Office of the Chairman

March 10, 2016

HAND DELIVERED

The Honorable Frank Guinta
Member of Congress
326 Cannon House Office Building
Washington, DC 20515

Dear Congressman Guinta:

Thank you for your letter of February 18, 2016, expressing your support for NCUA returning to an extended examination cycle, especially for smaller, lower-risk credit unions. Your views on important issues such as this one help the agency as we work to oversee 6,021 federally insured credit unions and insure nearly $1 trillion in deposits and shares of more than 102 million accountholders.

Credit Union Consolidation Trends

First and foremost, please know that I sincerely appreciate your concerns about the long-term trend in the consolidation of credit unions. The pace of credit union consolidation has been steady over more than two decades and across a variety of economic cycles, including the recession of the early 1990s, the bust of the technology boom in the early 2000s, and the recent Great Recession. The trend has remained relatively constant after the passage of landmark laws such as the Credit Union Membership Access Act of 1998 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. This long-term credit union trend is very similar to the consolidation trends occurring among banks and thrifts.

NCUA's Ongoing Regulatory Relief Efforts

To mitigate consolidation trends and minimize regulatory burdens, NCUA has worked to provide regulatory relief, where possible. In fact, NCUA finalized or proposed 15 modernized regulations to reduce compliance burdens or authorize new powers since 2015. Among our most significant relief initiatives, NCUA:

- Eliminated the 5-percent cap on fixed assets and removed the need for federal credit unions to apply to NCUA for fixed-asset waivers. In doing so, we transferred the power to make business decisions about purchasing land, buildings, office equipment and technology to credit union officials—where it belongs.

- Allowed federal credit unions to automatically add 12 pre-approved categories of associational groups to their charters. This change makes it easier for federal credit unions to grow their fields of membership.

- Modernized the agency's member business lending rules by removing limits not required by Congress. These changes empower credit unions to write their own business loan policies, eliminate the personal guarantee requirement and need for regulatory waivers, and remove unnecessary barriers on business loan participations, which help credit unions diversify risks.

- Expanded share insurance coverage for certain types of escrow accounts. Our updated share insurance regulation provides greater clarity and regulatory certainty around broad categories of escrow accounts that now automatically receive pass-through coverage. In addition to lawyers' trust accounts, these accounts include real estate agents' escrow accounts, prepaid funeral accounts, and other similar escrow accounts.

- Permitted corporate credit unions to make bridge loans for up to 10 business days to provide interim funding to Central Liquidity Facility borrowers, allowing consumer credit unions to receive funds more quickly.

- Lifted the asset threshold for the definition of "small" credit union from $50 million to $100 million. As a result of this change, three out of every four credit unions are now eligible for special consideration for regulatory relief in future rulemakings.

- Proposed expanding field of membership options for community charters and occupational charters. Under the proposal, federal credit unions would be eligible to serve entire congressional districts, combined-statistical areas with populations up to 2.5 million, or rural districts with populations up to one million. Federal credit unions also could extend membership eligibility to serve honorably discharged veterans, contractors and businesses in industrial parks. NCUA also proposed streamlining the application process for federal credit unions to serve select employee groups and underserved areas.

- Proposed eliminating an unintentionally burdensome investment requirement by providing federal credit unions with greater choices when investing in bank notes.[1]

In recent years, NCUA also has scaled several regulations based on the size and complexity of the credit union, exempting some credit unions from several regulations entirely. For example, NCUA's final risk-based capital rule exempts credit unions with assets less than $100 million. NCUA's final interest rate risk rule exempts credit union with assets less than $10 million, only requires a written policy for most credit unions between $10 and $50 million, and entails a policy and program for larger credit unions. In addition, under NCUA's final rule on liquidity and contingency funding, only credit unions with assets exceeding $250 million need to have access to NCUA's Central Liquidity Facility, the Federal Reserve's Discount Window, or both.

Small Credit Union Examination Program

Beyond providing regulatory relief, where possible and consistent with safety and soundness, NCUA has minimized examination burdens for small credit unions. Specifically, NCUA has adopted a streamlined examination for well-run credit unions with less than $50 million in assets. This reduces the burden of examinations on the smallest credit unions and allows resources to be

[1] This is a brief list of NCUA's most significant regulatory relief initiatives. For a more comprehensive list, see: https://www.ncua.gov/newsroom/Pages/RegulatoryModernizationInitiativeResults.pdf.

reallocated to larger credit unions. It also allows smaller credit unions to spend more time serving their members, rather than preparing for examinations.

