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NAFCU | Your Direct Connection to Advocacy, Education & Compliance

August 5, 2016

Michael J. McKenna
General Counsel
Office of General Counsel
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: 2016 NCUA Regulatory Review

Dear Mr. McKenna,

On behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing in regards to the National Credit Union Administration's (NCUA's) Annual Regulatory Review. NAFCU applauds the agency's annual regulatory review as an earnest attempt to solicit ideas and feedback to eliminate rules that are no longer necessary, as well as modernize rules to reflect a different regulatory environment.

While NAFCU appreciates this opportunity to provide comment on the rules currently under review, we are also using this opportunity to raise issues related to policies and regulations not being formally reviewed at this time. In general, we believe the agency should:

1. Increase collaboration with other federal regulators;
2. Continue a guidelines-based approach to cybersecurity
3. Provide clarifying guidance on how it interprets "overall financial performance" as it relates to executive compensation; and
4. Publish its updated examiner guide.

Increase Collaboration with other Federal Regulators

NAFCU urges NCUA to take a more proactive role in collaborating with other federal regulators during the rulemaking process on regulations that are likely to affect credit unions. For example, just over the past year, the Consumer Financial Protection Bureau (CFPB), Department of Defense (DoD), and the Financial Accounting Standards Board (FASB) have each moved forward in promulgating rules that significantly impact our

members. Unfortunately, many of these rules are redundant to other directives from the agency, or worse, improperly infringe on rulemaking authority congressionally granted to NCUA. For example, the CFPB's recently proposed payday loan rule would alter important provisions in the agency's Payday Alternative Loan (PAL) program, which was designed specifically to combat the types of loans and bad practices that the bureau is trying to eliminate.

Accordingly, NAFCU would fully support NCUA's resistance to unnecessary encroachment from other federal regulators during interagency negotiations and other rulemaking processes. Ideally, NCUA would collaborate with the CFPB, FASB, and others to develop commonsense and coordinated approaches to future rulemakings.

Continue a Guidelines-based Approach to Cybersecurity

NAFCU welcomes NCUA's initiatives to help ensure the security and safety of our members' sensitive consumer data as the cyber threat landscape continues to evolve. Accordingly, in addition to interagency collaboration discussed above, NAFCU believes that financial regulators must increase coordination on monitoring, sharing, and responding to threat and vulnerability information throughout the financial industry. We therefore urge NCUA to continue to coordinate with other federal regulators to quickly share industry-wide threat data with financial institutions as soon as practicable in order to protect against imminent cyber-attacks.

Additionally, we continue to support the implementation of the cybersecurity self-assessment tool as an important step in combating cyber-attacks. However, as the industry continues to use this tool to measure and assess their individual cybersecurity maturity, and determine what changes should be implemented based on their internal risk appetite, we urge NCUA to maintain the tool's voluntary nature. As such, we restate our caution against any future agency action to explicitly require credit unions to use the tool as a supervisory or regulatory expectation.

Guidance on "Overall Financial Performance" Relative to Compensation

Generally, section 701.21(c)(8) prohibits most credit union employees and officials from receiving compensation made "in connection with any loan" a credit union makes. There are some exceptions to this prohibition, namely that an employee, including senior management, may receive an incentive or bonus based on the credit union's "overall financial performance." However, despite these general exceptions, NAFCU member credit unions have reported issues with NCUA examiners regarding compensation programs that appear to comply with the requirements of NCUA's rule.

To remedy this issue, NAFCU requests that NCUA clarify how it interprets the term "overall financial performance" in section 701.21(c)(8)(iii). As NAFCU understands, the Office of General Counsel (OGC) recently stated in its 2015 Regulatory Review Report that this rule will be clarified in an upcoming rulemaking. NAFCU appreciates the

agency's response to this issue, and looks forward to NCUA's clarification that the regulation should allow for loan growth to be included as a part of the "overall financial performance" calculation. NAFCU believes the new rule should define "overall financial performance" as:

> "A quantifiable metric, set by the board of directors of the credit union, used for the purposes of measuring a credit union's achievement of targeted performance goals. This metric may include, but not be limited to, total asset growth, overall loan growth, return on assets, net-worth ratio, loan-to-value ratio, and delinquency ratios."

