



Testimony of

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On behalf of

The National Association of Federal Credit Unions

“Examining the State of Small Depository Institutions”

Before the

United States Senate Banking Committee

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Introduction

Good morning Chairman Johnson, Ranking Member Crapo and Members of the Committee. My name is Linda McFadden and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I am happy to be appearing before the Committee today to talk about the state of small financial institutions. I look forward to giving a general overview of the current regulatory environment and the most timely issues credit unions, including smaller credit unions like mine, face today.

XCEL Federal Credit Union is headquartered in Bloomfield, New Jersey. We were started in 1964 by the employees of the Port Authority of New York and New Jersey and are celebrating our 50th Anniversary this year. Over the past 50 Years, XCEL's field of membership has grown to include other agencies in the New York and New Jersey area along with many other smaller groups. Today we have over \$155 million in assets and over 18,000 members. Until the tragic events of September 11th, we were headquartered in the World Trade Center (Tower 1 – 39th Floor), but now we call North Jersey our home. For four years in a row we have been named one of the best places to work in New Jersey by NJBIZ and we were recognized as NAFCU's Credit Union of the Year for 2014, in the small asset class.

I have 40 years of experience in the financial services sector and have been with XCEL since the beginning of 2001, first as Vice President of Operations, where I helped implement our disaster recovery operations post-9/11, and then as President and CEO from 2006 until today.

As you are aware, NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU-member credit unions collectively account for approximately 69 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in today's hearing regarding the state of our nation's smaller financial institutions, such as credit unions.

Historically, credit unions have served a unique function in the delivery of essential financial services to American consumers. Established by an Act of Congress in 1934, the federal credit

union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom may otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need – a niche that credit unions still fill today.

Every credit union, regardless of size, is a cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 USC 1752(1)). While over 80 years have passed since the Federal Credit Union Act (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

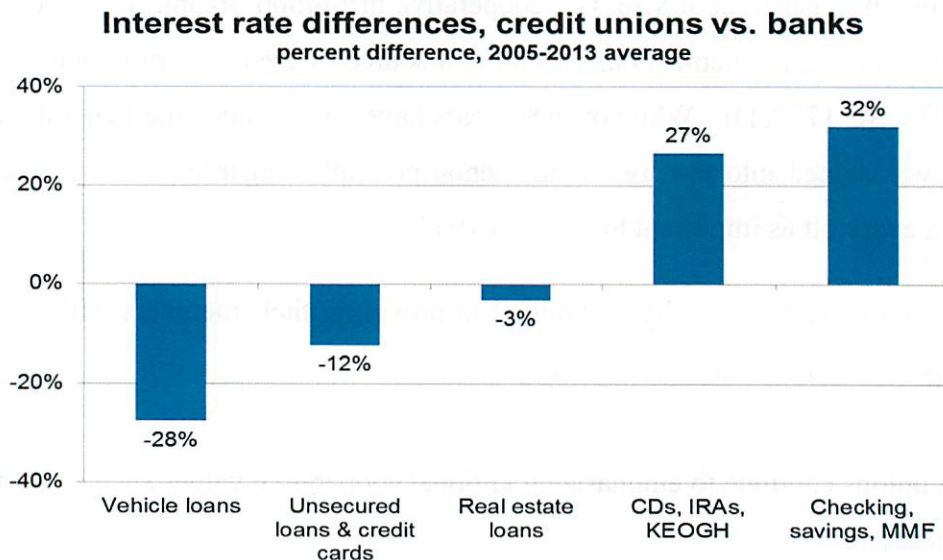
- credit unions remain wholly committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

These principles apply for all credit unions, regardless of their size. When compared with the nation’s “Too Big To Fail” financial institutions, all credit unions are “small” institutions. It is with this fact in mind that NAFCU believes that there should not be artificial or arbitrary asset thresholds established for which size credit unions should receive regulatory relief. The challenges facing the industry impact, or stand to impact, all credit unions and all ultimately need relief.

I. Increased Regulatory Burden has Impacted Credit Unions

Credit unions have a long track record of helping the economy and making loans when other lenders often have left various markets. This was evidenced during the recent financial crisis when credit unions kept making auto loans, home loans, and small business loans when other lenders cut back. Still, credit unions have always been some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital.

Credit unions continue to play a crucial role in the recovery of our nation’s economy. Credit unions remain a relatively small part of the marketplace when compared to the banking industry. They are oftentimes a lender of last resort for consumers that have been denied credit via other financial institutions. As detailed in the chart below, on average from 2005-2013, credit unions consistently outperformed banks with lower interest rates on loans and higher returns on savings and deposits.



Today, credit union lending continues to grow at a solid pace, up about 18% in June compared to 2009. In short, credit unions didn’t cause the financial crisis, helped blunt the crisis by continuing to lend during difficult times, and perhaps most importantly, continue to play a key role in the still fragile economic recovery. Although credit unions continue to focus on their members, the increasing complexity of the regulatory environment is taking a toll on the credit union industry. While NAFCU and its member credit unions take safety and soundness extremely seriously, the regulatory pendulum post-crisis has swung too far towards an environment of overregulation that threatens to stifle economic growth. As the National Credit Union Administration (NCUA) and the Consumer Financial Protection Bureau (CFPB) work to prevent the next financial crisis, even the most well intended regulations have the potential to regulate our industry out of business.

During the consideration of financial reform, NAFCU was concerned about the possibility of overregulation of good actors such as credit unions, and this was why NAFCU was the only credit union trade association to oppose the CFPB having rulemaking authority over credit unions.

Unfortunately, many of our concerns about the increased regulatory burdens that credit unions would face under the CFPB have proven true. While there are credible arguments to be made for the existence of a CFPB, its primary focus should be on regulating the unregulated bad actors, not adding new regulatory burdens to good actors like credit unions that already fall under a functional regulator. As expected, the breadth and pace of CFPB rulemaking is troublesome, and the unprecedented new compliance burden placed on credit unions has been immense. While it is true that credit unions under \$10 billion are exempt from the examination and enforcement from the CFPB, all credit unions are subject to the rulemakings of the agency and they are feeling this burden. While the CFPB has the authority to exempt certain institutions, such as credit unions, from agency rules, they have been lax to use this authority to provide relief.

The impact of this growing compliance burden is evident as the number of financial institutions continues to decline, dropping by 21% (more than 1,600) institutions since 2007. This trend rings true for credit unions as well, and a main reason for the decline is the increasing cost and complexity of complying with the ever-increasing onslaught of regulations. Since the 2nd quarter of 2010, we have lost 1,025 federally-insured credit unions, 96% of which were smaller institutions below \$100 million in assets. Many smaller institutions simply cannot keep up with the new regulatory tide and have had to merge out of business or be taken over. Credit unions need regulatory relief, both from Congress and their regulators.

This growing demand on credit unions is demonstrated by a 2011 NAFCU survey of our membership that found that nearly 97% of respondents were spending more time on regulatory compliance issues than they did in 2009. A 2012 NAFCU survey of our membership found that 94% of respondents had seen their compliance burdens increase since the passage of the *Dodd-Frank Act* in 2010. Furthermore, a March 2013 survey of NAFCU members found that nearly 27% had increased their full-time equivalents (FTEs) for compliance personnel in 2013, as compared to 2012. That same survey found that over 70% of respondents have had non-compliance staff members take on compliance-related duties due to the increasing regulatory burden. This highlights the fact that many non-compliance staff are being forced to take time away from serving members to spend time on compliance issues. Furthermore, a number of credit unions have also

turned to outside vendors to help them with compliance issues – a survey of NAFCU members, conducted in June of 2014, found that nearly 80% of respondents are using third-party vendors to help comply with the new CFPB TILA-RESPA requirements.

At XCEL FCU we have felt the pain of these burdens as well. There are costs incurred each time a rule is changed and most costs of compliance do not vary by size, therefore it is a greater burden on smaller credit unions like mine when compared to larger financial institutions. We are required to update our forms and disclosures, to reprogram our data processing systems and to retrain our staff each time there is a change, just as large institutions are. Unfortunately, lending regulation revisions never seem to occur all at once. In recent years, XCEL FCU has spent over \$13,000 just to update our loan documents and train our staff on these new documents. If all of the changes were coordinated and were implemented at one time, these costs would have been significantly reduced and a considerable amount of XCEL FCU's resources that were utilized to comply could have been used to benefit our members instead.

In some cases, our ability to provide service to our members has been hindered. For example, XCEL FCU eliminated processing outgoing international wires and ACHs due to the complexity of the revised remittance regulations that were implemented. We felt the risk and compliance requirements involved with providing these services were excessive.

In 2013, the CFPB implemented eight new mortgage rules, seven of which were finalized in October 2013 and were effective by January 2014. A majority of credit unions are small financial institutions like mine which operate with a limited staff. It is a struggle to keep abreast with the constantly changing regulations. Tracking the proposals and the changes made to them as they work through the regulatory process began to monopolize my senior management's time. Timeframes between when the rules are being finalized and are effective are often becoming shorter and shorter. These shorter periods do not provide ample time to read through these rules and implement and update systems and procedures to ensure that we stay in compliance. This is one of the reasons that I found it necessary to hire an additional staff person to work as a

Compliance Officer, so that my senior management staff can concentrate on other responsibilities that they have. This cost is an additional \$50,000 in salary and benefits, which is a considerable amount for a small institution like mine.

NAFCU continues to hear from its member credit unions that “enough is enough” when it comes to the overregulation of credit unions. Small credit unions are going away and larger credit unions are even having a hard time keeping up. If Congress and the regulators do not act to provide regulatory relief to credit unions, the industry may look vastly different a decade from now..

II. NCUA’s Risk-Based Capital Proposal: Regulating Credit Unions Out of Existence

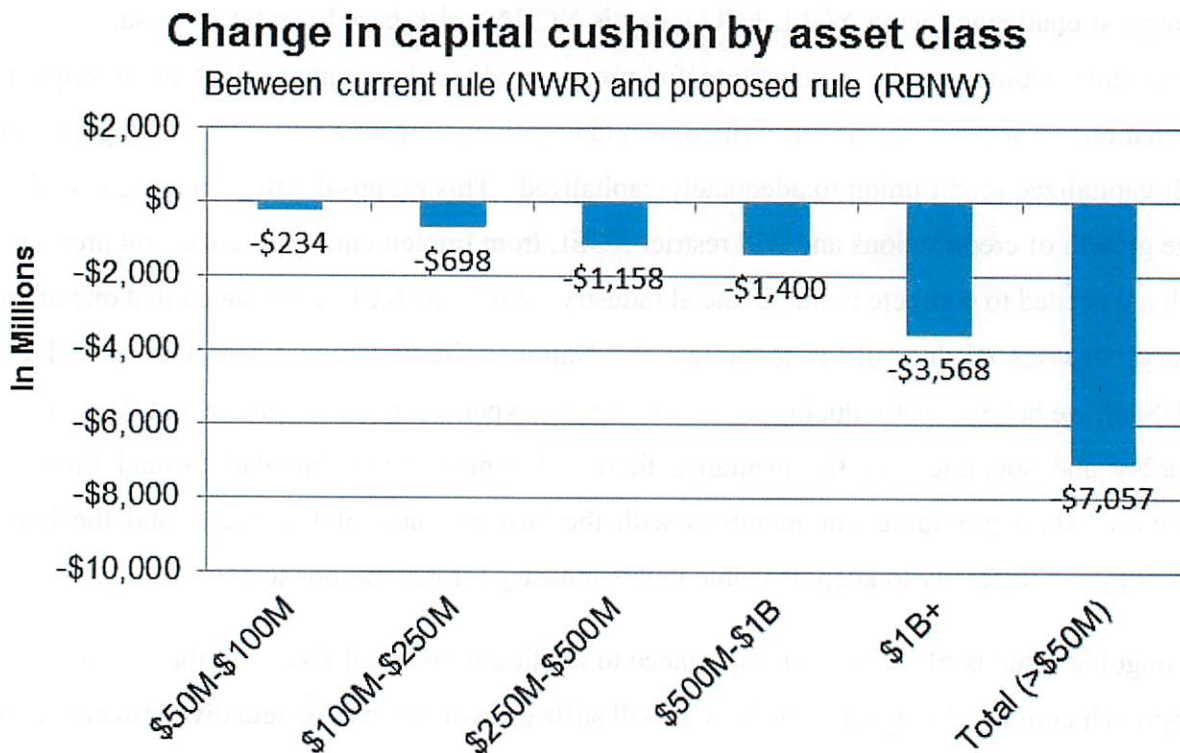
The biggest challenge facing XCEL FCU today is NCUA’s risk-based capital proposal. Capital requirements should not be a substitute for proper credit union management or appropriate examinations. The proposal, as it is written, would negatively impact XCEL FCU, taking us from a well-capitalized credit union to adequately-capitalized. This proposal will be putting restraints on the growth of credit unions and will restrict XCEL from implementing products and programs which are needed to compete in the financial industry. While the NCUA has stated that one of the primary purposes of this rule is to protect the National Credit Union Share Insurance Fund (NCUSIF), we believe that reducing assets and cutting expenses to gain capital is not the solution for safety and soundness of the insurance fund. Running a fundamentally sound financial institution, while providing our members with the best products and services, and the latest technology is a necessity to keep us viable in this industry for generations to come.

This ongoing issue is of the utmost importance to credit unions of all sizes and the one-size-fits-all approach currently being taken by NCUA will stifle growth, innovation and diversification, not only at XCEL, but at credit unions in general.

The proposed rule will force XCEL’s board and management to change our business model even though we have had steady balanced growth with good solid returns over the past few years. We have developed a sound concentration risk policy and set limits on our diversified loan and

investment portfolio. This proves that our credit union has been managing this portion of the business well for years. If the NCUA continues forward without heeding current concerns on the proposal, XCEL would need to curtail certain aspects of our lending, ultimately hurting our members and the local economy.

NAFCU’s Economics and Research department prepared the impact analysis graph found below that outline the impact the proposal would have on credit unions based on their asset size. NAFCU’s analysis of the proposed rule determined that credit unions with more than \$50 million in assets will have to hold \$7.1 billion more in additional reserves to achieve the same capital cushion levels that they currently maintain.



While NCUA contends that a lower amount of capital is actually needed to maintain current capital levels, the agency ignores the fact that most credit unions maintain a capital cushion above the minimum needed for their level – often because NCUA’s own examiners have encouraged them

to do so. Because credit unions cannot raise capital from the open market like other financial institutions, this cost will undoubtedly be passed on to the 98 million credit union members across the country. A survey of NAFCU's membership taken found that nearly 60% of respondents believe the proposed rule would force their credit union to hold more capital, while nearly 65% believe this proposal would force them to realign their balance sheet. Simply put, if the NCUA implements this rule as proposed, credit unions will have less capital to loan to credit-worthy borrowers, whether for a mortgage, auto, or business loan.

Additionally, it is also worth drawing the Committee's attention to the chart below breaking-down risk-weighting at the FDIC (under Basel III) compared to the proposed risk-weighting by NCUA highlighting the areas that will be especially problematic for our nation's credit unions.

	Category	Sub-Category	NCUA proposal	FDIC weights	
Numerator	Liabilities		1	1	
	Equity		1	1	
	Contra Assets		1	1	
	Other Assets	Goodwill		-1	-1
		Identifiable intangible assets		-1	-1
		NCUSIF		-1	**
Cash		0	0		
Denominator	Investments*	0-1 Year	0.2	0.2	
		1-3 Years	0.5	0.2	
		3-5 Years	0.75	0.2	
		5-10 Years	1.5	0.2	
		>10 Years	2	0.2	
		Corporate CU Member Capital	1	**	
		Corporate Paid-in Capital	2	**	
	Real Estate Loans	Nondelinquent 1st mort R/E loans (excl. MBLs)			
			<25% of assets	0.5	0.5
			25-35% of Assets	0.75	0.5
			>35% of Assets	1	0.5
		Other R/E and delinquent R/E			
			<10% of Assets	1	1
			10-20% of Assets	1.25	1
			>20% of Assets	1.5	1
	Other Loans	Nondelinquent student loans		1	1
		Nondelinquent other loans		0.75	1
		Delinquent other loans		1.5	1.5
SBA		-0.8	-0.8		
Member business loans					
		<15% of Assets	1	1	
		15-25% of Assets	1.5	1	
		>25% of Assets	2	1	
Other Assets	Goodwill		-1	-1	
	Identifiable intangible assets		-1	-1	
	NCUSIF		-1	**	
	Inv't in CUSO		2.5	**	
	Mort servicing rights		2.5	2.5	
	All other assets		1	1	
Off Bal Sheet	Loans with recourse		0.75	**	
	Unfunded commitments bus loans (75% conversion)		1	**	
	Unfunded commitments non-bus loans (10% conversion)		0.75	**	
Capitalization thresholds					
	Well Capitalized		10.5%	10.0%	
	Adequately Capitalized		8.0%	8.0%	

* U.S. Treasuries and other direct and unconditional claims on the U.S. government are weighted at zero by both NCUA and FDIC. Most other credit union investments are weighted from 0.2 to 2 according to their maturity. They would generally be rated at a constant 0.2 under the FDIC rule.

** No direct comparison with FDIC

Widespread concern about this proposal is also highlighted by the over 2,000 comment letters NCUA has received to date about the content of the proposal and the process used to fast track the

rule despite credit unions not contributing to the financial crisis. In NAFCU's own comment letter submitted on May 27, 2014 (attachment A) signed by the NAFCU Board of Directors and Regulatory Committee members, significant concerns about the proposal included:

- Several issues related to NCUA's legal authority to issue the rule as proposed, such as:
 - Comparability with banking regulatory requirements;
 - Substitution of statutorily defined legal terms;
 - Individual minimum capital requirements;
 - Definition of a "complex" credit union;
- The need for a legislative solution in order to achieve a fair and balanced risk-based capital system;
- NCUA's treatment of the regulatory process including the refusal to extend the comment period, form an industry working group prior to releasing a proposed rule, and the need for an additional notice of proposed rulemaking with public comment period;
- NCUA's drastic understatement of credit unions that will be affected by this rule and whose balance sheets and business plans will need adjustment;
- NCUA's proposed risk-based capital ratio for well capitalized credit unions set at 10.5 percent;
- NCUA's treatment of risk-weighted assets and the lack of explanation for deviation from similar banking risk-weights;
- NCUA's incorporation of interest rate and concentration risk into risk-weighting for real estate, investments, and member business loans (MBL's);
- Individual minimum capital requirements for credit unions including issues with the subjectivity of their imposition;
- Components not included in the numerator portion of the risk-based capital ratio, such as goodwill;
- The 1.25 percent cap on Allowance for Loan and Lease Losses (ALLL) especially considering the Financial Accounting Standards Board's (FASB) most recent proposal on ALLL;

- Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule; and
- The proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule.

