NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.842.2215 | 800.336.4644
f: 703.522.2734
dberger@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

March 27, 2019

The Honorable Rodney E. Hood
Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Dear Board Member Hood:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I would like to share with you the top priorities of our nation's credit unions as well as NAFCU's position on specific initiatives from the National Credit Union Administration (NCUA). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 116 million consumers with personal and small business financial service products. Credit unions of all sizes continue to face a variety of not only regulatory pressures but also competitive and economic pressures as technologies advance and marketplace preferences shift. In the attached documents, NAFCU outlines a series of principles identified by NAFCU's Board of Directors, comprised of credit union CEOs from across the nation, as the most pressing issues facing credit unions this year.

In the attachments you will also find a series of letters that NAFCU has written to the NCUA and other agencies detailing some of these priorities as they apply to areas including: (1) the current expected credit loss (CECL) standard; (2) federal credit union bylaws; (3) real estate appraisals; (4) the federal credit union loan interest rate ceiling; (5) the risk-based capital rule; (6) payday alternative loans; and (7) subordinated debt (alternative capital).

Again, congratulations on your confirmation as a Member of the NCUA Board. We look forward to discussing these and other important issues with you during your tenure at the agency. If I may be of assistance to you in any way, please do not hesitate to contact me directly.

Sincerely,

B. Dan Berger

NAFCU

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B. Dan Berger
President & Chief Executive Officer

National Association of Federally-Insured Credit Unions

January 9, 2019

The Honorable J. Mark McWatters, Chairman
The Honorable Rick Metsger, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Priorities of our Nation's Credit Unions

Dear Chairman McWatters and Board Member Metsger:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I would like to share with you the top priorities of our nation's credit unions. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 115 million consumers with personal and small business financial service products. Each year, the NAFCU Board, made up of credit union CEOs from across the nation, identifies the top issues in the upcoming year that impact credit unions.

Below, NAFCU outlines these general priorities, which touch upon both legislative and regulatory concerns, followed by a more detailed discussion of the priorities that specifically concern the National Credit Union Administration (NCUA). We hope that you will work with us to address these top legislative and regulatory issues for credit unions.

1. **Growth.** Support legislation and regulation that helps credit unions grow and better serve their membership.

2. **Strong NCUA.** Advocate for the NCUA to be the sole credit union regulator, including exempting credit unions from the Bureau of Consumer Financial Protection's (Bureau) authority.

3. **Regulatory Relief.** Fight for clear, streamlined regulations that allow credit unions to put more resources toward serving their members.

4. **Fair and Innovative Market.** Promote innovation, create national data security standards, and push back against big banks' baseless attacks on credit union growth.

5. **Promote Transparency.** Encourage government accountability, including reducing the NCUA's overall operating budget, establishing a commission at the Bureau and pushing for additional National Credit Union Share Insurance Fund (NCUSIF) distributions for credit unions.

6. **Tax Exemption.** Preserve the credit union tax exemption to save U.S. consumers $16 billion annually, protect nearly 1 million jobs and keep the focus on credit union members, not shareholders and profits.

NCUA-Specific Priorities

Field of Membership

Strengthening the federal charter and pursuing regulatory relief for federal credit unions is at the core of NAFCU's advocacy efforts. NAFCU fundamentally believes the industry's dual chartering system works best when the state and federal charters keep pace with each other. Several states, however, have been much more progressive in modernizing their field of membership (FOM) rules to recognize today's dynamic and ubiquitous marketplace. Additionally, NAFCU supports broader FOM relief, including: 1) eliminating or increasing the population limits applicable to community charter credit unions; 2) establishing a formal notification process for credit unions making FOM-related applications; and 3) considering new ways to efficiently address mergers. NAFCU is committed to supporting the NCUA as it works to modernize the FOM rules in order to help credit unions grow and better serve their communities.

Such support includes standing by the NCUA as the banking trade groups continue to challenge the legality of the agency's 2016 FOM rule and partially invalidated provisions aimed at granting community charters relief. NAFCU maintains that the NCUA's FOM reforms fall well within the bounds of its legal authority. NAFCU is committed to ensuring the swift and smooth implementation of the FOM rules and defending the interests of credit unions.

NAFCU is also committed to working with the NCUA and members of Congress to push for legislative improvements to sections of the *Federal Credit Union Act* (FCU Act) that restrict the ability of credit unions to serve their desired fields of membership, including allowing all credit unions to add underserved areas. NAFCU appreciates Chairman McWatters's support of such a legislative reform and is optimistic that Congress will make changes to help the credit union industry serve those Americans in need of access to financial services.

Capital/Risk-Based Capital Reform

NAFCU remains concerned about the impact the risk-based capital (RBC) rulemaking will have on the credit union industry, including regulatory burden and increased costs. Considering the changes to bank capital in the *Economic Growth, Regulatory Relief, and Consumer Protection Act* (S. 2155), from a parity perspective, the appropriate level of credit union capital requires further study. NAFCU appreciates the NCUA's recently finalized one-year delay of the implementation date and its fresh approach to the definition of "complex" credit union that would exclude more credit unions from the RBC rule; however, the NCUA should make further changes to its RBC rule. NAFCU opposes an approach to complexity that arbitrarily divides the industry based on an asset threshold in favor of a case-by-case determination of complexity and exemptions for those credit unions whose net worth ratios provide adequate protection from material risks, regardless

of their asset size. Therefore, NAFCU will continue to advocate for the NCUA to revise or withdraw the agency's RBC rule or for Congress to step in and delay the rule's effective date until 2021.

NAFCU will also continue to advocate for improved access to subordinated debt (formerly known as alternative capital), including both secondary capital and supplemental capital. NAFCU supports changes to the secondary capital plan approval process and a streamlined application to help low-income designated credit unions access capital faster. NAFCU also supports changes to the FCU Act that would permit credit unions to count certain forms of supplemental capital towards the net worth ratio calculation to alleviate current constraints on building net worth.

Current Expected Credit Losses (CECL)

In the NCUA's recently released 2019 Supervisory Priorities, credit unions are informed that examiners will inquire about efforts taken to prepare for the implementation of CECL. NAFCU still maintains that credit unions should never have been included within the scope of CECL because they did not engage in the poor lending practices that precipitated the financial crisis. Nevertheless, NAFCU greatly appreciates the NCUA's efforts to educate the industry about CECL. As the implementation date draws nearer, it has become apparent that more needs to be done. NAFCU remains focused on coordinating its efforts with those of the NCUA to provide credit unions with access to the resources they need to prepare for this comprehensive change to estimating allowances for credit losses. NAFCU will work with the NCUA to find ways to ensure that credit unions are not overly-burdened by CECL's impact on regulatory capital. NAFCU will also look for additional opportunities to partner with the NCUA to educate the industry about future implementation challenges.

Exam Fairness

NAFCU has consistently urged the NCUA to reduce examination burden by expanding eligibility for extended exam cycles to more credit unions and by conducting more efficient, virtual examinations. Although NAFCU is encouraged by the positive developments documented in the NCUA's 2019-2020 Budget Justification, recent outreach to our membership suggests that smaller credit unions are not seeing a meaningful reduction in exam duration. NAFCU generally supports the NCUA's long term exam modernization plans, which seek to leverage new technology, analytics, and monitoring capabilities to reduce examination burden. More specifically, NAFCU supports reforms to the examination process to improve consistency, speed, and cost savings for both credit unions and the NCUA. NAFCU encourages the NCUA to fervently continue to pursue its exam modernization efforts in a transparent fashion that allows credit unions to provide feedback. Additionally, NAFCU will work with the NCUA as it advances its continuous supervision program to ensure that the enhanced monitoring techniques do not threaten the autonomy of credit unions and interfere with their day-to-day operations.

Cybersecurity

NAFCU supports the NCUA's focus on protecting the security, confidentiality, and integrity of credit union member information. In 2018, the agency started formally testing its Automated Cybersecurity Examination Tool (ACET), which is largely based on the Federal Financial Institutions Examination Council (FFIEC) Cybersecurity Assessment Tool. The NCUA recently announced it would integrate the ACET with the standardized Cyber Security Evaluation Tool (CSET), used by the Department of Homeland Security, and continue to expand deployment of the tool at credit unions of different asset sizes. NAFCU will work with the NCUA to ensure that it employs a risk-based approach to cybersecurity that provides the necessary flexibility for a credit union to adopt controls based on their complexity as an institution and objective risk management principles. NAFCU fully expects the NCUA to continue to examine its own cybersecurity procedures to produce a safer and stronger credit union system.

Loan Maturities

NAFCU has long advocated for the NCUA to grant credit unions additional flexibility with respect to loan maturity limits. In August 2018, the NCUA issued a proposal inviting comment on extending maturity limits for certain types of loans. NAFCU recognizes that extending the general 15-year maturity limit requires legislative action and continues to urge the NCUA to support any legislative efforts that would amend the general maturity limit. The current 15-year limit is not on par with that of other lenders in the marketplace, and credit unions are at a competitive disadvantage. NAFCU encourages the NCUA to re-evaluate its definition of "principal residence" to conform with recent amendments to the FCU Act.

Interest Rate Ceiling

The fixed 18 percent interest rate ceiling has been in place since 1987. NAFCU has long advocated for a variable interest rate, specifically a 15 percent spread over Prime. Growth opportunities are stifled by credit unions' inability to take reasonable amounts of risk to lend to those members not suitable for an 18 percent rate. A variable interest rate will eliminate the need for credit union members to pursue higher rate alternatives, such as high-cost, traditional payday loans, or high interest credit cards. In addition, credit unions will be able to utilize tailored risk-based pricing, which reduces risks to the NCUSIF. NAFCU will continue to provide the NCUA with detailed feedback from its members regarding the potential benefits of a variable interest rate and collaborate with the NCUA to find other areas of opportunity to help credit unions grow and help their members access the credit they need.

Refunds of Stabilization Assessment Monies

Although NAFCU appreciates the NCUA's commitment to reevaluating the normal operating level (NOL) on an annual basis and the recently announced decrease to 1.38 percent, NAFCU continues to question the NCUA Board's original decision in to raise the NOL to 1.39 percent. The 2018 rebate to credit unions was a good first step, but NAFCU will continue to urge the agency to

focus on ways to provide additional refunds to credit unions and return the NOL to its customary level of 1.30 percent as soon as possible. Returning additional funds will allow credit unions to put those dollars to work helping their members.

Conclusion

NAFCU would like to thank the NCUA for its dedication to helping credit unions grow and improving the regulatory structure while ensuring a safe and sound system. NAFCU is also pleased to see the NCUA continually expanding the breadth of its credit union resources so that credit unions stay alert and informed. Thank you for your consideration and attention to the above-referenced matters. We look forward to working with you to address these priorities. If we can answer any questions or provide you with additional information on any of these issues, please do not hesitate to contact me.

Sincerely,

B. Dan Berger
President and CEO

3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

October 25, 2018

Mark A. Treichel
Executive Director
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Current Expected Credit Loss (CECL) Implementation

Dear Mr. Treichel:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing in regard to the National Credit Union Administration's (NCUA) future outreach plans as it prepares to implement the Financial Accounting Standards Board's (FASB) Current Expected Credit Loss (CECL) standard. Since the standard was finalized in June 2016, credit unions have wrestled with its potential impact on data retention processes and loan loss reserves. NAFCU continues to hear from credit unions about the costly investments that are necessary to implement CECL and the significant impact to operations that could soon take place. Accordingly, NAFCU maintains that credit unions should never have been included within the scope of the CECL standard because they were not a part of the poor lending practices that precipitated the financial crisis.

Given the extent of industry concern about CECL and its high potential for disruption, NAFCU believes that the NCUA should play an active role in educating industry about future implementation challenges. NAFCU has already devoted considerable resources to educating its members about CECL, but more can be done.

Both the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have offered interagency webinars to educate banks about CECL. We hope the NCUA will continue to offer similar industry resources in the future. We also ask that the NCUA partner with FASB and adopt a collaborative approach to providing industry education. While we appreciate that both FASB and the NCUA have committed to ensuring that the requirements of the standard are scaled appropriately, we believe that more active engagement will be beneficial in terms of clarifying transition expectations and when the CECL model must be implemented.

NAFCU has undertaken a number of initiatives to help address industry concerns regarding CECL. We have conducted member surveys, hosted multiple webinars, published a detailed study, and communicated member concerns to FASB through meetings and letters. We believe that these efforts may serve as a model for future outreach by the NCUA.

