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National Association of Federally-Insured Credit Unions

May 7, 2021

Melane Conyers-Ausbrooks
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

RE: CAMELS Rating System (RIN: 3133-AF32)

Dear Ms. Conyers-Ausbrooks:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the National Credit Union Administration's (NCUA) proposed rule adding an "S" component and redefining the "L" component of the existing CAMEL rating system. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 124 million consumers with personal and small business financial service products. NAFCU generally supports this proposed rule, but requests that the NCUA release more robust details about their expectations of credit unions meeting any new standards for the "S" component and what this change will mean for the examination process; additionally, the NCUA should give credit unions the opportunity to comment should the NCUA decide to modify the rating descriptions used by the banking agencies. NAFCU further requests that the NCUA address the consistency of the examination process as it has varied over the years from examiner to examiner and bifurcating components could create more inconsistencies.

General Comments

In 1997, the Financial Institution Examination Council (FFIEC) adjusted the CAMEL rating system to add a sixth component, Sensitivity to Market Risk ("S") but the NCUA did not sign on to this change because, at the time, credit unions lacked complexity in their consolidated balance sheets. As time has progressed, so have credit unions and their offerings; they have increased in size and complexity thus significantly increasing their assets. NAFCU agrees with the NCUA that there are some similarities between sensitivity to market risk and liquidity risk exposures, but there are also differences. NAFCU further agrees that creating distinct components will aide in clarity and transparency.

Sensitivity to market risk, including price and interest rate risk, is currently measured in connection with the "L" component of the CAMEL rating system, which specifically refers to liquidity and asset liability management. Adding the "S" component will bifurcate the risks into separate components and should allow for greater clarity and transparency in the examination process. NAFCU requests that in bifurcating these risks into separate components, the NCUA is careful not to inadvertently create inconsistencies in examination results when a credit union has not changed anything about their procedures or balance sheets. If the proposed rule is finalized, NAFCU requests that the NCUA issue Supervisory Letters that specifically address the "S" component to increase transparency between examiners and credit unions prior to an actual examination.

The proposed rule's descriptions for the "L" and "S" components are the same as those outlined in the Uniform Financial Institution Rating System (UFIRS) approved by the FFIEC and used by the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve, and many state banking authorities. However, the proposed rule states that the NCUA Board may consider modifying the rating descriptions used for the ''L'' and ''S'' ratings used by the other banking agencies (the UFIRS) but does not explicitly say that it would adopt the UFIRS or its rating descriptions and offers no explanation for declining to do so or whether the agency is considering an alternative. The NCUA should keep its rating descriptions consistent with the rating descriptions for the "L" and "S" ratings used by other banking agencies by adopting the UFIRS in its entirety.

This system has been the standard within the financial services industry for many decades and considering the NCUA is a member of the FFIEC, the agency would benefit from not having to establish and maintain a separate authoritative framework for its examination rating system. Using the same CAMELS terminology but with different definitions from the UFIRS would create unnecessary confusion, impair a common understanding of the condition of financial institutions, maintain a disconnect with FFIEC guidance, and impose additional regulatory costs and burdens on credit unions. Adopting the same approach will better prepare credit unions for examinations and keep uniformity with the other banking agencies.

Should the NCUA modify the rating descriptions used by the banking agencies, NAFCU requests that credit unions be given ample notice and the opportunity to comment on such modifications. NAFCU's member credit unions desire more detailed information about how these risk components are defined and evaluated, including what items and key factors will be reviewed. NAFCU's members have relied on NCUA's Letter to Credit Unions 03-CU-04, which contains detailed information regarding each component of the CAMEL rating system; if the NCUA declines to adopt the UFIRS, NAFCU requests that the agency at least include details similar to those in the above-mentioned Letter to Credit Unions in its final rule or issue an updated Letter to Credit Unions before this rule is finalized.