Many of these concerns were also expressed by XCEL FCU in our own comment letters (attachment B) and by the numerous Members of Congress who have also weighed in with NCUA. On behalf of NAFCU member credit unions and the entire credit union community, we want to thank all of you for your steadfast support. The outpouring of concern from Congress has been significant and NAFCU remains hopeful that a final rule will address many of the issues raised.

Despite NCUA's refusal to extend the official comment period, this summer's listening sessions on the proposal in Los Angeles, Chicago, and Alexandria, Virginia, reinforce the need for significant changes to the proposal and additional time for credit unions to digest the proposal and come into compliance. During these listening sessions, credit unions repeatedly stated that they believe that, given the magnitude of this rule and its potentially devastating effects on our member credit unions, it is imperative that NCUA re-propose the rule and put it out for additional comment.

As many of you are aware, the *Administrative Procedure Act* (APA) not only mandates consideration of all submitted comments, but it also requires an agency to engage in a subsequent comment period when the agency makes such substantive changes to a rule that it is no longer a logical outgrowth of the proposal. If NCUA implements changes to the proposed rule in accordance with even some of the 2,000 comments received, the changes will be substantive, and more than mere adjustments or clarifications to the initial proposal. In fact, both Chairman Matz and Board Member Metsger have publically supported changing the treatment of risk-weighted assets. NAFCU believes that this change alone would be substantive under the APA and warrant reissuing the proposal for public comment.

Furthermore, NAFCU encourages NCUA to allow credit unions the opportunity to voice their thoughts and concerns. The 2,000 comments submitted for the proposal clearly exemplify that credit unions around the country have a vested interest in this issue and they deserve the

opportunity to comment given the magnitude of the potential negative impact of this proposal. Credit unions believe it is critical that NCUA effectively consider and incorporate industry input to ensure that an appropriate risk-based capital regime is adopted for the credit union industry. In the best interests of all stakeholders, therefore, credit unions urge the NCUA Board to operate in a collaborative manner with the credit union industry and reissue the risk-based capital proposal for comment so that we may have the necessary opportunity to raise concerns and suggestions. Doing so, even if not required by the APA, would be good policy for the agency.

Should NCUA's proposal go forward with little or no changes, the new rule would precipitate the need for Congressional action on proposals to bring about capital changes for credit unions such as allowing credit unions to have access to supplemental capital sources. In addition this would prompt the need for statutory changes necessary to design a true risk-based capital system for credit unions. Lastly, a final rule mirroring the proposal in terms of an individual credit union's risk-based capital requirements being changed through the exam process only reinforces the need for action on S. 727, the *Financial Institutions Examination Fairness and Reform Act*. In such a circumstance, it would also be important for Congress to be ready to enact a "stop and study" requirement on NCUA to allow further examination of the issues surrounding the proposal while providing time for action on the legislative fixes that would be necessary. NAFCU looks forward to continuing to work with Congress on this timely issue.

III. NAFCU's Legislative and Regulatory Approaches for Relief

Regulatory burden is also a top challenge facing all credit unions. While smaller credit unions continue to disappear from the growing burden, all credit unions are finding the current environment challenging. Finding ways to cut-down on burdensome and unnecessary regulatory compliance costs is the only way for credit unions to thrive and continue to provide their member-owners with basic financial services and the exemplary service they need and deserve. It is also a top goal of NAFCU.

Ongoing discussions with NAFCU member credit unions led to the unveiling of NAFCU's "Five Point Plan for Regulatory Relief" [attachment C] in February 2013, and a call for Congress to

enact meaningful legislative reforms that would provide much needed assistance to our nation's credit unions. The "Five Point Plan" covers key areas for credit unions including: Administrative Improvements for the Powers of NCUA; Capital Reforms for Credit Unions; Structural Improvements for Credit Unions; Operational Improvements for Credit Unions; and, 21st Century Standards for Data Security.

Recognizing that there are a number of outdated regulations and requirements that no longer make sense and need to be modernized or eliminated, NAFCU also compiled and released a document entitled "NAFCU'S Dirty Dozen" [attachment D] in December 2013, that outlines twelve key regulatory issues credit unions face that should be eliminated or amended. The "Dirty Dozen" includes expanding credit union investment authority; updating NCUA's fixed assets rules; improving the process for credit unions seeking changes to their field of membership; increasing the number of transactions allowed to be made per month from savings accounts per the Federal Reserve Regulation D; providing flexibility for credit unions that offer member business loans; updating requirements to disclose account numbers to protect privacy of credit union members; updating advertisement requirements for loans products and share accounts; modernizing NCUA advertising requirements; making improvements to the Central Liquidity Fund; providing flexibility for federal credit unions to operate under state law in certain circumstances; simplifying regulations governing check processing and funds availability; and, eliminating redundant NCUA requirements to provide copies of appraisals upon request.

Our "Five Point Plan" and "Dirty Dozen" outline a number of areas where credit unions need action on both the legislative and regulatory fronts. We urge the Committee to review these documents. In our statement today, we highlight a number of key issues where regulatory burdens and proposals are posing immediate threats to the ability of credit unions to serve their members and give them the financial products that they want.

IV. Pending Bills Before the Senate to Provide Relief

There are several measures awaiting action in the Senate that would take small steps to provide relief to credit unions, and we would encourage the Senate to act on them this year.

S. 635, *The Privacy Notice Modernization Act of 2013*

We applaud Senators Brown and Moran for their leadership on this issue. This bipartisan legislation would remove the requirement that financial institutions send redundant paper annual privacy notices if they do not share information and their policies have not changed, provided that they remain accessible elsewhere. These duplicative notices are costly for the financial institution and often confusing for the consumer as well. Similar legislation has passed the House by voice vote and this legislation has over 70 cosponsors in the Senate. We strongly encourage the Senate to pass this small measure of relief this year.

S. 2698, *The RELIEVE Act*

We applaud Senators King, Warner, Tester and Fischer for their leadership in introducing this legislation, a key element of which would provide important relief to credit unions with Interest on Lawyers Trust Accounts (IOLTAs). Maintaining parity between the coverage provided by the National Credit Union Share Insurance Fund (NCUSIF) and the Federal Deposit Insurance Corporation (FDIC) on all types of deposits and accounts is imperative and a longstanding goal of NAFCU member credit unions. Consumers often do not distinguish between the government backing on accounts at financial institutions. It is important that the law dictate that there is no difference in coverage, so as not to favor one type of institution over another in the marketplace. NAFCU is pleased that the legislation, along with S. 2699, will provide NCUSIF parity with the FDIC for certain accounts, including IOLTAs. This issue passed the House by voice vote earlier this year and we urge the Senate to act on this issue.

S. 1577, *The Mortgage Choice Act of 2013*

We applaud Senators Manchin, Johanns, Toomey, Kirk, Stabenow and Levin for their leadership in introducing this measure. The *Mortgage Choice Act of 2013* would make important changes that would exclude affiliated title charges from the “points and fees” definition, and clarify that escrow charges should be excluded from any calculation of “points and fees.” These changes would greatly improve the definition of “points and fees” used to determine whether a loan meets the QM test, and would ensure that those with low and moderate means would continue to be able

to obtain their mortgages from their credit union at a reasonable price. We urge the Senate to advance this issue.

S.2732, The CFPB Examination and Reporting Threshold Act of 2014

We applaud Senators Toomey and Donnelly for introducing this legislation to address the arbitrary \$10 billion threshold for examination of depository institutions by the CFPB. As I noted earlier in my statement, NAFCU believes that all credit unions, as good actors during the financial crisis, should be exempt from being subject to the CFPB and would support adding language to the legislation exempting all credit unions in place of the proposed \$50 billion threshold.

Relief from the Credit Union MBL Cap

NAFCU supports and urges action on S. 968, the *Small Business Lending Enhancement Act of 2013*, introduced by Senators Mark Udall and Rand Paul, to raise the arbitrary cap on credit union member business loans. This issue is of particular concern to XCEL FCU, as we found ourselves approaching the cap in 2012, but ultimately had to change our business practices when Congress did not act to change the cap.

We would also urge Congressional action on legislation to exclude loans made non-owner occupied 1- to 4-family dwelling from the definition of a member business loan. We would urge Congressional action on legislation to exempt loans made to our nation's veterans from the definition of a member business loan. Such a measure can not only help our nation's returning heroes, but also the American economy.

Examination Fairness

Credit unions now face more examiner scrutiny than ever, as the examination cycles for credit unions have gone from 18 months to 12 months since the onset of the financial crisis even though credit union financial conditions continue to improve. Additional exams mean additional staff time and resources to prepare and respond to examiner needs. NAFCU has concerns about the continued use of Documents of Resolution (DOR) when they are not necessary or are used in place of open and honest conversations about examiner concerns. A survey of NAFCU members earlier this year found that nearly 40% of credit unions who received DORs during their last exam felt it was

unjustified and nearly 15% of credit unions said their examiners appeared less competent than in the past. NAFCU supports effective exams that are focused on safety and soundness and flow out of clear regulatory directives

New examination fairness provisions should be enacted to help ensure timeliness, clear guidance and an independent appeal process free of examiner retaliation. As outlined earlier, NAFCU supports the bipartisan S. 727, the *Financial Institutions Examination Fairness and Reform Act* which was introduced on April 15, 2013, by Senators Manchin and Moran. Credit unions must have adequate notice of and proper guidance for exams, the right to appeal to an independent administrative law judge during the appeal process, and be assured that they are protected from examiner retaliation.

V. Areas Where Regulators Can Provide Relief to Credit Unions

While my testimony has outlined important issues impacting credit unions and highlighted steps that Congress can take to help, there are additional steps that the NCUA, CFPB and the Federal Reserve can currently take to provide relief without Congressional action and we would encourage them to do so.

NCUA

We are pleased that the National Credit Union Administration has been willing to take some small steps recently to provide credit unions relief. A prime example of this is the agency's new fixed-asset rule this summer. This is a topic that is on NAFCU's "Dirty Dozen" and the agency deserves credit for taking steps to address it.

We are also glad to see NCUA's voluntary participation in review of its regulations pursuant to the *Economic Growth and Regulatory Paperwork Reduction Act of 1996* (EGRPRA). This review provides an important opportunity for credit unions to voice their concerns about outdated, unnecessary or unduly burdensome requirements of NCUA's Rules and Regulations.

Member Business Lending

A major area where we think NCUA can use its authority to provide relief is with member business lending. The Member Business Lending (MBL) regulation, as NAFCU and our members have consistently maintained, is far too restrictive and cumbersome.

As NAFCU outlined in both its March 5, 2014, letter to NCUA Board and its “Dirty Dozen” list of regulations to eliminate or amend, there are several aspects of the MBL requirements which should be improved, including: changes to the waiver requirements and waiver process to make it more efficient and easier to obtain individual and blanket waivers; expanding opportunities to obtain waivers; and removing the five year relationship requirement to obtain a personal guarantee waiver. Additionally, NCUA should use its authority granted in the *Federal Credit Union Act* (FCU Act) to provide an exception to the limitations on member business loans (the MBL cap) for those credit unions that have a history of making MBLs to their members for a period of time.

Section 1757a of the FCU Act contains the limitations on MBLs. Under Part 723 of NCUA’s Rules and Regulations, the aggregate MBL limit for a credit union is limited to the lesser of 1.75 times the credit union's net worth or 12.25% of the credit union's total assets. However, the FCU Act also contains exceptions to the MBL cap. In particular, it provides exception authority from the MBL cap for “an insured credit union chartered for the purpose of making, **or that has a history of primarily making, member business loans to its members** (emphasis added), as determined by the Board.” *See*, 12 U.S.C. § 1757a(b)(1).

Traditionally, this provision in § 1757a has been construed narrowly by NCUA. Section 723.17(c) of NCUA’s Rules and Regulations currently defines credit unions that have a history of primarily making member business loans as credit unions that have either 25 percent of their outstanding loans in member business loans or member business loans comprise the largest portion of their loan portfolios, as evidenced by any Call Report or other document filed between 1995 and 1998. NAFCU continues to hear from our members that this definition is overly restrictive and often prevents them from extending sound loans to their small business members, many of whom have been abandoned by other financial institutions due to their smaller size.

NAFCU has urged NCUA to take a broader interpretation of the history of primarily making MBLs provision of the FCU Act. This can be done by NCUA utilizing its statutory authority to create an exception from the MBL cap for all credit unions that have a history of making MBLs for an extended period of time. NAFCU and our members believe that a credit union that has had a successful MBL program in place for a period of five years or greater would be a reasonable basis to satisfy this statutory authority.

NCUA has explained that the current definition “focuses on a credit union’s historical behavior during the years leading up to the enactment of the *Credit Union Membership Access Act* (CUMAA).” NAFCU and our members believe this focus is unnecessarily restrictive, and we have urged the agency to expand the scope of the definition. NAFCU contends that it would be more appropriate for NCUA to consider a credit union’s history of making MBLs in general, rather than restricting its focus solely to a credit union’s behavior from 1995 through 1998. In particular, we believe the agency should define credit unions that have had a successful MBL program in place for at least five years as having a “history of primarily making MBLs.” NAFCU has encouraged the NCUA Board to set this standard and make the exception available to all credit unions.

NCUA expanding the opportunities for credit unions to obtain waivers is another area where they could help. In February 2013, NCUA issued supervisory letter 13-01 to credit unions attempting to shed light on the criteria and processes for obtaining MBL waivers. While this guidance was useful to credit unions, NAFCU continues to hear from its members that the waiver process is complicated, slow moving, and inefficient. As a result, many credit unions have been unable to extend sound loans to their small business members, loans which may have been lost to competitors, or worse, never extended at all.

While waivers should not be used so frequently that they are the norm, the process to obtain one should not be so excessively difficult as to prevent credit unions from serving their membership effectively. Healthy, well-run credit unions with risk focused MBL programs that maintain appropriate policies and procedures and that perform adequate due diligence on their member

borrowers should be able to apply for and obtain blanket waivers which would help their membership.

Furthermore, the MBL regulations should be amended to expand a credit union's ability to obtain an individual or blanket waiver. Credit unions, because of their fundamental nature, are in a great position to extend credit to small businesses which will help fuel our nation's economic recovery. Expansion of the waiver capabilities would enable well run credit unions to extend loans to their small business members.

As noted above, the FCU Act contains the limitations on and exceptions to MBLs. However, the FCU Act does not prescribe limitations on the waivers that NCUA can put in place with regard to the regulations it imposes for MBLs that are not statutory requirements.

Section 723.10 of NCUA's Rules and Regulations contains an enumerated list of MBL related requirements for which a credit union can apply for a waiver. NAFCU believes that this enumerated list of available waivers should be replaced with a more flexible waiver provision that would allow a credit union to apply for, and obtain, a waiver from a non-statutorily required MBL regulatory requirement. The use of an enumerated list necessarily restricts a credit union from obtaining a waiver of a requirement which is not listed, even where such a waiver would not pose a safety and soundness concern to the credit union. NAFCU encourages NCUA to amend Section 723.10 to provide a more flexible waiver provision.

NCUA could issue appropriate guidance for the types of waivers that a credit union could obtain using a more flexible standard, which could include enumerated lists and appropriate examples. Section 723.11 of NCUA's Rules and Regulations contains the procedural requirements for a credit union to obtain a waiver, and it requires a credit union to submit a waiver request accompanied by a great deal of information related to the credit union's member business loan program. Under a more flexible provision, and taking into account safety and soundness considerations, NCUA should be able to determine from the information required to be provided pursuant to Section 723.11 whether a waiver is appropriate for a credit union. This approach would

enhance a credit union's ability to provide MBLs to its members without compromising the safety and soundness of the credit union.

Advertising

Another area where NCUA could provide relief would be to amend its Rules and Regulations to accommodate for the rise of social media and mobile banking. Regulations governing advertising, such as 12 CFR 740.5, for example, contain requirements that are impossible to apply to social media and mobile banking, especially medias that are interactive. These rules should be amended with the use of social media and mobile banking in mind to include more flexibility as opposed to the rigidity of the current rules. Credit unions have fared very well in safely adopting the use of such technology, and they take actions necessary to ensure their policies and procedures provide oversight and controls with regard to the risk associated by social media activities. A modernization of these rules by NCUA would clear up ambiguity and help credit unions use new technologies to better meet the needs of their members.

Budget Transparency

NCUA is funded by the credit unions it supervises. Each year, credit unions are assessed a different operating fee based on asset size. NCUA then pools the monies it receives from credit unions and uses those funds to create and manage an examination program. The monies that NCUA collects, however, have significantly increased over the past six years to cover a \$109.7 million increase in the agency's budget during that period.

NAFCU supports the agency's efforts to accurately calculate the appropriate overhead transfer rate and urges NCUA to maintain a rate that is equitable to FCUs given they are funding the remaining agency expenses through operating fees. NAFCU encourages NCUA to continue to look for ways to decrease costs in order to reduce fees FCUs pay to the agency. In connection with this, NAFCU believes that credit unions deserve clearer disclosures of how the fees they pay the agency are managed.

As NAFCU has stated in previous communications to the agency, NCUA is charged by Congress to oversee and manage the National Credit Union Share Insurance Fund (NCUSIF), the Temporary

Corporate Credit Union Stabilization Fund, the Central Liquidity Fund, and its annual operating budget. These funds are comprised of monies paid by credit unions. NCUA is charged with protecting these funds and using its operating budget to advance the safety and soundness of credit unions.