NAFCU began formally assessing the impact of the CECL standard in 2016. Even before the standard was finalized, many NAFCU members anticipated increases to their credit unions' allowances for loan and lease losses. Based on responses to NAFCU's July 2018 Economic & CU Monitor Survey (Survey), this sentiment has not changed. In 2018, NAFCU also asked members whether they had selected a CECL model. As of July, only a quarter of respondents had settled on a particular option. However, nearly all survey respondents reported that they have begun the process of investigating methods for estimating loan losses under the new standard. In this context, it is essential that the NCUA act quickly to provide appropriate educational tools before credit unions commit to particular loss estimate models. Furthermore, 19 percent of Survey respondents indicated that they are still waiting for clearer guidance before adopting a particular model to implement CECL.

In April 2017, NAFCU published a study on CECL which discussed potential models and options for implementing the new accounting standard. Five potential options were evaluated in detail to help credit unions identify a preferred method for estimating expected losses and to understand potential tradeoffs in terms of data size requirements, complexity, computation time, and procyclicality of lifetime loss estimates. The study also emphasized that credit unions would need to act quickly to identify an appropriate option, as data requirements could vary significantly between models. NAFCU believes that the rigor of the study will help credit unions validate modeling choices in the future. We also believe that the NCUA should develop additional resources to help credit unions better understand approaches to implementing the CECL standard.

Since 2015, NAFCU has hosted CECL-related webinars to educate credit unions about key definitions, implementation challenges, and potential allowance methodologies. NAFCU has also met on numerous occasions with FASB to discuss the standard, provided insights at industry roundtables, and worked with members of Congress to better inform lawmakers of more practical alternatives. The cumulative effect of these efforts has helped achieve additional flexibility, as evidenced in proposed updates to the standard. In a September 2018 letter regarding FASB's Codification Improvements to Topic 326, NAFCU expressed its appreciation for extended implementation for non-public business entities, which NAFCU has supported since the CECL effective dates were first announced. However, more can be done, and NAFCU believes that the NCUA may be able to offer perspectives that could lead to future improvements. Accordingly, we encourage the NCUA to engage with credit unions and FASB to identify additional opportunities to promote flexibility and ease implementation concerns.

The CECL standard is an unnecessarily complex accounting method for the majority of credit unions and only adds to mounting regulatory stress. In such a climate, we encourage the NCUA to work closely with FASB to reduce burdens on credit unions and alleviate industry uncertainty. If you have any questions or concerns, please do not hesitate to contact me at amorris@nafcu.org or (703) 842-2266.

Sincerely,

Andrew Morris
Senior Counsel for Research and Policy

cc: Larry Fazio, Director of Office of Examination and Insurance, NCUA

3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

February 13, 2019

Mr. Russell G. Golden
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116

RE: CECL Relief for Credit Unions

Dear Chairman Golden:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to urge the Financial Accounting Standards Board (FASB) to relieve the unintended impact of the current expected credit loss (CECL) standard, issued as Accounting Standards Update 2016-13, on credit unions. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 115 million consumers with personal and small business financial service products. We have received much ongoing feedback from our members regarding the difficulty in implementing the CECL standard and urge the FASB to more proactively provide credit union relief before the standard becomes effective. NAFCU continues to believe that credit unions should not have been included in the CECL standard, especially because credit unions have a unique capital framework and face certain regulatory constraints.

NAFCU greatly appreciated the FASB's recent roundtable to discuss an alternative for the implementation of CECL. During the roundtable it became clear that participants could not agree on the viability of the proposed alternative being discussed. Furthermore, there has been no coalescence around an option to mitigate the negative impact the CECL standard will likely have on credit unions. This bolsters the need for a credit union exemption from CECL, and NAFCU strongly urges the FASB to reconsider its decision to include credit unions within the scope of CECL. Alternatively, NAFCU urges the FASB to provide a one-year delay of the effective date for non-public business entities (non-PBEs), so that credit unions have more time to understand the impact CECL will have on their capital levels and to begin preparing the necessary data for implementation of the standard.

Credit unions are subject to a statutorily defined capital framework that places substantial limits on the ability of the National Credit Union Administration (NCUA) to mitigate CECL's impact on net worth without accompanying action from the FASB. This is because net worth is defined as a credit union's "retained earnings balance, as determined under generally accepted accounting principles."[1] As long as retained earnings must conform with Generally Accepted Accounting

[1] 12 U.S.C. § 1757a(c)(2).

Principles (GAAP), it is unclear as to whether the NCUA can meaningfully address CECL's day one impact on credit union capital. To deal with this problem, we urge the FASB to partner with the NCUA to identify opportunities for capital relief and prevent a scenario where credit unions must dramatically scale-back asset growth or face mandatory supervisory action in the event that net worth ratios fall below minimum levels.

Given the staggering complexity of CECL and its ramifications for capital planning, NAFCU strongly encourages the FASB to consider at least a one-year delay for non-PBEs to improve understanding of the standard's economic impact. As noted by other industry stakeholders, there is pervasive concern that CECL will have a pro-cyclical effect on lending conditions and actually reduce access to credit during times of stress—an outcome at odds with the standard's implicit goal of improving economic stability. Bearing in mind credit unions' conventional reliance on retained earnings to support continued lending, a rapid increase in allowances during a recession could severely tighten credit conditions in a way that disproportionately impacts the credit union industry's 115 million members. Although NAFCU maintains that credit unions should not be subject to CECL, the FASB should consider less burdensome alternatives to the standard, including a delay of the effective date, in recognition of credit unions' unique structure and role within their communities.

NAFCU appreciates this opportunity to share credit unions' concerns regarding CECL and our thoughts on what is necessary to provide appropriate relief. If you have any questions or concerns, please do not hesitate to contact me at amorris@nafcu.org or 703-842-2266.

Sincerely,

Andrew Morris
Senior Counsel for Research and Policy

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nafcu@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

January 11, 2019

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

RE: Federal Credit Union Bylaws (RIN 3133-AE86)

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the National Credit Union Administration's (NCUA) proposed rulemaking on federal credit union (FCU) bylaws. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 115 million consumers with personal and small business financial service products. NAFCU and its members appreciate the NCUA's leadership and commitment to updating, clarifying and simplifying the bylaws. Governance is an essential function ensuring credit unions operate prudently, and preserve the safety and soundness of the industry. NAFCU proposes several bylaw amendments to carry out the NCUA's intent while allowing credit unions the flexibility necessary to implement bylaws that work best for their unique fields of membership, including updates to the bylaw amendment process, member meeting and election processes. More importantly, NAFCU urges the NCUA to amend the bylaws to expedite the process for expelling a member who is abusive, or conducting an illegal act. The importance of modernizing the expulsion process cannot be stressed enough.

General Comments

NAFCU continues to advocate for greater flexibility in developing bylaws that cater to a credit union's unique field of membership and member needs. Adaptability of the bylaws is important as the financial marketplace evolves with the current climate. While the NCUA recognizes that the current bylaws do not allow credit unions operational flexibility, the proposed rule could be substantially improved by the recommendations made below to offer even more flexibility. Ultimately, NAFCU encourages the NCUA to support legislative changes to the *Federal Credit Union Act* (FCU Act) should certain changes require additional authority.

The NCUA's Regulatory Reform Task Force recommended changes to the standard bylaws and suggested the issuance of an advance notice of proposed rulemaking (ANPR) and formation of a working group. The NCUA published an ANPR in March 2018 and specifically requested information related to: (1) improving the bylaw amendment process within the NCUA; (2) addressing ambiguities in the FCU bylaws allowing for an FCU to limit services to a member and

expel a member; (3) methods to facilitate recruitment and development of directors; (4) methods to encourage member attendance at annual and special meetings; and (5) eliminating regulatory overlaps between the FCU bylaws and the NCUA's regulations. NAFCU's comment letter, dated May 21, 2018, recommended several improvements to the FCU bylaws for each question posed in the ANPR. NAFCU appreciates the NCUA incorporating stakeholder suggestions from the ANPR into this proposed rule, but would like to reiterate several of its original recommendations plus new feedback gathered from our members. NAFCU encourages the NCUA to consider incorporating these recommendations into a final rule amending the FCU bylaws. In addition, the NCUA's December 2018 Regulatory Reform Task Force final report noted that bylaws modernization is a Tier I priority as the bylaws have not been updated in over a decade, NAFCU requests more frequent review of the FCU bylaws. The NCUA should revisit the bylaws on a more regular basis to reduce confusion and keep up with technological advances as well as changing credit union and member needs.

Executive Summary

In this comment letter, NAFCU outlines the recommended bylaws changes provided by its member credit unions regarding each individual article. The recommendations are as follows:

Amendment Process

- Re-establish standard and non-standard bylaw amendment categories, and adopt a distinguishable timeline for approval of each category. Standard bylaws that are not new or novel should be afforded a 30-day timeline for approval. New or novel bylaw amendments should be afforded the proposed 90-day timeline. Alternatively, more options of "fill-in-the-blank" provisions should be added.
- Implement a process that notifies the applicant credit union of the approval process status, and provide written notification and reasoning for the denial of a bylaw amendment.

Shares of Members

- Include a provision for community property states explicitly stating whether the owners jointly own the par value, and how credit unions can rely upon the par value in underwriting a loan for the married couple.

Limitation of Services

- Set forth factors to measure physical and verbal abuse for credit unions to make risk-based decisions regarding a limitation of services policy.

Meetings of Members

- Continue to allow a quorum that includes board members, directors, and employees. Alternatively, allow for a proportion of the quorum to be made up of board members, directors, and employees.
- Clarify what "prominently displayed," means regarding the requirement to display a meeting notice on the credit union's website.
- Allow credit unions the ability to increase the timeframe for advanced notice of meetings based on the type of meeting and the credit union's internal policies and procedures.

- Amend the bylaws to explicitly permit member attendance and participation at annual and special meetings via technology such as teleconference, video conferencing or other web-based conferring tools, with comprehensive cybersecurity measures in place.

Elections
- Reform the four voting options to explicitly allow for more combinations of voting utilizing technology.
- Remove the requirement of the nomination committee to interview all nominees.
- Remove the instructions encouraging credit unions to adopt a resolution inserting an age of 21 years of age or greater for holding elective or appointive office.

Recruitment and Development
- Consider conducting NCUA-sponsored, voluntary education sessions to facilitate the development of current and potential directors.

Expulsion
- Expand the definition of "nonparticipation" to encompass those members who do not utilize credit union services in a legitimate or legal manner.
- Remove the requirement of credit unions posting a copy of the bylaws on their website.

Introduction - Amendment Process

The current amendment process is outdated and an expedited and simple process for bylaw amendments should be adopted. NAFCU raised this issue with the NCUA's Office of General Counsel (OGC) in 2014 when it formed a working group to discuss possible bylaw revisions. NAFCU suggests that the NCUA allow credit unions the ability to amend their own bylaws without regulatory approval for those simple and standard bylaw amendments.

Previously, the NCUA bylaws made a distinction between "standard" and "nonstandard" bylaw amendments, which allowed for "fill-in-the-blank" provisions and standard amendments to be adopted without the NCUA's approval. The NCUA removed the distinction between standard and non-standard amendments, and all amendments that are not "fill-in-the-blank" provisions require the NCUA's approval. The proposed rule retains a range of options that are considered "fill-in-the-blank" provisions that require a two-thirds vote of the board of directors. In addition, the proposed rule establishes a 90-day deadline for the NCUA's Office of Credit Union Resources and Expansion (CURE) to reach a decision on bylaw amendments.

First, NAFCU suggests that the NCUA re-establish the allowance for standard or pre-approved bylaw amendments that do not require the NCUA's approval. In the alternative, NAFCU suggests expansion of the options for "fill-in-the-blank" provisions that have been vetted by the OGC and are considered lower risk for adoption without prior approval. Secondly, NAFCU suggests the adoption of two distinguishable timelines. The first timeline is for those standard amendments that do not fall within the "fill-in-the-blank" category, but are not new or novel. The second timeline is for those amendments that are new or novel and require a lengthier approval process. NAFCU understands that the NCUA may require more time for approval of a bylaw amendment even if

previously approved for a different credit union, as each amendment must be looked at given the unique facts and circumstances of the applicant credit union. However, to impose a 90-day timeline for approval of *all* amendments causes an undue burden on the applicant credit union. Especially given that previously, a credit union would bring bylaw amendments to the Regional Director and would be provided with a decision within 15 days. While we understand that CURE needs sufficient time to process the amendment request, the amendment process for those standard bylaw amendments that are not new or novel should be processed more expeditiously than in 90 days. We suggest a 30-day deadline for such amendments. For those bylaws that are new or novel, the 90-day deadline is more appropriate.

