National Association
of Federal Credit Unions
3138 10th Street North
Arlington, VA 22201-2149

NAFCU | Your Direct Connection to Education, Advocacy & Advancement

March 22, 2016

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

RE: Comments on the *Economic Growth Regulatory Paperwork Reduction Act of 1996* - Review Part 4

Dear Mr. Poliquin:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally insured credit unions, I am writing to you regarding the National Credit Union Administration's (NCUA) fourth and final request for comment on the review of its regulations pursuant to the *Economic Growth and Regulatory Paperwork Reduction Act of 1996* (EGRPRA). NCUA requests comments on areas of review within the categories of its existing regulations related to "Rules of Procedure" and "Safety and Soundness."

General Comments

NAFCU applauds NCUA's voluntary participation in the EGRPRA review process since it provides the credit union industry with the opportunity to voice concerns over outdated and burdensome regulatory requirements. NAFCU also appreciates the agency's responsiveness to comment letters submitted by it and other industry stakeholders asking NCUA to provide credit unions with desperately needed regulatory relief. NAFCU looks forward to continuing to work with NCUA as part of this process to provide even further relief.

In addition to providing comments on the subject matters listed in this EGRPRA review, NAFCU would like to take this opportunity to reiterate our members' positions on several pending issues before the NCUA Board, including:

Supplemental Capital

As Chairman Matz has indicated at recent industry events and congressional testimonies, NCUA intends to make rulemaking changes regarding supplemental capital in the near-

future. While NAFCU looks forward to discussing this matter further with the agency, we urge NCUA to carefully consider any such potential rulemaking and its impact on the industry, as well as to provide stakeholders with ample time to study the issue.

Asset Securitization

According to NCUA's fall 2015 rulemaking agenda, the agency expects to finalize an Asset Securitization rule soon. While NCUA works to finalize this rule, NAFCU renews our earlier calls for the agency to allow credit unions to purchase loans from other originators for the purposes of issuing securities.

In July 2014, NCUA proposed to permit federal credit unions (FCUs) to issue securities, backed by loans originated by the issuing FCU. NAFCU supports the fact that asset securitization would provide FCUs with much needed flexibility for managing liquidity and interest rate risk. However, NAFCU is concerned that the rule as proposed is too limiting. Instead, NCUA should permit FCUs to purchase, aggregate, and securitize loans originated from other FCUs or credit union service organizations (CUSOs).

As the agency's preamble recognized, issuing a security is an expensive endeavor that is only feasible for large pools of loans. Without permitting credit unions to purchase and aggregate loans originated from other credit unions, few credit unions will be able to take advantage of this expanded power. In fact, in the proposal's "Estimated PRA Burden," agency staff estimated that only one FCU could undertake asset securitization activities under the proposed regulatory structure.

NAFCU asks the agency to allow FCUs to purchase loans from other FCU originators for the purpose of issuing asset-backed securities. NAFCU believes this rule can provide powerful tools for FCUs, and as such, should not be limited to only one credit union.

Regulatory Impact on Small Credit Unions

NAFCU recognizes and appreciates that reducing regulatory burden must be consistent with ensuring safety and soundness. However, despite NCUA's efforts to ease regulatory burden for small credit unions, NAFCU is concerned that small credit unions are still being regulated out of existence. The number of credit unions continues to decline, dropping by more than 17 percent (more than 1,280 institutions) since the second quarter of 2010. Ninety-six percent of these credit unions were smaller institutions with less than $100 million in assets. These trends show that small credit unions are being disproportionately affected, due in large part to regulatory burden.

While NAFCU appreciates the agency's recent rulemaking expanding the definition of small credit union to include federally insured credit unions (FICUs) with less than $100 million in assets, NAFCU believes it would be prudent for the agency to apply this threshold to more provisions in NCUA Rules and Regulations. As such, NAFCU urges the

agency to make conforming changes to all rules that are based on outdated "small entity" asset thresholds.

