for the size and activities of an institution. Smaller credit union respondents noted that they review all loans, have low delinquencies, and have limited credit risk review staff. The proposed qualifications will detract from other staff duties as staff performs multiple functions, will require increased reliance on third parties or outsourcing for the credit review function, and will likely result in higher compliance costs. It should be modified based upon the complexity of the loan portfolio or lack thereof.

C. Overview of Credit Risk Review Systems

The Association generally supports the objectives listed in the proposed guidance of an effective risk review system. The guidance should focus more on the objectives and less on the details of how the objectives are to be achieved. The achievement of the objectives is the result of business decisions that credit unions should be permitted to make without regulatory directives.[5]

D. Credit Risk Rating or Grading Framework

Members support the inclusion of the general discussion of the importance and use of credit risk ratings in the credit review process. However, the guidance details the attributes of an effective risk rating system. Guidance should not seemingly dictate every aspect of the credit risk rating framework. NCUA's "Examiner's Guide" discusses credit risk rating systems for business loans. While the "Examiner's Guide" covers many of the same topics as the proposed guidance, it is less proscriptive in several areas. To be most helpful to credit unions, the Association suggests that the guidance should address the intersection of its provisions with issues set forth in the "Examiner's Guide."

With respect to credit risk review staff, knowledge of a credit union's membership, experience with underwriting, and experience in analyzing risk is paramount. Knowledge of laws and supervisory guidance is separate. Appropriate personnel qualifications should be determined by and evaluated by management, including job descriptions, employment reviews and hiring processes.

The inclusion of a risk-based methodology in the scope of the credit risk review is welcomed by Association members.

E. Elements of an Effective Credit Risk Review System

The proposed guidance discusses the need for a written credit risk review policy, which it indicates should be reviewed by the board at least annually. The Association believes that a periodic review of the policy, the frequency of which is determined by the board on a reasonable basis, is an approach that should be considered as it would provide more flexibility to credit unions without sacrificing prudent risk management.

F. Independence of Credit Risk Review Personnel

Members agree that prompt identification of problem loans is critical to a prudently managed loan program. However, serious concerns exist with language contained in the proposed guidance which directs the credit risk review function to report directly to the board of directors.

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[5] Respondents noted that the objectives relating to assessing and adhering to internal credit policies and procedures are express credit risk review functions. Monitoring compliance with applicable laws and regulations are express compliance functions distinct from credit risk management functions.

The importance of an independent credit risk review process is acknowledged and understood. However, the proposed guidance is not clear why the function should report to the board, rather than to management. The approach in the guidance seems to blur the lines between the roles of the board of directors and the duties of management, which would not be conducive to sound operations based on clear distinctions between the board and management, without an overriding public policy need.

G. Communication and Reporting of Results

The proposed guidance directs that credit risk reviews be reported to the board of directors at least quarterly. The guidance does not provide the reasoning for or any explanation why "effective communication" necessitates such frequency. The Association suggests that, as guidance, management should be allowed to determine a reasonable frequency based on the credit union's risk profile, complexities and other relevant factors. This structure provides a clear roadmap, rather than a stringent time frame, and a flexible cycle that is reasonable based on the totality of the circumstances, including asset size and lending programs. Members noted that "at least" quarterly reporting to the board of directors with the proposed level of detail is operational and excessive.

H. Conclusion

Robust credit risk review programs are essential to the proper functioning of credit unions' lending activities. The Association appreciates the efforts of the NCUA and others to provide guidance to help facilitate strong credit risk review processes and procedures. Member concerns set forth in this comment letter about the intended use and purpose of the guidance as well as several provisions that would erode the flexibility of credit union boards and management to make sound, reasonable business decisions without undue regulatory interference, are of merit and are respectfully presented for further consideration at this time. The guidance has practices proposed that contain principles supported by Association members but it has not struck the appropriate balance as management duties are shifted to the board of directors.[6] Accordingly, the Association urges the NCUA to address these issues which will improve the guidance for all before adopting it in final form.

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[6] In particular, respondents expressed opposition to the creation and approval of another formal credit risk review policy at the board level as the requirements and level of detail should be responsibilities delegated to management with reporting back to a board. Procedures for reviewing credit risk and reporting should not be codified into a policy. Furthermore, the evaluation of lending personnel is assessed in many ways, is on record for examiners, and therefore is not recommended as an appropriate guidance objective.

Thank you for the opportunity to share the views of members on the interagency guidance and for your consideration of the Association's comments. If you have any questions about the recommendations set forth in this comment letter or require further information, then please do not hesitate to contact me.

Sincerely,

Ronald McLean
President/CEO
Cooperative Credit Union Association, Inc.

RM/mac/kb