Further, NAFCU suggests that the NCUA implement a process for CURE to notify the credit union of the approval status at various stages of the process. An open dialogue with the applicant credit union will help minimize time and resources expended by both parties, and mitigate frustrations. The proposed rule states that if an applicant does not receive approval in the 90-day timeline, then this constitutes a denial. The applicant credit union should at least be notified in writing within this 90-day timeline why the amendment request is being denied. This saves the credit union time if they choose to appeal the decision or re-apply. NAFCU members would appreciate more contact with the NCUA during the bylaw amendment process.

Article II – Qualifications for Membership

In NAFCU's May 2018 *Economic & CU Monitor Survey*, over 60 percent of members reported that modernization of the limitation of services and expulsion of members is a top priority. The current bylaw is vague and, when read in conjunction with the Legal Opinion Letters, creates a patchwork landscape for credit unions to craft a limitation of services policy. Incorporation of the Legal Opinion Letters would provide greater clarity, and the addition of the proposed new section regarding a "member in good standing" would help to facilitate a limitation of services policy; however, this still leaves too much grey area with respect to the type of physical and verbal abuse that qualifies for the limitation of services.

Members in good standing retain all the rights and privileges associated with membership, and the proposed rule sets forth the requirements for maintaining good standing. The proposed rule states that a member must be current on all loans and avoid engaging in any violent, belligerent, disruptive, or abusive behavior towards credit union staff, other members, property, and not cause a financial loss to the credit union. Accordingly, if a member causes a financial loss and destroys credit union property, the credit union may broadly limit services to the member, but the member retains certain member rights as stated in the proposed rule. To illustrate a potential flaw, those members not in good standing who are subsequently denied physical access to credit union locations may be unable to attend member meetings or vote depending upon the specific meeting and election processes in place. Therefore, the credit union runs the risk of a de facto expulsion and possible infringement of the member's rights. To prevent this, the credit union would then be burdened with a difficult, time-consuming, and potentially dangerous choice: (1) request changes to its bylaws to make accommodations for those members not in good standing, such as allowing voting by mail or electronic means; or (2) pursue approval from its board of directors to amend the limitation of services policy to allow those members to gain access to the physical credit union

locations solely for the purposes of attending meetings and voting, which runs the risk of additional harm to the credit union, its employees, or other members.

NAFCU recommends that the NCUA more clearly address what types of verbal or physical abuse merit a limitation of services. Retention of the intentionally vague bylaw is important to a certain degree, so credit unions have the flexibility to craft a limitation of services policy that works best for their institution and membership; however, credit unions are left guessing what degree of abuse they must endure before limiting the services of an abusive member. Not appropriately defining the limits of physical or verbal abuse means that credit unions may tolerate more abusive behavior than necessary, which puts the institution, employees, and other members at risk. NAFCU suggests that the NCUA address this issue not by providing a list of examples, but by setting forth concrete factors that a credit union can make a risk-based decision when evaluating the behavior against the factors. Additionally, NAFCU has heard from many of its members that the limitation of services does not resolve the underlying issue with the member's behavior. Consequently, and as explained below under the expulsion section, additional remedies may be necessary. NAFCU urges the NCUA to evaluate all potential avenues within the authority provided in the FCU Act that would permit more severe consequences for physical or verbal abuse.

Article III - Shares of Members

NAFCU members located in community property states have identified an operational challenge in the context of establishing par value and lending to married couples. The proposed rule allows for joint owners to establish one share account jointly or separately. However, in a community property state, each joint owner would equally own one-half of the share account. NAFCU suggests that the NCUA amend section seven of Article III of the bylaws to include provisions for community property states explicitly identifying whether the owners jointly own the par value, and how credit unions can rely upon the par value in underwriting a loan for the married couple. Such a clarification would assist credit unions in community property states to explain the parameters of membership to their members.

Article IV– Meetings of Members

NAFCU supports the proposal's requirement of providing more advance notice by posting notice of an annual meeting on the credit union's website, if a website is maintained. With the rise of online banking, it is only fitting that the notice be posted on the credit union website in conjunction with a conspicuous notice at branch locations. This change promotes awareness and encourages greater member attendance at annual meetings. NAFCU suggests that the NCUA further clarify "prominently displayed" and whether that means a credit union homepage, or a calendar listing upcoming meetings and events suffices.

The proposed rule does not allow for virtual or hybrid meetings, and these options are only available on a case by case basis. Over 50 percent of NAFCU member respondents to our May 2018 *Economic & CU Monitor Survey* identified that they would use technological solutions to encourage greater member participation in annual and special meetings. NAFCU recommends that the NCUA amend the bylaws to explicitly permit member attendance and participation at meetings

via technology such as teleconference, video conferencing or other web-based conferring tools. Conversely, any technology utilized must ensure members are not harmed or at risk for cybersecurity threats. Offering a registration link whereby a member's identity can be vetted would assist with documentation and verification for meetings. Multi-factor authentication would ensure a sufficient level of privacy and security protections are in place to prevent instances of identity fraud, specifically with respect to voting. NAFCU recommends the NCUA include a cybersecurity requirement within this provision.

Allowing for technology-enabled participation at annual and special meetings will increase overall member attendance and governance. Given many credit unions serve members all over the globe, it is not practical to require attendance in person, and allowing for easy to use alternatives is imperative. Further, there are circumstances where members are not given ample advanced notice in order to attend. For example, a credit union may give seven-day notice before a special meeting is held, and it may not be feasible for a member to participate in the special meeting if they no longer live in a geographical area where the credit union is located, but for joining the meeting via technology-enabled participation. It appears that the NCUA believes in virtual meetings encouraging greater member attendance. Staff commentary added in the proposed rule encourages credit unions to provide live webcasts of the annual and special meetings on their websites. NAFCU suggests that the NCUA clarify whether those members who participate in the meetings via a live webcast count towards the quorum, and whether credit unions will need to keep track of members that view the meeting via the live webcast.

Although the timeframes for providing members advanced notice of annual and special meetings is sufficient, NAFCU suggests that the NCUA explore allowing credit unions the ability to increase the timeframe based on the type of meeting and the credit unions internal policies and procedures. A credit union should be able to provide more advanced notice if they so choose. A suggested increase is allowing advanced notice of annual meetings up to 120 days before the scheduled date of the meeting. Allowing for a longer timeframe will put more members on notice of the meeting, and allow for resolution of scheduling conflicts well in advance of the meeting.

Lastly, NAFCU members request that the NCUA revisit the quorum requirements and allow for greater flexibility to attain a quorum. The proposed rule requires a quorum of twelve members excluding board members, directors, and employees. Credit unions were designed to operate as independent, democratic units, therefore we understand the NCUA's logic in the proposed rule. However, NAFCU believes that more specifically, quorums should not be made up solely by those members who are also in charge of the day to day operations of the credit union. Often times, however, board members, directors, and employees are members themselves. As members, these board members, directors, and employees' attendance should count just as any other member's attendance. The required minimum quorum may be more difficult for smaller credit unions to attain. NAFCU suggests that the NCUA allow a quorum to consist of a proportionate number of members who are directors and employees so long as a certain number of members who are not directors and employees are also present. Alternatively, we suggest a provision be added to the bylaw allowing for a phase-in quorum requirement to give a credit union time to formulate a program that works best for its membership. This would allow credit unions time to implement

online capabilities and other flexible channels. Further, the bylaws do not address the implications of when a quorum has not been obtained. NAFCU asks the NCUA to clarify this point as well.

Article V - Election Process

NAFCU appreciates the NCUA's intent to increase the number of members who vote in elections, however the bylaws do not reflect this intent. NAFCU does support the proposed rule's requirement of publicizing the call for nominees by any medium. This proposal aligns with the intent to increase voting, and could lead to more candidates. NAFCU has advocated that the bylaws offer more convenient election options and allow credit unions to conduct elections utilizing a combination of voting options without needing to make an individual request to the NCUA to do so. The current bylaws allow credit unions to choose one of four options listed, none of which allow for an entirely electronic mode of voting. The proposed rule adds new commentary clarifying that credit unions may use as many forms of electronic voting as desired, so long as the credit union does not adopt an entirely electronic voting process. Considering the rapid pace of technological advancements, credit unions need the flexibility to adapt to available technology as soon as they see fit. Those credit unions who wish to have an electronic-only voting process are still burdened with having to go to the NCUA to request this voting process on a case-by-case basis. NAFCU reiterates the call to reform the four options for voting processes to allow for more combinations of voting methods without needing the NCUA's approval via a bylaw amendment request.

Secondly, NAFCU suggests that the NCUA remove the provision in the proposed rule that requires nomination committees to interview every candidate that applies for a board or volunteer position. Credit unions should be allowed to vet candidates as they see fit. Requiring all candidates to be interviewed requires significant time from the nomination committee, and interviews would have to be completed within 30 days of being appointed, and in certain circumstances would not be feasible. Nomination committees have their own internal policies and procedures for determining those candidates who should be interviewed. Requiring the nomination committee to interview all the candidates blurs the intended role of the committee which its intended function is to vet qualified candidates. NAFCU urges the NCUA to prioritize flexibility in the election process and adopt these recommended changes to the bylaws.

Finally, the proposed rule adds instructions at the end of section seven encouraging credit union boards to adopt a resolution inserting an age not greater than 21 years of age for holding elective or appointive office, as opposed to the general limitation of 18 years of age to vote. The FCU Act does not prohibit a credit union from setting a minimum age, other than the legal age of majority. Encouraging a minimum age higher than 21 years of age could have the unintended consequences of less members able to participate in the governance of the credit union who would otherwise be qualified and eager candidates. Further, to assist with the development and recruitment of board members, a credit union may be looking to cultivate young and talented members. In order to facilitate greater flexibility, NAFCU recommends that the NCUA remove the instructions specifically encouraging the adoption of a resolution inserting an age not greater than 21 years of age for holding elective or appointive office.

Article VI – Board of Directors

Recruitment and development of future credit union directors is vital to credit union longevity. Credit unions, based on their size and complexity, need the freedom to best determine what constitutes a capable director. The necessary prerequisites as well as education and work history should be left up to the individual credit union. However, the NCUA has weighed in on requirements in Legal Opinion Letters in the past. NAFCU suggests that these Legal Opinion Letters be incorporated into the bylaws to allow for greater clarity.

The proposed rule includes bylaw provisions for the positions of Director Emeritus and Associate Director. Additionally, to encourage and facilitate the development of directors, NAFCU suggests that the NCUA consider sponsoring voluntary educational sessions for those individuals who are currently directors and associate directors. Such sessions would be a valuable opportunity to exchange ideas and share best practices, especially for smaller or new credit unions. Moreover, educational sessions would have the added advantage of not posing an additional regulatory burden on credit unions. NAFCU supports the creation of such educational opportunities as it would benefit the entire credit union industry by promoting greater understanding and encouraging more members to get involved in their credit union. Accordingly, the NCUA should amend the FCU bylaws to provide clearer direction to credit unions and help identify, retain, and promote the development of its directors.

Article XIV - Expulsion

Credit unions need an expedited process for expelling those members that are a threat to the safety of the credit union, its employees and members. While having a robust limitation of services policy is a good step, there are still obstacles as to how these policies are enforced. As requested by the NCUA in the proposed rule, NAFCU members have provided the following examples of extremely abusive member behavior. These examples are listed under this section to illustrate the egregiousness of the behavior warranting greater action than a limitation of services and illustrating the necessity for a more streamlined expulsion process is necessary for certain instances:

- A credit union employee assisting a member was physically stabbed by the member.
- A credit union member stole an employee's purse while assisting the member in connection with applying for a loan.
- A credit union member attempted to steal an ATM machine and in the process damaged credit union property and put other members and employees in danger.
- A credit union member made a bomb threat against the credit union.

This is just a short sampling of activities we have heard over the years. Currently, there are two main methods to limit services to disruptive members. First, the credit union may adopt a limitation of services policy, or may formally expel the member as spelled out in the FCU Act. In addition, the FCU Act outlines the removal of a member for "nonparticipation." Of note, the FCU Act does not define "nonparticipation" and the NCUA has the authority to interpret the term as necessary. Legal Opinion Letters throughout the years have interpreted this to mean a "continuing failure to

take an interest in the credit union or use its services." NAFCU reiterates its call to expand the definition of "nonparticipation" to those members who are not utilizing credit union services in a legitimate or legal manner.

NAFCU and its member credit unions strongly urge the NCUA to adopt a more streamlined approach to expelling an extremely abusive member because the current avenues are grossly inadequate. Adding extremely abusive or illegal behavior to the definition of "nonparticipating," as outlined in the examples above, would cause minimal disruption to the industry because those members who are expelled are still not relieved of their liability to the credit union. Expelling a credit union member is not a threat to the safety and soundness of the credit union or the National Credit Union Share Insurance Fund.