Section 701.21 - Lending

Section 701.21(c)(iii) Payday Alternative Lending

NAFCU believes that Payday Alternative Loans (PALs) give credit unions another opportunity to work with members in an effort to get them into traditional financial services products and direct them away from predatory actors. However, as NCUA is aware, the Consumer Financial Protection Bureau (CFPB) is currently engaged in the early stages of a rulemaking aimed at changing the payday lending market. While NAFCU is generally supportive of a rulemaking that would curb unscrupulous lending practices, we urge NCUA to open a dialogue with the CFPB to ensure that the agency's PAL program receives a clear and express exemption from the bureau's upcoming payday lending rulemaking.

Section 701.21 was amended in 2010 and 2011 to enable FCUs to extend PALs. NCUA spent significant time and resources carefully crafting the PAL program in order to create a more consumer-friendly option in the payday lending market. NAFCU remains concerned that the CFPB's proposed rule would substantially alter FCUs' ability to offer PALs.

For example, while NCUA's rules currently allow FCUs to offer up to three PALs in a six-month period, the CFPB is considering limiting FCUs to two PAL loans during that period. The CFPB is also indicating that it may require credit unions to notify its members three days in advance of accessing their accounts for purposes of paying a PAL.

NAFCU and our members believe that any increase in the regulatory burden associated with these loans will create overwhelming challenges, and the end result will be decreased availability of short-term, small-dollar loan products from reputable credit union lenders. The number of FCUs offering PALs has increased steadily in the six years since NCUA first established the program, growing from 257 to 561 FCUs.

However, if the CFPB incorporates changes that would affect the viability of this program as it currently stands, then NAFCU believes the number of FCUs offering PALs would cease to grow. This would negate the hard work of the agency and FCUs committed to finding small dollar alternatives for low-income members. Therefore, it is imperative that NCUA and the CFPB collaborate to ensure that any future rulemaking does not impede credit union advancements in this space.

Section 701.21(c)(8) Guidance on Incentive Based Pay

NAFCU requests that NCUA clarify how it interprets the term "overall financial performance" in section 701.21(c)(8)(iii). Generally, section 701.21(c)(8) prohibits most

credit union employees and officials from receiving compensation made "in connection with any loan" a credit union makes. However, there are some exceptions to this prohibition, namely that an employee, including senior management, may receive an incentive or bonus based on the credit union's overall financial performance.

Despite these general exceptions, NAFCU member credit unions have reported issues with NCUA examiners regarding compensation programs that appear to comply with the requirements of NCUA's rule. Without direct guidance from NCUA on what "overall financial performance" means, NAFCU and its member credit unions will continue to worry that NCUA examiners will apply subjective interpretations of the rule to penalize otherwise compliant compensation programs.

As NAFCU understands, the Office of General Counsel (OGC) recently stated in its 2015 Regulatory Review Report that this rule will be clarified in an upcoming rulemaking. NAFCU appreciates the agency's response to this issue, and looks forward to NCUA's clarification that the regulation should allow for loan growth to be included as a part of the "overall financial performance" calculation. NAFCU believes the new rule should define "overall financial performance" as:

> "A quantifiable metric, set by the board of directors of the credit union, used for the purposes of measuring a credit union's achievement of targeted performance goals. This metric may include, but not be limited to, total asset growth, overall loan growth, return on assets, net-worth ratio, loan-to-value ratio, and delinquency ratios."

Part 703 - Investment and Deposit Activities

Section 703.16(a) Mortgage Servicing Rights

NAFCU urges NCUA to continue to focus its efforts on evaluating new products and services that would serve as beneficial investment opportunities for credit unions. In particular, NAFCU and our members ask that the agency permit credit unions to purchase Mortgage Servicing Rights (MSRs), which are currently listed as a prohibited investment under section 703.16.