Because these funds are fully supported by credit union assets, NAFCU and our members strongly believe that credit unions are entitled to know how each fund is being managed. Currently, NCUA publicly releases general financial statements and aggregated balance sheets for each fund. However, the agency does not provide non-aggregated breakdowns of the components that go into the expenditures from the funds. Although NCUA releases a plethora of public information on the general financial condition of the funds, NAFCU urges the agency to fully disclose the amounts disbursed and allocated for each fund. For example, NAFCU and our members believe that NCUA should be transparent about how the monies transferred from the NCUSIF through the overhead transfer rate are allocated to the NCUA Operating Budget.

CFPB

We would also like to acknowledge efforts by the CFPB to provide relief, such as seeking to act on the privacy notice issue in the absence of any final Congressional action and efforts to revisit some of the concerns raised about points and fees under the new QM rule. While we believe that legislative action is still necessary in both regards, the Bureau deserves credit for taking steps in the absence of Congressional action.

Exemption Authority

One area where the CFPB could be the most helpful to credit unions would be to use its legal authority to exempt credit unions from various rulemakings. Given the unique member-owner nature of credit unions and the fact that credit unions did not participate in many of the questionable practices that led to the financial crisis and the creation of the CFPB, subjecting credit unions to rules aimed at large bad actors only hampers their ability to serve their members. While the rules of the CFPB may be well-intentioned, many credit unions do not have the economies of scale that large for-profit institutions have and may opt to end a product line or service rather than face the hurdles of complying with new regulation. This happened with us at XCEL when it came to the

new remittance requirements. As a small credit union, the new compliance burden was just too high and we ultimately had to drop this service for our members.

Reg E

As NAFCU outlined in its “Dirty Dozen” list of regulations to eliminate or amend in order to better serve credit union customers, the requirement to disclose account numbers on periodic statements should be amended in order to protect the privacy and security of consumers.

Under Regulation E, credit unions are currently required to list a member’s full account number on every periodic statement sent to the member for their share accounts. Placing both the consumer’s full name and full account number on the same document puts a consumer at great risk for possible fraud or identity theft. We strongly urge you to update the language of Regulation E to allow for truncated account numbers to be used on member’s periodic statements.

NAFCU encourages the CFPB to amend Regulation E §205.9(b)(2) to allow financial institutions to truncate account numbers on periodic statements. This modification is consistent with 12 C.F.R. § 205.9(a)(4), which allows for truncated account numbers to be used on a receipt for an electronic fund transfer at an electronic terminal. This change is also consistent with § 605(g) of the Fair Credit Reporting Act that states, “no person that accepts credit cards or debit cards for the transaction of business shall print more than the last 5 digits of the card number or the expiration date upon any receipt.” NAFCU believes that by adopting this change, the CFPB will allow financial institutions to better protect the security and confidentiality of consumer information.

Compromised accounts are not only dangerous for consumers, but can be extremely costly for credit unions. In the past year alone data breaches have cost the credit union industry millions of dollars. According to feedback from our member credit unions, in 2013 each credit union on average experienced \$152,000 in losses related to data breaches. The majority of these costs were related to fraud losses, investigations, reissuing cards, and monitoring member accounts.

As the recent high-profile data breaches at some of our nation’s largest retailers have highlighted, criminals are willing to go to great extremes to obtain consumer’s sensitive financial information.

Credit unions understand the importance of steadfastly protecting their member's confidential account information, which is why we strongly suggest this regulatory update.

Until Congress passes new legislation to ensure other third parties, such as merchants, who have access to consumer's financial information, have effective safeguards in place to protect consumer information, the CFPB should consider this minor modification to Regulation E. This change would go a long way in keeping sensitive financial information out of the hands of criminals and reduce the increasing fraud costs borne by credit unions and other financial institutions.

Federal Reserve Board

NAFCU has long encouraged the Federal Reserve to update Regulation D. This issue is also on NAFCU's "Dirty Dozen" list. Regulation D generally imposes reserve requirements on depository institutions with transaction accounts or nonpersonal time deposits, and requires reporting to the Federal Reserve. The regulation aims to facilitate monetary policy and ensure sufficient liquidity in the financial system. It requires credit unions to reserve against transaction accounts, but not against savings accounts and time deposits.

NAFCU believes the Federal Reserve Board should revisit the transaction limitation requirements for savings deposits. The six-transaction limit imposes a significant burden on both credit union members in attempting to access and manage their deposits and credit unions in monitoring such activity. Member use of electronic methods to remotely access, review and manage their accounts, as well as the contemporary transfer needs of members and consumers at all types of financial institutions, make a monthly transaction limit an obsolete and archaic measure. Should the Board decide not to outright remove the transaction limitation requirement for savings deposits, NAFCU has urged the Board to raise the current limitation from six to twelve transactions. If the Board fails to act in this area, we believe Congress should be ready to address this issue.

FHFA

On September 2, 2014, the Federal Housing Finance Agency (FHFA) released a proposed rule that would require institutions to hold 10% of assets in residential mortgage loans, not only to become a member, but also to maintain that 10% on a constant basis to remain a member. The current rule

only requires the 10% be held at the time membership is approved. FDIC-insured banks with under \$1 billion in assets currently have a statutory exemption from this 10% requirement in the *Federal Home Loan Bank Act*, but credit unions do not.

Credit union membership in federal home loan banks (FHLBs) has been increasing, and, as of June 2014, 19% of credit unions had membership in a federal home loan bank. FHLBs can also be an important source of liquidity for credit unions. This proposed rule change threatens to hamper credit union access to, and membership in, FHLBs. We would urge Congress to express concerns to the FHFA about this proposal. Furthermore, we would urge legislative action to grant credit unions parity in the exemptions enjoyed by banks under the *Federal Home Loan Bank Act*.

VI. Regulatory Coordination is also Needed

With numerous new rulemakings coming from regulators, coordination between the agencies is more important than ever. Congress should use its oversight authority to make sure that regulators are coordinating their efforts and not duplicating burdens on credit unions by working independently on changes to regulations that impact the same areas of service. There are a number of areas where opportunities for coordination exist and can be beneficial. I outline two of them below.

Financial Stability Oversight Council (FSOC)

NAFCU has been on the forefront encouraging the FSOC regulators to fulfill their Dodd-Frank mandated duty to facilitate rule coordination. This duty includes facilitating information sharing and coordination among the member agencies of domestic financial services policy development, rulemaking, examinations, reporting requirements and enforcement actions. Through this role, the FSOC is effectively charged with ameliorating weaknesses within the regulatory structure and promoting a safer and more stable system. It is extremely important to credit unions for our industry's copious regulators to coordinate with each other to help mitigate regulatory burden. We urge Congress to exercise oversight in this regard and consider putting into statute parameters that would encourage the FSOC to fulfill this duty in a thorough and timely manner.

Data Security

Outside of advocating for federal legislation with regard to the safekeeping of information and breach notification requirements for our nation's retailers, NAFCU has also urged regulatory coordination for credit unions already in compliance with the stringent standards in the *Gramm-Leach-Bliley Act*. In the wake of the massive Target data breach in December 2013 the Federal Trade Commission began exploring a range of regulatory options to assist consumers, businesses, and financial institutions. Moving forward, it is imperative that NCUA ensure that credit unions are protected from any unnecessary regulatory burden and continue to allow them to provide quality services to their members.

VII. Conclusion: All Credit Unions Need Regulatory Relief

The growing regulatory burden on credit unions is the top challenge facing the industry today and credit unions are saying "enough is enough" when it comes to the overregulation of the industry. All credit unions are being impacted regardless of asset size.. This burden has been especially damaging to smaller institutions that are disappearing at an alarming rate. The number of credit unions continues to decline, as the compliance requirements in a post Dodd-Frank environment have grown to a tipping point where it is hard for many smaller institutions to survive. Those that do are forced to cut back their service to members due to increased compliance costs.

Credit unions want to continue to aid in the economic recovery, but are being stymied by this overregulation. NAFCU appreciates the Committee holding this hearing today. Moving forward, we would urge the Committee to act on credit union relief measures pending before the Senate and the additional issues outlined in NAFCU's Five-Point Plan for Credit Union Regulatory Relief and NAFCU's "Dirty Dozen" of regulations to review and amend. Additionally, Congress needs to provide vigorous oversight to the NCUA's proposed risk-based capital rule and be ready to step in and stop the process so that the impacts can be studied further. Finally, the Committee should also encourage regulators to act to provide relief where they can without additional Congressional action.

We thank you for the opportunity to share our thoughts with you today. I welcome any questions you might have.

Attachment A: NAFCU’s May 27, 2014 comment letter on the NCUA’s Prompt Corrective Action/ Risk-Based Capital proposal

Attachment B: XCEL FCU’s comment letters on the NCUA’s Prompt Corrective Action/ Risk-Based Capital proposal

Attachment C: NAFCU’s “Five Point Plan for Regulatory Relief” released in February 2013

Attachment D: NAFCU’s “Dirty Dozen” – Twelve Regulations to Eliminate or Amend

**Attachment A: NAFCU's May 27, 2014 comment letter on the
NCUA's Prompt Corrective Action/ Risk-Based Capital
proposal**



National Association
of Federal Credit Unions
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NAFCU | Your Direct Connection to Education, Advocacy & Advancement

May 27, 2014

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

RE: Comments on NCUA Prompt Corrective Action – Risk-Based Capital
Proposed Rule

Dear Mr. Poliquin:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I am writing to you regarding the proposed rule on prompt corrective action and risk-based capital. As the credit union community comments on this rule, NAFCU is hopeful that the National Credit Union Administration (NCUA or Agency) Board will realize the devastating effect that this proposal will have on the credit union industry, the American consumer, and our nation's small businesses. While we are supportive of the idea of a risk-based capital regime for credit unions, the current NCUA proposal is not appropriate for credit unions or the credit union industry. If it were to be implemented as proposed, credit unions would find themselves at a significant competitive disadvantage to banks. As proposed, the rule is one-size-fits-all and would serve to stifle growth, innovation, and diversification within credit unions. We ask that the NCUA Board withdraw the rule or alternatively make major modifications to the proposal before any rule is finalized.

NAFCU has many concerns with the proposed rule which we explain in detail below; however, our major concerns include:

- Several issues related to NCUA's legal authority to issue the rule as proposed, such as:
 - Comparability with banking regulatory requirements;
 - Substitution of statutorily defined legal terms;
 - Individual minimum capital requirements;
 - Definition of a "complex" credit union;
- The need for a legislative solution in order to achieve a fair and balanced risk-based capital system;
- NCUA's treatment of the regulatory process including the refusal to extend the comment period and form an industry working group prior to releasing a

proposed rule, and the need for an additional notice of proposed rulemaking with public comment period;

- NCUA's drastic understatement of credit unions that will be affected by this rule and whose balance sheets and business plans will need adjustment;
- NCUA's proposed risk-based capital ratio for well capitalized credit unions set at 10.5 percent;
- NCUA's treatment of risk-weighted assets and the lack of explanation for deviation from similar banking risk-weights;
- NCUA's incorporation of interest rate and concentration risk into risk-weighting for real estate, investments, and member business loans (MBL's);
- Individual minimum capital requirements for credit unions including issues with the subjectivity of their imposition;
- Components not included in the numerator portion of the risk-based capital ratio, such as goodwill;
- The 1.25 percent cap on Allowance for Loan and Lease Losses (ALLL) especially considering the Financial Accounting Standards Board's (FASB) most recent proposal on ALLL;
- Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule; and
- The proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule.

Legal Authority

NAFCU does not believe that NCUA has the legal authority to issue the rule as proposed. There are several areas of the proposed rule where NAFCU questions whether the rule is consistent with the requirements of the Federal Credit Union Act (FCU Act.)

The FCU Act Requirements

The FCU Act 12 U.S.C. §1790d contains the requirements for Prompt Corrective Action (PCA), including the required regulations and the risk-based net worth requirement. These provisions were added to the FCU Act by the Credit Union Membership Access Act of 1998 (CUMAA).

NCUA acknowledges in the proposed rule that it derives its legal authority for promulgating the proposed risk-based capital rule from sections 1766¹ and 1790d of the FCU Act, and maintains that the proposed rule achieves the purposes that the FCU Act requires.

NCUA states in the proposed rule that "Congress set forth a basic structure for PCA in section 216 that consists of three principal components: (1) A framework combining mandatory actions prescribed by statute with discretionary actions developed by NCUA; (2) an alternative system of PCA to be developed by NCUA for credit unions defined as

¹ This section refers to powers of the NCUA Board.

'new'; and (3) a risk-based net worth requirement to apply to credit unions that NCUA defines as 'complex.'"²

Comparability

The FCU Act requires that the NCUA Board "shall, by regulation, prescribe a system of prompt corrective action for insured credit unions that is—(i) consistent with this section; and (ii) comparable to section 1831o of this title."³ (Emphasis added.) This reference to 12 U.S.C. §1831o is to the PCA requirements of the Federal Deposit Insurance Act, as implemented through the Federal Deposit Insurance Corporation (FDIC) regulations.

During the deliberations on CUMAA, Congress also stated on the record that "'Comparable' here means parallel in substance (though not necessarily identical in detail) and equivalent in rigor."⁴ This proposed rule goes far beyond this interpretation of comparable in a number of instances that are highlighted throughout this letter.

Risk-Based Net Worth vs. Risk-Based Capital Terminology

NCUA's proposed amendments to 12 C.F.R. §702.102 would replace statutorily defined terms with what it considers to be "functionally equivalent" terms.⁵ NAFCU questions whether NCUA has the legal authority to deviate from these statutory terms. The FCU Act also requires a "risk based net worth requirement for complex credit unions;" the statutory requirement reads:

"Risk-based net worth requirement for complex credit unions.—

(1) In general.—The regulations required under subsection (b)(1) of this section shall include a risk-based net worth requirement for insured credit unions that are complex, as defined by the Board based on the portfolios of assets and liabilities of credit unions.

(2) Standard.—The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be adequately capitalized may not provide adequate protection."⁶ (Emphasis added.)

The FCU Act also provides specific definitions for "net worth"⁷ and "net worth ratio."⁸ These terms are specifically defined in the FCU Act as follows:

"(2) Net worth.—The term "net worth"

(A) with respect to any insured credit union, means the retained earnings balance of the credit union, as determined under generally accepted accounting principles, together with any amounts that were previously retained earnings of any other credit union with which the credit union has combined;

² Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11185.

³ 12 U.S.C. § 1790d(b)(1)(A).

⁴ S. Rep. No. 193, 105th Cong., 2d Sess. 13 (1998) (S. Rep.).

⁵ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11191.

⁶ 12 U.S.C. § 1790d(d).

⁷ 12 U.S.C. § 1790d(o)(2).

⁸ 12 U.S.C. § 1790d(o)(3).

(B) with respect to any insured credit union, includes, at the Board's discretion and subject to rules and regulations established by the Board, assistance provided under section 208 to facilitate a least-cost resolution consistent with the best interests of the credit union system; and
(C) with respect to a low-income credit union, includes secondary capital accounts that are—
(i) uninsured; and
(ii) subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the Fund.⁹

(3) Net worth ratio.

The term "net worth ratio" means, with respect to a credit union, the ratio of the net worth of the credit union to the total assets of the credit union."¹⁰ (Emphasis added.)

The preamble to the proposed rule discusses NCUA's proposed amendments to § 702.102, including changes to the terminology used. NCUA acknowledges that the FCU Act specifically uses the term "risk-based net worth requirement" but proposes to replace that terminology with "risk-based capital," which it contends is "functionally equivalent."¹¹

The proposed rule also replaces the term "net worth" with the term "capital categories" to describe the combined "net worth ratio" and "risk-based net worth" measurements, as well as several other modifications to the terminology currently used.

NCUA contends that "no substantive changes to the requirements of section 216(c) are intended by these changes in terminology."¹² These changes are not only substantive, but redefine statutorily defined terms including "net worth" and "net worth ratio" with terms that do not encompass the same things.

These statutorily defined terms may not be redefined by NCUA through regulation in order to place an ill-fitting risk-based capital system on top of the current PCA system. NAFCU believes that if NCUA really wants to institute a working risk-based capital system that would be comparable to what banks have, then NCUA would need Congress to change the FCU Act to give it the authority to do so.

Individual Minimum Capital Requirements

NAFCU questions whether NCUA has the statutory authority to institute individual minimum capital requirements. Under the proposed rule, NCUA introduces a new power to raise individual minimum capital requirements for credit unions "that varies from any of the risk-based capital requirement (s) that would otherwise apply to the credit union..."¹³ The proposed rule contains a list of circumstances where NCUA could raise a credit union's individual minimum capital requirements that includes, among others, a credit union receiving special supervisory attention or a portfolio that reflects weak credit quality or significant likelihood of financial loss. The FCU Act 12 U.S.C. § 1790d(h) states:

⁹ 12 U.S.C. § 1790d(o)(2).

¹⁰ 12 U.S.C. § 1790d(o)(3).

¹¹ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11191.

¹² *Id.*

¹³ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11216 (to be codified at 12 C.F.R. § 702.105(a)).

“(h) More stringent treatment based on other supervisory criteria

With respect to the exercise of authority by the Board under regulations comparable to section 1831o(g) of this title—

- (1) the Board may not reclassify an insured credit union into a lower net worth category, or treat an insured credit union as if it were in a lower net worth category, for reasons not pertaining to the safety and soundness of that credit union; and***
- (2) the Board may not delegate its authority to reclassify an insured credit union into a lower net worth category or to treat an insured credit union as if it were in a lower net worth category.” (Emphasis added.)***

A broad interpretation of the statute¹⁴ would allow for NCUA to use issues of safety and soundness to reclassify an insured credit union or treat it as though it were in a lower net-worth category. By doing so, the NCUA Board could subject those individual credit unions that did not meet the individual minimum capital requirements to the same restrictions as those credit unions that are less than well capitalized. The statute, if read broadly, could allow for the NCUA Board to downgrade a credit union in cases pertaining to safety and soundness.