The existing options available to expel a member are burdensome and difficult. Calling a special meeting and obtaining the necessary votes is difficult, especially when short advanced notice is provided to members. Moreover, as illustrated in the above examples, in some cases the inability to expel a member immediately poses a risk to the safety of the credit union, its employees, and other members. Currently, the credit union may immediately limit the member's services, which creates its own set of complications for the member and the credit union and may not resolve the abusive behavior, or contact law enforcement. Beginning the process of expulsion would not be feasible to resolve an immediate issue. In addition to being time-consuming and costly, calling for a special meeting and disclosing the member's behavior also poses privacy concerns.

Furthermore, credit unions run into the issue of enforcement when dealing with a member who has committed an illegal activity. Although a credit union may have limited a member's services, local law enforcement may have difficulties assisting in the enforcement. In order to limit a member from entering the premises or having no contact with certain credit union personnel, a restraining order would need to be filed. Applicable state laws determine whether or not an entity may file a restraining order against the individual member. In certain states, the entity is unable to file, and the individual who was harmed or threatened must file the restraining order, leaving the credit union employee to file and disclose their personal information and seek legal recourse on their own.

Lastly, state laws allow state chartered credit unions more leniency in the ability to expel members for abusive and violent behavior. More recently, there has been a noticeable trend of federal credit unions converting to state charters. Although the reason for conversion may be due to various reasons, the additional flexibility may be a primary factor, especially for those credit unions that have persistent issues with members. Allowing for greater parity between state and federally chartered credit unions will ease the burden of those credit unions forced to convert to a state charter in order to alleviate issues with members.

The proposed rule requires credit unions that maintain a website to post a copy of the bylaws on the website. This poses privacy and cybersecurity concerns as names, titles, and the structure and duties of the board of directors would be publicly disclosed. All books of account and records, including the bylaws, are available upon request. By not requiring credit unions post a copy of the bylaws online is not disenfranchising members or impeding their ability to request a copy. The

potential costs far outweigh the benefits of having the bylaws available on the credit union's website. There are several alternatives that would still allow access while protecting sensitive information. One alternative is to require the credit union post a disclosure of the right to inspect all books of account and records, including a copy of the bylaws. Another alternative is to only provide the copy within a password-protected, members only access area of the website. Due to the privacy and cybersecurity concerns, NAFCU recommends the NCUA remove the requirement of posting the bylaws online or adopt alternative methods for posting the bylaws safely.

Conclusion

NAFCU appreciates the opportunity to provide comments on the proposed rule regarding FCU bylaws. In summary, there are several amendments to the bylaws that would provide greater clarity and flexibility for credit unions. The most vital amendment needed that would provide the greatest impact to credit unions is amending Article 14 to allow for an expedited process to expel those credit union members who do not utilize credit union services in a legitimate and legal manner. If you have questions, please contact me at kschafer@nafcu.org or (703) 842-2249.

Sincerely,

Kaley Schafer
Regulatory Affairs Counsel

NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

December 3, 2018

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

RE: Real Estate Appraisals (3133-AE79)

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing to you in regard to the National Credit Union Administration's (NUCA) proposed rule regarding real estate appraisal requirements.

NAFCU generally supports the proposed amendments to the NCUA's appraisal rules, which are required under Title XI of the *Financial Institutions Reform, Recovery, and Enforcement Act of 1989* (Title XI). NAFCU anticipates that the new threshold for required appraisals in commercial real estate transactions will address appraiser capacity issues that have been observed in smaller markets, and which have contributed to unnecessary delays and increased costs for borrowers. In essence, NAFCU believes the proposed rule will improve access to credit by reducing closing times and transaction costs. Furthermore, NAFCU believes the threshold adjustment more appropriately reflects the actual risk of commercial real estate transactions, while still preserving strong safety and soundness standards for credit unions.

General Comments

NAFCU believes that the framework advanced in the proposal, which modestly improves the clarity of the current regulation while meaningfully reducing regulatory burden in connection with commercial real estate transactions, represents the type of deregulatory action that is long overdue for the credit union industry. NAFCU also appreciates the agency's decision to incorporate new language that accounts for Section 103 of the *Economic Growth, Regulatory Relief, and Consumer Protection Act* (S. 2155), which provides appraisal relief for certain federally-related, rural real estate transactions valued below $400,000 if no state-certified or state-licensed appraiser is available. Although Section 103 is self-implementing, credit unions should benefit from the additional clarification in the regulatory text.

The decision to increase the appraisal threshold for commercial real estate-related transactions is a positive development that aligns credit unions' collective risk profile with evolving regulatory expectations for appraisals. Judging from years of historically sound valuation practices, NAFCU

believes that credit unions are readily capable of exercising prudent judgment in commercial transactions valued below $1 million when determining whether to use an appraisal or a written estimate of market value. Appraisal practices have not raised safety and soundness concerns that would warrant the current appraisal threshold of $250,000 for commercial real estate transactions. The supervisory analysis provided in the proposal supports this conclusion. NAFCU agrees with the NCUA that faulty valuations of underlying real estate collateral have not been a material cause of losses, and that the primary underwriting factor in commercial transactions is the cash flow of the business. Furthermore, as the NCUA's experience and material loss reviews indicate, faulty appraisals were not the cause of credit unions' loss experience during the financial crisis.

Accordingly, NAFCU supports the NCUA's decision to increase the threshold at which non-residential real estate-related financial transactions are exempt from appraisal requirements from $250,000 to $1 million.

Complex Residential Real Estate Transactions

NAFCU supports clarification of the definition for complex residential real estate transactions, which provides that a credit union may presume that appraisals of one-to-four family residential properties are not complex unless the institution has readily available information that a given appraisal will be complex. NAFCU believes that the amended definition better reflects the appraisal rule's existing contents but presents the information more clearly.

NAFCU does not agree with newly proposed appraisal requirements for complex residential real estate transactions that are partially insured or guaranteed by a U.S. government agency or U.S. government sponsored agency, but have $250,000 or more of the transaction value not insured or guaranteed, and which are not otherwise exempt. The proposed requirement to have a state-certified appraisal for such transactions would contribute to regulatory burden without meaningfully enhancing the safety and soundness of the credit union industry. Furthermore, these transactions are exempt from appraisal requirements under the current rule, and there is no indication that current valuations represent a supervisory concern or pose an undue risk to the Share Insurance Fund. In general, residential appraisals are less complex than commercial appraisals. To the extent that the NCUA seeks to reconsider the existing threshold for complex, residential real estate-related transactions that are only partially insured, NAFCU believes that lowering the threshold is appropriate and can be done without impairment to safety and soundness principles.

Appraisal Threshold for Residential Real Estate Transactions

The proposal solicits comment on whether the NCUA should reconsider the current appraisal threshold for one-to-four family residential transactions and what factors should guide such a decision. NAFCU believes the NCUA should seek to raise the $250,000 appraisal threshold which currently applies to one-to-four family residential transactions. The treatment of residential real estate loans in the NCUA's risk-based capital rule, when compared with commercial loans, suggests that there is an opportunity to recalibrate appraisal requirements to match risk assumptions. Additionally, greater transparency and technological innovation in the past decade

provide for significantly more detailed information about trends in the residential market, including collateral valuations, which should further alleviate safety and soundness concerns.

NAFCU also believes that the NCUA's conclusion about the limited relief that would follow from an adjustment to the residential appraisal threshold should be reconsidered. While it is true that appraisals would still be required for a large percentage of residential real estate transactions, pursuant to the rules of the federal housing agencies and the standards set by the government-sponsored enterprises (GSEs), there may be opportunities for future relief which the NCUA should not prematurely foreclose. Already there is some evidence that the GSEs are willing to waive appraisal requirements in certain circumstances.

Freddie Mac's Automated Collateral Evaluation tool and Fannie Mae's Property Inspection Waiver programs offer ways for financial institutions to benefit from existing databases of appraisal information and streamline underwriting by providing—in certain circumstances—only a written estimate of market value. NAFCU encourages the NCUA to evaluate these developments to determine whether potential relief from an adjusted residential real estate appraisals threshold may be greater than originally anticipated.

The NCUA should also consider the limited consumer protection benefit derived from an artificially low appraisal threshold for residential real estate transactions. The proposal cites the view of the Bureau of Consumer Financial Protection (Bureau) that appraisals can provide consumer protection benefits and that there may be risks to consumers resulting from an expansion of the number of residential mortgage transactions that would be exempt from the Title XI appraisal requirement. However, the benefit of a lender ordered appraisal is primarily to protect the credit union against the risk of default. Written estimates can adequately serve this function and credit unions have every incentive to exercise sound judgment when determining whether an appraisal is needed to assess the value of real-estate collateral. In the absence of more detailed Bureau analysis or data regarding potential consumer protection issues, the NCUA should explore the possibility of raising the threshold.

A recent proposal jointly issued by the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and the Board of Governors of the Federal Reserve System ("other banking agencies") should serve as additional evidence that reconsideration of the residential appraisal threshold is appropriate. The proposal would increase the appraisal requirement for residential transactions from $250,000 to $400,000, a level that does not pose safety and soundness concerns according to the other banking agencies. NAFCU believes that the NCUA should, at a minimum, consider similar amendments to Part 722 to ensure parity with bank rules for residential real estate transactions.

Real Estate-Related Transactions That Are Fully or Partially Guaranteed by a U.S. Government Agency or U.S. Government Sponsored Agency

The proposal eliminates the current exemption for appraisal and written estimate of market value requirements for real estate-related financial transactions that are fully or partially guaranteed by a U.S. government agency or U.S. government sponsored agency. Under the current rule, this is a categorical exemption that applies regardless of whether the insurance or guarantee is for the full

transaction value or only a part of the transaction value. As noted in the preamble, this exemption was adopted based on the presumption that a U.S. government agency's or sponsored agency's insurance or guarantee program would have an appraisal requirement. While the NCUA anticipates that such a presumption could no longer apply, the other banking agencies chose not to eliminate this exemption from their own appraisal rules, even as the GSEs have started to experiment with more flexible appraisal requirements. Accordingly, NAFCU believes that absent more definitive information regarding the development of guarantee and insurance program appraisal requirements, it would be premature for the NCUA to eliminate the exemption in current § 722.3(a)(7). Furthermore, such a change might impair future efforts to promote flexibility that are perhaps best informed by the experiences of the GSEs.

De Minimis Threshold for Transactions that are Partially Insured or Guaranteed

With respect to written estimate requirements for transactions that are partially insured or guaranteed by an agency or government sponsored agency, NAFCU would support efforts by the NCUA to establish an exemption from the written estimate requirement when the uninsured or unguaranteed portion is below a certain amount. An appropriate de minimis threshold could be $50,000, as the NCUA suggests. NAFCU believes that credit unions already exercise sound judgment when assessing the risk of underlying collateral. For lower value transactions, the cost of preparing a written estimate may be unnecessary given the credit union's experience and familiarity with the locality involved. Accordingly, NAFCU believes the NCUA should establish a de minimis threshold to encourage flexibility and reduce borrower costs.

Exemption for Existing Extensions of Credit

The proposed rule would amend current §722.3(a)(5) by providing that an existing extension of credit would not require an appraisal or written estimate of market value if the transaction is not considered a new loan under Generally Accepted Accounting Principles (GAAP). As the proposal acknowledges, there may be circumstances where the new definition necessitates an appraisal that would not otherwise be needed under the current rule; however, it is unclear whether this would be a common scenario or whether the GAAP definition is well-suited to valuation practices.

If the NCUA believes that the current definition for an existing extension of credit is unreasonably difficult to apply in practice, then the justification for any new definition should clearly explain the tradeoffs in terms of enhanced objectivity versus impaired flexibility. Furthermore, other components of the regulation that are equally subjective have not warranted significant revision, such as the definition of "complex," which refers generally to atypical conditions.

Given that the other banking agencies chose not to modify the language pertaining to existing extensions of credit in their May 2018 final appraisal rule, NAFCU believes that the NCUA should gather additional data from credit unions before making such a change. Most importantly, the NCUA should ensure that any future change is not more burdensome than the definition adopted by the other banking agencies. NAFCU also encourages the NCUA to codify the policy expressed in the preamble, which states that a written estimate of market value is not required for all modifications, workouts, or troubled debt restructurings of existing loans.

