NASCUS
National Association of State Credit Union Supervisors

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Regulatory Review (2015)
Office of the General Counsel
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314

Via e-mail to ogcmail@ncua.gov

To Office of the General Counsel,

The National Association of State Credit Union Supervisors (NASCUS) appreciates the opportunity to offer the following comments and recommendations regarding NCUA's Rules and Regulations pursuant to the 2015 Regulatory Review.[1] We commend NCUA for its ongoing rolling rule review pursuant to Interpretive Ruling and Policy Statements (IRPS) 87-2 and 03-2. As a representative of state regulatory agencies, NASCUS understands it is incumbent on regulators to reduce unnecessary regulatory burden on their supervised entities to the extent compatible with public policy and principles of safety and soundness.

The 2015 Regulatory Review covers NCUA Parts 700 through 710. It appears that of the 35 provisions subject to this year's review, only 15 apply to federally insured state chartered credit unions (FISCUs) by way of reference in § 741. NASCUS' comments, which follow below, are limited to those provisions applying to FISCUs for which we have recommendations. Furthermore, because the application to FISCUs of the provisions subject to this regulatory review invoke provisions in §741, we address changes to those provisions as well. Because of the structure of NCUA's rules and NCUA's use of incorporation by reference, we consider relevant §741 provisions ripe for review under this request for comments.

Consolidation of NCUA Title II Share Insurance Rules

As noted above, only 15 of the 35 provisions of NCUA's rules subject to this year's rule review apply to FISCUs. However, nothing in NCUA's notice regarding the rule review indicates which rules apply to FISCUs. To submit relevant comments, a FISCU would have to compare each of the 35 provisions against the entirety of Part 741 to identify the cross reference to the provisions subject to the review. This unnecessarily burdensome process is emblematic of the regulatory burden NCUA places on FISCUs by the agency's continued resistance to reorganizing its rules and regulations to consolidate those rules applicable to FISCUs. The process of identifying which provisions apply to FISCUs is further complicated by the fact that often only sub-provisions of a referenced rule applies. This requires FISCUs to work their way thru NCUA's

[1] NASCUS is the professional association of the 46 state and territorial credit union regulatory agencies.

federal credit union rules (FCU rules) to match up the applicable sub-provision. As NASCUS has noted in the past, it is incumbent on a regulator to make it as unambiguous as possible to its regulated industry what the compliance obligations are.

Simply consolidating rules applicable to FISCUs would make it easier for FISCUs to understand which rules apply, in turn facilitating compliance. Consolidation would also reduce confusion among examiners, state and federal, as to which rules apply to FISCUs. We note that consolidating rules requires no lengthy safety and soundness analysis, or balancing of supervisory concerns with regulatory burden.

701.14 Change in Official or Senior Executive Officer in Credit Unions that are Newly Chartered or are in Troubled Condition

Part 701.14 applies to FISCUs, in part, by way of reference in §741.205. This provision requires newly chartered or certain troubled credit unions to receive prior approval from NCUA and their state regulator before engaging new senior executive officers or directors. As noted above, the applicable sections of §701.14 should be incorporated in §741, rather than merely referenced in §741.205.

In addition, NCUA should clarify the role of the state regulator in the approval process for newly chartered or troubled FISCUs. In some states, the approval/rejection determination is made by the state regulator in consultation with NCUA. NCUA should amend the regulation to note that a FISCU will be notified by its state regulator, or NCUA, of the determination regarding a change of senior official.

It is our understanding that credit unions subject to this provision must file the notice using specific forms designated by NCUA, yet the regulation makes no mention of that fact. To facilitate a credit union's understanding of the process, the regulation should clearly designate the specific forms needed to comply with the notice requirement.

§ 701.21 Loans to Members and Lines of Credit to Members

NCUA's regulations concerning loans applies to FISCUs, in part, by way of reference in §741.203. Part 701.21 provides a clear example of the confusion presented by NCUA's practice of incorporation by reference. While the rule itself is extensive, only three sub-provisions apply to FISCUs, and even those sub-provisions explicitly reference only federal credit unions. To clarify the rule, we recommend NCUA make the following changes.

Part 701.21(c)(8) should be incorporated into Part 741 in its entirety. At a minimum, NCUA should change the references within the sub-section (c) to include FISCUs. NCUA should also consider revising, and simplifying, the exception for loan compensation pursuant to a credit union board approved policy. It is our understanding that in the field, there is sometimes confusion as to whether a specific credit union is in compliance with this provision regarding the formality of a policy versus a "plan." To minimize the risk of confusion, NCUA should amend §701.21(c)(8)(iii)(C) to allow for such compensation "as approved" by the credit union's board.

Currently, the controlling provision for application of these rules for FISCUs is §741.203, which contains a partial exemption for states with substantially similar rules. Specifically, §741.203(a) provides an exemption to the requirements of §701.21(c)(8) and (d)(5) if a state has adopted a substantially similar rule. However, the requirement for FISCUs to comply with §701(h) is contained in §741.203(c) and contains no similar exemption. NCUA should extend the exemption provision to include the limitations regarding third party servicing contained in §721(h).