Many credit unions, especially small credit unions, neither have the capacity nor the resources to perform mortgage servicing for their members' loans. As a result, they often choose to rely on third parties to perform such functions. NAFCU and our members believe it is both in the best interest of these credit unions, and the industry as a whole, if mortgage servicing is performed by other credit unions. This approach is not only consistent with the credit union cooperative model, but would also better address safety and soundness concerns of individual credit unions and the National Credit Union Share Insurance Fund (NCUSIF).

NAFCU and our members strongly believe NCUA should remove MSRs as a prohibited

investment. At the very least, a FICU should not be prohibited from purchasing MSRs from other FICUs. However, if NCUA does not authorize credit unions to purchase MSRs outright, then NAFCU believes NCUA should provide guidance for eligible credit unions that wish to purchase MSRs under a pilot program authority (discussed below).

Section 703.19 Investment Pilot program

Section 703.19 sets forth contingent permissibility for certain FCUs that possess advanced skills and resources to invest in otherwise prohibited investment products. NAFCU believes this section of Part 703 is underutilized by credit unions, in part due to the uncertainty of authority surrounding this provision. As such, NAFCU urges NCUA to provide guidance to FCUs on ways to expand FCU investment powers that are prohibited by regulation, but otherwise permitted under the FCU Act.

NAFCU believes that pilot programs can enable NCUA to review the demands and risks associated with investment programs before developing a full-fledged regulation. Other federal banking regulators have followed suit and also encourage such innovation through enacted policy. For example, the CFPB recently finalized a policy to facilitate consumer-friendly innovation. Under the new policy, the bureau will reduce potential regulatory uncertainty for innovative products that promise significant consumer benefits.

NAFCU believes that by providing guidance, NCUA would encourage innovation of safe, innovative investment products for the ultimate benefit of the member. By providing guidance, NCUA could do much to reduce uncertainty surrounding such innovations.

Part 715 – Supervisory Committee Audit

Part 715 prescribes the responsibilities of the Supervisory Committee to obtain an annual audit of the credit union, dependent on its asset size. Currently, section 715.5 sets out three asset tiers and the varying requirements under each threshold. Those tiers are currently set at: (1) assets of $500 million or greater, (2) assets of less than $500 million but more than $10 million, and (3) total assets of $10 million or less.

NAFCU urges the agency to amend this rule's asset thresholds, and replace the $10 million asset threshold with a $100 million threshold. This change would conform with recent changes to NCUA's definition of "small entity," which increased the upper asset threshold to $100 million.

Section 741.1 - Examinations

Improvement of AIRES and Call Report

NAFCU appreciates NCUA's 2016 Strategic Plan that lays the path for the agency to reorganize the Call Report for credit unions not involved in complex activities, eliminate data no longer needed, and expand the data collected to address increasing authorities of

credit unions. Additionally, NCUA has indicated that it will invest in updating the Automated Integrated Examination System (AIRES) platform. According to NCUA, both of these improvements will leverage new technology and techniques to make the exam process more efficient and effective, as well as to support improved off-site supervision.

NAFCU generally supports these plans as contemplated, especially as they would enable examiners to conduct more examinations off-site, thus reducing examination time spent at credit unions. Ideally, this will decrease travel expenses, mitigate operational disruptions at credit unions, and increase the quality of exams. However, NAFCU does not believe that these improvements have to be a perquisite to an 18-month examination schedule, but can rather be unrolled in conjunction with an extended exam cycle (discussed further below).

18-Month Examination for Low-Risk Credit Unions

NAFCU believes that an 18-month exam cycle for low-risk credit unions is a prudent path forward to providing regulatory relief to credit unions while simultaneously helping NCUA control examination costs. Further, NAFCU strongly believes that implementing such a cycle does not have to wait until the implementation of technological improvements in the Call Report and AIRES.

The NCUA Board and staff have recently indicated that the agency would begin to consider reverting back to an 18-month examination cycle. However, the agency has repeatedly pushed back plans for an implementation date, first due to promulgation of new rules, then due to antiquated Call Report and AIRES software.