Without direct guidance from NCUA on what "overall financial performance" means, NAFCU and our member credit unions are concerned that NCUA examiners will continue to apply subjective interpretations of the rule to penalize otherwise compliant compensation programs. We look forward to this much needed clarification.

Publication of Revised Examiner Guidance

NAFCU and our members are still eagerly awaiting the publication of an updated examiners guide, particularly sections that cover member business lending (MBL), interest rate risk (IRR), and the Financial Accounting Standards Board's "current expected credit loss" (CECL) standard. Each one of these topics is complex and nuanced, meaning that examiner guidance is critical to a credit union's successful implementation of programs affected by these rules. As such, credit unions depend on reviewing examiner guidance several months before a program is launched to ensure adequate compliance with the rule. As the effective dates for these rules approach, NAFCU urges NCUA to publish these updated manuals as soon as possible so that our members have the time necessary to adequately plan and develop programs.

712 - Credit Union Service Organizations

Part 712 sets out the permissible forms of organization activities for credit union service organizations (CUSOs). While NAFCU believes that CUSOs are strong partners for credit unions to meet their member's needs, certain regulations are diminishing their total potential. For example, NCUA has increased its focus on CUSOs over the past few years, most recently mandating registration on the agency's website. The rule requires CUSOs to submit basic registration information to NCUA's CUSO Registry.

NCUA's stated basis for this information collection is to address a perceived "regulatory blind-spot" in the number of CUSOs in existence. However, after the collection of information, it was discovered that approximately 75 percent of the industry's CUSOs are wholly-owned. As the agency is aware, NCUA already receives information from wholly-owned CUSOs through the Call Report, and as such, created a redundant requirement for a substantial number of our members' CUSOs. Because this redundant reporting requirement

increases CUSO expenses, NAFCU urges NCUA to revise the current reporting requirement.

CUSO Accounting

Under section 712.3(d), federally-insured credit unions (FICUs) must generally require their CUSOs to account for all transactions according to Generally Accepted Accounting Principles (GAAP), and obtain an annual audit of their financial statements by a licensed certified public accountant. However, an exemption to this requirement is provided for wholly-owned CUSOs, so long as those CUSOs are included in the annual consolidated financial statement audit of the investing FICU. While NAFCU appreciates that NCUA does not require separate audits for wholly-owned CUSOs, we firmly believe that this exemption should be extended to CUSOs that are majority-owned.

Under GAAP, consolidated financial statements generally include enterprises in which the parent has a controlling financial interest, usually a majority voting interest. As NCUA staff noted in the preamble when this exemption was first considered in 2005, "GAAP would allow for consolidated financial reporting in cases that involve a CUSO that is majority owned." Clearly, NCUA has the discretion to extend this exemption to CUSOs that are majority owned. Despite this discretion, NCUA was concerned about the rights of minority owners. The preamble goes on to state, "absent a provision in the rule, a minority investor could encounter some difficulty in asserting its right to a separate opinion audit."

While NAFCU understands the agency's desire to protect the rights of minority owners of CUSOs, we firmly believe that concern can be addressed by requiring such CUSOs to avail themselves of independent audits at the request of the minority owners. This provision would be much more flexible than the current mandate of automatic audits, regardless of the desires of the minority owners. Accordingly, NAFCU strongly urges NCUA to revisit this issue and permit majority owned CUSOs to file consolidated financial statements.

715 - Supervisory Committee Audits and Verifications

Part 715 covers the responsibilities of the Supervisory Committee to obtain an annual audit of the credit union according to its charter type and asset size, and to conduct a verification of members' accounts. Part 715 prescribes the responsibilities of the Supervisory Committee to obtain an annual audit of the credit union, dependent on its asset size. Currently, section 715.5 sets out three asset tiers and the varying requirements under each threshold. Those tiers are currently set at: (1) assets of $500 million or greater, (2) assets of less than $500 million but more than $10 million, and (3) total assets of $10 million or less.