§ 701.22 Loan Participations & § 701.23 Purchase, Sale, and Pledge of Eligible Obligations

NCUA's Loan Participation and Eligible Obligation rules apply to FISCUs by way of reference in §741.8 & §741.225. We recommend several changes to the existing rules.

Part 701.22(b)(4) requires the borrower in a loan participation to become a member of one of the participating credit unions. The safety and soundness nexus between membership of the borrower and quality of the participation loan is too tenuous for NCUA to extend it to FISCUs. NCUA should exempt FISCUs from §701.22(b)(4).

Existing §701.22 contains two prescriptive thresholds for which waivers from the NCUA Regional Director are available. These include limitations on the aggregate amount of loan participations and the aggregate amount of participations connected to one borrower.[2] We recommend NCUA replace these prescriptive thresholds with principle based thresholds that defer to state law, credit union policy, and prudent supervisory oversight.

We also urge NCUA to clarify the application of its loan participation and eligible obligation rules, to FISCU indirect vehicle loan purchases. It is our understanding that the definitions contained in current Part 701.22(a) pertaining to "originating lender," "loan participation," and "eligible organization," may be interpreted to limit the ability of federally insured credit unions to participate in indirect auto loans.[3]

701.32 Payment on Shares by Public Units & Nonmembers & § 701.34 Designation of Low-Income Status; Acceptance of Secondary Capital

Parts 701.32 and 701.34 apply to FISCUs by way of reference in §741.204. Part 701.32 limits FISCU holdings of public deposits and non-member shares to those limits applied to FCUs, but

[2] See 12 C.F.R. 701.22(b)(5)(ii), and 701.22(b)(5)(iv)

[3] See 12 C.F.R. 701.22(a), defining the terms as follow:

- *Originating Lender* – means the participant with which the borrower initially or originally contracts for a loan and who thereafter or concurrently with the funding of the loan, sells participations to other lenders.
- *Loan Participation* –means a loan where one or more eligible organizations participate pursuant to a written agreement with the originating lender and the agreement requires the originating lender's continuing participation throughout the loan.
- *Eligible Organization*– means a credit union, credit union organization or financial institution.

provides for a waiver to those limits. In 2012, NCUA raised the prescriptive threshold from 20% of total shares or $1.5 million to 20% of total shares or $3 million.[4]

NCUA should take a principle based approach and exempt FISCUs from the prescriptive limits of §701.32, allowing FISCUs to hold both public deposits and non-member deposits to the extent permissible by state law. In so doing, NCUA should replace the reference to §701.32 contained in §741.204 with a provision in §741.204 that subjects FISCU holding of nonmember deposits and public deposits to state law and prudent safety and soundness supervision.

When raising the prescriptive threshold in 2012, NCUA noted that nonmember deposits are more volatile than member share deposits.[5] As a result, at the time, NCUA declined to raise the prescriptive dollar threshold above $3 million. We believe the concerns expressed by NCUA in 2012 are sufficiently mitigated to warrant eliminating the prescriptive thresholds for FISCUs. A FISCU's ability to accept both nonmember and public deposits is limited by state law prescriptions, including, in some cases, prohibitions. In addition, NCUA retains supervisory authority as the share insurer to evaluate the levels of such deposits and take remedial action as necessary in its capacity as share insurer.

Adopting a principle based approach toward public and nonmember deposits, rather than the current prescriptive and waiver approach, would be consistent with NCUA's recent proposal to provide "greater flexibility and individual autonomy" to credit unions to meet members' needs in the context of commercial lending.[6]

NASCUS also recommends several changes in NCUA's application of its rules related to low-income designation and acceptance of secondary capital accounts to FISCUs. Pursuant to §741.204(b) a FISCU must obtain a low-income designation from its state regulator, pursuant to requirements established in §701.34(a) prior to applying to NCUA for the designation. We note that the low-income designation provided for in both Parts 741.204 and 701.34 are federal regulatory designations that affect the application of other federal regulations.[7]

While it is proper for NCUA to consult with the state regulator to make a determination on whether the designation implicates state law or state supervisory concerns, the determination is based in federal law. Part 741.204 should be amended to clarify that the determination of low-income designation in consultation with the state regulator. This change would reinforce that the low-income designation is a federal share insurance rule and not tied to specific state rules.

[4] Nonmember Deposits, 77 FR 38981 (May 21, 2012).
[5] Ibid.
[6] Commercial Lending, Proposed Rule, 80 FR 37898 (July 1, 2015).
[7] See 12 U.S.C. 1752(5), 1757a(b)(2)(A), 1757a(c)(2)(B), 1772c-1.
• Exemption from the statutory cap on member business loans;
• Authorization to accept non-member deposits from any source;
• Authorization to accept secondary capital; and
• Eligibility for assistance from the Community Development Revolving Loan Fund.

§702 Capital Adequacy

NCUA's Prompt Corrective Action rules apply to FISCUs by way of reference in §741.3. Currently, NCUA is considering finalizing a risk-based capital rule for which NASCUS submitted extensive comments.[8] We reiterate here that NCUA should exercise its authority to incorporate supplemental capital into any future risk-based capital rule.