While NAFCU appreciates the fact that the Call Report and AIRES software needs to be modernized, we do not believe that an update needs to be complete before moving to an 18-month examination cycle. Rather, NAFCU urges the agency to develop an 18-month examination strategy in concert with updates to requisite software needs.

Additionally, NAFCU would like to note that Risk Based Capital (RBC) will become effective in January 2019 – a mere 34 months away. As the agency is aware, RBC is a large and far reaching regulatory regime shift. Because of this, NAFCU envisions a scenario where transition to compliance with such a complicated new rule could prove burdensome, both for agency and credit union staff. Therefore, NAFCU believes it would be prudent for the agency to implement an 18-month examination well in advance of January 2019, lest the difficulties of implementing RBC coincide with the roll-out of an 18-month cycle.

Exam Appeals Process

NAFCU continues to hear from our members that the examination process is sometimes inequitable. Although there is a current appeals process in place for credit unions to voice such feelings, the current system has not yielded a significant number of appeals. For example, as Board Member McWatters recently wrote in a NCUA Report, a 2012 NCUA

OIG report found a yearly average of only six credit union "complaints" filed regarding exams between 2007 and 2011.

NAFCU believes that the agency could seek stakeholder input on ways to improve or modernize the process. In fact, this stakeholder input could be sought in tandem with updates to the Call Report, as such technological updates could practicably address some concerns regarding the examination process. As such, NAFCU asks the agency to solicit stakeholder input on the current process, possibly through an Advanced Notice of Proposed Rulemaking (ANPR) issued in conjunction with an updated Call Report.

Section 741.12 - Liquidity and Contingency Funding Plans

In November 2013, NCUA finalized its rule on requiring certain FICUs to have liquidity access and contingency funding plans. Since the rule was finalized, the Board revised the definition of ''small entity'' from a credit union with less than $50 million in assets to one with less than $100 million in assets. NAFCU urges NCUA to raise the lowest threshold in this rule—requiring a basic written policy—to include credit unions with less than $100 million in assets. This revision would be a conforming change.

Part 748, Appendices A and B - Guidelines for Safeguarding Member Information and Responding to Unauthorized Access to Member Information

NAFCU and our members are committed to cybersecurity. In keeping with its overall focus on cybersecurity, NCUA recently noted in its 2016 Supervisory Priorities letter that the agency will review credit union incident response programs. These incident response programs include and address unauthorized access or use of member information that can result in substantial harm to the member and, as a result, reputational risk to the credit union.

The Supervisory Priorities letter also discussed the Federal Financial Institutions Examination Council's (FFIEC) cybersecurity assessment tool, released in 2015. The letter noted that the tool, which allows financial institutions to conduct risk management self-assessments, will be incorporated into NCUA's exam process in the second half of this year. NAFCU, while supporting credit unions' use of the tool, has urged NCUA to keep it voluntary.

At this time, we renew our call for NCUA to keep this tool voluntary. The assessment tool was designed to be used by credit union management on an ongoing basis when considering changes to its business strategy; it was not designed to prescribe desired or required outcomes of individual financial institutions.

Conclusion

NAFCU appreciates NCUA's participation in the EGRPRA review as well as the agency's efforts for soliciting feedback and input from credit unions regarding unnecessary or

unduly burdensome requirements of its rules and regulations. NAFCU and our members continue to urge NCUA to reduce future compliance costs and regulatory difficulties faced by credit unions by addressing the issues raised in this letter.

We look forward to continuing to work with NCUA to address more ways that the agency can streamline and refine existing regulations in order to more effectively grow and support the dynamic credit union industry. Should you have any questions or would like to discuss these issues further, please do not hesitate to contact me at memancipator@nafcu.org or (703) 842-2249.

Sincerely,

Michael Emancipator
Senior Regulatory Affairs Counsel