Taking a more narrow interpretation of the statute, one could argue that having the authority to treat an insured credit union as if it were in a lower net worth category is not the same as having the authority to arbitrarily subject individual credit unions to different individual minimum capital requirements. While the effects of lowering a credit union’s net worth category could be similar for a credit union under the proposed individual minimum capital requirement, it is not the same as being authorized to be able to pick the point at which a credit union would not be safe and sound.

Finally, a strict reading of the statute would not provide the authority necessary for the NCUA Board to promulgate a rule that includes proposed § 702.105. Nowhere in the statute does Congress specifically authorize the NCUA Board to provide different minimum capital requirements for individual credit unions.

There is a second major issue regarding individual minimum capital requirements. Assuming the NCUA Board is deemed to have the authority to institute a system that would allow for individual minimum capital requirements because of its interpretation of 12 U.S.C. § 1790d(h)(1), at issue is whether the NCUA Board can delegate that authority to anyone other than itself, such as an examiner or regional director. Congress was clear in its intent that this authority is not to be delegated to anyone other than the NCUA Board.¹⁵

The proposed rule uses phrases such as “The decision is necessarily based, in part, on subjective judgment grounded in agency expertise...”¹⁶ and “NCUA may establish

¹⁴ 12 U.S.C. § 1790d(h).

¹⁵ 12 U.S.C. § 1790d(h)(2).

¹⁶ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11217 (to be codified at 12 C.F.R. § 702.105(c)).

increased individual minimum capital requirements...”¹⁷ The proposed § 702.105 uses the term NCUA, not NCUA Board, as is used in other parts of the proposed rule.¹⁸ The proposed rule also specifically sets out in the summary that the initials “NCUA” are meant to mean the National Credit Union Administration as a whole agency and “Board” to mean the NCUA Board.¹⁹ NAFCU believes this proposed rule intends to delegate the power to raise individual minimum capital requirements from the NCUA Board to other individuals or departments within the NCUA. This would fall directly outside the power authorized by Congress in 12 U.S.C. § 1790d. These discrepancies must be addressed in any final rule that is issued.

Definition of Complex

The proposed rule seeks to establish new more stringent risk-based capital standards for all credit unions with more than \$50 million in assets, which NCUA has defined as “complex.” NCUA’s re-definition of a “complex” credit union is outside of the scope of the authority designated to it by Congress. The proposed rule arbitrarily sets the threshold at \$50 million in assets with no additional tests to actually determine if the credit union itself is “complex.”

The FCU Act²⁰ directs NCUA to develop a risk-based net worth system for complex credit unions that is based on the “portfolios of assets and liabilities of credit unions.”²¹ Congress could have directed NCUA to focus only on asset size in defining “complex.” Instead, the FCU Act²² requires NCUA to consider the complexity of a credit union’s book of assets such as types of investments and loans, as well as liabilities. The definition of “complex” must be based on whether the credit union’s financial activities and operations are sufficiently elaborate to warrant that credit union be designated as “complex” rather than just on its asset size.

As NAFCU has previously stated, the size of an institution does not determine the complexity of the assets and liabilities of a given credit union. There are many credit unions with well over \$50 million in assets that are run out of one branch with only a handful of employees that often engage in only the most basic of transactions for members. Furthermore, there are many large credit unions that have very simple portfolios and are not involved in “risky” activities. There are also some smaller credit unions that engage in more risky activities that would require them to hold more capital. Limiting the definition of “complex” for credit unions to only those credit unions over \$50 million is completely arbitrary and contrary to Congressional mandate.

¹⁷ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11216 (to be codified at 12 C.F.R. § 702.105(b)).

¹⁸ See Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184 (to be codified at 12 C.F.R. §§ 702.110, 702.111, 702.112).

¹⁹ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184.

²⁰ 12 U.S.C. 1790d(d).

²¹ *Id.*

²² As modified by The Credit Union Membership Access Act of 1998 (CUMAA).

Legislative Solution

NAFCU supports a risk-based capital system for credit unions. We support less capital for lower-risk credit unions and more capital for higher-risk credit unions. However, we continue to believe that we need Congress to make statutory changes to the FCU Act to achieve a fair system.

Ongoing discussions with NAFCU member credit unions led to the unveiling of NAFCU's "Five Point Plan for Regulatory Relief" in February 2013, and a call for Congress to enact meaningful legislative reforms that would provide much needed assistance to our nation's credit unions. In NAFCU's "Five Point Plan for Regulatory Relief," NAFCU calls on Congress to direct NCUA and industry representatives to conduct a study on PCA and recommend changes. It also calls on Congress to modernize capital standards by directing the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks and allows the NCUA Board to authorize supplemental capital. Finally, it asks Congress to establish special capital requirements for newly chartered federal credit unions that recognizes the unique nature and challenges of starting a new credit union.

NCUA's proposed rule on risk-based capital does not achieve a truly risk-based capital system for credit unions. NAFCU believes that the proposal is conceptually flawed, deviates from statutory requirements for PCA, and tries to establish an ill-fitting risk-based capital system without the necessary legislative solution. This results in a one-size-fits-all rule that will ultimately hurt credit unions while disregarding Congressional intent, and will require credit unions to hold additional unnecessary capital.

The FCU Act also prescribes that credit unions have net worth ratios of six percent to be considered adequately capitalized and seven percent for well capitalized,²³ while banks have leverage ratios of four percent to be adequately capitalized and five percent for well capitalized.²⁴ Credit unions are already at a competitive disadvantage to banks in this regard, and this proposed rule only serves to multiply that competitive disadvantage by requiring credit unions to hold even more capital as compared to banks.

These additional requirements are increasing the capital that credit unions cannot use to help members by providing loans. Furthermore, credit unions also have to account for a one percent contribution to the NCUSIF which constructively limits the amount of funds available for credit unions to extend credit, placing additional capital burdens on credit unions. NAFCU believes that NCUA should work with Congress to change PCA requirements such that credit unions are put on equal footing with and better able to compete with banks.

Should NCUA's current proposed rule go forward with little or no changes, the new rule would precipitate the need for other Congressional action to bring about capital changes for credit unions such as H.R. 719, the Capital Access for Small Businesses and Jobs Act,

²³ 12 U.S.C. § 1790d(c).

²⁴ 12 U.S.C. § 1831o.

which would allow credit unions to have access to supplemental capital sources. Additionally, the inclusion of an individual minimum capital requirement that starts with the examiner in any final rule only reinforces the need for action on H.R. 1553, the Financial Institutions Examination Fairness and Reform Act.

The Regulatory Process

Capital touches every part of a credit union's operations and decision-making. NAFCU believes that this proposed rule is one of the most important rulemakings to come out of the Agency in recent history. It is troubling that NCUA has refused to work with credit unions throughout the rulemaking process.

On May 8, 2013, NAFCU sent a letter to the NCUA Board requesting it to consider creating a working group on reforming current regulatory capital requirements for credit unions. That request specifically sought a working group made up of industry stakeholders to be formed and convened prior to any rulemaking by NCUA. NAFCU continued to stress to NCUA the need for a capital working group to perform an analysis prior to the issuance of a proposed rule on risk-based capital. Unfortunately, a working group was not convened prior to the release of this proposed rule.

Furthermore, NAFCU believes that for complex and important rules it is appropriate to issue an Advanced Notice of Proposed Rulemaking (ANPR) to collect public input on key issues. NCUA did not issue an ANPR prior to the release of the risk-based capital proposed rule. A risk-based capital rule is one such issue that is complex and important enough that an ANPR made sense for both the Agency and the credit union industry. It would also have given NCUA an opportunity to gather data from credit unions about the true effects of any changes in the capital regime. NAFCU believes that NCUA should have issued an ANPR to solicit comments from the public instead of releasing a proposed rule without credit union input either by formal comment period or working group.

Additionally, NCUA released a "Risk-Based Capital Calculator" when the NCUA Board approved the proposed rule in January 2014, and made this calculator available to the public. The calculator uses the most recent 5300 Call Report data and generates a credit union's current net worth ratio, net worth classification, and most importantly what the credit union's risk-based capital ratio would be pursuant to the proposed rule.

NAFCU believes that this calculator should not have been made available to the public. While this may be a useful tool for a credit union to understand what its capital position would be under the proposed rule, its public disclosure could have unintended consequences such as damage to a credit union's reputation. The proposed rule is complex and an uninformed viewer of this information could draw the wrong conclusions about the strength of the credit union, particularly as the rule is still in the proposal stage and subject to change. A better alternative would have been to provide credit unions with access to the calculator through a secure portal on NCUA's website.

On February 28, 2014, NAFCU sent a joint letter along with the Credit Union National Association (CUNA) to Chairman Matz to request an extension of the comment period by

90 days to give credit unions more time to understand this complex rule and to provide valuable feedback to NCUA about the possible effects of the rule on their credit union. Chairman Matz denied this request and in doing so, stated that the comment period provided enough time for credit unions to understand the rule and provide constructive comments to the Agency.

After Chairman Matz denied the request, credit unions continued to ask for more time and NAFCU, along with CUNA, wrote another letter to all members of the NCUA Board to again request that the comment period for the rule be extended for 90 days. That request was also denied. This rule is too important to rush the rulemaking process. Giving credit unions extra time to realize the full effects of the rule on present and future portfolios and business decisions easily outweighs any possible negatives in delaying its implementation.

Given the recent comments from NCUA Board members regarding the significant changes that will be made to the rule before it is finalized, NAFCU believes that NCUA should re-issue the proposed rule with any changes made using the input received from this comment period and the scheduled listening sessions through a notice of proposed rulemaking. This would give credit unions an opportunity to see those significant changes and contribute comments. If NCUA intends the final rule to include as many changes as the NCUA Board members have indicated, then NCUA will need to re-issue a proposed rule with another public comment period as required by the Administrative Procedure Act.

Affected Credit Unions

NCUA has stated publicly that this proposed rule would only affect around 200 credit unions.²⁵ That number simply includes those credit unions whose net worth classification will be downgraded. While there may only be around 200 credit unions whose net worth categories will be downgraded, there are many more credit unions that will be affected by this proposed rule. There are 1,404 federally-insured credit unions (FICUs)²⁶ that currently have more than \$50 million in assets but are not currently defined as complex pursuant to PCA requirements. These credit unions would be defined as complex by the proposed rule. This means that 1,404 additional FICUs would be subject to a risk-based capital standard that would otherwise not be affected, based solely on the change in definition of "complex." All credit unions subject to the requirements of this proposed rule will need to carefully examine their balance sheets and potentially make substantial portfolio changes.

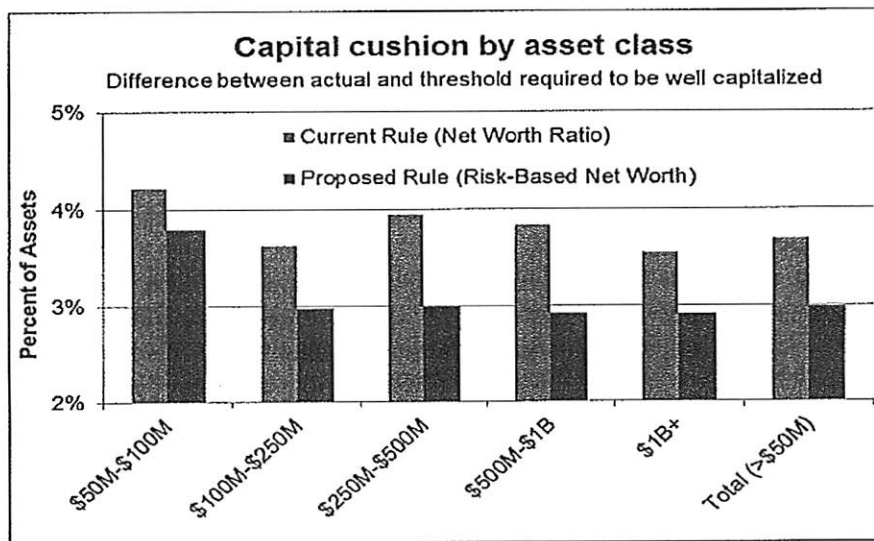
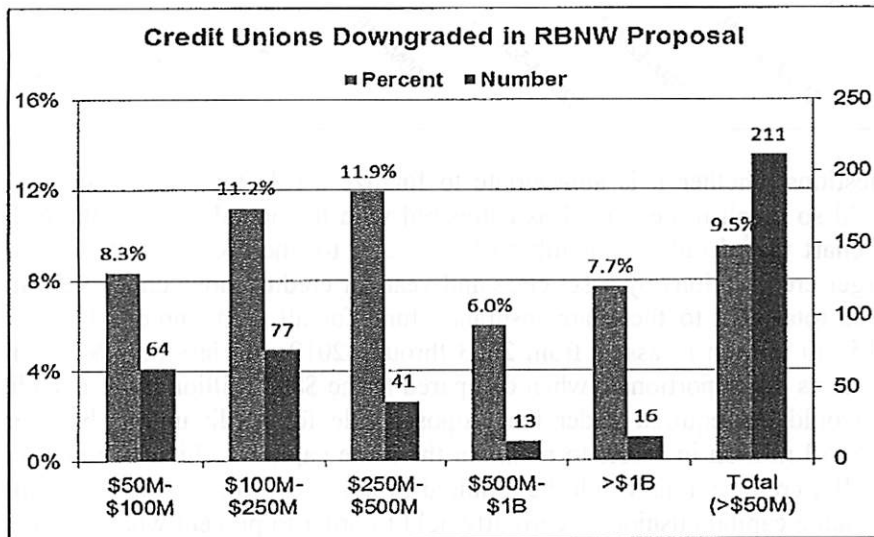
A survey of NAFCU's membership taken in April 2014 found that nearly 60 percent of respondents believe the proposed rule would force their credit union to hold more capital, while nearly 65 percent believe this proposal would force them to realign their balance sheet. If the NCUA implements this rule as proposed, most credit unions will have to hold more capital. This additional capital requirement is not commensurate with the actual risks

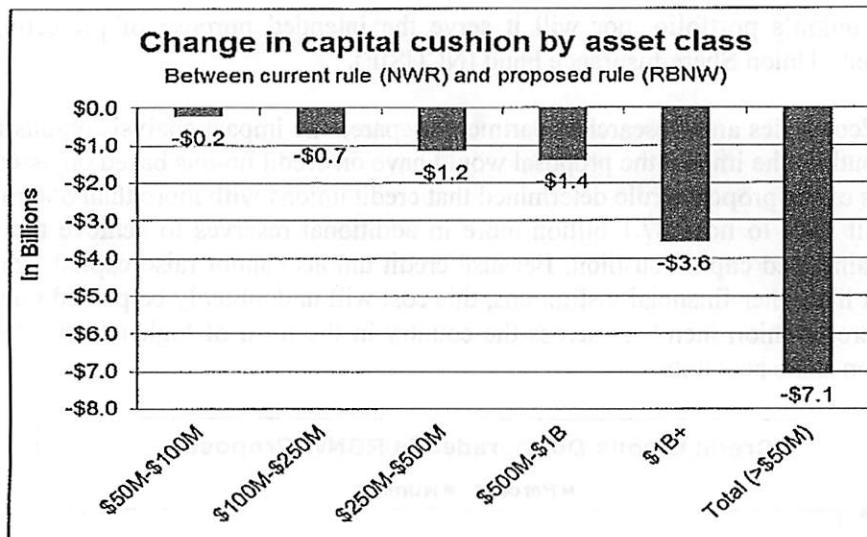
²⁵ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11188.

²⁶ As of December 31, 2013, there are 2,222 FICUs with assets over \$50 million. 818 FICU's have a risk-based net worth over 6% and are currently rated as complex. 1,404 FICU's have a risk-based net worth less than or equal to 6% and are therefore not considered complex by the current definition, but would be under the proposed rule.

of a credit union's portfolio, nor will it serve the intended purpose of protecting the National Credit Union Share Insurance Fund (NCUSIF).

NAFCU's Economics and Research department prepared the impact analysis graphs found below that outline the impact the proposal would have on credit unions based on asset size. Our analysis of the proposed rule determined that credit unions with more than \$50 million in assets will have to hold \$7.1 billion more in additional reserves to achieve the same currently maintained capital cushion. Because credit unions cannot raise capital from the open market like other financial institutions, this cost will undoubtedly be passed on to the 97 million credit union members across the country in the form of higher loan rates and lower rates on share accounts.





NAFCU questions whether it is appropriate to finalize a rule that would require credit unions to hold so much more capital as compared with the actual costs to the NCUSIF. Below is a chart that details the number of, and cost to, the NCUSIF of liquidated or assisted merger credit unions by asset class and year for credit unions under \$250 million in assets. The total cost to the share insurance fund for all credit unions between \$50 million and \$250 million in assets from 2003 through 2012 was less than \$285 million. This stands out as disproportionate when compared to the \$898 million more in additional capital that would be required under the proposed rule for credit unions between \$50 million and \$250 million in assets to maintain the same capital cushion as in the current rule. Essentially, credit unions would be required to hold \$898 million more in capital to maintain the same capital cushion as currently held in order to prevent what was less than \$285 million in losses over the past 10 years.