The NCUA's Discretionary Authority to Require Appraisals

NAFCU believes that the NCUA should limit application of its discretionary authority in §722.3(e) if credit unions transition to new appraisal rules. As we have seen in the context of mergers, catchall regulatory language imposes real costs on credit unions that find themselves caught off guard by unannounced agency policies. Furthermore, the use of such discretionary authority—particularly in connection with the more subjective aspects of the appraisal rule—could create industry confusion. If the NCUA is intent on adopting clearer definitions, such as for existing extensions of credit, then it should limit application of its discretionary authority and communicate supervisory expectations unambiguously if there are perceived safety and soundness concerns.

Conclusion

NAFCU appreciates the NCUA's recognition of credit unions' low risk in the proposal, which is reflected in the amended appraisal threshold for commercial real estate-related transactions. The proposed change will improve borrower access to credit while meaningfully reducing regulatory burden. We also encourage the agency to explore increasing the threshold for required appraisals in connection with residential real estate transactions, which would further improve credit unions' ability to close transactions at reduced cost to borrowers. If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2266 or amorris@nafcu.org.

Sincerely,

Andrew Morris
Senior Counsel for Research and Policy

3138 10th Street North
Arlington, VA 22201-2149
703.842.2215 | 800.336.4644
f: 703.522.2734
dberger@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

May 31, 2018

The Honorable J. Mark McWatters, Chairman
The Honorable Rick Metsger, Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Federal Credit Union Loan Interest Rate Ceiling

Dear Chairman McWatters and Board Member Metsger:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the interest rate ceiling applicable to loans made by federal credit unions. As the agency is aware, the current 18 percent interest rate ceiling expires on September 10, 2018, and I would encourage the National Credit Union Administration (NCUA) Board to consider the potential benefits of increasing the interest rate ceiling when it considers the issue in advance of its expiration. However, absent an increase, the NCUA Board should at minimum maintain the current 18 percent interest rate ceiling, and avoid lowering the rate given the rising interest rate environment. Also, I would encourage the NCUA Board to explore a floating interest rate ceiling.

General Comments

NAFCU believes that lowering the interest rate will be detrimental to the safety and soundness of credit unions as it could potentially result in a loss of capital. Further, it could discourage federal credit unions (FCUs) from making loans or approving credit card applications for higher risk members. This in turn would likely lead members to pursue loans from other lenders at considerably higher rates.

While the *Federal Credit Union Act* (FCU Act) generally limits FCUs to a 15 percent interest rate ceiling on loans, it provides the NCUA flexibility to establish a higher rate for up to 18 months after considering statutory criteria.[1] Specifically, the NCUA Board may increase the rate – or in the alternative, maintain the rate above 15 percent – if it determines interest rates have risen over the preceding six month period and that the prevailing interest rate would threaten the safety and soundness of individual credit unions. Given that the prevailing interest rates have increased over the last six months, and will continue to increase as forecasted by the Federal Open Market Committee (FOMC), NAFCU believes the NCUA should increase the current interest rate ceiling, as it will increase lending and competition in the marketplace.

[1] 12 U.S.C. § 1757(5)(A)(vi)(I).

The following table shows increases in short-term interest rates during the past six months:

Table 1: Selected Monthly Interest Rates

figures in basis points, monthly average	Apr 2018	Nov 2017	Change
1-Month Treasury	163	107	+56
3-Month Treasury	176	123	+53
6-Month Treasury	193	136	+57
1-Year Treasury	208	151	+57

Source: Federal Reserve

"Most Common" Interest Rates – All Unsecured Loans

Loans with Rates Higher Than 15 Percent

As of December 31, 2017, 2,361 of the 3,499 FCUs in the U.S. reported making loans with interest rates above 15 percent. Among those FCUs, the average rate on such loans was 17.1 percent. Of these FCUs, 59 percent are designated as low-income credit unions. If the interest rate ceiling was not maintained at a level above 15 percent, 67.6 percent of all federal credit unions would be required to change their rate policy, which might discourage many of them from making these kinds of loans going forward. This would not only reduce available credit options for members, but would also reduce the competitiveness of credit unions due to the reduced loan portfolio they would be able to offer to their members.

These credit unions would be impacted by any reduction in the interest rate ceiling. A majority (52.3 percent) of these credit unions have assets below $50 million. Their growth potential as well as their liquidity, capital and earnings levels would be negatively affected by a reduction in the interest rate ceiling.

Table 2: FCU Interest Rates on Unsecured Loans

Asset Peer Group	**Number of FCUs charging >15%**	**Percent of total FCUs charging >15%**
Less than $10M	427	18.1%
$10M to less than $50M	807	34.2%
$50M to less than $100M	363	15.4%
$100M to less than $500M	532	22.5%
More than $500M	232	9.8%
Total	2,361	100.0%

Source: NCUA's December 2017 5300 Call Report

Floating Interest Rate Ceiling

The interest rate ceiling has been set at an 18 percent fixed rate since 1987, and the NCUA should explore options to modify the interest rate ceiling from a fixed rate to a "fixed spread over Prime" or "floating" interest rate ceiling. Specifically, the NCUA should consider amending the interest rate ceiling to a "15 percent spread over Prime."

Mitigation of Interest Rate Risk (IRR)

Using today's rates, the ceiling would be set at 19.75 percent and it would *automatically adjust* with the level of Prime. Historically, the NCUA has expended a number of resources in an effort to educate and examine credit unions' exposure to IRR, as evidenced by the topic consistently listed as a supervisory focus for the agency. IRR is a primary concern for all FCUs, and as a result, credit unions have been vigilant in identifying and managing such risk. Using a "fixed spread over Prime" approach to the interest rate ceiling would go a long way towards helping credit unions reduce IRR, while still serving the needs of members, and mitigating impairments to FCUs' earnings.

While the benefits of a floating interest rate ceiling would be applicable to all variable rate products, such an approach is particularly germane to credit cards. Credit card interest rates typically reflect the riskiness of the borrower. As such, borrowers with higher-risk FICO scores may receive credit cards at, or near, the maximum rate of 18 percent; a rate that still fulfills credit unions' mission as the rate is lower than rates offered by banks for similar credit cards. As interest rates continue to rise, as anticipated by the Federal Reserve, credit cards may not be re-priced because they could potentially exceed the 18 percent ceiling – even though they are a variable rate product. This means, in the likely event of an interest rate increase, these credit cards are incorrectly priced given the default risk of the borrower. This can create adverse trends in credit unions' earnings and capital, which would present an increased risk to the National Credit Union Share Insurance Fund (NCUSIF). A floating interest rate ceiling would effectively mitigate this issue.

Increase in Overall Lending

Maintaining the current fixed rate interest rate ceiling may force FCUs to simply stop lending to individuals who have few alternatives for credit as interest rates rise, placing these FCUs in a position inconsistent with their mission. Conversely, a floating interest rate ceiling would likely lead to an overall increase in lending and expand access to credit. NAFCU has observed an increasing trend in overall credit lending, and we anticipate that this growth will continue.

Year over year figures show that at the end of March 2018, revolving credit increased by 4.8 percent from March 2017.[2] Although revolving credit has increased year over year, we would likely see additional growth with a floating interest rate ceiling due to consumer demand for

[2] *See* Federal Reserve's G.19-Consumer Credit release

credit cards, and the ability to offer credit card products to a larger portion of the membership by adjusting the rate ceiling on par with the level of risk associated with the member. Also, looking at the transformation to digital payments, more payments are now made by debit and credit cards, necessitating lending by FCUs to members across all consumer borrowing segments as credit cards are an essential financial tool. JP Morgan estimates that by 2021, credit card payments will make up 68% of all transactions.[3] Due to their small size and regulatory limitations, FCUs have less opportunity to diversify lending through offering multiple credit products, or by offering credit products to different types of borrowers, due to limitations on field of membership, and credit risks associated with the borrowing member. A floating interest rate ceiling would permit more diversified lending and increase credit availability for FCU members.

Delinquency Rates & Subprime Lending

A floating interest rate will allow FCUs to lend to those members who need access to credit the most but fall within the "subprime" or "near-prime" consumer segments at a higher rate (i.e. the ceiling cap). Breaking down revolving credit card growth for the past quarter into credit risk profiles, growth in the "super prime" consumer segment increased by 4.9 percent, "prime plus" increased by 3.2 percent, and "subprime" or "near-prime" fell by 2.7 percent.[4] Despite subprime credit card lending falling in Q1 2018, there was an increase year over year from Q1 2017 to Q1 2018 by 3.3 percent.[5]

A recent quarterly report by TransUnion found that delinquency rates on credit cards remain low at 1.78 percent at the end of Q1 2018 for borrowers past due by 90 days.[6] Lenders are mitigating risks by slowing originations for those individuals who pose a higher risk and extending lower amounts of credit.[7] Delinquency rates on all loans are still below those immediate post-recession delinquency rates.[8] Our members have reported that their delinquency rates have remained relatively unchanged since 2014, and also significantly lower than the delinquency rates they saw post-recession.[9] FCUs are cognizant of delinquency rates and continue to mitigate risk. Delinquency rates on all loans by credit unions continue to be lower than banks.[10]

Although FCUs have worked within the bounds of the current interest rate ceiling to lend to members who pose heightened credit risks, a floating cap would permit greater flexibility while

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[3] David Marino-Nachison, PAYMENTS: THE NEXT STEP TOWARD THE EXTINCTION OF CHECKS AND CASH, BARRON'S (2018), https://www.barrons.com/articles/payments-the-next-step-toward-the-extinction-of-checks-and-cash-1526048738 (last visited May 15, 2018).
[4] Credit Card Usage at All-Time Highs, But Delinquency Rates Still Remain in Check, TransUnion (2018), https://newsroom.transunion.com/credit-card-usage-at-all-time-highs-but-delinquency-rates-still-remain-in-check/ (last visited May 15, 2018).
[5] *Id.*
[6] *Id.*
[7] NAFCU, *supra,* note 2
[8] TransUnion, *supra,* note 4
[9] *See* NAFCUs Quarterly CU Industry Trends Report
[10] *Id.*

still taking into account the riskiness of the borrower. Furthermore, a floating interest rate would in no way impair FCUs' ability to safely offer rates below those of traditional banks.

Recommendation

NAFCU recommends the Board consider increasing the interest rate ceiling above the current 18 percent. In the absence of an increase, the Board should—at the very least—maintain the current 18 percent interest rate ceiling. NAFCU also asks that the Board explore the use of a floating interest rate ceiling – specifically a 15 percent spread over Prime. It is NAFCU's opinion that the Board has this authority so long as they continue to reauthorize such a structure every 18 months, as required by the FCU Act. We suggest the Board add this topic to the docket for a potential Board briefing, as rising interest rates are a reality and this issue is of importance to the industry as a whole.

Conclusion

I hope this information is helpful, and we thank you for this opportunity to share our views on this matter. Should you have any questions or require additional information, please contact me or Kaley Schafer, Regulatory Affairs Counsel, at 703-842-2249 or kschafer@nafcu.org.

Sincerely,

B. Dan Berger
President and CEO

cc: Mr. Mark Treichel, Executive Director
Mr. Michael McKenna, General Counsel
Mr. Rendell Jones, Chief Financial Officer

NAFCU

3138 10th Street North
Arlington, VA 22201-2149
703.842.2215 | 800.336.4644
f: 703.522.2734
dberger@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

September 7, 2018

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

RE: Material Risk-Based Capital

Dear Mr. Poliquin:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I would like to thank you for your continued commitment to revising the 2015 final rule on risk-based capital (RBC). The issue of what capital levels are appropriate for an institution to hold is of paramount importance to both credit union growth and the safety of the share insurance fund. Ultimately, we believe that statutory changes are required to provide credit unions with a modern capital regime, and that the risk-based capital rulemaking put into place in 2015 should be significantly revised or withdrawn prior to its implementation date.

Inherently, credit unions and the NCUA may have different opinions on appropriate capital levels for complex credit unions. In the past, these differences of opinion led to a robust debate and we expect they will lead to future debates. Subsequent to the finalization of the 2015 rule, NAFCU undertook a project to look at credit union capital with the goal of suggesting changes to the NCUA's rules. NAFCU's Regulatory and Legislative Committees looked closely at credit union data, bank data, economic trends and the NCUA's legal authority, in particular as it relates to comparable bank authority, to develop recommendations. Under the *Federal Credit Union Act*, credit union capital standards, including complex credit union standards, must be comparable to the standards for institutions insured by the Federal Deposit Insurance Corporation (FDIC).

After the study, earlier this year, NAFCU's Board of Directors completed its review of the committee recommendations. However, the passage of S. 2155 made changes to bank capital, and as a result, from a parity perspective, the appropriate level of credit union capital requires further study. Based on these circumstances, NAFCU believes that further changes to the capital rule are warranted beyond what the NCUA has proposed in its current rulemaking. Although NAFCU recognizes that the NCUA Board is not currently contemplating changes beyond what it has proposed, NAFCU strongly urges the NCUA to consider its entire rulemaking anew.

