NASCUS
National Association of State Credit Union Supervisors

May 2, 2011

Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Re: NASCUS Comments on Notice of Proposed Rulemaking - Removing References to Credit Ratings

Dear Ms. Rupp:

The National Association of State Credit Union Supervisors (NASCUS)[1] appreciates the opportunity to provide comments to the National Credit Union Administration (NCUA) concerning the proposed rule to remove references to credit ratings in determining the credit-worthiness of a security as directed by Title IX of the Dodd-Frank Act.[2]

NCUA's proposal affects four chapters of the agency's rules and regulations: Part 703, Investment and Deposit Activities; Part 704, Corporate Credit Unions; Part 709 Involuntary Liquidation of Federal Credit Unions and Adjudication of Creditor Claims; and Part 742 Regulatory Flexibility Program. All four chapters impacted by the proposed rule directly or indirectly affect state-chartered federally insured credit unions.

Part 703, Investment and Deposit Activities

Eight of the 24 existing references to the credit rating of a security are contained in Part 703 of NCUA's rules governing investment authority for federal credit unions. State-chartered federally insured credit unions are affected by changes to NCUA's investment rules because of Part 741.3(2), Special Reserve for Non-Conforming Investments. Part 741.3(2) requires state-chartered credit unions:

> *"…to establish an additional special reserve for investments if those credit unions are permitted by their respective state laws to make investments beyond those authorized in the Act or the NCUA Rules and Regulations."*

Currently, many state investment rules for credit unions contain the same "rating based" structure that NCUA is now changing. NCUA should make clear in the preamble to the final rule that state investment authority is not deemed "beyond those authorized" for federal credit unions and therefore does not trigger Part 741.3(2) non-conforming reserve requirements if the

[1] NASCUS is the professional association of the nation's state credit union regulatory agencies.
[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, §939A (2010).

state investment authority and the NCUA proposed rule result in the same credit quality. NCUA notes in its proposal that the narrative description provided by rating agencies often correlates to the rating assigned to a specific security.[3] As such, the proper focus of a regulatory analysis of the application of §741.3 should be the underlying credit quality and not the specific wording of the state rule.

NCUA should also clarify the proposed rule's treatment of municipal securities. The proposal imposes concentration limits on such investments which raises several concerns for state-chartered federally insured credit unions and the application of non-conforming investment reserve requirements.[4] If NCUA considers the proposed concentration limits applicable to state-chartered federally insured credit unions for reserving requirements, it should make that more clear. Furthermore, if that is NCUA's position, those limits should be codified in Part 741 to reduce the regulatory burden on state charters.

Before expanding the municipal security concentration limits to state-chartered credit unions for reserving, NCUA should consider the potential utility of such holdings to state-chartered credit unions. NCUA's proposal dismisses the utility of holding municipal securities for federal credit unions because of the broad tax exemption already enjoyed by federal credit unions. However, state-chartered credit unions do not enjoy the same tax exempt status as their federal counterparts. In some cases where state taxation may be applicable to a state-chartered credit union, the holding of tax free municipal securities may have increased value. Given that NCUA itself raised the benefit of the tax free status of such holdings, the agency should reconsider the application of the concentration limits and its effect on state credit unions.

In addition, NCUA may wish to consider distinguishing between types of municipal securities. Municipal securities backed by the full faith and credit of the issuing entity present a lower risk than other types of municipal securities. In fact, the Federal Credit Union Act recognizes this distinction by exempting general obligation bonds from a statutory limit on investments.[5]

Part 704, Corporate Credit Unions

Fourteen of the proposed changes to rating references are contained in Part 704 of NCUA's regulations. Because §704 applies directly in its entirety to state-chartered corporate credit unions, the possibility for confusion is mitigated. As presented, the proposed changes provide corporate credit unions the necessary flexibility to operate under the rules.

Implementation Period

The proposed rule was silent as to an effective compliance date. While the Dodd-Frank Act provided a certain deadline for the federal agencies to study the removal of references to credit ratings and the modification of rules, it was silent as to effective date for compliance with new

[3] "Removing References to Credit Ratings in Regulations; Proposing Alternatives to the Use of Credit Ratings; Notice of proposed rulemaking" 76 Federal Register 40 (March 1, 2011), p. 11164.
[4] Id. at 11166. Limiting investments in municipal securities to no more than 75% of the credit union's net worth in the aggregate and 25% limit for any single issuer.
[5] 12 U.S.C. 1757(7)(k).

rules. Given the possible effect on credit unions holding securities now limited by the proposal, NCUA should explicitly provide for grandfathering of existing holdings similar to the grandfather exemption found in §703.18.

NASCUS and state regulators remain committed to working with NCUA to mitigate material risk throughout the credit union system, and appreciate the opportunity to submit comments on this proposed rule.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
SVP Regulatory Affairs & General Counsel