The Number of and Cost to Insurance Fund of Liquidated or Assisted Merger Credit Unions by Asset Class and Year

Year	Assets < \$250M		Assets < \$100M		Assets < \$50M	
	Number	Cost to Ins Fund	Number	Cost to Ins Fund	Number	Cost to Ins Fund
2003	13	\$ 10,158,257	13	\$ 10,158,257	13	\$ 10,158,257
2004	21	\$ 11,892,786	21	\$ 11,892,786	21	\$ 11,892,786
2005	15	\$ 15,088,257	15	\$ 15,088,257	15	\$ 15,088,257
2006	16	\$ 6,717,182	16	\$ 6,717,182	16	\$ 6,717,182
2007	11	\$ 9,470,960	10	\$ 7,539,629	10	\$ 7,539,629
2008	17	\$ 32,989,171	16	\$ 32,989,171	14	\$ 31,334,427
2009	26	\$ 156,497,713	24	\$ 137,520,215	18	\$ 36,954,777
2010	27	\$ 60,346,866	23	\$ 26,803,469	23	\$ 26,803,469
2011	16	\$ 52,876,674	14	\$ 31,100,299	13	\$ 18,259,280
2012	21	\$ 138,544,436	19	\$ 58,687,421	17	\$ 48,865,808
Total	183	\$ 494,582,303	171	\$ 338,496,687	160	\$ 213,613,873

Source: NCUA FOIA response 13-FOI-00097

Between the years 2003-2012 there were 190 total credit union failures, but only 7 of these failures were credit unions above \$250 million in assets. During this time period, the total number of credit unions under \$250 million in assets that failed was 183. However, 160 of those failed credit unions were under \$50 million in assets. There were only 23 failed credit unions between \$50 million and \$250 million in assets during that time period.

Additionally, almost half of the losses to the NCUSIF from 2003-2012 for those credit unions under \$250 million in assets were incurred because of failures of credit unions with under \$50 million in assets.

This rule will not cover those credit unions with under \$50 million in assets. Meaning, if this proposed rule had been implemented prior to those failures, it would not have helped to prevent the losses to the NCUSIF. While holding additional capital for assets that do carry higher risk makes sense in a true risk-based system, holding more capital for the sake of holding more capital is not the solution, and will not prevent failures.

10.5% Risk-Based Capital Ratio

The proposed rule introduces a 10.5 percent risk-based capital ratio requirement in order for a credit union to be categorized as well capitalized. This ratio will make credit unions less competitive than their banking counterparts. NCUA reasons that the proposed “10.5 percent risk-based capital ratio target is comparable to the [o]ther [f]ederal [b]anking [r]egulatory [a]gencies’ 8 percent plus the 2.5 percent capital conservation buffer...”²⁷ The Agency states this was done in order to “avoid the complexity of implementing a capital

²⁷ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11192.

conservation buffer.”²⁸ In its efforts to avoid complexity, NCUA is proposing an ill-fitting risk-based capital ratio for credit unions.

The impact of the 2.5 percent capital conservation buffer was designed specifically for banks and does not work for credit unions, and will result in an unnecessary additional increase to credit union capital requirements. The banking regulators developed the capital conservation buffer in order to ensure that banks retained capital in times when it was needed most. During the crisis, distressed banks were distributing capital to shareholders and employees even though it was negatively affecting their capital ratios. This led the banking regulators to include a capital conservation buffer of 2.5 percent on top of the Tier 1 risk-based capital ratio minimum level of 8 percent as part of the FDIC rules that become effective over the next five years.

The specific purpose of the capital conservation buffer is to ensure that banks are only able to pay stock dividends and share buybacks if they meet their 2.5 percent capital conservation buffer and not just the 8 percent Tier 1 risk-based capital minimum. This approach to capital distribution does fit the credit union business model.

NCUA failed to include any rationale or data for why it chose to have a 10.5 percent minimum capital requirement to be well capitalized other than to “avoid the complexity of implementing a capital conservation buffer.”²⁹ NAFCU believes that the FDIC Tier 1 ratios are more consistent to the types of capital that credit unions are allowed to hold, as opposed to the FDIC’s other risk-based capital ratios, as indicated in the chart below.

Net Worth Classification	Proposed Risk-Based Capital Ratio	FDIC Tier 1 Capital Requirements	NAFCU’s Alternative
Well Capitalized	10.5% or above	8% or above	8% or above
Adequately Capitalized	8% to 10.49%	6% to 7.99%	6% to 7.99%
Undercapitalized	Less than 8%	Under 6%	Under 6%

NAFCU believes that unless NCUA provide compelling rationale and/or data to differ from the FDIC rule, NCUA should remove the 2.5 percent capital buffer component of the minimum risk-based capital ratios and make capital categories mirror the FDIC Tier 1 capital requirements.

Risk Weights:

The proposed rule revises the risk-weights for many of NCUA’s current asset classifications and requires higher minimum levels of capital for credit unions that are perceived as having riskier portfolios. NAFCU and its member credit unions have identified several key areas where risk-weighting in the proposal does not accurately capture the risks associated with the asset in question. In particular, a number of the NCUA proposed risk-weights require credit unions to hold much more capital as compared with the FDIC and Basel III requirements for community banks — often without solid justification for the deviations.

²⁸ *Id.*

²⁹ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11192.

Concentration Risk and Interest Rate Risk

As discussed above, the FCU Act requires that the system of prompt corrective action that the NCUA prescribes by regulation be comparable to those that the banking regulators institute.³⁰ In the many iterations of Basel and most recent rules that the FDIC has finalized, banking regulators have chosen not to incorporate interest rate risk and concentration risk into their risk-weights. However, NCUA's proposed rule incorporates concentration risk and interest rate risk into many of its proposed risk-weights. NAFCU acknowledges that interest rate and concentration risk are risks that every credit union needs to manage and plan for, but this rule is not the way to avoid losses due to those risks in the future.

NAFCU urges NCUA to eliminate the interest rate and concentration risk components of the risk-weighting for non-delinquent first mortgage real estate loans, other real estate secured loans, member business loans (MBLs), and investments. Rather, NCUA should change those risk-weights to be consistent with the risk-weighting given to those assets by the FDIC.

A risk-based capital rule is a poor tool for managing these additional risks, and simply requiring credit unions to hold more capital does not address or solve any issues that individual credit unions have when trying to manage those risks. Both Basel III and the FDIC interim final rule are constructed in such a way that authorities would employ other mechanisms to measure and control for risk other than credit risk. In order to comply with the comparability mandate of The FCU Act,³¹ NCUA should follow the other federal banking regulatory agencies in this regard.

To better control for interest rate risk, NAFCU believes that a more sensible alternative to the proposed rule would be to continue to apply industry-accepted methods as part of a competent supervision and examination process.³² Banking regulators have prescribed this as well and by holding credit unions to significantly different standards, NAFCU is concerned that NCUA may be running afoul of the will of Congress regarding the requirement that the rule be comparable to what banks have to follow.

This rule will also constrict capital availability that would otherwise be used for loans to members because credit unions will be required to hold more capital for interest rate and concentration risk. This is harmful to credit unions and to their members. During the financial crisis credit unions continued to lend when banks and other financial institutions pulled back. This rule would constrict the ability of credit unions to lend to members because so much more of their capital would have to be held for interest rate and

³⁰ 12 U.S.C. §1790d(b)(1)(A)(ii).

³¹ *Id.*

³² NCUA already has a number of requirements and guidance regarding interest rate risk that credit unions must comply with, such as the interest-rate risk final rule, a letter to credit unions on the subject (12-CU-05), and it is the top subject in the most recent NCUA supervisory focus (13-CU-01). Instead of making credit unions hold more capital, NCUA should first look to its existing requirements and regulations.

concentration risk. This is another reason this rule puts credit unions at a disadvantage to banks.

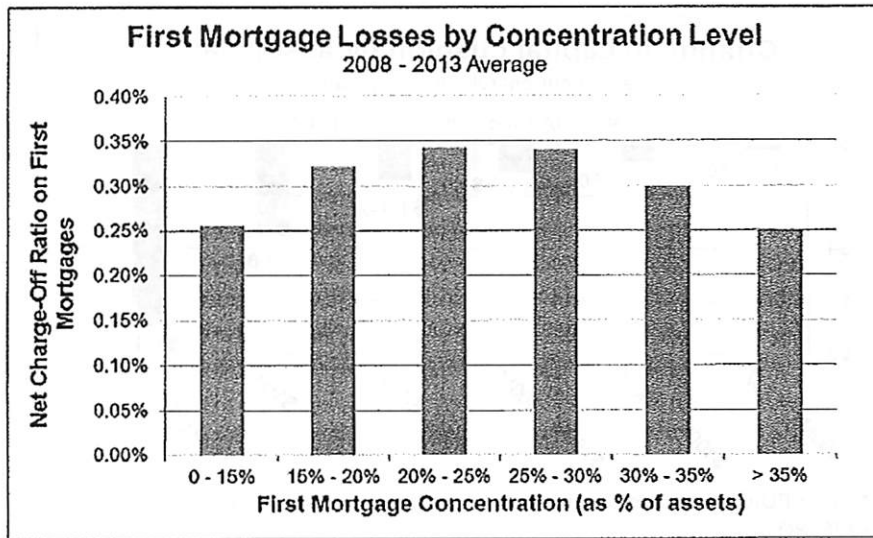
Non-Delinquent First Mortgage Real Estate Loans

NCUA’s proposed rule uses the non-delinquent first mortgage real estate loans risk-weights to compensate for concentration risk by increasing the risk-weights to correspond with the percentage of those assets held by the credit union in its portfolio. The FDIC on the other hand, does not take into consideration concentration risk through its capital standards and assigns risk-weights for non-delinquent first mortgage real estate loans at 50 percent regardless of the concentration in the portfolio.

NAFCU believes that in any final rule, NCUA should set all non-delinquent first mortgage real estate loan risk-weights at 50 percent so as to align with FDIC weights as seen in the chart below.

Non-delinquent 1st Lien Real Estate Loans	NCUA Proposed Risk-Weights	FDIC Risk-Weights
<25% percent of assets	50 percent	50 percent
25 to 35% of assets	75 percent	50 percent
>35% of assets	100 percent	50 percent

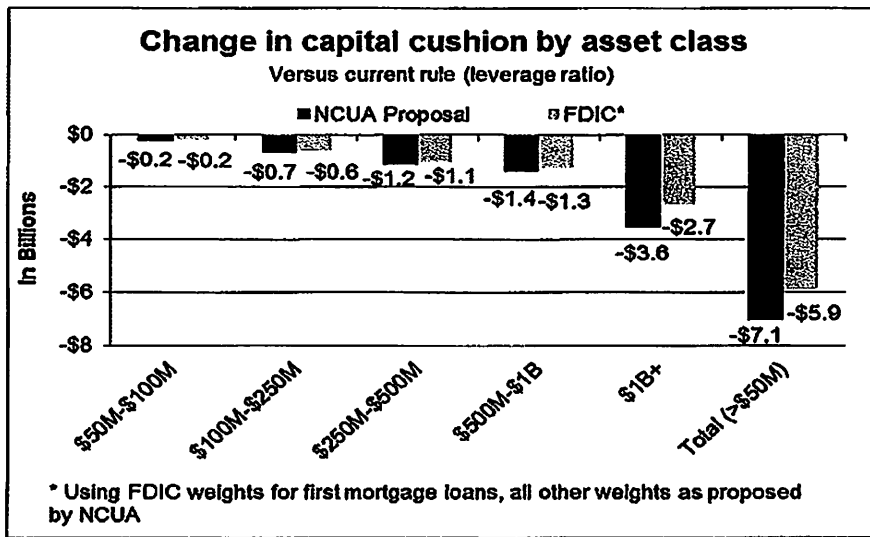
The risk-weights for each asset should also be rooted in the loss histories associated with that asset. When considering whether variable weights to account for concentration risk are warranted, it makes sense to look at the loss history for different levels of concentration for a given asset. Only in the case where higher asset concentrations are shown to result in higher loss histories would there be justification for increased risk-weights. In the case of non-delinquent first lien mortgage loans, the data shows that for different concentration levels, there has been no significant difference in average charge-offs since the onset of the financial crisis. Therefore, NCUA should do away with the risk-weights associated with higher concentrations of non-delinquent first mortgage loans and simply use a single risk-weight – 50 percent – for all outstanding loans.



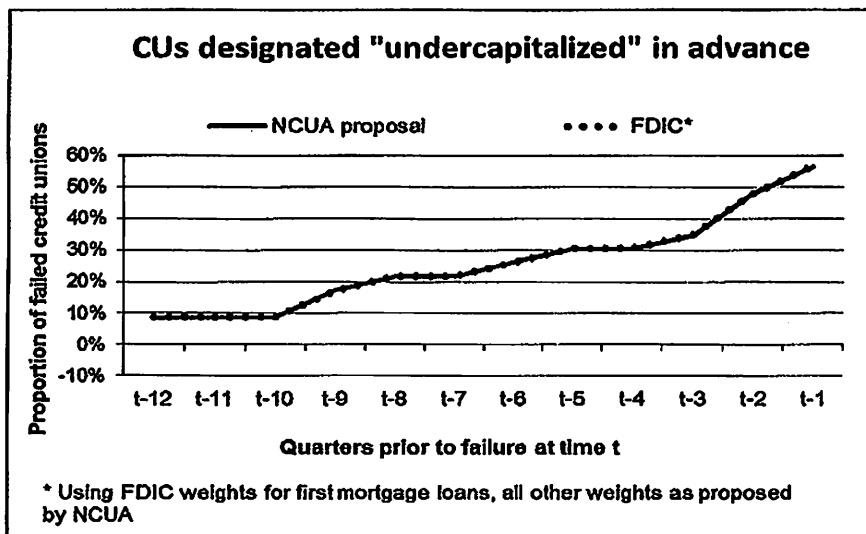
The graph above shows that aggregate losses for the highest concentrated credit unions (the “> 35%” group on the right) are equal to or lower than the losses for any other concentration group. NCUA argues that high concentrations of real estate and MBL loans led to numerous failures during recent years. This one-size fits all approach is not appropriate. Credit unions with high concentrations of mortgage loans on their books do not experience a higher loss rate on those loans than other credit unions, on average.

NAFCU also believes that concentration risk should be controlled through the supervision and examination process and not a one-size fits all capital regime that requires credit unions to hold more capital without allowing those credit unions with less risk to hold less capital.

The next chart shows that the capital cushion for credit unions would still shrink from current levels using FDIC risk-weights for non-delinquent first mortgage real estate loans, but the impact would not be as severe as under the NCUA proposal. The FDIC weights would result in a benefit to the capital cushion for credit unions at every asset group above \$100 million in assets as compared to the NCUA proposal.



The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as “undercapitalized” prior to failure based upon NCUA’s proposed rule and the FDIC risk-weights for non-delinquent first mortgage real estate loans. This proportion is tracked over the twelve quarters prior to a credit union’s failure. The chart indicates that there is no difference between when the NCUA or FDIC weights would have designated a credit union as “undercapitalized” prior to its failure. This is significant because it means that changing the risk-weighting to the FDIC risk-weights for other real estate loans will not detract at all from NCUA’s intention that the proposed rule would act as an early warning system for troubled credit unions.



There are a number of other concerns regarding the logical inconsistencies with this one-size-fits-all capital rule. For example, the proposed rule's treatment of real estate presents issues where a credit union may take steps to remove credit and liquidity risk from its portfolio by selling a 30-year mortgage that is currently risk-weighted at 50 percent. If that same credit union were to sell these mortgages to Fannie Mae and take back a Fannie Mae security with an average life of seven years, that mortgage-backed security would be risk-weighted at 150 percent. By doing so, the credit union has minimized its liquidity and credit risk while not providing any more interest rate risk. The result is that the credit union will be required to hold three times as much capital while having a less risky asset. This represents just one of many examples of the proposed risk-weights in this rule that do not match the actual risks posed to the credit union.

Other Real Estate Loans

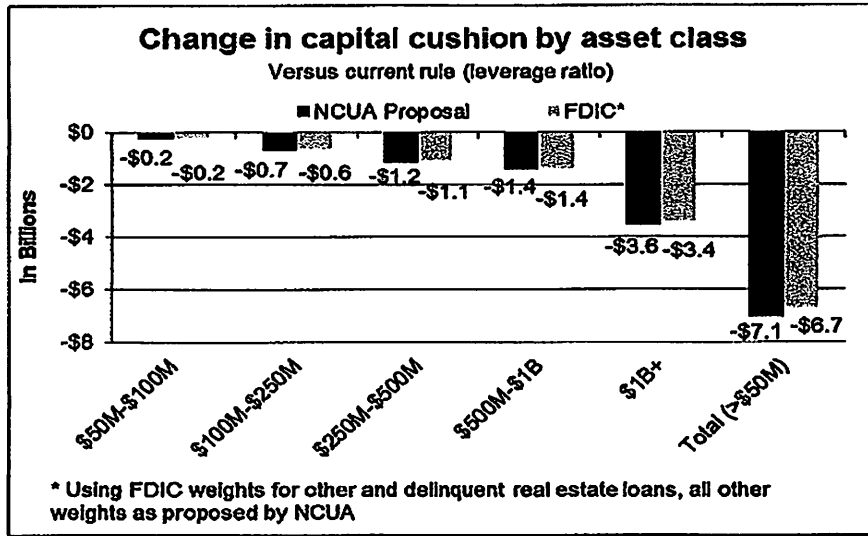
According to the proposed rule, "real estate-secured loans not meeting the definition of first mortgage real estate loans would be referred to as 'other real estate loans.'"³³ In the proposed rule, the risk-weights for these other real estate loans would incorporate concentration risk and increase as the percentage of these assets held by the credit union in its portfolio increases. The FDIC weights for these types of loans are 100 percent regardless of concentration.

NAFCU believes that in any final rule, NCUA should align other real estate loans risk-weights with FDIC weights as seen in the next table.