Relative to the current rulemaking, NAFCU supports the one-year delay at a minimum, but strongly believes that a two-year delay would better afford credit unions the time they need to make any adjustments and preparations to come into compliance.

During its study of capital rules this spring, NAFCU considered a very similar definition of "complex" to what the NCUA Board has currently proposed. Within the NCUA's current regulatory constructs, NAFCU supports the fresh approach to complexity, which takes volume of activity into consideration, but does not support a definition that divides the industry with a static asset threshold. In the preamble to this rulemaking, the NCUA indicates that through the supervisory process it will address material-risk capital levels for credit unions $500 million in assets and below. NAFCU suggests that for credit unions that are deemed "complex," the NCUA can utilize its supervisory authority to exempt, on a case-by-case basis, credit unions whose net worth ratio provides adequate protection from material risks irrespective of asset size.

NAFCU also asks the Board to expand the proposed one-year delay to include the grandfathering of "excluded goodwill" and "excluded other intangible assets," which were originally set to expire on January 1, 2029 in the final rule. The additional time would benefit credit unions that hold a significant amount of excluded goodwill or other intangible assets, as those terms are defined in the final RBC rule.

Thank you for your consideration and attention to this important matter. We look forward to working with you both now and in the future. Ultimately, as noted above, we believe statutory and additional regulatory changes are warranted to take the credit union industry into the future as nimble, responsive and responsible financial institutions. We urge the NCUA to work with credit unions to dramatically revise its risk based capital rule to only focus on true material risks.

If we can answer any questions or provide you with additional information regarding these recommendations, please do not hesitate to contact me or NAFCU's Executive Vice President and General Counsel, Carrie Hunt, at 703-842-2234 or chunt@nafcu.org.

Sincerely,

B. Dan Berger
President and CEO

3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org

National Association of Federally-Insured Credit Unions

August 2, 2018

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

RE: Payday Alternative Loans (RIN 3133-AE84)

Dear Mr. Poliquin,

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing in response to the National Credit Union Administration's (NCUA) proposed rulemaking on payday alternative loans (PALs). NAFCU and its members appreciate the NCUA's proactive approach toward strengthening an important lending option for credit union members. Credit unions are responsible lenders that provide short-term, small-dollar loans to meet the demands of their members while remaining consumer friendly. NAFCU believes that providing additional short-term, small-dollar loan options will help curtail the predatory practices of bad actors in the traditional, high-cost payday loan market. To achieve this goal, NAFCU recommends the NCUA adopt PAL loans that have flexible parameters allowing credit unions to establish loans that work best for their members.

General Comments

NAFCU has long advocated for short-term, small-dollar lending options that meet the needs of credit union members. Access to safe and affordable lending options is a necessity, and given the current options available, the need for greater innovation and expansion of product availability has never been more paramount.

Historically, the marketplace for short-term, small-dollar loans has been dominated by less-regulated entities, such as traditional payday lenders and check cashers, who charge consumers unfathomable rates of interest. In fact, the average annual percentage rate (APR) for a payday loan is upwards of 400%.[1] These high-cost loans create a "snowball effect" where consumers continually renew loans and are unable to get out of debt. Despite the unfavorable characteristics of traditional payday loans, there is a persistent demand for short-term, small-dollar lending. In a recent survey, 40 percent of adults reported they would need to borrow money or sell something

[1] What is a payday loan? (2017), https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/ (last visited Jul 17, 2018).

in order to cover an unexpected emergency expense of $400 dollars or more.[2] Furthermore, research shows that most consumers use payday loans to cover ordinary living expenses, such as rent or utility bills.[3] Consumers need better options than those currently available in the marketplace. When armed with a workable framework, credit unions will be able to meet their members' demands for short-term, small dollar loans, while ensuring accessibility, safety, and affordability. The Bureau of Consumer Financial Protection (Bureau) recognized the importance of needing better options and extended safe harbor protections over those payday loans adhering to NCUA's PAL I rule.

Although there is a strong demand for short-term, small-dollar products in the marketplace, credit unions have experienced minimal demand for their products due to the restrictive nature of PALs I. As of March 2018, out of the 5,530 total federally-insured credit unions, 605 claimed to offer PALs, but only 523 of them showed recent activity.[4] This equates to just 10 percent of credit unions actually making PALs. Given these low numbers of PAL participants evidences that the restrictiveness of PALs I has stifled credit unions ability to provide this loan product. With greater flexibility and the ability to serve members more efficiently, demand for PALs products will likely increase. Moreover, NAFCU members report seeing a push at the state level for increased regulation of the payday loan industry, especially when there are few options besides high-cost, traditional payday loans in the state, which creates an opportunity for credit unions to gain market share. Arming credit unions with a second PALs option would allow credit unions to lend to more members, and more quickly, safely and cheaply than traditional payday lenders. Greater competition leads to greater innovation, and will ultimately force high-cost, traditional payday lenders to improve their product offerings, leading to safer products for consumers.

Credit unions generally support a PALs II option.

Generally, NAFCU and our members support a PALs II option. A recent NAFCU semi-annual compliance survey reported that 35% of members would be interested in offering, or will offer, a PALs II option. NAFCU members that do not currently offer PALs products reported that the existing framework is too restrictive and, in some instances, an unattractive lending product for their members. NAFCU appreciates the proposal's increased flexibility, as a more workable framework may lead to more credit unions offering PALs products.

The most attractive features of PALs II include the removal of a required minimum length of membership and the ability to offer more than one loan in a six-month period. Removal of these barriers allows credit unions to assist new members almost immediately, facilitating the goal of PALs, which is providing members with immediate and emergency cash. Members place a premium on speed, thus removal of a minimum membership requirement enhances the

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[2] Report on the Economic Well-Being of U.S. Households in 2017, (2018), https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf (last visited Jul 17, 2018).
[3] Payday Lending in America: Who Borrows, Where to Borrow, and Why, (2012), http://www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why (last visited July 17, 2018).
[4] NCUA Call Report Data (March 2018)

attractiveness of the option. Allowing more than one loan in a six-month period is appealing because financially distressed members may need multiple loans to accommodate their financial situation and regain a strong financial foothold. When a consumer applies for a credit card, the credit card company does not tell that consumer that they are ineligible because they already have credit cards. The same principle should apply for these short-term, small-dollar loans. So long as credit unions perform the necessary and required due diligence, members should be able to take out more than one loan during the given timeframe.

Despite the new attractive features of PALs II compared to PALs I, the option may still not be a viable product for credit unions. NAFCU fears that the NCUA's goal of increasing the availability of consumer-friendly, short-term, small-dollar loans may not come to fruition. While PALs II is somewhat more flexible than PALs I, the framework is still restrictive. Further, NAFCU members have mixed feelings in regard to losing safe harbor protection from the Bureau of Consumer Financial Protection's (Bureau) payday lending rule. At this time, we recommend the NCUA explore additional PALs options that may be implemented more easily by credit unions and will better serve members, but maintain an option afforded safe harbor protection from the Bureau’s payday lending rule.

The NCUA should set flexible, simple parameters that allow credit unions to develop their own PALs option according to their respective risk profiles and member needs.

NAFCU members support a PALs option with simple parameters set forth by the NCUA that afford credit unions the flexibility to develop their own PALs product. Above all, additional options would arm credit unions with the tools necessary to assist members more effectively and safely, while continuing to balance the risks associated with short-term, small-dollar loans. Greater limitations restrict credit union participation and ultimately hurt members who may be forced to turn to traditional, high-cost payday loans. PALs I and the proposed PALs II options contain more rigid frameworks that in some cases impede consumers' access to credit, thus a high demand persists for a flexible PALs option. Credit unions will base development around their respective risk profiles and member needs. Credit unions will continue to engage in risk avoidance strategies and follow their respective underwriting standards. NAFCU suggests that this option have no minimum membership requirement, as well as the additional flexible parameters outlined below.

Parameters should set a maximum loan amount, maturity term, and an APR that is greater than those available under PALs I and II.

NAFCU members understand that credit unions are held to a statutory limitations regarding APR, pursuant to the *Federal Credit Union Act* (FCU Act). However, NAFCU believes that a higher APR will encourage credit unions to increase lending. Payday loan APR set by the Bureau and the *Military Lending Act* are slightly higher, and have been deemed by Congress and the Bureau as appropriate APRs. The NCUA should explore setting the APR on par with these rates (up to 36% APR). Setting a competitive APR will allow credit unions to increase short-term, small-dollar lending. NAFCU is not requesting an unreasonable increase in APR, the nominal increase is still far below the APR attributed to traditional, high-cost payday lenders.

The NCUA should also set reasonable parameters for higher loan amounts and maturity terms than those under PALs I and II. Due to the restrictive loan dollar amount for existing PALs products, NAFCU believes that financially distressed members will continue to seek out high-cost, traditional payday loans even after obtaining a PALs loan in order to meet financial obligations. As a result, credit unions need the ability to build a product with higher loan amounts and maturity terms, while still protecting members and ensuring the loan amount does not exceed a reasonable percentage of the members' net worth.

Parameters should allow credit unions the ability to offer open-end and closed-end loan options.

NAFCU members envision an option that allows both open-end and closed-end loans, which will enhance credit unions' flexibility and ability to cater to their membership. An open-end PALs loan would involve a revolving line of credit whereby members are approved for a certain amount, but would only incur the initial underwriting costs, therefore saving time and resources for credit unions and members alike. Having the ability to offer an open-ended option assists members who may have to turn to other high-interest, open-ended loan options for emergency cash needs such as high interest credit cards. Allowance of an open-ended loan option also assists those members who would be unable to qualify for other open-ended loan products.

Parameters should set a higher application fee, as well as set participation fees for open-end loans.

Credit unions constantly battle to strike a balance between providing a vital loan product that enables member financial stability and health with managing the associated risks of these loan products. Circumstances often result in the risks outweighing the return, and as a result, credit unions are unable to offer short-term, small-dollar loan options to their members. PALs loans are priced at below market cost and often result in losses to credit unions because credit unions are in the business of helping their members recover from financial emergencies. At their very core, credit unions were organized "for the purpose of promoting thrift among [their] members and creating a source of credit for provident or productive purposes."[5] In order for credit unions to continue to provide this important credit, the NCUA needs to reevaluate PALs fee caps.

The current rule allows credit unions to charge an application fee that reflects the actual costs associated with processing the application, but in no case may this application fee exceed $20 dollars. In some cases, NAFCU members have found that the statutory cap on application fees equals fees paid to third-party service providers. At the very least, a higher application fee cap would be necessary given the technology, personnel, and marketing costs incurred in order to process an application. These costs reflect the actual costs of processing the application. A reasonable increase to the application fee cap would still provide a low-cost option to credit union members.

For those PAL options that are open-end loans, credit unions should be able to charge participation fees, so long as the participation fees do not constitute finance charges under the *Truth in Lending Act* (Regulation Z). Members would avoid multiple application fees resulting in lower costs

[5] 12 U.S.C. § 1752(1).

overall. Given the risks involved, and the fact that credit unions are taking on these risks with little to no financial gain on their end, allowing a credit union to charge an annual participation fee further incentivizes offering the PALs.

Parameters should allow credit unions the ability to offer multiple outstanding loans at a given time.

Originally, PALs I prohibited multiple outstanding loans with the idea that a PALs loan could get members back on sound financial footing and able to utilize traditional lending products. However, it may take members some time to regain their financial footing if they are unable to repay an outstanding PALs loan but have a continued cash need. Further, prohibition on multiple outstanding loans may force the member to undertake a higher-cost loan to fulfill the cash need. Our members recommend that credit unions be given the ability to provide multiple outstanding loans at one time if they so choose, which will allow them to better serve members. Credit unions will hold themselves accountable and ensure proper underwriting. Further, credit unions will continue to participate in risk avoidance strategies ensuring that a member has the ability to take out multiple PAL loans.

Parameters should allow credit unions flexibility in verifying income.

Under the current rule, credit unions must establish practices of verifying income of member borrowers. The rule broadly provides that some established practice must be implemented and later states in the "best practices" section that looking at the balance of the member's established account along with proof of financial income constitutes sufficient underwriting standards for PALs. NAFCU recommends maintaining a broad underwriting standard for verifying a member's income. Given that this option will likely not have a minimum membership requirement; credit unions will only be able to verify income given the member's share account is just established.

The NCUA should work with the Bureau to ensure all PALs, both proposed and adopted in the future, fall within the safe harbor exemption.

