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National Association of Federally-Insured Credit Unions

September 22, 2020

The Honorable Rodney E. Hood, Chairman
The Honorable Todd M. Harper, Board Member
The Honorable J. Mark McWatters, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Share Insurance Fund and Credit Union Investment Authorities

Dear Chairman Hood and Board Members Harper and McWatters:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), we are writing to express our views regarding the National Credit Union Share Insurance Fund (SIF) in response to the Share Insurance Fund Quarterly Report presented at the most recent NCUA Board meeting. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve nearly 121 million consumers with personal and small business financial service products. NAFCU supports a strong SIF and appreciates the updates on the status of the equity ratio as the COVID-19 pandemic continues. NAFCU would oppose any SIF premium that is largely intended to remedy the temporary effects of increased share growth during the COVID-19 pandemic. In lieu of imposing a premium, NAFCU supports the NCUA adopting or support relief measures to provide credit unions with more options to manage the large influx of deposits, including additional temporary investment authorities.

Credit Union Investment Authorities

NAFCU believes the NCUA should consider approving potential tools for credit unions to manage the recent influx of deposits that precipitated the decline in the equity ratio. One such tool would be additional investment authorities under Part 703 of the NCUA's regulations, even if those authorities are on a temporary basis until the impacts of the COVID-19 pandemic subside. For example, currently natural person credit unions are not permitted to invest in asset-backed securities although credit union service organizations are permitted to do so under Part 704. Similarly, federal credit unions are not explicitly permitted to invest in corporate bonds although some state laws permit state-chartered credit unions to do so. NAFCU encourages the NCUA to evaluate its authority under the FCU Act to permit such investments on a temporary basis to ensure the safety and soundness of the industry while helping to restore the equity ratio without more drastic measures such as assessing a premium.

Although the FCU Act may not explicitly permit investments such as the examples listed above, the NCUA may determine that certain types of investments are incidental to a federal credit union's exercise of its express authorities. Section 107(17) of the FCU Act indicates that federal credit unions may "exercise such incidental powers as shall be necessary or requisite to enable it to carry on effectively the business for which it is incorporated." Part 721 of the NCUA's regulations establishes a three-prong test for determining whether an activity can be defined as an "incidental power." Under Section 721.2, an "incidental power" includes an activity that: (1) is convenient or useful in carrying out the mission or business of credit unions consistent with the [FCU Act]; (2) is the functional equivalent or logical outgrowth of activities that are part of the mission or business of credit unions; and (3) involves risks similar in nature to those already assumed as part of the business of credit unions. The examples described above all easily meet the three prongs of this test.

Considering the current economic circumstances, the NCUA should determine that a credit union may temporarily engage in additional investments that share a rational nexus to those explicitly outlined in the FCU Act, do not pose more risk than those activities explicitly authorized by the FCU Act, and are essential to carrying on the credit union's operations. This would ensure that credit unions and their members are well-positioned to endure the difficulties of this unprecedented time. Such additional authority should apply in instances where a credit union has exhausted all available investment options explicitly listed in the FCU Act and is looking for opportunities to not only preserve its own net worth ratio but also preserve the equity ratio of the SIF. NAFCU urges the NCUA to take immediate action in providing such relief with respect to investment authorities so that credit unions are better able to weather this economic downturn.

Management of the Share Insurance Fund

At the agency's September Board meeting, staff presented the SIF's second quarter financial summary. It was revealed that the equity ratio fell 13 basis points since the prior year end, from 1.35 percent to 1.22 percent. Staff emphasized that this drop was due to extraordinary share growth related to the COVID-19 crisis. Once insured credit unions' capitalization deposit accounts are trued up, the agency expects the associated collections to result in an increase in the equity ratio back to 1.33 percent.

During the meeting, the presentation of the SIF's financial condition was followed by the discussion of several related topics. First, it was noted that the Federal Deposit Insurance Corporation (FDIC) enacted a restoration plan[1] for the Deposit Insurance Fund (DIF) earlier that same week due to related stresses in the DIF which resulted in the fund's reserve ratio falling five basis points below the statutory minimum. Second, there was some discussion of the possibility of a premium assessment either in 2020 or 2021. This was generally discussed in hypotheticals and with nods to the uncertainty of projecting the future path of the equity ratio. Finally, there were discussions of structural differences between the SIF and the DIF and whether the agency should

[1] Notice of Establishment of Restoration Plan, Federal Deposit Insurance Corporation (Sep. 15, 2020)

pursue changes in the FCU Act to expand agency authorities over the SIF in line with those that the FDIC currently has.

Regarding a potential premium, NAFCU believes that the NCUA should refrain from any assessments in 2020, so long as the outlook for potential losses does not severely deteriorate through the end of the year. While the FDIC did enact a restoration plan for the DIF as was required by statute, the plan made no changes to the assessment schedule. The plan itself states that "it is the FDIC's view that raising assessments based on two quarters of extraordinary insured deposit growth would be premature." The plan goes on to outline a path back to the statutory minimum reserve ratio over the entire allowable eight-year span. As the NCUA considers whether to charge a premium, either in 2020 or beyond, we urge the NCUA to adopt an approach which recognizes the root cause of the decline in the equity ratio. A decline which results from uniquely high share growth is fundamentally different from one which results from higher losses or reserve expenses. Furthermore, when determining the necessity and size of a premium, the agency should do so with the full eight-year restoration horizon in view. Such an approach is consistent with other insurers and with the FCU Act.