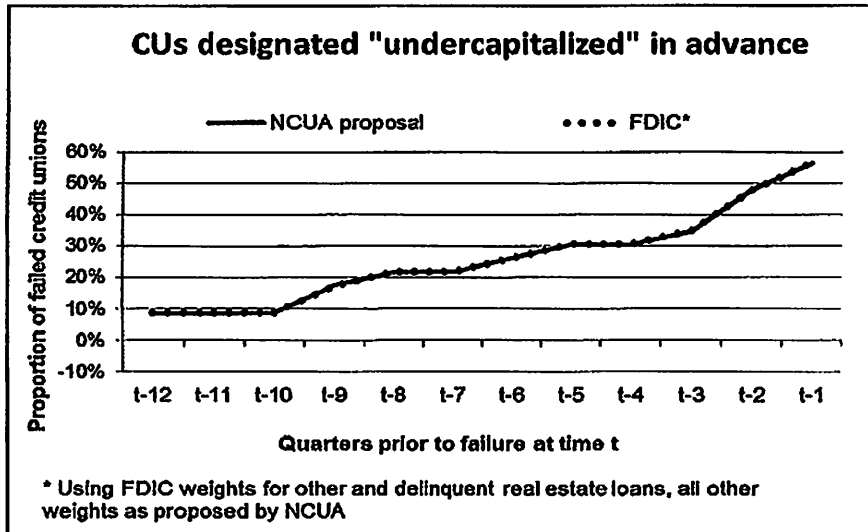
Other Real Estate Loans	NCUA Proposed Risk-Weights	FDIC Risk-Weights
0-10% percent of assets	100 percent	100 percent
>10 to 20% of assets	125 percent	100 percent
>20% of assets	150 percent	100 percent

The next chart shows that the capital cushion for credit unions would still shrink from current levels using the FDIC weights for other real estate loans, but the impact would not be as severe as under the NCUA proposal. The FDIC weights would result in a benefit to the capital cushion for credit unions at every asset level size except \$500 million – \$1 billion (no change) as compared to the proposed rule as seen in the next graph.

³³ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11197.



The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as “undercapitalized” prior to failure based upon NCUA’s proposed rule and the FDIC risk-weights for other real estate loans. This proportion is tracked over the twelve quarters prior to a credit union’s failure. The chart indicates that there is no difference between when the NCUA or NAFCU weights would have designated a credit union as “undercapitalized” prior to its failure. This is significant because it means that changing the risk-weighting to the FDIC risk-weights for other real estate loans will not detract at all from NCUA’s intention that the proposed rule would act as an early warning system for troubled credit unions.



Investments

The proposed rule uses the investment risk-weights to compensate for interest rate risk. This is apparent in the differences in proposed risk-weights for investments based on the Weighted-Average Life of Investments (WAL).

NAFCU has a number of issues with the proposed rule's risk-weights for investments. First, any final rule should eliminate the interest risk component from the capital requirements to align itself with FDIC risk-weights for investments. As noted above, credit unions already monitor and control for interest rate risk through internal policies and in accordance with NCUA examination and supervision policies. It is unnecessary and redundant for a risk-based capital regime to perform this function. This proposed rule is a one-size-fits-all requirement to hold more capital for almost all types of investments as a means to control for interest rate risk. Requiring more capital only serves as a disincentive to invest in longer-term investments, it does not provide the in-depth analysis to evaluate investments that is needed and brought about through the current supervision and examination process.³⁴

As NAFCU compares the NCUA proposal to the FDIC requirements for risk-based capital, we note that for those investments that credit unions are permitted to make, the FDIC does not incorporate interest rate risk into the investment risk-weights for community banks. Instead, it generally weights the investments that credit unions can make with a single risk-weight regardless of maturity. FDIC weights most types of investments that credit unions are able to make at a 20 percent risk-weight regardless of the WAL. This is another example of how this rule would put credit unions at a competitive disadvantage to banks. NCUA's proposal also does not account for any mitigation efforts, such as variable-rate assets or derivatives, which would offset some exposure for credit unions to interest rate risk.

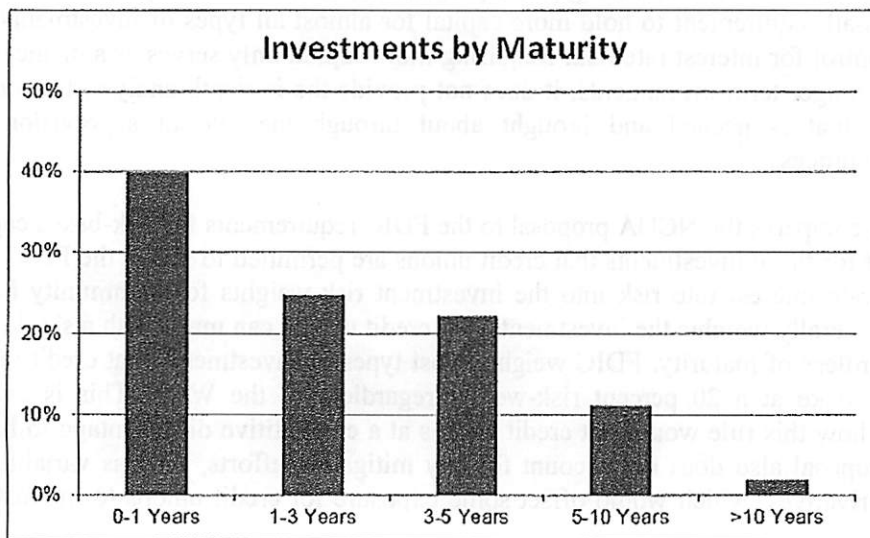
According to the proposed rule, the specific risk-weights are based primarily upon the 300 basis point interest rate shock used to prepare for a worst-case scenario of interest rate fluctuation. This means the NCUA has selected the increments for the investment weight scale to match the loss that would take place due to a 300 basis point interest rate shock. NAFCU believes that this methodology is flawed and does not result in the appropriate risk-weights for investments.

NAFCU strongly believes that NCUA should stay within their statutory mandate and use the 20 percent FDIC risk-weights for investments regardless of WAL, as illustrated in the next chart.

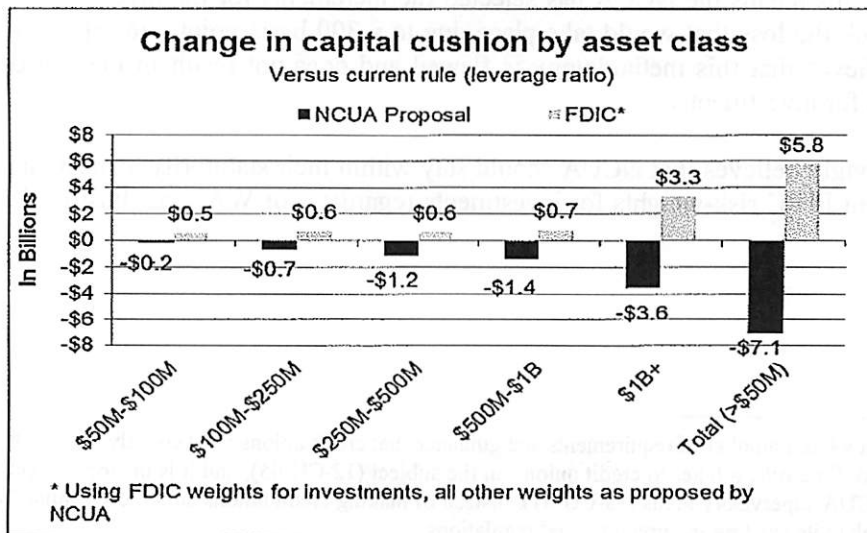
³⁴ NCUA already has a number of requirements and guidance that credit unions must comply with such as the interest-rate risk final rule, a letter to credit unions on the subject (12-CU-05), and it is the top subject in the most recent NCUA supervisory focus (13-CU-01). Instead of making credit unions hold more capital, NCUA should first look to its existing requirements and regulations.

Investments By WAL	NCUA Proposed Risk-Weights	FDIC Risk-Weights
0-1 year	20 percent	20 percent
1-3 years	50 percent	20 percent
3-5 years	75 percent	20 percent
5-10 years	150 percent	20 percent
>10 years	200 percent	20 percent

NCUA should also be mindful of the cooling effects of the final rule on short- and medium-term investments. The chart below shows the distribution of total credit union investments by maturity bucket. Note that only about 13 percent of credit union investments have an average life of over five years.

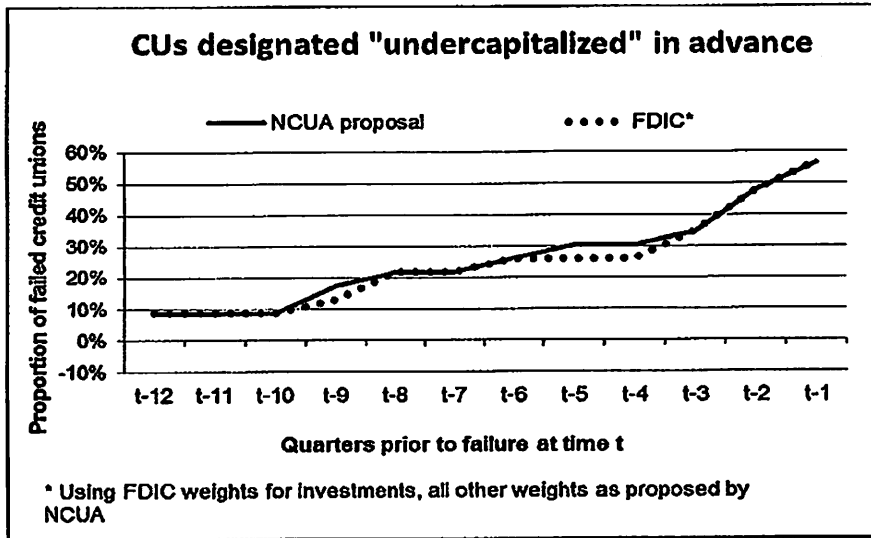


The FDIC risk-weights would benefit the capital cushion for credit unions at every asset level size as compared to the proposed rule. This is illustrated in the next graph.



Changing the risk-weighting to the FDIC risk-weights does not significantly affect the warning available prior to a failure of a troubled credit union. The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as "undercapitalized" prior to failure based upon NCUA's proposed rule and the FDIC risk-weights. This proportion is tracked over the twelve quarters prior to a credit union's failure, serving as an early warning sign to NCUA that capital issues were on the horizon.

As the graph on the next page shows, using the FDIC risk-weights for investments would result in negligible changes in the early warning signs for troubled credit unions as compared to the proposed rule. As illustrated, the alternative investment risk-weights deviate only slightly in the t-6 through t-3 and t-10 through t-8 timeframes prior to failure.



To summarize, NAFCU strongly urges NCUA to remove the interest rate risk component from any final rule. Interest rate risk should continue to be controlled for and monitored through the supervision and examination process, continuing to incorporate industry standard methods. Finally, NCUA should use the FDIC risk-weights of 20 percent for investments regardless of the WAL of the investment.

Federal Reserve Deposits

The proposed rule does not specifically identify how cash held at the Federal Reserve is to be treated. The rule does address how cash on deposit (which is normally interpreted as cash on deposit at other insured financial institutions), cash equivalents, and cash on hand are to be treated, but does not propose a specific risk-weight for cash held at the Federal Reserve. Credit unions often have balances at the Federal Reserve as a repository for excess cash or to satisfy their minimum reserve requirement.

NAFCU believes that cash held at the Federal Reserve should have a risk-weight of zero percent. A zero percent risk-weight would take into account the Federal Reserve's unique relationship with the U.S. Government. NCUA should risk-weight all balances held at the Federal Reserve at zero percent.

Federal Home Loan Banks

The proposed rule also does not specifically address Federal Home Loan Banks (FHLB). NAFCU believes that the proposed rule could risk-rate FHLB consolidated obligations and stock from 20 percent to 200 percent creating a distinct disadvantage when compared to other insured depository institutions and potentially restricting credit extensions to the communities served by credit unions.

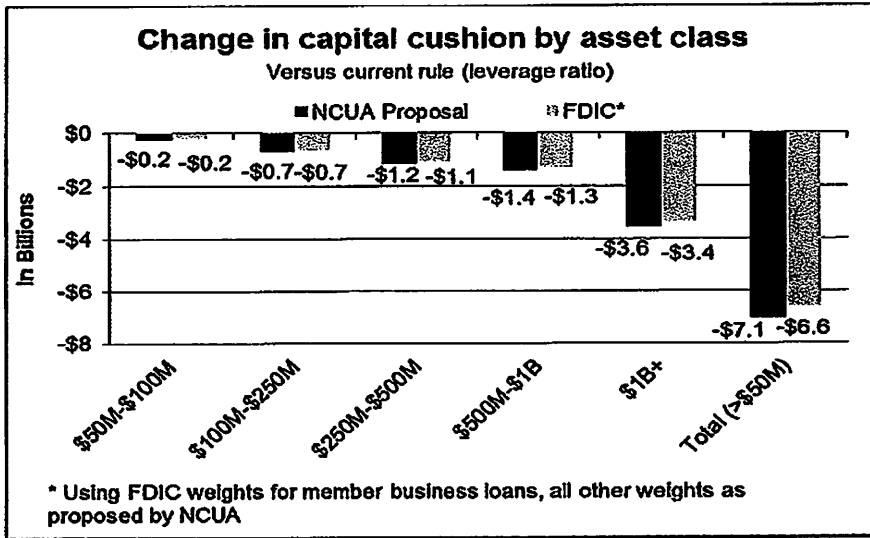
NAFCU notes that the risk weighting for FHLB consolidated obligations (highly liquid and safe – generally rated AAA and track treasuries) and FHLB stock (statutorily mandated to be redeemed at par and no member has ever lost a cent on stock) are weighted at 20 percent under Basel and by the other banking regulators. NCUA should weight FHLB consolidated obligations and stock at 20 percent to be comparable to other banking regulators.

Member Business Lending

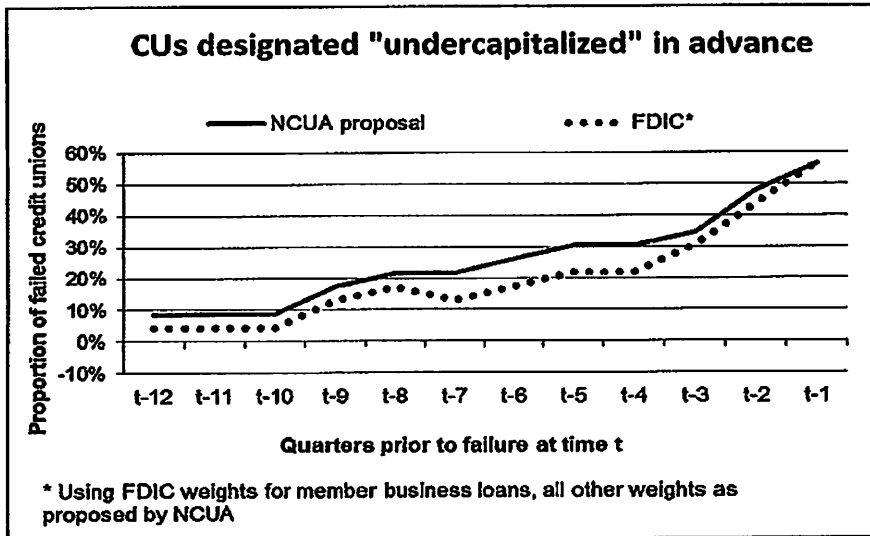
The proposed rule factors concentration risk into the proposed risk-weighting for MBLs by setting the risk-weights to correspond with the percent of assets in MBLs held by the credit union. As mentioned above, NAFCU believes that concentration risk should be controlled through the supervision and examination process and not a one-size-fits-all capital regime that requires credit unions to hold more capital without allowing those credit unions with less risk to hold less capital. The FDIC does not take concentration risk into consideration and risk-weights all business loans at 100 percent. NAFCU believes that NCUA should follow the FDIC and risk-weight MBLs at 100 percent regardless of the concentration of credit union's assets in MBLs as seen in the chart below.

MBL's as % of CU Assets	NCUA Proposed Risk-Weights	FDIC Risk-Weights
0-15% percent of assets	100 percent	100 percent
>15 to 25% of assets	150 percent	100 percent
>25% of assets	200 percent	100 percent

The next chart shows that the capital cushion for credit unions would still shrink from current levels using the FDIC weights for MBLs, but the impact would not be as severe as it would be under the NCUA proposal. The FDIC weights would result in a benefit to the capital cushion for credit unions at every asset level size above \$250 million as compared to the proposed rule as seen in the next graph.



The next chart uses NCUA call report data to determine the proportion of credit unions that would have been designated as “undercapitalized” prior to failure based upon NCUA’s proposed rule and the FDIC risk-weights for MBLs. This proportion is tracked over the twelve quarters prior to a credit union’s failure. The chart indicates that there is very little difference between when the NCUA or FDIC weights would have designated a credit union as “undercapitalized” prior to its failure. This is significant because it means that changing the risk-weighting to the FDIC risk-weights for MBLs will only slightly change the early warning system indications for troubled credit unions as compared with NCUA’s proposed rule.



Furthermore, there are a number of credit unions chartered historically for business-loan purposes that will be significantly hurt by this proposed rule. The risks to the portfolios of these special credit unions, including concentration risk, should be managed through the examination and supervision process, not through these capital risk-weights. NAFCU

believes that credit unions with proven minimal losses in business lending should be given credit for diversified portfolios and proven underwriting standards. Additionally, the proposed risk-weights would negatively impact credit unions with the low income credit union designation (LICUs), which are not subject to the statutory MBL cap. These LICUs would have a disincentive to utilize their ability to exceed the MBL cap in order to provide business loans to their members due to the restrictive requirements to hold more capital.

The proposed rule states that "MBLs that are government guaranteed at least 75 percent, normally by the Small Business Administration (SBA) or U.S. Department of Agriculture, would receive a lower risk-weight of 20 percent under the proposed rule."³⁵ This 75 percent threshold does not include beneficial programs that are guaranteed at between 50 percent and 75 percent such as the SBA Express program which helps many member small businesses. NCUA should factor in all guarantees made by the SBA or U.S. Department of Agriculture when determining risk-weighting for MBLs.