Although NAFCU members are generally open to additional PAL options, concerns still remain about complying with the Bureau's payday lending rule. We understand that PALs II, as proposed, will fall within the Bureau's alternative loan exemption; however, any future PALs options are afforded no exception from the rule. Expanding the safe harbor exemption to encompass all PAL loans will assist in widespread adoption of the PALs program, and a greater number of these loans will be made. Expansion of the safe harbor exemption will give credit unions peace of mind knowing that they are in compliance with both the NCUA and the Bureau's rules. Credit unions will be more apt to begin PALs programs if they have not already done so, or to expand their PALs programs to include additional PALs options. Alternatively, NAFCU recommends that at a minimum, the safe harbor exemption should expand to encompass the PAL II option as proposed.

Conclusion

NAFCU recommends the NCUA provide a PALs program encompassing the PALs I option, preserving the safe-harbor exemption from the Bureau's payday lending rule, as well as an additional PAL options with simple and flexible parameters as suggested herein, allowing credit unions to build their own loan products. NAFCU believes that removing the restrictive boundaries of the PALs options will achieve better small-dollar, short-term loan options for members, and consequently will lead to increased volume in credit unions offerings. NAFCU appreciates the opportunity to share its members' views on this matter. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,

Kaley Schafer
Regulatory Affairs Counsel

3138 10th Street North
Arlington, VA 22201-2149
703.842.2234 | 800.336.4644
f: 703.522.0594
chunt@nafcu.org | nafcu.org

Carrie R. Hunt
Executive Vice President of Government Affairs
and General Counsel

National Association of Federally-Insured Credit Unions

May 8, 2017

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

RE: Advance Notice of Proposed Rulemaking for Alternative Capital

Dear Secretary Poliquin,

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I would like to share with you our thoughts on the Advance Notice of Proposed Rulemaking for Alternative Capital. Consistent with our previous support of a supplemental capital framework for credit unions, NAFCU commends NCUA for initiating this rulemaking and exploring relief options for credit unions that must meet regulatory capital requirements. With respect to secondary capital, NAFCU welcomes the opportunity to suggest modest improvements, such as additional flexibility during the preapproval stage for issuing credit unions and broader call options to encourage investor interest.

Since the financial crisis tipped our country into recession, credit unions have served as a vital source of capital and market liquidity in local communities. Credit unions did not engage in the risky lending practices that led up to the crisis and have not cost taxpayers a dime. When sound small businesses and homebuyers were having trouble finding credit during the liquidity drought, credit unions filled that lending gap in many parts of the country. A regulatory capital framework that authorizes supplemental capital would grant credit unions an additional option to guard against risk, achieve growth, and ensure that our industry remains a bedrock of stability for the 106 million Americans who currently look to credit unions as a vital source of affordable financial services.

NAFCU's approach to alternative capital emphasizes the following general principles:

1. Preserve the not-for-profit, mutual, member-owned and cooperative structure of credit unions and ensure that ownership interest (including influence) remains with the members.

2. Ensure that the capital structure of credit unions is not fundamentally changed and that the safety and soundness of the credit union community as a whole is preserved.
3. Provide a degree of permanence such that a sudden outflow of capital will not occur.
4. Allow for a feasible means to augment supplemental capital.
5. Provide a solution with market viability.

NAFCU also believes that NCUA should develop its alternative capital framework through a pilot program, similar to what the NCUA Board implemented for the derivatives rule.[1] NAFCU believes that the use of a pilot program to measure well-capitalized, well-run credit unions' deployment of supplemental capital will yield best practices that could benefit the entire industry.

NAFCU understands that statutory amendments may be necessary to provide meaningful alternative capital options for all credit unions; however, a regulatory capital framework would still offer increased flexibility to credit unions that must meet NCUA's risk-based net worth requirement.

I. Supplemental Capital

NAFCU supports supplemental capital as an option for improving capital buffers, encouraging growth, and meeting regulatory capital requirements—so long as it is compatible with the not-for-profit, mutual and cooperative structure of credit unions. For example, NAFCU believes that supplemental capital structured as subordinated debt and possessing the same key features as secondary capital (with certain exceptions) is one option that ensures such compatibility. NAFCU also expects appropriately structured supplemental capital to compliment the mission and purpose of credit unions in a way that raises no question about the tax exempt status of credit unions.

In April 2010, NCUA published a "Supplemental Capital White Paper" (White Paper) that identified three capital instruments capable of meeting key public policy objectives outlined below. These instruments were Voluntary Patronage Capital (VPC), Mandatory Membership Capital (MMC), and Subordinated Debt. NAFCU believes that subordinated debt possesses characteristics that will guarantee compatibility with the FCU Act and also yield sufficient investor interest to develop a healthy supplemental capital market. Furthermore, NCUA's familiarity with secondary capital makes subordinated debt a logical regulatory capital option. While VPC, MMC or other forms of regulatory capital might offer similar (if not greater) utility, NAFCU believes that subordinated debt should be the focus of NCUA's preliminary efforts.

NAFCU also believes that NCUA possesses the legal authority to allow federally-chartered credit unions[2] to issue subordinated debt and count it towards risk-based net worth calculations. As the ANPR acknowledges, Congress has not defined risk-based net worth, which gives the Board "the latitude to include within that requirement items that would not meet the statutory

[1] *See* 12 CFR 703.113.
[2] The FCU Act places no restrictions on the ability of state-chartered credit unions to issue forms of supplemental capital otherwise authorized under state law; however, some offerings may be prohibited by NCUA through share insurance regulation.

definition of 'net worth' but otherwise serve as capital in protecting the Share Insurance Fund from losses when a credit union fails."[3] For example, subordinated debt would be subordinate to the Share Insurance Fund (SIF) and only count toward satisfying credit unions' risk-based net worth ratio. Accordingly, NCUA may permit this type of capital instruments consistent with credit unions' borrowing authority.

To the extent that NCUA seeks to allow natural person investors to purchase forms of supplemental capital, NAFCU welcomes efforts to promulgate rules that would clarify credit unions' borrowing authority. NAFCU also recommends that NCUA design these rules to specify what types of supplemental capital instruments may be sold to natural person investors, if any, and in what amount.

A. *Prudential Safety and Soundness*

In general, the ability to issue supplemental capital would help credit unions adjust to changing economic conditions more effectively. When a credit union's economic outlook fluctuates, either as a result of asset growth or declines in capital resulting from losses on loans or other assets, it must rely on retained earnings to satisfy regulatory capital requirements. Because retained earnings accumulate slowly, the present cost of ensuring future financial stability may necessitate less than desirable tradeoffs. For example, a credit union may need to offer less attractive rates in order to build retained earnings that will support future growth and guard against unexpected downturns. Supplemental capital would make this process of capital planning and adaptation more cost-effective and predictable.

The Risk-Based Capital Rule will go into effect January 1, 2019, establishing a risk-based capital ratio of 10 percent for complex credit unions to qualify as "well-capitalized." As NAFCU noted throughout the risk-based capital rulemaking process, many credit unions may struggle to achieve their desired capitalization level because they lack access to capital in the financial markets. As evidenced by experiences in the banking and thrift sectors, supplemental capital frameworks can provide important mechanisms by which financial institutions can raise capital outside of simply retained earnings. As opposed to slowly building up capital over the course of years, supplemental capital issuances can provide credit unions the ability to rapidly raise capital when the need or desire arises. For example, a complex credit union that issues supplemental capital may do so to strengthen its risk-based capital buffer and offset the acquisition or growth of riskier assets. Other issuers might leverage supplemental capital to expand services to untapped markets, such as underserved or low-income communities. NAFCU anticipates that supplemental capital can grant credit unions additional flexibility to meet risk based capital requirements and yield more effective capital planning strategies.

NAFCU understands that it may also be desirable to import certain features of NCUA's secondary capital framework to ensure that credit unions are adequately prepared to issue subordinated debt. At a minimum, NAFCU believes that credit unions should be adequately or well capitalized under Prompt Corrective Action (PCA) standards before receiving authorization to issue supplemental capital.

[3] *See* Advanced Notice of Proposed Rulemaking, Alternative Capital, 82 Fed. Reg. 9691, 9695 (Jan. 2017).

Lastly, NAFCU agrees that subordinated debt is analogous to Tier 2 capital, and as such, NCUA should take into account the unique structure of credit unions when deciding whether to import capital limits derived from the Basel Committee or existing bank standards.

B. Preservation of Mutuality and Cooperative Structure of Credit Unions

Supplemental capital structured as subordinated debt is compatible with the mutual and cooperative structure of credit unions. Subordinated debt confers no voting rights, carries a fixed or floating interest rate, and would be subordinate to all other claims of the credit union (with the exception of secondary capital), including the claims of creditors and members. As a result, investors will not wield influence that interferes with member control of credit unions.

In addition, subordinated debt is capable of satisfying all of the key requirements that NCUA has identified in the ANPR; namely, that supplemental capital must be uninsured, subordinate to all other claims against the credit union—including the claims of creditors, members, and the National Credit Union Share Insurance Fund—available to cover operating losses in excess of the credit union's retained earnings (and to the extent supplied, not replenished), adhere to maturity limits as determined by the NCUA Board, and remain limited to those credit unions designated as sufficiently capitalized. These requirements are the same as those that apply to secondary capital, and as such, should raise no material concern about the cooperative status of credit unions.

As a matter of comparison, low-income designated credit unions have been able to count secondary capital toward net worth calculations since the passage of *Credit Union Membership Access Act of 1998* (CUMAA). Secondary capital resembles subordinated debt in all functional aspects and preserves the mutual and cooperative structure of credit unions. Accordingly, supplemental capital structured as subordinated debt should be viewed as equally accommodating so long as it avoids conflict with the FCU Act (i.e., only satisfies risk-based net worth requirements).

Supplemental capital will have no effect on credit unions' tax exempt status.

NAFCU believes that supplemental capital structured as a form of regulatory capital does not raise any question regarding the tax exempt status of credit unions. Subordinated debt would not convey voting rights and restrictions on covenants (similar to what exists for secondary capital) would easily limit interference with a credit union's governance and business planning. Other forms of supplemental capital, such as VPC or MMC, would be even less concerning because only credit union members would be able to purchase these instruments, thus ensuring that the cooperative principles of the credit union are not disturbed.

Section 122 of the FCU Act (12 U.S.C. 1768) confers tax exempt status to FCUs, whereas state credit unions are tax exempt by virtue of the Internal Revenue Code (Code) (Section 501(c)(14)(A)). Section 122 does not reference capital structure. In addition, Congress' findings in CUMAA have since clarified that credit unions receive a tax exemption because they are "member-owned, democratically operated, not-for-profit organizations generally managed by

volunteer boards of directors and because they have the specified mission of meeting the credit and savings needs of consumers ... "[4] Because alternative capital does not alter these essential features, it should be viewed as wholly compatible with the legislative rationale for the credit union tax exemption.

The PCA capital standards added by CUMAA acknowledge that "credit unions are not-for-profit cooperatives that—(i) do not issue capital stock (ii) must rely on retained earnings to build net worth; and (iii) have boards of directors that consist primarily of volunteers."[5] Despite the fact that PCA capital standards do not relate **in any way** to credit unions' tax exempt status, NAFCU believes that supplemental capital can conform to each of the three criteria.

First, it would be disingenuous to classify regulatory capital such as subordinated debt as "capital stock," based on the de minimis presence of equity-like features.[6] Neither the FCU Act nor the IRS Code define the term "capital stock;" however, based on extensive review of IRS guidance and court cases that have sought to distinguish between capital investments and debt for accounting purposes, NAFCU does not believe that subordinated debt constitutes a form of capital stock. The shared characteristics of subordinated debt and secondary capital also suggest that a similarly structured capital instrument should be fully compatible with the FCU Act. Second, supplemental capital would be a form of regulatory capital that would not alter the conventional reliance on retained earnings to build net worth. Supplemental capital would be limited to the numerator portion of the risk based capital ratio. Third, none of the forms of supplemental capital discussed in the White Paper would interfere with the control of the credit union by volunteer boards of directors. NCUA could also restrict covenants to adequately preserve the independent decision making of boards of directors.

NAFCU understands that NCUA may be considering other forms of supplemental capital such as VPC or MMC. NAFCU does not believe that these forms of supplemental capital would resemble stock in the traditional sense either.

Investor Safeguards

As a general principle, NAFCU believes that it would be appropriate for NCUA to seek investor safeguards in proportion to investor sophistication. NAFCU agrees with the sentiment expressed in the ANPR that a lack of disclosure in specific cases could produce litigation risk for credit unions that may not only harm the individual credit union, but might also pose significant harm to the Share Insurance Fund. To guard against these possible risks while simultaneously providing a straightforward and accessible approval process for issuers of supplemental capital, NCUA should afford credit unions the greatest flexibility possible in pursuing investors. Below, we discuss considerations related to the potential types of investors mentioned in the ANPR.