NCUA also recently issued final rules adjusting its Capital Planning and Stress Testing schedules.[9] NASCUS submitted extensive comments on that proposal as well, and we thank NCUA for adopting several of our recommendations in that final rulemaking.

§ 704 Corporate Credit Unions

NCUA's corporate credit union rules apply to all state chartered corporates by way of reference in §741.3. During the recent recession, some sectors of the corporate credit union system experienced extreme distress with the potential for cascading losses to decimate thousands of natural person credit unions. In response, NCUA re-promulgated a comprehensive re-vamped corporate credit union rule, containing on-going capitalization thresholds and benchmarks and dramatically limiting approved corporate credit union activities.

While NASCUS concurs with NCUA that some corporates engage in high risk activity for which their capitalization, and mitigation strategies, were insufficient, we remain equally concerned with the current homogenization of the corporate credit union system.

NCUA's corporate credit union rule should provide for variances at the state level unless a direct, material, nexus to safety and soundness exists. For example, a state chartered corporate credit union should be permitted to follow state law with respect to the composition of its board of directors,

Allowing diversity of regulation between state and federal charters, within prudent safe and sound parameters, yields benefits to both charters, and contributes to a more vibrant credit union system.[10]

Part 704.19 requires corporate credit unions prepare, maintain, and disclose annually, the compensation of top executive employees. The rule, however, is silent as to how the requirement may be satisfied.[11]

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[8] Risk-Based Capital, Proposed Rule, 80 FR 4340 (January 27, 2015).
[9] Available at http://www.ncua.gov/Legal/Documents/Regulations/FIR20150723CapitalPlanning.pdf.
[10] For example, with respect to natural person credit unions, NCUA's recent rulemaking with respect to fixed assets has prompted some states to review their existing regulations with regard to fixed assets. Likewise, recent NCUA rulemaking considerations relaxing federal credit union limitations of derivatives, field of membership, securitization, and member business lending demonstrate the forward looking state regulations which NCUA has considered emulating.
[11] 12 C.F.R. 704.19.

As NCUA knows, all state chartered credit unions, including state chartered corporate credit unions, are required to annually file an Internal Revenue Service Return of Organization Exempt from Income Tax (Form 990).[12] The Form 990 is a publically available document. NCUA should clarify that state chartered corporate credit unions satisfy the requirements of this provision so long as the corporate's Form 990 filing contains the information required by the provision, and access to the Form 990s is made available to the members. We note that with corporate credit unions in particular, the "members" in question are primarily institutional members (natural person credit unions) who themselves file, and understand, the Form 990 and the information it provides. Clarifying the ability of a corporate credit union to satisfy Part 704.19 with the filing of a Form 990 reduces regulatory burden, vindicates the spirit of the rule, and raises no safety and soundness implications.

§708a Bank Conversions and Mergers & §708b Mergers of Federally-Insured Credit Unions; Voluntary Termination or Conversion of Insured Status

NCUA's rules regarding mergers and conversions apply to FISCUs by way of reference in §741.208. While the Federal Credit Union Act grants NCUA the authority to promulgate rules for the merger of federally insured credit unions as well as conversion to non-credit union status, we continue to urge NCUA to read its statutory mandate, with respect to FISCUs, in the spirit of safety and soundness concerns rather than a members' rights and governance perspective. NCUA should limit application of both §708a and §708b to FISCUs to questions of safety and soundness and share insurance liability. The form of notice to members, the means by which elections are conducted, vote thresholds, and other governance issues should be left to state law. We offer additional specific recommendations below.

Current §708a.103 requires a credit union's board to publish multiple public notices before it votes on whether to take a proposal to convert to a non-credit union charter. As NASCUS noted at the time of this change to the rule, this is an extraordinary requirement. We offer no opinion as to whether this provision is appropriate for FCUs, but urge NCUA to exempt FISCUs from this requirement. State credit union law may vary from NCUA as to the duties and obligations of directors. Given that in all cases, members ultimately vote on conversions, the inclusion of this provision seems only to slow a board's faithful deliberation and vote on the issue.

Current §708b.2 requires specific disclosure, in a credit union merger, of any merger related change in compensation for director or senior official of 15% or $10,000.00. NASCUS favors transparency, but recommend that this threshold be limited to FCUs, or raised. We note that FISCUs are already subject to compensation disclosure in an ongoing manner by way of the annual Internal Revenue Service (IRS) Form 990 that must be filed. Furthermore, as noted above, issues related to disclosure of merger related compensation are governance issues properly left to state law.

In closing, we once again commend NCUA for its commitment to regularly reviewing the agency's rules and regulations. We also note that NCUA has, in addition to its own annual one-third rule review, committed to voluntarily participating with the rule review process Congress

[12] IRM §6033.

mandated for the other federal bank agencies. NASCUS remains committed to working with NCUA to foster the partnership between state and federal regulators and reduce regulatory burden for FISCUs consistent with prudent supervisory standards. Please do not hesitate to contact me to discuss any of these suggestions and recommendation.

Sincerely,

Brian Knight
NASCUS General Counsel