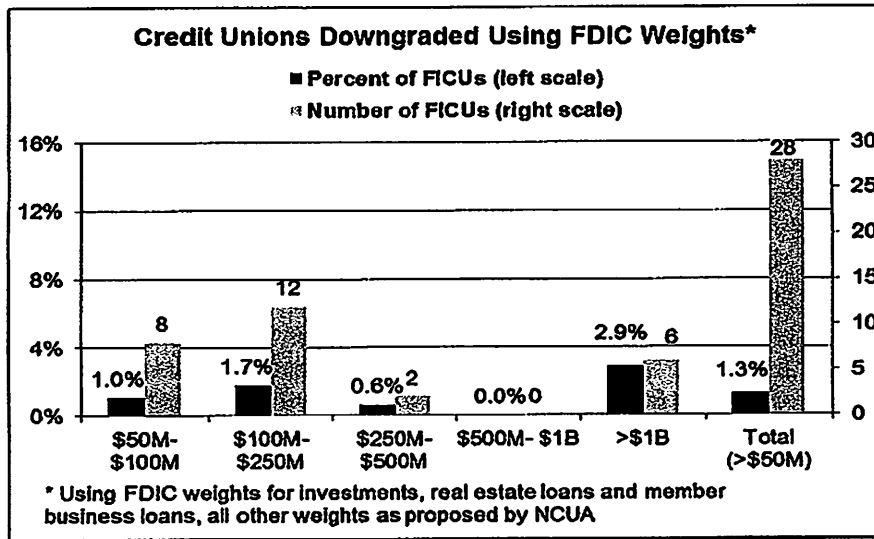
Another issue that NCUA has failed to address with this proposed rule is the difference risks based on the types of MBL loans by category. For example, risk-weights could also be broken down into types of loans using call report data and given appropriate risk-weights based on actual risk for the following categories: (1) agricultural MBLs; (2) construction and development; (3) non-farm, non-residential; (4) commercial and industrial loans; and (5) unsecured business loans. At this time the call report does not collect information on write-offs for different types of MBLs, but NCUA could modify the call report to collect this information.

The Effects of Combined FDIC Weights

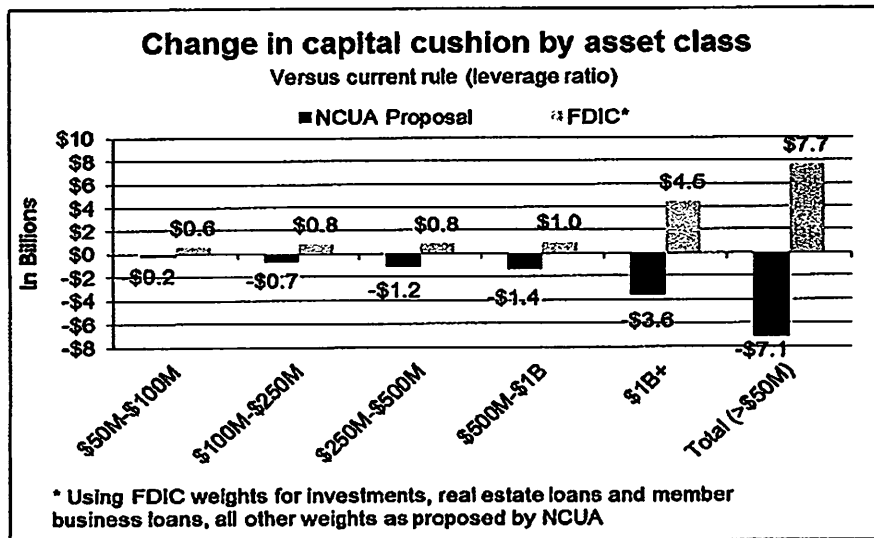
As shown in the sections above, NAFCU believes that NCUA should use the FDIC risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs rather than the NCUA's proposed risk-weights that incorporate interest rate and concentration risk. While previous graphs show the industry wide benefits to credit unions of changing the individual risk-weights from what was proposed by the NCUA to the FDIC risk-weights, the following graphs show the *combined* benefit of changing the proposed risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs to FDIC risk-weights.

This first graph shows the number and percent of credit unions that will be downgraded by asset class as a result of changing non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs to FDIC risk-weights. 28 federally insured credit unions will be downgraded as opposed to more than 200 which would be downgraded under the proposed rule. NAFCU believes that this is a more appropriate result and represents a more balanced system.

³⁵ Prompt Corrective Action - Risk-Based Capital, 79 Fed. Reg. 11184, 11196.

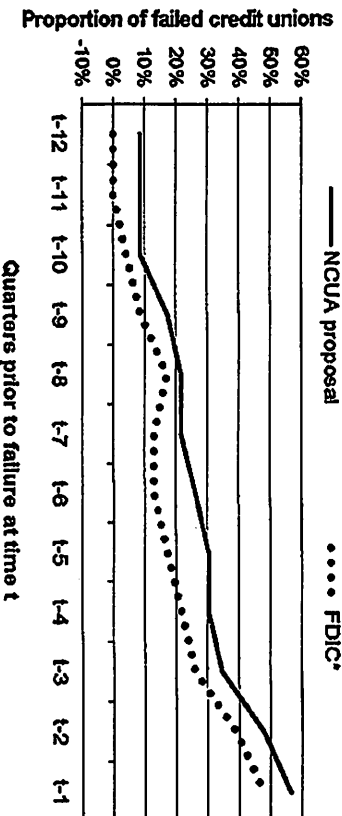


The next graph shows the change in capital cushion by asset class as a result of changing the individual risk-weights from what was proposed to the FDIC risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs. It shows a benefit to credit unions capital cushion for credit unions in every asset category as compared to the proposed rule.



The chart below uses NCUA call report data to determine the proportion of credit unions that would have been designated as “undercapitalized” prior to failure based upon NCUA’s proposed rule and the FDIC risk-weights for non-delinquent first mortgage real estate loans, other real estate loans, investments, and MBLs. This proportion is tracked over the twelve quarters prior to a credit union’s failure. The chart indicates that there is very little difference between when the NCUA or FDIC weights would have designated a credit union as “undercapitalized” prior to its failure.

CUs designated "undercapitalized" in advance



* Using FDIC weights for investments, real estate loans and member business loans, all other weights as proposed by NCUA

Importantly, changing the risk-weighting for these assets to the FDIC risk-weights does not compromise the NCUA's stated intent for the proposed rule to serve as an early warning system for troubled credit unions. Using the FDIC risk-weights will still accomplish this essential function of a balanced risk-based capital system. NAFCU strongly believes that NCUA should align the risk-weights for these assets with the FDIC risk-weights.

Credit Union Service Organizations (CUSOs)

The proposed rule sets a 250 percent risk-weight for investments in CUSOs and 100 percent for loans to a CUSO. In the proposed rule, NCUA does not include rationale as to why investments in CUSOs should get a proposed risk-weight of 250 percent except to say that a CUSO is an unsecured equity investment with no secondary market. Any final rule should include more detailed rationale, as well as any data used to support the final risk-weight.

The proposed rule also fails to explain the difference in proposed risk-weights between the 250 percent for investments in CUSOs and 100 percent for loans to CUSOs. This would suggest that loans to CUSOs are 2.5 times safer than investments in CUSOs, or in the reverse, that investments in CUSOs are 2.5 times riskier than a loan to a CUSO. Consumer debt that is over sixty days delinquent is currently rated at 150 percent while investments in a CUSO are rated at 250 percent.

Although there have been a couple of high-profile credit union losses partially driven by bad CUSO investments, the overwhelming majority of CUSOs are performing very well, generating considerable savings through economies of scale, and providing much needed non-interest income to the credit union owners. During a time of increased regulatory costs, shrinking fee income, and artificially depressed interest rates, it is imperative that credit unions are able to use CUSOs to decrease overhead costs while increasing business.

NCUA's argument that CUSOs represent a safety and soundness threat to the NCUA is also without merit. Less than 22 basis points of credit union assets are invested in CUSOs

and do not represent a systematic risk that could take down the share insurance fund. Those same 22 basis points are less than what credit unions have paid in annual corporate assessments in 2012. Each credit union may only invest less than 1 percent of its assets into CUSOs.³⁶ For example, suppose that in an unlikely scenario a credit union lost its entire investment in a CUSO. This loss alone would not be material and the consequences of requiring a disproportionate amount of capital, as compared with actual risk, are more far reaching as credit unions will not enjoy those cost savings made available only through the collaborative model of CUSOs.

NCUA is making policy decisions that affect business decisions for credit unions through these proposed risk-weights. This proposed rule could force credit unions to reconsider current and future investments in CUSOs. Credit unions might divest currently held investments and not invest in future CUSOs. This will hurt members and credit unions alike.

If NCUA declines to lower the risk-weighting to a reasonable level for investments in CUSOs, NCUA should at least consider differentiating between different types of CUSOs and assessing a risk-weight that accurately measures the risk of loss. Some of the possible factors to consider would be the types of services provided by a given CUSO (mortgage servicing, IT, compliance, etc.), whether the amount of investment is material, whether the CUSO has a history of profitability or loss, or whether the investment has already been recovered by the credit union through income or savings. Then NCUA could provide lower risk weights for CUSOs that present less of a risk to credit union assets.

Mortgage Servicing Assets (MSA)

The proposed rule would set the risk-weight at 250 percent for mortgage servicing assets (MSAs). This is an artificially high and excessive risk-weight relative to the actual risk presented by the underlying assets. The 250 percent weight is punitive and indicates a change in NCUA's view regarding loan participations.

Last year NCUA finalized a rule on loan participations that was intended to help credit unions and NCUA better manage the potential concentration risk in loan participations. The loan participation rule is working and should be allowed to continue to do so instead of assigning artificially higher risk-weights for mortgage servicing assets.

The proposed rule does not include a mechanism for NCUA to differentiate between an asset that is sold with recourse versus one that is sold without recourse. This would change the actual risk to a credit union depending on the underlying loans in a mortgage servicing asset. This one-size fits all approach does not appropriately measure actual risk.

MSAs are fairly liquid and gain value as rates rise. These present excellent opportunities to gain income and help prevent against some forms of interest rate risk. Also, credit unions do a great job servicing loans and want to continue to serve members. Many credit unions originate loans and then sell those loans to reduce interest rate and liquidity risk, yet retain

³⁶ 12 CFR 712.2(a).

the servicing due to the relationship with the member and because these are valuable assets. This arbitrary risk-weight provides a disincentive to retain those servicing rights.

NAFCU believes that NCUA should set the risk-weights for mortgage servicing assets at 150 percent. NCUA should also find a way to consider whether the loan is a recourse loan and assign those a 150 percent risk-weight. NCUA could then allow a lower weighting of 100 percent if the loans are sold without recourse but are serviced by the credit union.

Corporates Paid-In Capital

The proposed rule would set a risk-weight for paid-in corporate capital at 200 percent. This is one of the higher risk-weights proposed by this rule and does not appear to accurately represent the unique nature of corporate credit unions.

The corporate credit unions have had more regulatory changes over the past five years than any other sector of the credit union system including additional capital requirements. These changes include: stricter investment limits, concentration risk prohibitions, and governance changes. These prior regulatory changes to the corporate credit union system and the eliminated risks should be represented through a lower risk-weight.

The proposed risk-weight does not reflect the actual risk of this asset. The proposed rule suggests that corporate paid-in capital is two times as risky as a dollar invested in a mortgage loan in excess of 35 percent of assets. This could also serve as a disincentive to credit unions to invest in corporate credit unions and thereby endanger the current corporate credit union structure.

A weight that reflects the actual risk for paid-in capital to corporate credit unions would benefit natural person credit unions, corporate credit unions, and the share insurance fund. Paid-in capital would be more appropriately weighted at 125 percent to recognize that the corporate credit union structure is different than it once was, and now presents less risk to the credit union system. The 125 percent also recognizes that the corporates paid-in capital is riskier than safer investments such as treasuries or consumer loans.

Individual Minimum Capital Requirements

The proposed rule provides NCUA with the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where the Agency determines the circumstances, such as the level of risk of a particular investment portfolio, the risk management systems, or other information, indicate that a higher minimum risk-based capital requirement is appropriate. This means NCUA may establish increased individual minimum capital requirements upon its determination that the credit union's capital is, or may become, inadequate in light of the credit union's circumstances, regardless of the actual risk-based capital ratio of the credit union.

In other words, NCUA can increase a credit union's individual risk-based capital requirement by subjective action through the examination process or "supervisory assessment" based on the determination that the credit union needs additional capital based

on the credit union's balance sheet risk. A survey of NAFCU's membership taken in April 2014 found that over 65 percent of respondents have serious concerns about this portion of the rule.

NAFCU believes there are serious concerns regarding the legal authority of NCUA to enact this portion of the rule, as discussed above.

In addition to potential legal issues, this portion of the proposal seems to undermine the stated purpose of the rule. On the one hand, credit unions are led to believe that the proposal is designed to factor in a number of different risks including interest rate and concentration risk. On the other hand, if the risk-based capital ratios laid out in the proposal do not result in the numbers NCUA examiners would like to see, NCUA can change the rules for an individual credit union. This makes it nearly impossible for a credit union to make a sound business decision concerning its portfolio makeup, leading to even more uncertainty for credit unions and credit union members.

Individual Minimum Capital Requirement Appeals Process

The proposed appeals process does not alleviate any of the underlying concerns with the individual minimum capital requirements portion of the rule. The process itself lays a great deal of burden on individual credit unions to prove that the NCUA action was not an appropriate exercise of discretion by the Agency. The process also requires credit unions to appeal to the same NCUA Board that, according to statute, is required to make the judgment in the first place.

While the proposed rule allows credit unions to seek the opinion of the NCUA's Ombudsman, the NCUA Board is not bound by, or required to give deference to, the Ombudsman's recommendations. NAFCU believes that NCUA should enact an independent appeals process free of examiner retaliation. It is important that the independent appeals process include appeals to non-interested parties that do not have an opportunity to retaliate against individual credit unions that make appeals.

Goodwill and Other Issues

The proposed rule fails to include a number of components to the numerator portion of the risk-based capital ratio including goodwill, other intangible assets, and identified losses not reflected as adjustments to components of the risk-based numerator.

The loss of goodwill within the risk-based capital ratio numerator presents two significant issues to consider. First, it penalizes credit unions for past actions. Goodwill is present on the balance sheets of credit unions recently involved in mergers. Without goodwill, credit unions will be unable to fully realize the benefit of merging in troubled credit unions.

Secondly, this can present significant problems in the future. The credit union industry has seen increased consolidation in the past few years and this is a trend that is likely to continue. Without goodwill as a component of the numerator, a healthy credit union is less likely to agree to take on a troubled credit union as a partner (even at the request of

NCUA). This is going to make it harder and more expensive for NCUA (and the industry as a whole) to find merger partners for troubled or failing credit unions that will ultimately lead to more expensive liquidations for the NCUSIF.

NAFCU believes that NCUA should reconsider removing goodwill from the numerator portion of the risk-based capital ratio.

Allowance for Loan and Lease Losses

In the capital elements of the risk-based capital ratio numerator, the proposed rule limits ALLL to 1.25 percent of risk assets. The discussion in the rule states this limitation is proposed to provide an incentive for granting quality loans and recording loan losses timely. The disregard for excess ALLL does not provide an equitable solution.

Credit unions are generally more conservative than banks when it comes to ALLL. This cap of 1.25 percent will penalize a credit union for being conservative with its allowance and provide a disincentive for holding ALLL above the 1.25 percent cap.

NAFCU encourages NCUA to consider changing the 1.25 percent cap to 1.50 percent of risk assets to provide a better incentive for fully funding ALLL above 1.25 percent. In addition, in the most recent Financial Accounting Standards Board (FASB) proposal on ALLL (the Current Expected Credit Loss model), issued in December 2012, if put into place, has the potential to significantly increase ALLL reserves by as much as 20-50 percent. If those changes are put into place, NCUA should increase the limit of ALLL to be included in the risk-based capital numerator comparable to the additional levels of ALLL required.

Supplemental Capital

Supplemental capital authority is needed now more than ever considering the restrictions brought on by this rule. NCUA should continue to call on Congress to pass a legislative solution that modernizes capital standards to allow supplemental capital.

Currently, a credit union's net worth ratio is determined solely on the basis of retained earnings as a percentage of total assets. Because retained earnings often cannot keep pace with asset growth, otherwise healthy growth — such as growth resulting from taking deposits — can dilute a credit union's regulatory capital ratio and trigger non-discretionary supervisory actions under PCA rules. Allowing eligible credit unions access to supplemental capital, in addition to retained earning sources, will help ensure that healthy credit unions can achieve manageable asset growth and continue to serve member-owners efficiently.

While supplemental capital authority is important for those credit unions that are able to raise it, it is important to understand that supplemental capital authority is not the answer to all of the problems with this proposed rule. There is a difference between the authority to raise supplemental capital and the ability of individual credit unions to actually obtain it.

Not every credit union would be able to use that important tool to actually raise significant capital even if the credit union were given the authority to do so.

Implementation Date

NCUA has proposed an implementation time period and effective date of 18 months after the passage of a final rule and its publication in the *Federal Register*. During that 18 months implementation period, credit unions would need to prepare balance sheets for the new risk-based capital ratio requirements, and would also be required to continue to comply with the current PCA requirements of part 702 on NCUA's rules and regulations.

NAFCU believes that the proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule. The proposed revisions to net-worth and capital requirements will vastly affect a credit union's decision making and it will take time for a credit union to adjust its balance sheets related to this new regulation. Credit unions will also need to adjust internal systems and operations well in advance of the effective date.

Credit unions will be faced with difficult decisions when attempting to raise risk-based capital ratios under the proposed rule. Credit unions will have to either divest assets that are more heavily risk weighted or generate retained earnings. It is difficult to generate retained earnings in a short period of time when credit unions are being forced to divest the assets that have the largest returns and produce the most retained earnings.

When comparing NCUA's proposed timeframe and the time frame afforded to banks during the implementation of BASEL standards, it is evident that the proposed implementation timeframe is insufficient. Given the difficulties that credit unions will face to accumulate additional capital through retained earnings, a longer time frame for the implementation of this rule is necessary.

NAFCU believes any implementation period should be no less than three years after passage of any final rule. Credit unions will need at least that long to make safe and sound decisions about potentially fundamental changes to core business decisions including investments and product offerings. This would also be more consistent with the time frame given to the banking industry during the BASEL standards implementation. On September 10, 2013, the FDIC issued a consolidated interim final rule (Basel III interim final rule) and its final rule was issued on April 14, 2014. While some portions of the rule take effect as soon as two years after the final rule, all portions of the rule do not become fully effective until January 1, 2019, almost five years after the rule was finalized.