NAFCU urges the agency to amend this rule's asset thresholds, and replace the $10 million asset threshold with a $100 million threshold. This change would conform with recent changes to NCUA's definition of "small entity," which increased the upper asset threshold to $100 million. Although the 2013 OGC Regulation Review Report indicated the NCUA Board would consider this change in early 2014, it appears that the issue was never raised.

NAFCU believes this regulatory review serves as a good opportunity to reconsider.

717 - Fair Credit Reporting

The purpose of section 717 is to implement provisions of the *Fair Credit Reporting Act*, stipulating how federal credit unions (FCUs) obtain and use information about a consumer to determine the consumer's eligibility for products, services, or employment, share information among affiliates, and furnish information to consumer reporting agencies. These topics are also covered by the CFPB in Regulation V. The CFPB's Regulation V is substantially similar to section 717 except for subpart J covering identity theft red flags, which is not present in Regulation V.

NAFCU recommends that NCUA address the duplicative nature of the two regulations and retract subsections A, C, D, E, and I of section 717. These are already covered by the CFPB and perform the same function. In fact, in its 2013 Regulation Review Report, OGC agreed with this assessment and recommended that NCUA amend Part 717 to reflect the transfer of remaining sections of Part 717 to the CFPB. However, the recommendation does not appear to be implemented, three years later. In response, we once again urge the NCUA Board to implement NAFCU and OGC's recommendation, and remove the duplicative sections of Part 717.

721 - Incidental Powers

Part 721 contains the activities that an FCU may engage in as permissible exercise of its incidental powers. NAFCU believes the NCUA OGC should update several sections of part 721, taking into account recent developments.

According to NCUA's spring 2016 rulemaking agenda, the agency expects to finalize an asset securitization rule soon. First proposed in July 2014, the rule would permit FCUs to issue securities backed by loans originated by the issuing FCU. While NCUA works to finalize this rule, NAFCU renews our earlier calls for the agency to allow credit unions to purchase loans from other originators for the purposes of issuing securities.

As the agency's preamble recognized, issuing a security is an expensive endeavor that is only feasible for large pools of loans. NAFCU is concerned that the rule as proposed is too limiting. Instead, NCUA should permit FCUs to purchase, aggregate, and securitize loans originated from other FCUs or CUSOs. NAFCU supports the fact that asset securitization would provide FCUs with much needed flexibility for managing liquidity and IRR. However, without the power to purchase and aggregate loans originated from other credit unions, few credit unions will be able to take advantage of this expanded power.

723 - Member Business Loans

Part 723 lays out the provisions related to MBLs. NCUA recently finalized much needed modernization updates to the MBL rule, for which NAFCU and our members have long

advocated. The final rule constitutes an important step toward achieving regulatory relief as credit unions provide competitive commercial loans to their small business members. We strongly support the elimination of the prescriptive underwriting criteria with a more principles-based lending regime. Additionally, we are pleased the agency used a tiered-implementation approach for promulgating this rule. As a result, credit unions and their members have already enjoyed for several months the flexibility of not requiring a personal guarantee.

Although NAFCU appreciates that this rule is more principles-based, it becomes even more important that our members receive a timely copy of such guidance to ensure good-faith compliance with the rule. Surely, developing an adequate program will take several months. Because so many of our members are eager to develop robust MBL programs that take advantage of added flexibility, NAFCU asks the agency to release the examination manual containing the updated examiner guidance so that our members can start planning accordingly. NAFCU requests that such guidance discuss the legal relationship between NCUA and State Supervisory Authority (SSA) in those states that administer their own rules.

725 – Central Liquidity Facility

Part 725 covers rules and requirements related to the Central Liquidity Facility (CLF). NAFCU supported the agency's final rule allowing corporate credit unions to establish a correspondent relationship with the CLF. Under the final rule, corporate credit unions are now enabled to serve as financial correspondents to help service and administer liquidity advances for CLF members, without requiring the credit union to maintain an account at the corporate credit union. These services include assisting with new member questions and application forms, managing collateral, perfecting security interests, and performing other tasks related to facilitating and administering CLF loans.