NCUA has followed a risk-focused exam program since 2002. This approach is designed to efficiently allocate agency resources to credit unions and areas of operations exhibiting the greatest potential risk exposure to the Share Insurance Fund. The program relies on examiner judgment to determine the areas needing review, rather than reviewing every aspect of each credit union. Over time, NCUA has adjusted this approach by adding minimum scope requirements and establishing the *National Supervision Policy Manual* to ensure consistency of supervisory actions across the country.

In 2011, we determined the resources used to complete examinations were not in balance with the credit union system's risks. NCUA was spending more exam hours on the smallest credit unions rather than on the largest credit unions that have the greatest concentration of the system's assets and the greatest potential risk exposure to the Share Insurance Fund.

NCUA has since reallocated resources and concentrated supervision on credit union activities posing the most risk. The agency has put in place a targeted, streamlined examination program for financially and operationally sound federal credit unions with less than $30 million in assets. NCUA field staff also have the discretion to choose a similarly streamlined, defined-scope examination for federal credit unions with $30 million to $50 million in total assets that received a composite CAMEL rating of 1, 2, or 3 at their last examination.

Through the Small Credit Union Examination Program, NCUA spends less time, on average, in smaller, well-managed federal credit unions. This decreased examination burden reflects a reduced overall scope but is more precisely focused on the most pertinent areas of risk in small credit unions—lending, recordkeeping, and internal control functions. As a result, between 2012 and 2015, exam and off-site supervision hours allocated to credit unions with less than $50 million in assets decreased by nearly 21 percent. During the same time period, hours allocated to large credit unions with more than $500 million in assets increased by more than 15 percent.

Examination Technology Updates

Additionally, NCUA is now in the process of updating our Call Report and examination software platforms. The platforms upon which these systems are built are at the end of their life cycles. Therefore, NCUA must invest in updating them to maintain functionality. For the past year, the agency has been identifying the requirements and specifications to achieve this goal. In updating these systems, NCUA can leverage new technology and techniques to make offsite monitoring and the exam process more efficient and effective. For example, the agency is exploring expanded capabilities related to evaluating the quality of a credit union's loan and investment portfolios, conducting pre-examination planning more efficiently, and reducing data entry by examiners.

One of the goals of these system improvements is to enable examiners to conduct more examination steps off-site, reducing on-site examination time by as much as half. This new approach will increase the quality of exams, lower travel costs, reduce any disruption for credit unions caused by exams, and improve the quality of life for examiners. These changes to the supervision system and process improvements require a significant investment of agency capacity over the next few years to implement, including developing examiner guidance, adopting new and specialized training for examiners, and designing, testing, and implementing the new software systems.

The Steps Ahead

Let me assure you: I recognize the potential advantages to adopting an extended exam cycle for healthy credit unions, such as devoting more resources to an improved examination experience, focusing on weaker institutions, and possible budgetary savings which you articulate in your letter. However, given the amount of regulatory improvements occurring and extensive examination systems work that must be completed first, it is best to prioritize building out the improved systems and processes, and finalizing and incorporating the various regulatory relief measures instead of implementing an extended examination cycle during the current year.

Given that the agency's 2016 exam cycle and budget are already in place, there is a limited amount of organizational capacity to make such changes at this time. The agency already has put in motion many initiatives that will improve the examination process, which will take time and resources to complete and that would be critical aspects of the foundation upon which the NCUA Board might consider extending the examination cycle. An extended examination cycle might run longer or shorter than 18 months depending on the effectiveness of the systems we build and the need to ensure safety and soundness. I believe the Board should ensure these improved systems and processes are in place and operating properly before the Board makes any decision to extend the examination cycle.

These new processes and procedures are scheduled to be in place by the end of 2017. At that time, the NCUA Board will be in a better position to consider a comprehensive, well-integrated plan for an extended examination cycle that complies with the recommendations previously made by the U.S. Government Accountability Office and NCUA's Office of the Inspector General. In the meantime, NCUA will continue its efforts to conduct streamlined examinations at smaller, well-run credit unions. We will also continue working to provide regulatory relief and new powers, consistent with the requirements of the Federal Credit Union Act.

Thank you again for contacting NCUA about ongoing changes to the examination process. Please do not hesitate to contact me about any other questions or concerns you might have.

Sincerely,

Debbie Matz

Debbie Matz
Chairman

cc: The Honorable Rick Metsger, NCUA Board Vice Chairman
The Honorable J. Mark McWatters, NCUA Board Member