NAFCU generally supports the proposed rule but is concerned with its impact on examinations

NAFCU generally supports the NCUA adopting the recommendation of the Office of the Inspector General (OIG) to disaggregate sensitivity to market risk and liquidity in the CAMEL rating system. NAFCU is concerned that changing the rating system will disrupt the examination process of credit unions, making it overly burdensome for some credit unions to comply. For credit unions that already maintain separate policies to address these risks, this change will likely result in simple streamlining and transparency in the examination processes, as the NCUA has indicated. Conversely, credit unions that do not already maintain separate policies, often smaller institutions, may be required to create new policies and train staff on procedures to monitor them to comply with the proposed rule. Smaller credit unions may not have reached the level of sophistication that necessitates this change, thus creating a challenge for them.

If the NCUA examiners have not prompted these credit unions to establish and conduct training on these separate policies due to safety and soundness concerns in the past, they should not be asked to expend resources to do so now. Small credit unions already face numerous burdens in following the regulations of the NCUA as well as competition with larger institutions. Small credit unions are important because they typically provide services to low-income communities but when regulations are overly burdensome it becomes expensive for them to comply. The NCUA should make it clear that despite the "L" and "S" components being accounted for separately, credit unions that have combined their risk management programs do not need to establish separate policies if their current program is sufficient given the size and sophistication of the credit union. Although credit unions appreciate the opportunity to comment on the proposal, unfortunately, the proposal contains minimal information about the actual changes to the examination process.

Another source of concern for NAFCU's member credit unions is examiner consistency. According to NAFCU's November 2020 *Economic & CU Survey*, 50 percent of NAFCU members report that their highest priority in examination reform is a more consistent application of rules and guidance. In that same survey, NAFCU's members suggest that examinations are sometimes inconsistent due to inconsistencies amongst the approaches taken by individual examiners; credit unions have found that examination findings often differ based on examiners.

NAFCU and its member credit unions recognize that the unexpected pivot to virtual examinations, impending implementation of the Modern Examination and Risk Identification Tool (MERIT) platform, and expected alteration of the CAMELS rating system poses challenges for NCUA's examiners, potentially increasing the difficulty of their job. However, it is critical that credit union examinations remain consistent, not only between regions but also from year to year. Even though the new CAMELS rating system may express examination findings differently than in previous years, it should not create substantively different results. Setting these risks out as stand-alone components may translate to examiners over-emphasizing these risks compared to previous years. NAFCU urges the NCUA to closely monitor the evaluation of these newly separated components to ensure consistency. NAFCU suggests that the NCUA offer a transitional year in 2022, specifically performing examinations with the bifurcation but waiting to officially apply the "S" to the CAMEL rating until 2023. This will afford the NCUA time to complete the implementation of its new MERIT system and prepare clear internal guidance for examiners to follow along with clear guidance to the credit unions.

To further offset these concerns, the NCUA should establish and publish an examination policy stating that if a credit union's operations have not changed from previous years, yet the same circumstances are leading to a new finding or a downgrade of a credit unions' composite rating under the new system, an automatic review will trigger. Further, examiners should take extra steps to document a justification of any differential treatment of circumstances that did not change over years prior. Finally, the Regional Offices should actively encourage credit unions to discuss concerns regarding examiner findings connected to these changes. Credit union staff and examiners are all fallible and a free flow of feedback will improve consistency, reliability, and speed the normalization of these changes across the credit union system.

Conclusion

Overall, NAFCU's member credit unions are supportive of the change to a CAMELS rating system and believe it may increase transparency and efficiency. However, the NCUA should offer an opportunity to provide feedback on more detailed information regarding the components and to establish meaningful feedback mechanisms for examiners and credit unions during the implementation phase of this change. NAFCU requests that prior to transitioning to the new rating system, the NCUA issue Letters to Credit Unions and Supervisory Guidance that give a more detailed explanation of the bifurcation as it relates to the examination process.

If you have any question or concerns, please do not hesitate to contact me at (703) 842-2268 or amoore@nafcu.org.

Sincerely,

Aminah M. Moore
Regulatory Affairs Counsel