Additionally, NAFCU urges NCUA to update technical provisions and information related to the CLF in order to leverage the agency's recent actions as discussed. For example, NCUA's CLF operating circular has not been updated since October 1999. Given the significant changes the CLF has undergone in the last decade, NAFCU requests the agency revise its operating circular that provides guidance on CLF membership and advances. NAFCU believes that an updated operating circular will provide credit unions with an opportunity to reevaluate whether the CLF is a practical solution to their potential liquidity problems.

On the legislative front, NAFCU believes that certain legislative changes are needed to address shortfalls in the current CLF framework. The CLF should be modernized to meet liquidity needs by: (1) removing the subscription requirement for membership, and (2) permanently removing the CLF borrowing cap so that it may meet current industry needs.

740 - Accuracy of Advertising and Notice of Insured Status

Part 740 covers the requirements governing NCUA's official sign and how it should be displayed, the official advertising statement and the manner in which it should be used, and the accuracy of any advertising used by a FICU. In 2013's Regulation Review, OGC staff recommended the NCUA Board consider amending the current rule to modernize it in light of the growing use of rapidly advancing technology and also to meet consumer needs. However, in the three years since that recommendation, NCUA has yet to modernize these rules.

In the past, the NCUA Board has recognized that modernizing the agency's advertising and share insurance disclosure rules to recognize the growing use of advancing technology will provide a significant benefit to consumers. NAFCU would like to take this opportunity to urge NCUA to take specific actions within its power to amend Part 740 to accommodate the rise of social media, mobile banking, and digital communication platforms.

NAFCU continues to hear from our members that applying Part 740 to social media is unclear, complicated, and burdensome. Section 740.5, for example, contains requirements that are impossible to apply to social media, especially interfaces that are interactive. NAFCU and our members believe these rules should be amended with the use of social media in mind to include more flexibility as opposed to the rigidity of the current rules.

In regards to Part 740's application to print advertisements, NAFCU believes the rule requires the official statement to be unnecessarily prominent, resulting in the reduction of the advertisement's substance and purpose. We believe the NCUA logo and statement is a visual representation that only needs to be present to convey its value and importance. Accordingly, NAFCU and our members urge NCUA to remove Part 740's size requirement.

741 - Requirements for Share Insurance

In addition to establishing requirements for insurance, Part 741 includes requirements applicable to FCUs to apply to FICUs, as well. As NAFCU has repeatedly urged, we encourage the agency to find efficiencies wherever possible and practicable in order to maintain a lean operating budget, which is directly funded by the NCUSIF. One such efficiency is the collaboration between and reliance on examinations conducted by NCUA staff and SSA staff. Accordingly, we were pleased when the Board removed the performance goal requiring the examination each calendar year of all federally-insured state chartered credit unions with more than $250 million in assets, and every FCU. Additionally, NAFCU is pleased with the agency's recent adoption of a Call Report Working Group and an Exam Flexibility Initiative Working Group.

Call Report Working Group

NAFCU appreciates NCUA's 2016 Strategic Plan that lays the path for the agency to reorganize the Call Report for credit unions not involved in complex activities, eliminate data no longer needed, and expand the data collected to address increasing authorities of

credit unions. Additionally, NCUA has indicated that it will invest in updating the Automated Integrated Examination System (AIRES) platform. According to NCUA, these improvements will both leverage new technology and techniques to make the exam process more efficient and effective, as well as support improved off-site supervision.

NAFCU generally supports these plans as contemplated, especially as they would enable examiners to conduct more examinations off-site, thus reducing examination time spent at credit unions. Ideally, this will decrease travel expenses, mitigate operational disruptions at credit unions, and increase the quality of exams. However, NAFCU does not believe that these improvements have to be a prerequisite to an 18-month examination schedule, but can rather be unrolled in conjunction with an extended exam cycle (discussed further below).

Exam Flexibility Initiative Working Group

As NAFCU has repeatedly stated, we believe an 18-month examination cycle would allow NCUA to better prioritize staff and resources, while still balancing risk factors and maintaining the safety and soundness of credit unions. Credit unions have healed along with the overall U.S. economy since the financial crisis. Given that current risk to the NCUSIF and economic trends mirror 2001-2007, NAFCU and our members strongly urge the agency to implement an 18-month examination cycle that would allow FCUs determined to be "low risk" to receive no more than two exams in a three year period. This approach would preserve the agency's ability to address risk through requisite supervision and monitoring, but would streamline NCUA's staff and resources for a more cost-effective budget.