[4] Pub. L. 105–219, § 2, Aug. 7, 1998, 112 Stat. 913.
[5] 12 U.S.C. § 1790d(b)(1)(B).
[6] The accounting treatment of secondary capital clearly indicates that subordinated debt is not regarded as a form of equity on a credit union's balance sheet *except* for regulatory accounting purposes. *See* NCUA Examiner's Guide, 16-6. In addition, GAO testimony before the House Committee on Ways and Means has also affirmed that secondary capital is debt-like in nature. "A 'secondary capital instrument' is either unsecured debt or debt that has a lower priority than that of another debt on the same asset." U.S. House of Representatives, Review of Credit Union Tax Exemption : Hearing Before the Committee on Ways and Means, No. 109-38, 38 n.42, (Nov. 3, 2005).

Non-Natural Person Investors

NAFCU believes that allowing non-natural persons (institutional investors) to purchase supplemental capital could be accomplished without introducing novel disclosure requirements. Institutional investors are not sensitive to the same risks as natural person investors and possess the experience and expertise necessary to evaluate a credit union's capital plan (as part of the preapproval process) and ascertain the risks associated with holding subordinated debt. Accordingly, NAFCU believes that institutional investors would be adequately protected by requiring credit unions to provide the same "Disclosure and Acknowledgment" form that is used for offerings of secondary capital.[7]

Natural Person Investors

As NCUA noted in the ANPR, natural person investors may range significantly with regard to their level of financial sophistication. While some individual investors, such as those who satisfy the definition of "accredited investor" under Regulation D, can be considered to be quite sophisticated, other individuals who lack such a designation may carry more risk. Again, NAFCU does not see a need to prohibit the sale of supplemental capital to non-members, so long as investors are educated on the risks of the instrument. The level of necessary disclosure to achieve this purpose would be commensurate with an investor's sophistication.

Natural person investors who satisfy the definition of an "accredited investor" are likely capable of evaluating the risks of supplemental capital investments based on a credit union's business plan for issuing the capital. Like institutional investors, they are presumed to have experience and sophistication gleaned from prior purchases of securities. For example, private placements to qualifying investors could benefit from certain exemptions provided in the Section 505 and 506 of Regulation D. NAFCU believes these exemptions could serve as an appropriate benchmark for investor sophistication and would support exemptions from disclosure requirements if offerings were made to this class of investors.

The ANPR also considered the possibility of allowing non-accredited natural person investors to purchase alternative capital from credit unions. In this case, it may be appropriate for NCUA to require credit unions to provide disclosures to investors and register the offering with the agency. Initial and ongoing costs of educating these types of investors would likely cause the cost of issuing the instrument to rise.

The ANPR noted that the sale of secondary capital was not originally permitted to natural-persons, accredited or not, because those consumers may be confused "given that the low-income designated credit union is federally insured."[8] NAFCU believes that this confusion could be remedied by using a model disclosure to specify that purchases of supplemental capital are not insured and subordinate to certain claims against the credit union.

Amount of Disclosure Necessary to Achieve Anti-Fraud Purpose

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[7] *See* Appendix to 12 CFR 701.34.

[8] *See* ANPR, Alternative Capital, 82 Fed. Reg 9698.

NAFCU understands that investors in supplemental capital must receive certain minimum protections embodied in Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act); however, NAFCU does not think that supplemental capital—in particular subordinated debt—must necessarily conform to Securities Exchange Commission (SEC) regulations. NAFCU believes that the timing, contents and frequency of investor disclosures should depend upon the nature of the investor.

With respect to consumer disclosures, NAFCU understands that any plan to allow non-institutional investors to purchase supplemental capital should necessitate a heightened degree of investor protection. NAFCU believes that if natural person investors are allowed to purchase alternative capital instruments, then NCUA should adopt the same disclosures used by the OCC for subordinated debt offerings. These disclosures are flexible insofar as they cross-reference the SEC's own safe-harbor language for accredited investors. NAFCU believes that NCUA could use these disclosures "out-of-the-box," reducing the need to develop new forms or rely on novel standards for meeting the investor safeguards and anti-fraud provisions described in §10(b) of the Exchange Act.

Treatment of Supplemental Capital as Registered Security

NAFCU believes that Section 3(a)(5) of the Securities Act would exempt credit unions from the SEC's registration and disclosure requirements when issuing supplemental capital. In addition Rule 506 of Regulation D would also provide an independent exemption for accredited investors. Although the ANPR mentions the possibility of registering supplemental capital offerings with NCUA, NAFCU does not believe that such a requirement would materially enhance investor protection. While the OCC requires national banks to register subordinated debt, the FDIC imposes no such requirement. NAFCU believes that credit unions should not be subject to registration requirements that community banks would not face when offering subordinated debt. Furthermore, NCUA has never imposed a registration requirement for secondary capital; there is no prospectus requirement and the only disclosure a LICU must provide is the Disclosure and Acknowledgment form.

NAFCU urges NCUA to craft a regulatory capital framework that does not impose burdensome registration requirements on credit unions that are disproportionate to the complexity and risk of supplemental capital offerings. NCUA should avoid any proposal that would require credit unions to register a prospectus with either the SEC or NCUA, and instead seek parity with the current model that LICUs use when issuing secondary capital. NAFCU believes that streamlining investor disclosures as much as possible is essential to reduce the cost of issuing alternative capital.

NAFCU also does not see why the ANPR raises the issue of broker-dealer registration when federal credit unions cannot register as broker dealers and have traditionally received an exemption from the SEC's registration requirements when selling non-deposit investments directly to members.[9] The SEC permits this activity through "networking" arrangements, where an affiliated or third-party broker-dealer provides brokerage services for the financial institution's

[9] *See* NCUA Letter to FCUs 10-FCU-03, Sale of Nondeposit Investments, December 2010.

customers, according to conditions stated in no-action letters.[10] The ANPR recognizes that credit unions still need to meet a due diligence requirement when selecting a broker dealer, but these requirements could be obviated if credit unions are limited to raising supplemental capital through non-member investors. In conversations with member credit unions, NAFCU has learned that non-member institutional investors could support a robust supplemental capital market. Nonetheless, NAFCU encourages NCUA to explore regulatory options that could reasonably permit member investments, and in doing so, clarify its position on broker-dealer registration by explaining how its previous guidance must be reconsidered.

In general, NAFCU would prefer for NCUA to identify a regulatory capital framework that does not force credit unions into a position where they must perform costly due diligence to take advantage of the broker-dealer exemption.

II. Secondary Capital

NAFCU supports modest changes to the approval and review of secondary capital issuers and recommends that NCUA offer low-income credit unions (LICUs) broader call options to relieve certain market inefficiencies. To the extent that the ANPR raises questions about the application of securities law to secondary capital and whether additional investor protections are required, NAFCU believes that the current framework for secondary capital adequately addresses those concerns. Likewise, NAFCU does not think that additional prudential restrictions on secondary capital are warranted.

A. *Impact of supplemental capital on market for secondary capital; suitability for natural person investors*

NAFCU is aware that secondary capital investors are sensitive to regulatory changes that would make secondary capital subordinate to supplemental capital. Because the FCU Act requires that secondary capital must remain the most subordinate form of debt on a credit union's balance sheet, NCUA should consider whether it would be advantageous to credit unions (for the purposes of preserving investor confidence) to segregate supplemental and secondary capital markets.

NAFCU does not see a significant benefit in allowing natural person investors to purchase secondary capital. The ANPR notes that when the secondary capital regulations were initially written, "the purchasers were presumed to be foundations and other philanthropic-minded institutional investors." Based on recent outreach, NAFCU believes that institutional investors will continue to represent the primary market for secondary capital purchases.

B. *Relaxed pre-approval standards for issuing secondary capital*

NAFCU has heard from low-income designated credit unions that the current preapproval process for obtaining authorization to issue secondary capital could benefit from additional streamlining to reduce the cost of funds. One credit union has informed NAFCU that the time

[10] *See* SEC "Guide to Broker - Dealer Registration" *available at* http://www.sec.gov/divisions/marketreg/bdguide.htm).

spent waiting for NCUA to approve a secondary capital plan while investors wait raises the cost of funds by approximately 75-100 basis points. In order to reduce these costs, NAFCU suggests that NCUA consider a preapproval process whereby a credit union submits a capital plan that can be reused in subsequent offerings, provided that future offerings conform to the original plan in general size and scope. If the capital plan were to change materially, a credit union could amend its original capital plan and receive approval on an expedited basis, without having to submit a new plan for each new offering.

C. Need for broader call options

NAFCU has heard from investors that large national banks interested in purchasing secondary capital for *Community Reinvestment Act* credit are interested in expanding the volume of their investment activity. However, a limiting factor for these investments is the rate at which capital revolves into and out of secondary capital accounts. NCUA could ease this bottleneck by granting credit unions more flexible early redemption options and relaxing the preapproval process based on the remaining maturity of the capital account.

For example, a credit union that has previously issued secondary capital, maintained a status of well capitalized, and successfully obtained streamlined approval to redeem secondary capital early should not need to seek NCUA approval for redemption in the future. Additionally, NCUA should consider allowing credit unions to redeem secondary capital that has been on deposit for less than two years depending on the term to maturity and whether the credit union satisfies all other components of § 701.34(d)(1). NAFCU believes that granting LICUs flexibility when redeeming discounted secondary capital could yield additional market efficiency.

Secondary capital issuers could also benefit from improved clarity in NCUA's Supervision Policy Manual. NAFCU has heard that certain criteria used to determine whether a Secondary Capital Redemption (SCR) request qualifies for streamlined approval have been interpreted inconsistently. Specifically, the Supervision Policy Manual asks whether a credit union's "post-redemption capital level will remain sufficient relative to any extraordinary risks." NAFCU recommends that NCUA consider using more objective criteria to improve the consistency of SCR determinations.

D. Secondary capital must be examined consistently

NAFCU has heard from investors and LICUs that examination of credit union balance sheets has sometimes resulted in inconsistent treatment of secondary capital accounts. There is particular concern that some examiners may be subjectively evaluating a credit union's philosophy toward building and maintaining net worth, and that review of the credit union's capital position may not properly take into account principles of leverage. To ensure that a credit union's capacity to take on risk is objectively and consistently measured, NCUA should clarify in its examiner guide that a credit union may use secondary capital to execute growth-oriented strategies. NAFCU believes that this additional level of detail will result in a more objective process for evaluating perceived level of risk.

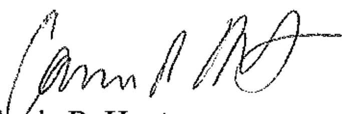
III. Conclusion

NAFCU has long supported regulatory reform that would authorize credit unions to issue supplemental capital and applauds NCUA on approaching the issue in a thoughtful, comprehensive fashion. NAFCU understands that the ANPR's vision for supplemental capital is confined by statutory definitions, and that the utility of subordinated debt or other regulatory capital instruments will be limited to the numerator of the risk-based net worth ratio. In conversations with our members, there is agreement that despite this limitation, supplemental capital can be a valuable tool for credit unions. On the other hand, there is also a need to take caution, as any potential form of supplemental capital must demonstrate complete compatibility with the mutual and cooperative structure of credit unions. NAFCU is confident that NCUA can identify a regulatory capital instrument that is consistent with the FCU Act.

NAFCU also supports amendments to Section 216(o)(2) of the FCU Act that would allow credit unions to include certain forms of supplemental capital as part of the net worth calculation. Although NCUA must proceed carefully with this rulemaking, that does not foreclose the possibility that Congress may yet recognize the challenges credit unions face when building net worth. NAFCU asks that NCUA recognize the need for an amendment to PCA standards in its rulemaking in order to encourage more effective capital planning. Access to capital markets is an important safety feature that guarantees that financial institutions can rebuild their capital after a crisis and support future growth. Unreasonable restrictions on credit union access to capital markets limits flexibility, depresses share rates, and exposes credit unions to greater risk in the event of an unexpected economic downturn.

NAFCU appreciates the chance to submit comments regarding NCUA's Advance Notice of Proposed Rulemaking on Alternative Capital. Should you have any questions or concerns, please do not hesitate to contact me or Andrew Morris, Regulatory Affairs Counsel, at amorris@nafcu.org or (703) 842-2266.

Sincerely,



Carrie R. Hunt
Executive Vice President of Government Affairs & General Counsel