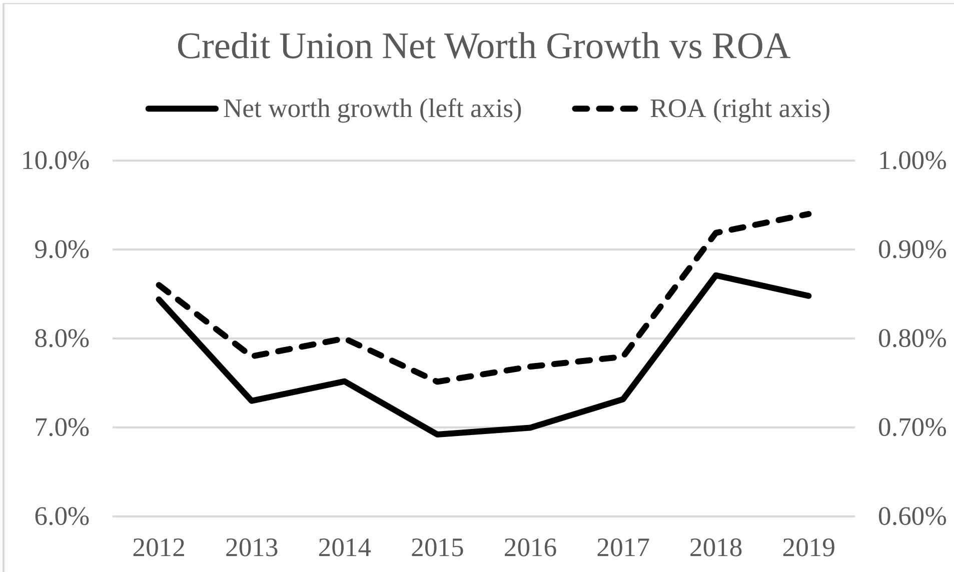
The September NCUA board meeting also included discussion of expanding the authorities of the NCUA to manage the SIF. Some of the parameters that have in the past been identified by agency officials as constraining the Board's ability to manage the SIF include the prohibition of any premium assessments when the equity ratio exceeds 1.3 percent and the 1.5 percent upper bound on the normal operating level (NOL). Changing these thresholds would require legislative action, as they are codified in the FCU Act.

NAFCU is opposed to these specific changes based on the SIF's historical record. Moderate recessions have not precipitated large premium assessments in the past. At the time that the Temporary Corporate Credit Union Stabilization Fund (TCCUSF) was merged with the SIF, the NCUA set the NOL at 1.39 percent.[2] This level was determined to be one that would "withstand a moderate recession without the equity ratio falling below the statutory minimum of 1.20 percent." The increase in the NOL was a departure from historical norms, as it had never before exceeded 1.3 percent. If the NCUA nevertheless believes that more authorities are needed to manage the fund to withstand the impact of a moderate recession, or if a moderate recession is no longer the proper standard, NAFCU would appreciate the opportunity for public comment or a hearing on this matter.

To the extent that the expansion of such authorities seems intended to increase SIF equity on average, a review of the TCCUSF merger is relevant. The nine-basis point increase in the NOL had the effect of increasing SIF equity by roughly $900 million. Nevertheless, the equity in the TCCUSF was of such a size that roughly $700 million was still returned to insured credit unions

[2] Closing the Temporary Corporate Credit Union Stabilization Fund and Setting the Share Insurance Fund Normal Operating Level, 82 FR 46298 (Oct. 4, 2017).

as a dividend. The chart below illustrates how those funds impacted industry return on average return on assets (ROA) and net worth.



The $700 million was distributed to credit unions in 2018, which coincides with a sharp increase in both ROA and net worth growth. This suggests that a substantial share of the distribution was retained as industry net worth. This dynamic is an important one to keep in mind as the NCUA considers pursuing changes which would have the effect of raising equity levels in the SIF, on average. As the agency pulls equity into the SIF, some part of that will necessarily represent a loss of net worth for the insured credit unions, mitigating the apparent increase in the industry's overall loss-absorbing capital.

NAFCU also believes that the agency should clarify how discretionary premium assessments interact with other goals the agency has stressed. It is likely the case that not all of the 2018 distribution to credit unions was converted into net worth. Some of that amount was most likely diverted to other productive purposes, such as investments in cybersecurity and financial technology. As the NCUA has acknowledged, cybersecurity is a particularly costly investment, but a critical one for the industry to undertake. In a recent NAFCU report, we provide survey data showing that as a percent of credit unions' operating budgets, cybersecurity expenditures have tripled over the last five years, from 2.5 percent to 7.5 percent; the disparity is even wider for small credit unions.[3]

Likewise, investments in financial technology can be quite expensive, but they are necessary to keep the industry competitive, to say nothing of the benefits to members and especially those in low-income communities. To the extent that the funds which were released from the SIF went toward things like cybersecurity and fintech, it may have actually enhanced the overall long-term

[3] NAFCU 2019 Report on Credit Unions

safety and soundness of the industry, versus the alternative of holding those funds in the SIF. NAFCU supports a strong SIF and it is prudent to discuss ways to further strengthen it, but that discussion should include a consideration of the effects that premium assessments have on the industry by soliciting stakeholder comments.

Conclusion

Thank you for your attention to this matter and we would be happy to discuss our thoughts on the Share Insurance Fund or on credit union investment authority with you in more detail. NAFCU supports a strong SIF and a strong credit union industry that is both robust to unforeseeable crises such as COVID-19 and positioned to thrive during the recovery, and we believe our positions are supportive of these goals. If you have any questions, please do not hesitate to contact Curtis Long, NAFCU's Chief Economist and Vice President of Research, at clong@nafcu.org or (703) 842-2276.

Sincerely,

Curtis Long

Curtis Long
Vice President of Research and Chief Economist