Simply put, this approach will allow NCUA more flexibility in balancing staff and resources without compromising the safety and soundness of the industry. NAFCU and our members appreciate NCUA's thoughtful review of our letter, and we look forward to continuing the dialogue about how to adopt an extended exam cycle for healthy credit unions that will efficiently provide relief and effectively maintain our industry's safety and soundness. Further, we welcome engagement with NCUA about what processes and procedures are needed in order for the agency to implement an 18-month exam cycle.

NAFCU believes that an 18-month exam cycle for low-risk credit unions is a prudent path forward to providing regulatory relief to credit unions while simultaneously helping NCUA control examination costs. The NCUA Board and agency staff have recently indicated that the agency would begin to consider reverting back to an 18-month examination cycle. However, NCUA has repeatedly pushed back plans for an implementation date, first due to the promulgation of new rules, then due to antiquated Call Report and AIRES software.

While NAFCU appreciates the fact that the Call Report and AIRES software needs to be modernized, we do not believe that an update needs to be completed before moving to an 18-month examination cycle. Rather, NAFCU urges the agency to develop an 18-month examination strategy in concert with updates to requisite software needs.

745 - Share Insurance and Appendix

Part 745 sets the requirements for share insurance coverage for various types of member share accounts. Recently, NCUA amended Part 745 in order to implement changes to the *Federal Credit Union Act* mandated by the NAFCU-backed *Credit Union Share Insurance Fund Parity Act*. The legislation directed NCUA to provide enhanced, pass-through share insurance for interest on lawyers trust accounts (IOLTA) and "other similar escrow accounts." Although NCUA contemplated whether stored value cards rose to the level of "other similar escrow accounts," the NCUA Board decided they did not rise to the fiduciary level of IOLTA accounts. However, the rule's preamble discussed other methods for pass-through insurance to be applied to stored-value cards.

As the proposal preamble states, "if funds in a prepaid card program deposited in a federally insured credit union can qualify as a share account that can be traced back to a specific owner in a specific amount and the owner is a member of the credit union where the funds are kept, then those funds would be entitled to share insurance pursuant to the terms and limits of part 745." Accordingly, NAFCU believes this same logic would apply to nonmember accounts of low-income credit unions (LICU), as a nonmember account opened at a LICU is a "member account" as defined under 12 CFR § 745.1(b). Therefore, NAFCU believes the NCUA Board should authorize insurance coverage for all payroll or stored value cards issued by LICUs.

747 - Administrative Actions, Adjudicative Hearings, Rules of Practice and Procedure, and Investigations

Part 747 covers the procedures related to formal and informal adjudicative and non-adjudicative proceedings available to the NCUA Board. NAFCU continues to hear from our members that the examination process is sometimes inequitable. Although there is a current appeals process in place for credit unions to voice such feelings, the current system has not yielded a significant number of appeals. For example, as Board Member McWatters recently cited in a NCUA Report, a 2012 NCUA OIG report found a yearly average of only six credit union "complaints" filed regarding exams between 2007 and 2011.

NAFCU believes that the agency should seek stakeholder input on ways to improve or modernize the process. In fact, this stakeholder input could be sought in tandem with updates to the Call Report, as such technological updates could address some concerns regarding the examination process. As such, NAFCU asks the agency to solicit stakeholder input on the current process, possibly through an Advanced Notice of Proposed Rulemaking (ANPR) issued in conjunction with an updated Call Report.

Lastly, as NAFCU wrote on July 11, 2016, capital adequacy continues to be a hotly debated issue, and NAFCU supports maximum flexibility for our members. As such,

NAFCU and our members believe that NCUA should reassess the implementation of the risk-based capital rule until a number of regulatory, legislative, policy, and economic issues fully unfold.

Thank you for the opportunity to participate in this annual review. Should you have any questions or would like to discuss these issues further, please do not hesitate to contact me at memancipator@nafcu.org, or (703) 842-2249.

Sincerely,

Michael Emancipator
Senior Regulatory Affairs Counsel