NASCUS
National Association of State Credit Union Supervisors

May 23, 2011

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

Re: NASCUS Comments on Proposed Rulemaking – Part 741, Interest Rate Risk

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 rulemaking Part 741.3(b)(5) requiring a written interest rate risk (IRR) policy and an "effective interest rate risk management program." State regulators support the concept that IRR management is an essential component of a credit union's safe and sound operations and they would expect that all credit unions under their supervision, regardless of size, appropriately identify and manage IRR.

NASCUS appreciates the difficulties associated with drafting sound and reasonable regulations concerning IRR. As NCUA correctly notes, it is impossible to promulgate specific regulatory requirements and thresholds for IRR that are appropriate for all institutions. Effective IRR management requires fact specific judgment that considers a credit union's balance sheet, structure, circumstances and mission.

Our evaluation of NCUA's proposed rule focuses on whether it effectively balances the need for regulatory recourse with the necessary flexibility for credit unions to adopt policies that make sense for their balance sheet and circumstances. Although NCUA's proposed rule attempts to achieve this balance by developing a three (3) tiered approach to compliance and by including detailed guidance in the form of an Appendix to the proposed rule. However, NASCUS supports a more simple approach. We believe our approach maximizes flexibility for credit unions while making clear the regulatory requirement to effectively manage IRR.

Balancing Flexibility, Simplicity, and Unequivocal Regulatory Mandate

At NASCUS, our objective is to ensure the safety and soundness of the state credit union system and to pursue reasonable efficiencies to minimize regulatory burden. In general, NCUA's proposed tiered compliance concept ignores the fact that IRR may be present in a credit union of any size. Likewise, a larger credit union may have negligible IRR present on its balance sheet. The regulatory standard should be to require every credit union to identify and to effectively manage IRR, including shock testing as appropriate. We believe the following alternative to NCUA's proposal both

[1] NASCUS is the professional association of the nation's state credit union regulatory agencies.

satisfies regulatory concerns and provides credit unions flexibility to manage IRR to their unique situations:

> *741.3(b)(5) Interest Rate Risk – (A) An effective interest rate risk management program that is appropriate for the size and complexity of the credit union. An effective program:*
> *(i) considers the assets and liabilities of the institution;*
> *(ii) is documented;*
> *(iii) provides for management reports to the credit union's board; and*
> *(iv) utilizes testing as appropriate or directed by state regulators or NCUA.*
> *(B) State specific rules – upon application to NCUA, state-chartered credit unions in compliance with a state specific interest rate risk rule will be deemed in compliance with this part if NCUA determines the state rule provides sufficient protection to the fund.*

A regulatory approach as described above balances the credit unions' and regulators' needs. Our alternative proposal makes clear that credit unions must identify, evaluate and manage any interest rate risk. It provides clear and conspicuous authority for regulators to require shock testing, but also provides credit unions with freedom to design a program that matches whatever IRR may exist. This approach is consistent with the IRR program requirements contained in Federal Deposit Insurance Corporation (FDIC) regulations for other types of depository intuitions.[2]

The guidance NCUA proposes to publish as an Appendix to the rule could be published separately but concurrently with the proposed rule to provide credit unions a better understanding of regulators' expectations as to "effective" and "appropriate" IRR management.

NCUA's Proposed Rule

While NASCUS prefers an approach to IRR regulations as outlined above, if it is NCUA's determination to retain the three (3) tiered approach, it should clarify its expectations for small credit unions. In the commentary accompanying the proposed rule, NCUA states "FICUs less than $10 million in assets are not required by the rule to have a written policy" even if they meet the balance sheet thresholds established for credit unions with assets between $10 million and $50 million.[3] However, the proposed rule itself is worded differently. The proposed rule states "FICUs less than $10 million in assets **are not required by the rule to have** a written policy and **an effective interest rate risk management program** even if the total of first mortgage loans held plus total investments with maturities greater than five years is greater than 100% of its net worth." [emphasis added]. See 76 Federal Register 57 (March 24, 2011) p. 16573. As written, the proposed rule seems to state that a small credit union is not required to have an IRR program at all. While NCUA clearly intended to exempt small credit unions from the requirements of a

[2] FDIC's rule, 12 C.F.R. Appendix A to Part 364 §(II)(E), reads as follows:

> E. *Interest rate exposure.* An institution should:
> 1. Manage interest rate risk in a manner that is appropriate to the size of the institution and the complexity of its assets and liabilities; and
> 2. Provide for periodic reporting to management and the board of directors regarding interest rate risk with adequate information for management and the board of directors to assess the level of risk.

[3] See 76 Federal Register 57 (March 24, 2011) p. 16572.

detailed written IRR program, it seems unlikely that NCUA intended to exempt small credit unions from having a program, e.g. policies and procedures, in place to identify and manage IRR. To our knowledge small credit unions have never been excluded from previous guidance on IRR. If the proposed rule was intended to change the application of IRR guidance and management for small credit unions, NCUA should make that clear.

In addition, the benchmark for the middle tier of compliance raises some questions. NCUA's proposal requires credit unions with assets between $10 million and $50 million to have a written IRR policy if "the total of first mortgage loans held plus total investments with maturities greater than five years is equal to or greater than 100% of its net worth." Ibid p. 16573. If NCUA ultimately adopts this proposed benchmark, it should discuss why this particular benchmark is appropriate, rather than a higher level, or conversely, why it does not include second mortgage or other interest sensitive extensions of credit.

NCUA's Proposed Guidance as an Appendix to the Proposed Rule

As a general matter, NASCUS recommends that NCUA publish guidance on the proposed rule independently of the rule rather than as an Appendix to the rule. By publishing the guidance independently, NCUA can minimize confusion as to what is "rule" and what is "guidance." Furthermore, by publishing the guidance independently, NCUA preserves the ability to quickly amend or augment the guidance in the future.

As NCUA notes in its proposal, there already exist seven (7) previously issued NCUA Letters to Credit Unions on various aspects of IRR as well as a January 2010 Interagency Guidance (in which NCUA participated) which remind institutions of supervisory expectations regarding sound practices for managing IRR. NCUA should make clear if it considers the proposed Appendix in conjunction with the rule to be the definitive guidance to date superseding all others.

Better Reporting of Interest Rate Risk

Although outside the scope of the current proposal, NCUA could also consider making changes to the Call Report to better capture information regarding the potential IRR on a credit union's balance sheet. NASCUS believes better reporting would mitigate some of the need for more detailed requirements for IRR management. Currently, the NCUA Call Report captures only basic investment, deposit and liability and mortgage loan information.[4] In comparison, the FDIC Call Report collects more detailed information on an institution's investments, loans, deposits, and liabilities with more detailed maturity durations.[5] While NASCUS recognizes that more detailed Call Report information may not be necessary for all credit unions, this recommendation is made as an alternative to a more comprehensive regulation, not in addition to it. The benefit

[4] The NCUA Call Report may be found at: http://www.ncua.gov/dataservices/data/5300/June2011CallReportFormandInstructions.pdf.

[5] The FDIC Call Report may be found at: http://www.ffiec.gov/PDF/FFIEC_forms/FFIEC041_201103_f.pdf.

of regulatory simplicity in this case outweighs, in our view, the burden that may be imposed by better IRR reporting.

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. Whether NCUA chooses to explore NASCUS' recommendations for a more streamlined approach to interest rate risk regulation, or moves forward with rulemaking similar to that proposed, NASCUS and state regulators would be pleased to discuss these comments at NCUA's convenience.

Sincerely,

- signature redacted for electronic publication -

Brian Knight
SVP Regulatory Affairs & General Counsel