Conclusion

In conclusion, NAFCU is supportive of the idea of a risk-based capital regime for credit unions; however, the current NCUA proposal does not achieve the desired system and would ultimately harm credit unions. If it were to be implemented as proposed, credit unions would be at a significant competitive disadvantage to banks. As proposed, the rule is one-size-fits-all and would serve to stifle growth, innovation, and diversification at

credit unions. NAFCU hopes that the NCUA Board will ultimately withdraw the proposal and work with Congress to modernize capital standards in accordance with the recommendations in NAFCU's "Five Point Plan for Regulatory Relief"

Alternatively, should the NCUA Board fail to withdraw the proposal, it should remove the interest rate and concentration risk components that are currently incorporated into the risk weightings and lower the risk-weights to accurately reflect the risk associated with specific assets and to become comparable to the standards of other banking regulators. The NCUA Board should also remove the provision regarding individual capital requirements as this authority rests on questionable legal grounds and its inclusion increases uncertainty for credit unions.

Thank you for your continued commitment to listen to feedback from credit unions on this important issue. Should you have any questions or would like to discuss these issues further, please feel free to contact me or PJ Hoffman, Regulatory Affairs Counsel, at PJHoffman@nafcu.org or (703) 842-2212.

Sincerely,



B. Dan Berger
President and CEO
National Association of Federal Credit Unions

NAFCU Board of Directors:

Michael J. Parsons, Chairman
President/CEO
First Source FCU
Assets: \$371,264,380

Ed Templeton, Vice Chairman
President/CEO
SRP FCU
Assets: \$654,084,919

Richard L. Harris, Treasurer
President/CEO
Caltech Employees FCU
Assets: \$1,253,020,681

Jeanne Kucey, Secretary
President/CEO
JetStream Federal Credit Union
Assets: \$156,143,673

Martin Breland
President/CEO
Tower FCU
Assets: \$2,609,559,081

Rod Taylor
President/ CEO
Barksdale FCU
Assets: \$153,707,628

Cutler Dawson
Chairman, NAFCU Regulatory Committee
President/CEO
Navy FCU
Assets: \$55,502,976,265

Michael N. Lussier
NAFCU Regulatory Committee Member
President/CEO
Webster First FCU
Assets: \$646,079,823

Jan N. Roche
President/CEO
State Department FCU
Assets: \$1,520,520,032

Debra Schwartz
NAFCU Regulatory Committee Member
President/CEO
Mission FCU
Assets: \$2,449,729,632

Daniel Weickenand
NAFCU Regulatory Committee Member
CEO
Orion FCU
Assets: \$527,592,209

NAFCU Regulatory Committee Members:

Dan Berry
Chief Operating Officer
Duke University FCU
Assets: \$109,877,949

John Buckley
President/CEO
Gerber FCU
Assets: \$121,916,895

Joe Clark
Chief Legal Officer
Truliant FCU
Assets: \$1,667,349,920

Connie Dumond
Manager
Greater Woodlawn FCU
Assets: \$110,670,295

John Farmakides
President/CEO
Lafayette FCU
Assets: \$396,760,547

John Harwell
AVP Risk Management
Apple FCU
Assets: \$1,845,999,114

Mitchell Klein
Chief Risk Officer
Citadel FCU
Assets: \$1,880,414,011

Jim Laffoon
President/CEO
Security Service FCU
Assets: \$7,679,605,307

Janet Larson
Director
SunState FCU
Assets: \$297,621,812

Leanne McGuinness
SVP/CFO
The Summit FCU
Assets: \$719,691,062

Michael Pardon
President/CEO
Sea Air FCU
Assets: \$146,830,582

Jane Verret
Chief Administration
Campus FCU
Assets: \$509,914,856

Susan Lezotte
AVP Compliance
Eli Lilly FCU
Assets: \$1,033,855,869

Jim Mooney
President/CEO
Chevron FCU
Assets: \$2,352,852,646

Wayne Schulman
SVP, Corporate Counsel
Logix FCU
Assets: \$3,703,062,025

**Attachment B: XCEL FCU's comment letters on the NCUA's
Prompt Corrective Action/ Risk-Based Capital proposal**

From: Linda McFadden
To: Regulatory Comments
Cc: Nicola Foggie
Subject: Prompt Corrective Action, Risk-Based Capital
Date: Monday, May 26, 2014 4:59:24 PM

May 26, 2014

Dear Gerard Poliquin, Secretary of the Board,

This letter will address XCEL Federal Credit Union's viewpoint and concerns regarding the Risk Based Capital Proposed Rule.

XCEL FCU and the credit union industry remains a strong and viable in the aftermath of the recession. Even with the loss of some corporate credit unions, natural person credit unions took up the charge and relieved the stress that such economic times caused. With this information in mind, XCEL feels that this new proposal is not necessary and the NCUA has not adequately justified the need for this rule/change. Credit unions continue to be stronger, more self-reliant than other banking entities. So, why are we trying to fix/adjust what isn't broken.

Capital requirements should not be a substitute for proper credit union management or appropriate examinations. The proposal, as it is written, would negatively impact XCEL Federal Credit Union, taking us from a well-capitalized credit union to adequately-capitalized. Now is not the time to restrict credit union growth, which is the result, if this proposal goes forward. This proposal will restrict XCEL from implementing products and programs which are needed to compete in the financial industry. Reducing assets and cutting expenses to gain capital is not the solution for safety and soundness of the insurance fund. Running a fundamentally sound financial institution, while giving our members the best products and services and, the latest technology, is!

The proposed rule will force XCEL's board and management only to think of gathering more capital to protect the insurance fund instead of why we are in business to begin with. XCEL has had steady balanced growth with good solid returns over the past few years but to achieve the new capital requirements we would to change our business model from being a credit union for our members to a focus on profitability. We might as well become a bank. XCEL did our part for the corporate bailout so why does NCUA think it is necessary to make these restrictions. Why should we cut service to our members because the insurance fund, which weathered the economic stress of the recession, wants even more protection?

XCEL is all for safety and soundness but since the recession; NCUA has put additional restrictions on all credit unions with concentration limits and restrictions. XCEL gladly complied and developed a sound concentration risk policy and set limits on our already diversified loan and investment portfolio. This exercise only proved that our credit union was already well managing this portion of the business.

With the proposed regulation XCEL would need to curtail participation lending. Participation loans help to mitigate risk and ensures steady loan growth during non-peak member lending season. If the underwriting criteria are as or, in some cases even more conservative, why should we have to reserve more than is necessary just because it is participated out with other credit unions also regulated by NCUA.

If NCUA continues with this proposal, we would hope that for the industry's sake, the impact of the risk weights is well thought out before requiring any implementation. As an example, the proposed rule assigns rigid risk-weights to many federally backed investments that when properly examined represent much less risk with less return. This is taking caution to the extreme. Credit unions need to have someplace to put excess cash other than a liquid overnight account with little or no return for the investment. We could address many more of the individual risk weights but I feel the main point to make is as presented they are not in the best interest of the credit union industry and our members.

Last but not least is removing the 1% NCUSIF capital deposits out of the calculation. This is just wrong! Taking those funds out of the calculation will put undue pressure on many credit unions unjustifiably.

Sincerely,

Linda McFadden, President / CEO

XCEL Federal Credit Union

1460 Broad St.

Bloomfield, NJ 07003

Linda McFadden

XCEL Federal Credit Union

President / CEO

T: 800-284-8663 x3024

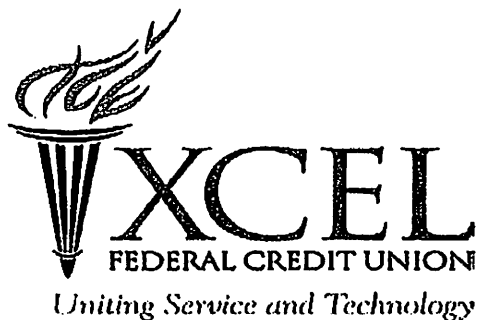
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F: 201-714-5736

LindaMcFadden@XCELfcu.org

www.XCELfcu.org

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1460 Broad Street, Bloomfield, NJ 07003

May 28, 2014

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

RE: Comments on NCUA Prompt Corrective Action –
Risk-Based Capital Proposed Rule

Dear Mr. Poliquin:

On behalf of the Board of Directors and Management Staff of XCEL Federal Credit Union (XCEL), I am writing to you regarding the proposed rule on Prompt Corrective Action and Risk-Based Capital (RBC). In reviewing the proposal, and the multiple comment letters from the Credit Union industry, we at XCEL are shaken at the potentially devastating effect this proposal will have on us, the credit union industry, the American consumer, and our nation's small businesses.

We ask you to strongly consider the comments posted by former Senator D'Amato and former Speaker Gingrich, when they point out that your proposal is contrary to the language and intent of the 1998 Revisions to the Federal Credit Union Act. Many other current and former legislators have expressed similar concerns to you, challenging the legality of your proposal.

XCEL concludes, as have others, that if your RBC proposal is implemented, it would put us at a significant competitive disadvantage to banks here in the Northeast. The rule is based on a poorly designed "one-size-fits-all" concept and would stifle our growth, potential innovation, and diversification. We ask the NCUA Board to withdraw the proposal or alternatively make major modifications to the proposal before any rule is finalized.

The proposal's RBC ratio for well capitalized credit unions is set at 10.5 percent. This increase to current PCA limits of 7.0 percent cannot be supported by the arbitrarily weight limits assigned to concentration risk components. We urge that you lower the risk weights to more accurately reflect risks associated with our credit union's specific assets. We further urge NCUA to defer to the industry suggestion of a joint committee made up of NCUA and Credit Union leaders to review and create a more realistic threshold and rational for PCA.



1460 Broad Street, Bloomfield, NJ 07003

Under the proposed rule, XCEL will be faced with many difficult decisions when attempting to reach the RBC ratios stated. We face the possibility of having to divest ourselves of profitable assets that, under your rule, are more heavily risk weighted in order to generate higher retained earnings your proposal seeks from us. We feel that in the current economic climate, this would be virtually impossible to accomplish and fulfill our mission of serving our members under the credit union model.

We hope you will consider our thoughts as you review and hopefully revise your RBC proposal.

Sincerely:

Daniel H. Moffit
CHAIRMAN, Board of Directors

XCEL Federal Credit Union Board of Directors:

VICE-CHAIRMAN
Joseph Tolciss

TREASURER
Salvador Schiano

SECRETARY
Richard Masella

DIRECTORS
Gennaro Aprile
Phyllis Ford
Jerome Lafragola

Stacey Walker
Jerome Lafragola

Donald Monah

DIRECTOR EMERITUS
Tom Doogan

Copy to:

B. Dan Berger
President and CEO
National Association of Credit Unions

Bill Chaney
President and CEO
Credit Union National Association

Attachment C: NAFCU's "Five Point Plan for Regulatory Relief"
released in February 2013

Learn How NAFCU's Five-Point Plan Will Bring Regulatory Relief to Credit Unions

In February 2013, NAFCU was the first trade association to call on this Congress to provide comprehensive broad-based regulatory relief for credit unions. As part of this effort, NAFCU sent Congress a five-point plan for regulatory relief that will significantly enhance credit unions' ability to create jobs, help the middle class, and boost our nation's struggling economy. The five-point plan is built on a solid framework of recommendations that provide regulatory relief through the following:

1. Administrative Improvements for the Powers of the NCUA

- › Allow a federal credit union to petition NCUA for a waiver of a federal rule in favor of a state rule.
- › Provide NCUA the authority to delay implementation of CFPB rules that affect credit unions and to tailor those rules for credit unions' unique structure.
- › Require a cost/benefit analysis of all rules that includes a three-year look back and reevaluation of rules that cost 20 percent or more than their original cost estimate.
- › Enact new examination fairness provisions to help ensure timeliness, clear guidance and an independent appeal process free of examiner retaliation.
- › Improve the Central Liquidity Facility by removing the subscription requirement for membership and permanently removing the borrowing cap.

2. Capital Reforms for Credit Unions

- › Direct NCUA and industry representatives to conduct a study on prompt corrective action and recommend changes.
- › Modernize capital standards by directing the NCUA Board to design a risk-based capital regime for credit unions that takes into account material risks and allows the NCUA Board to authorize supplemental capital.
- › Establish special capital requirements for newly chartered federal credit unions that recognize the unique nature and challenges of starting a new credit union.

3. Structural Improvements for Credit Unions

- › Direct NCUA, with industry input, to conduct a study of outdated corporate governance provisions in the Federal Credit Union Act and make recommended changes to Congress.
- › Improve the process for expanding a federal credit union's field of membership by allowing voluntary mergers among multiple common bond credit unions, easing the community charter conversion process and making it easier to include those designated as "underserved" within a credit union's field of membership.



4. Operational Improvements for Credit Unions

- › Raise the arbitrary cap on member business loans to 27.5% or raise the exemption on MBL loans from \$50,000 to \$250,000, adjusted for inflation, and exempt loans made to non-profit religious organizations, businesses with fewer than 20 employees and businesses in “underserved areas.”
- › Remove requirements to mail redundant and unnecessary privacy notices on an annual basis, if the policy has not changed and new sharing has not begun since the last distribution of the notice.
- › Allow credit unions greater authority and flexibility in how they invest.
- › Provide NCUA the authority to establish longer maturities for certain credit union loans and greater flexibility in responding to market conditions.
- › Provide federal share insurance coverage for Interest on Lawyers Trust Accounts (IOLTAs).

5. 21st Century Data Security Standards

- › Establish national standards for safekeeping of all financial information.
- › Establish enforcement standards for data security that prohibit merchants from retaining financial data, and require merchants to disclose their data security policies to customers.
- › Hold merchants accountable for the costs of a data breach, especially when it was due to their own negligence; shift the burden of proof in data breach cases to the party that incurred a breach and require timely disclosures in the event of a breach.

For more information, visit www.nafcu.org/regrelief.



**Attachment D: NAFCU's "Dirty Dozen" – Twelve Regulations to
Eliminate or Amend**

NAFCU's "Dirty Dozen" - Twelve Regulations to Eliminate or Amend

- 1. Expand credit union investment authority** to include permissible investments in derivatives, securitization and mortgage servicing rights. NAFCU strongly pushed for the expansion of credit unions' investment authority to include the ability to engage in limited derivatives activities. NAFCU will continue to seek this authority for qualified credit unions. In addition, NAFCU will push for the authority to securitize loans and expanded ability to invest in mortgage servicing rights.
- 2. Seek updates and modernization of the NCUA's fixed assets rule.** In particular, the NCUA should: (1) increase the current 5 percent aggregate limit; (2) re-define what constitutes "fixed assets"; and, (3) improve the process of obtaining a waiver.
- 3. Improve the process for credit unions seeking changes to their field of membership.** Improvements should include: (1) enabling credit unions to strengthen their associational membership charter; (2) streamlining the process for converting from one charter type to another; (3) remove or greatly increase the current population limits for serving members in a metropolitan area (1 million) and contiguous political jurisdictions (500,000); and, (4) making it easier for all credit unions to add "underserved" areas within their field of membership.
- 4. Increase the number of transfers allowed to be made per month from savings accounts.** The restriction on "convenience transfers" under Regulation D presents an ongoing concern for NAFCU and its members. Members are often unable to understand and remember the arbitrary limits on the number and types of transfers the regulations permit them to make from their savings account. Members expect to have the ability to transfer their funds with ease to and from particular accounts, and the regulation's six-transfer limitation from savings accounts creates an undue burden for both members and credit unions. This six-transfer limitation should be updated and increased to at least nine transfers per month, while still making a distinction between savings and transaction accounts.
- 5. Seek added flexibility for credit unions that offer member business loans.** These improvements could include: (1) securing credit union-friendly changes to the waiver process; (2) increasing the general minimum loan-to-value ratio from 80% to 85%; and, (3) securing removal of the 5 year relationship requirement.
- 6. Update the requirement to disclose account numbers to protect the privacy of members.** Credit unions are currently required to list a member's full account number on every periodic statement sent to the member for their share accounts pursuant to Regulation E. These requirements need to be updated to allow the credit union to truncate account numbers on periodic statements in order to protect the privacy of the member and to reduce the risks of fraud and identity theft.
- 7. Update advertising requirements for loan products and share accounts.** The regulatory requirements for advertisement of credit unions' loan products and share accounts have not kept pace with technological changes in the current market place. The requirements of Regulation Z and Truth in Savings should be updated to reflect these changes and advances in practical advertisements and the disbursement of information, while maintaining the integrity and accuracy of the information that the member truly needs to know from the advertisement.
- 8. Modernize NCUA advertising requirements to keep up with technological changes and an increasingly mobile membership.** Update NCUA regulations to clarify that the official sign is not required to be displayed on (1) mobile applications, (2) social media, and (3) virtual tellers.



- 9. Seek Improvements to the Central Liquidity Facility** by reducing the amount of time that it takes for a credit union to secure access to liquidity. In addition, work with the NCUA to secure changes the Central Liquidity Facility by removing the subscription requirement for membership and permanently removing the borrowing cap.
- 10. Obtain flexibility for federal credit unions to determine their choice of law.** Federal credit unions should be allowed the opportunity to choose the jurisdiction under which they operate without surrendering their federal charter. To this end, NAFCU will work with the NCUA to establish a waiver process under which a federal credit union, taking into account safety and soundness considerations, would choose the state law under which it wants one or more of its operations.
- 11. Update, simplify and make improvements to regulations governing check processing and funds availability.** These enhancements should include: changing outdated references (i.e., references to non-local checks); changes that are required by statute and are already effective and incorrectly stated in the regulation; and changes that enable credit unions to address fraud.
- 12. Eliminate redundant NCUA requirements to provide copies of appraisals upon request.** Credit unions are required to provide copies of appraisals under the CFPB's final mortgage rules upon receipt of an application for certain mortgages. The NCUA's requirements to provide a copy upon request should be amended to remove this duplicative requirement.

